CFO

OCTOBER 2020
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CLOUD INSECURITIES

IS REMOTE WORK WORKING?

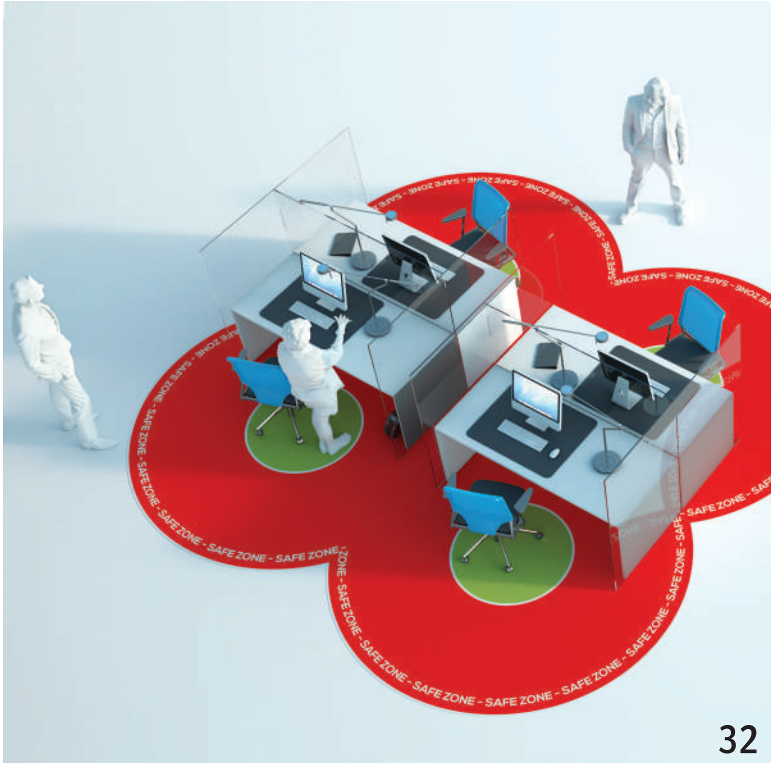
COVID DEAL KILLERS

CHINA TUSSLE

Will China-based issuers be banned from U.S. exchanges?

IN THIS ISSUE

October 2020
Volume 36, No. 5



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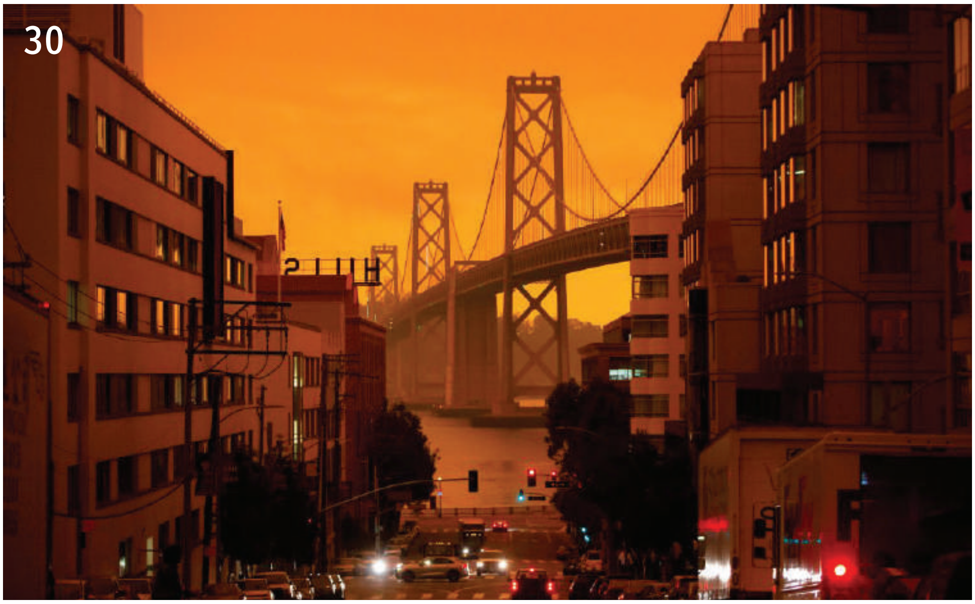

Up Front

By the Numbers

Getty Images (4)

FROM THE EDITOR

From the Future

Whew! It's been a tumultuous, long five years since the COVID-19 pandemic hit, but it finally feels like the U.S. economy may be out of the woods. ¶ What makes me really optimistic is that 80% of New York City workers are back in their offices. I guess what finally turned the tide was that weeklong Zoom outage in 2022 and that infamous study in 2024 from The Institute for Corporate Productivity. The study showed, if you recall, that 65% of white-collar workers had computer problems this summer because sand got inside their laptops' hard drive mechanisms.

For finance teams, I guess the last straw was the Apple earnings restatement last year. Who knew an assistant treasurer could siphon that much cash out of a Fortune 500 company by tricking an all-remote accounts payable team into thinking he was the CFO?

Of course, there is still a lot of work ahead. Yes, we found a way to avoid becoming the next Japan—that masterstroke of dropping the target federal funds rate to -5.5% in Trump's second term (after unemployment hit 25.5%) saved our bacon. But I think enough is enough. If the Fed adopts the new 18% inflation target, the national minimum wage will have to be raised to $45.50 per hour. Yes, there are only 1,546 small businesses left in the entire country that would need to pay that rate, but do want to see those die, too?

Of course, I'm not forgetting about the elephant in the room—the U.S. defaulting on $5 trillion worth of Treasury bonds in 2023. But now we seem to be back on track. Let's thank Warren Buffett for taking that 51% stake in the U.S. government. And Tesla for spending $450 billion to plaster its name on the Securities & Exchange Commission building. (Sponsoring government agencies—genius!)

We all miss democracy, but what choice did we have? That last election seemed so obviously fraudulent—no one ever got 105% of the vote when we did it by mail! I hated Google Voting.

By the way, is Amazon Pharmaceuticals still working on that COVID-19 vaccine? I thought we were supposed to hear any day.

Vincent Ryan
Editor-in-Chief

EDITOR'S PICKS

MANAGEMENT
In a desire to preserve harmony, many workers fall into groupthink, write consultants from Affective Advisory in Harvard Business Review. Ways to prevent it include appointing a strategic dissenter and collecting opinions independently. Read **"7 Strategies for Better Group Decision-Making"** on the HBR website.

DATA
The podcast **"Can Election Polls Be Trusted?"** looks at why polling doesn't always get the presidential election right. Wharton statistics professor Abraham Wymer discusses why a lot depends on who is polled and how many voters change their minds as the election draws near. Listen to the podcast at the Knowledge@Wharton website.

EVENTS
CFO Magazine's biannual conference **CFO Live** (virtual, of course) is back. It's being held November 3-5—three days of finance- and strategy-filled presentations for CFOs and other finance executives. Just click on "Events" in the top menu on CFO.com.

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Mark Bennington

"Employers Balk at Payroll Tax Holiday" (page 13) discusses how many employers think the temporary relief to employees is too complex to be worth taking advantage of. "Trump has gone on record as saying he would forgive the tax," said one CFO.com reader. "If this is in fact how things work out, **then employers will morally owe those forgiven taxes.** As for not allowing any to take the deferral, it should be the employee's option."

Another reader added, "This is the dumbest idea yet and helps no one, least of all low- and middle-income employees. **It creates an unnecessary administrative burden on employers.**"

"Fraud Prevention Firm's Ex-CEO Charged With Fraud" (CFO.com, September 18) discussed how Adam Rogas, the former CEO of fraud prevention startup NS8, was charged with fraud for fabricating millions of dollars in revenue to raise $123 million from investors.

"Sometimes it isn't about the controls you put in place. It comes down to integrity, transparency, and honesty of the person. **Greed is a terrible characteristic**," said one LinkedIn reader.

"These are basic character traits that are foundations of a well-functioning business," agreed another reader. "**I have to wonder what the CFO, external auditor, and audit committee have to say**. While I don't believe internal controls are infallible, it does serve a purpose to set guides and provide warning flags."

Another LinkedIn reader added, "**So many lessons to be learned here on internal control**. And, oh, the irony."

In response to the online version of "**Remote Work Future Exposes Holes in Operational Strategy**" (page 26), one reader commented, "Thank you for this article representing the business tax issues; but at the same time, individuals are no longer able to take a home office deduction while working as a W-2 employee." They continued, "And on the business side, how are corporate workman's comp and liability insurance audits **going to determine whether a person is an employee or a contractor**."

Another reader added, "Companies must be able to adapt to the new reality. **Those that fail risk losing their best professionals**."

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H. Total	98,057	97,784
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Electronic Copy Circulation		
A. Requested and paid electronic copies	43,142	42,052
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TOPLINE

STATS OF THE MONTH

POWER PLAY

$282B
U.S. renewable energy capacity investment*

$143B
Wind energy investments, worldwide

854,000
Renewable energy jobs in U.S.

$55.5B
Total renewables capacity, U.S.

82%
10-year drop in cost, solar photovoltaics power

* All numbers are for or as of 2019.

Source: International Renewable Energy Agency

THE ECONOMY

Consumer Spending Still Dulled By Pandemic

As a result, the Federal Reserve projects it won't raise interest rates until 2023. By Vincent Ryan and Matt Heller

In the Federal Reserve's mid-September statement, the central bank's rate-setting committee projected no interest-rate hikes until the end of 2023. It said that the ongoing public health crisis would continue to weigh on economic activity, employment, and inflation in the near term. While economic activity and jobs had picked up in the previous months, the Fed noted weak demand and lower prices for commodities like oil, which keep inflation low.

Consumer data releases backed up that position. As of mid-September, at least 29.6 million people in the United States were still collecting unemployment benefits.

Consumer confidence was still sagging in August, with the Conference Board's index reaching its lowest level in six years. And while retail sales rose 6%, the increase was below expectations. August marked the fourth consecutive month of positive sales but the third straight month of waning momentum.

"A slower-than-expected pace of sales following a downward revision to July suggests consumers may be systematically reducing monthly purchases, particularly as federal assistance wanes and the prospect of further relief funding is far from certain," Stifel chief economist Lindsey Piegza said in mid-September.

While the consumer price index rose 0.4% in the same month, the third consecutive monthly increase, prices were up only 1.3% compared with a year earlier. "Consumer prices are rebounding from the pandemic shock, but as supply shortages are resolved, upward price increases should moderate," said Kathy Bostjancic, chief U.S. financial economist at Oxford Economics.

Consumers appear to be readjusting their basket of goods back toward a pre-pandemic composition, shifting, for example, at least some expenditures back to restaurants from eating and drinking at home, Piegza said.

One market that received a boost in August was used vehicles, where prices rose 5.4%, as consumers positioned themselves to

avoid mass transportation and factory shutdowns interrupted supply chains for new vehicles.

Another explanation for lackluster consumer activity was consumers increasing their level of saving.

Sonal Desai, chief investment officer of the fixed income group at Franklin Templeton, said that "one concern we have about people having increased their savings is that then they're not consuming." However, she added, "the good news here is they're not using all their savings to pay down debt. It's like a buffer, which is sitting there waiting to be deployed. This, I think, is something to be optimistic about."

Will consumers use that some of that savings to splurge during the holidays? One of the first holiday spending forecasts, released in September by Deloitte's consulting arm, predicted U.S. retail sales would rise only slightly amid "unparalleled uncertainty." The firm predicted retail sales would increase between 1% and 1.5% for the November 2020 to January 2021 timeframe, resulting in sales of about $1.2 trillion. That would be down from a jump of 4% in 2019.

E-commerce sales are expected to offset slower brick-and-mortar store traffic this year by jumping between 25% and 35%, compared with last year's 15% spike.

Daniel Bachman, Deloitte's U.S. economic forecaster, noted the depressive effects of high unemployment and economic anxiety. But, he added, "reduced spending on pandemic-sensitive services [like travel] may help bolster retail holiday sales somewhat."

Overall, Deloitte sees two possible holiday scenarios.

Under one scenario, sales will grow between 0% and 1% as consumers—especially lower-wage earners—"continue to experience mounting anxieties related to both their finances and health," reinforcing the trend of higher consumer savings.

Alternatively, there could be sales growth of 2.5% to 3.5% if wealthier consumers become more confident due to shrinking unemployment, additional government stimulus, and an effective COVID-19 vaccine.

Regardless of which scenario plays out, "the consumer's focus on health, financial concerns, and safety will result in a shift in the way they spend their holiday budget," said Rod Sides, vice chairman and U.S. retail and distribution sector leader at Deloitte. CFO

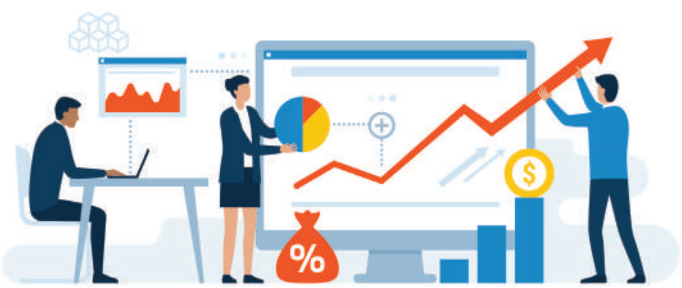
CAPITAL MARKETS

SEC Expands Investor Pool

The U.S. Securities and Exchange Commission approved a final rule allowing financially sophisticated investors to participate in private placements even if they do not meet thresholds for income or net worth.

Since 1982, the SEC had limited eligibility to participate in private offerings to "accredited investors" with a net worth of more than $1 million and annual income greater than $200,000.

The new rule allows investors to qualify as accredited based on "professional knowledge, experience, or certifications" in addition to the existing financial tests. The SEC did not say how many additional investors would fall under the new definition, but said it was aimed at individuals—such as hedge fund employees and brokers—who are knowledgeable about private placements.



"For the first time, individuals will be permitted to participate in our private capital markets not only based on their income or net worth, but also based on established, clear measures of financial sophistication," SEC Chairman Jay Clayton said in a news release.

According to the commission, an investor with the required level of sophistication would be able to "assess an investment opportunity" or "bear the risk of a loss." Those who would be professionally certified to qualify as accredited investors include holders of Series 7, Series 65, and Series 82 broker licenses.

Holders of those licenses and "well-informed employees of private funds clearly have the knowledge and expertise to evaluate the merits and risks of an investment," said Mitch Ackles, global president of the Hedge Fund Association.

However, investor advocates and SEC officials say even seasoned investors struggle to spot problems with private companies criticized the new rule.

"With its actions today, the commission continues a steady expansion of the private market, affording issuers of unregistered securities access to more and more investors without due regard for the risks they face, and without sufficient data or analysis to ensure that our policy choices are grounded in fact rather than supposition," Commissioners Allison Lee and Caroline Crenshaw, who voted against the changes, said in a joint statement.

The new rule also changes the definition of "qualified institutional buyer." | M.H.

Getty Images (2)

WORKPLACE ISSUES

Sexual Harassment Foreshadows Weak Stocks

A new study asks, how much does a high incidence of sexual harassment hurt firm value? Plenty, concludes the research presented at the annual meeting of the American Accounting Association in August.

The research on sexual harassment in the workplace draws on data from about a thousand public firms over a six-and-a-half-year period. A high incidence of sexual harassment in a given year is likely to predict decidedly weak stock performance in the following year, the study found.

Take, for example, firms with the dubious distinction of ranking among the top 2% in harassment incidence, as measured by sexual-harassment complaints on popular career-information web sites. Those companies' returns in the following year averaged about 20% below what would be expected from standard asset-pricing models and the market's overall performance.

Comments Prof. Shiu-Yik Au of the University of Manitoba, who co-authored the study with Ming Dong of York University, Toronto, and Andreanne Tremblay of Laval University, Quebec City: "The relationship between rank-and-file sexual harassment and company stock price is probably not evident to most CEOs, who may consider it merely a modest, if unpleasant, cost of doing business. Our study strongly suggests otherwise."

The professor adds: "What our research shows is that a high level of sexual harassment not only is morally reprehensible but signals financial damage for the companies where it occurs."

As indicated above, companies whose high incidence of sexual harassment landed them in the top 2% in this regard averaged decidedly subpar stock returns in the following year. The researchers estimate that among the 101 companies that fell into this category, the shortfall in shareholder value to each amounted on average to $1.92 billion per year.

Similar analysis reveals that the 237 firms that were in the top 5% of sexual-harassment incidence sustained an average shareholder value shortfall of $0.93 billion per year.

CREDIT

Another Shaky Quarter for U.S. Banks

While federal regulators are comfortable with the capital levels of U.S. banks, there's no hiding the fact that financial institutions are starting to feel the economic backlash of the COVID-19 pandemic, as their profits fall and loan and lease losses creep upward.

For the 5,066 commercial banks and savings institutions insured by the FDIC, aggregate net income totaled $18.8 billion in the second quarter of 2020, down $43.7 billion (70%) from a year ago. The decline in net income was a continuation of uncertain economic conditions, which drove an increase in provision expenses, the FDIC said.

Slightly less than half of all banks reported annual declines in net income, and the share of unprofitable institutions increased to 5.4%.

Lower interest earned on loans also contributed to the dismal quarter for banks. Banks' average net interest margin fell by 58 basis points from a year ago to 2.81%, the lowest level ever reported in the FDIC's quarterly banking profile.

Net interest income (the income earned from lending) fell by $7.6 billion (5.4%) from the second quarter of 2019, marking a third consecutive quarterly decline.

"Lower levels of business activity and consumer spending contributed to higher provisions for loan and lease losses, as well as a decrease in net interest margins," FDIC Chair Jelena McWilliams said. "Notwithstanding these disruptions, however, the banking industry maintained strong capital and liquidity levels at the end of the second quarter, which will protect against potential losses in the future." | V.R.

Getty Images(2)

LEGAL

U.S. Busts Crypto Terrorists

The U.S. government has announced it seized about $2 million in cryptocurrency from terrorist groups, using sophisticated blockchain analysis techniques.

Federal authorities covertly operated a website to receive bitcoin donations as part of an investigation that resulted in the largest ever seizure of cryptocurrency assets related to terrorism financing.

Investigators infiltrated the financing operations of Al Qaeda and Hamas's paramilitary arm, the Al Qassam Brigades, obtaining court orders to forfeit about 300 cryptocurrency wallets held by banklike institutions.

"Today's actions deprive Hamas, Al Qaeda, and ISIS of millions of dollars they solicited to buy weapons and train terrorists," said John Demers, the assistant attorney general for the Justice Department's national security division. "By raising cryptocurrency on social media, these terrorists tried to bring terrorist financing into the current age."

Both bitcoin and Ether offer anonymity to users, with each transaction referenced in the blockchain ledger by a complex series of numbers and letters. According to the government, criminals have also looked for ways to "make their transactions even more anonymous."

But in an affidavit, IRS Special Agent Jonathan Gebhart said analyzing the blockchain "can sometimes lead to the identification of both the owner of an address and any other accounts controlled by the same individual."

For the investigations of Hamas and Al Qaeda, agents worked with blockchain analysis experts at Chainalysis, using software that looks for "clusters" of transactions to identify bitcoin possessed by the same individual.

In the case of an account beginning with 17QAW that was used to solicit donations to Hamas, they clustered it with 10 other addresses, eventually tracing at least one transaction to a Turkish national who operated an unlicensed money transmitting business. | M.H.

CASH FLOW

Cash-to-Cash Cycle Time

Cash-to-cash cycle time, also known as the cash conversion cycle (CCC), measures the amount of time it takes for a company to convert resources like inventory or investments in production into cash from sales. CCC is a critical measure of a business's health and cash efficiency.

There are three variables that account for a company's CCC: days inventory outstanding (DIO), days sales outstanding (DSO), and days payable outstanding (DPO). You can calculate CCC by subtracting DPO from the sum of DIO and DSO: **DIO + DSO – DPO = CCC**

Focusing on the supply chain side of the equation shows how finance can partner with supply chain operations to drive a better CCC. As with DPO and DSO, any strategies you take to optimize a supply chain should be balanced with the risk of doing so.

Here are three ways in which finance can act as a partner to the supply chain function for a better.

1. Keep finance data clean. One of the most impactful practices for a better CCC is working to ensure that master data is accurate. Finance has a key role to play here. As the function that pays suppliers, finance is the most likely to know when supplier data like addresses or bank accounts have changed.

2. Provide analysis. When finance brings analytically mature data and analysis to the table in a collaborative sales and operations planning process, supply chain leaders are empowered to make better decisions.

3. Help plan for the future. Finance is uniquely positioned to leverage its expertise in scenario modeling and analysis to help supply chain leaders anticipate and plan for the future. Companies that model scenarios and perform sensitivity analysis to a significant extent have an average CCC of 49 days; those who do so only to some extent, 60 days.

Working to drive down CCC is imperative in an environment where cash is king, but this work cannot and should not happen in a vacuum. Each of the three practices above shows what's possible when finance acts as a business partner by providing supply chain leaders with the resources and support they need. | PERRY D. WIGGINS

FRAUD

Hedge Fund Founder Accused of Neiman Fraud

The founder of distressed debt hedge fund Marble Ridge Capital has been charged with defrauding creditors of Neiman Marcus by coercing a rival bidder to drop a higher offer for the thriving e-commerce business of the bankrupt retailer.

Daniel Kamensky, 47, was arrested on criminal charges alleging he abused his position on the Neiman unofficial creditors' committee (UCC) after he learned in July that the Jefferies investment bank was willing to bid twice as much for shares in the MyTheresa online unit as Marble Ridge.

The U.S. Department of Justice also charged Kamensky with extortion and obstruction of justice for allegedly attempting to enlist Jefferies in a cover-up of his misconduct.

In a related civil action, the Securities and Exchange Commission has accused Kamensky of violating an anti-fraud provision of the federal securities laws.

"Kamensky intentionally violated his fiduciary duty as a member of the [creditors' committee] by preventing the sale of securities to an investment bank so he could acquire the same securities at a significantly lower price for his own fund," FBI Assistant Director-in-Charge William F. Sweeney said.

Neiman filed for Chapter 11 bankruptcy in May, with Kamensky being appointed co-chair of the UCC. On July 28, he outlined a proposal to the committee to purchase 60 million MyTheresa shares at 20 cents per share from other creditors wishing to sell their stock.

Three days later, however, Jefferies unveiled a bid at a price between 30 cents and 40 cents per share.

According to the government, Kamensky pressured Jefferies into withdrawing by telling the bank he would use his position on the committee to ensure its bid was rejected and if it moved forward with the offer, Marble Ridge would cease doing business with Jefferies. | M.H.

COMPENSATION

Employers Balk at Payroll Tax Holiday

President Donald Trump's payroll tax holiday began in September but many employers are balking at offering the temporary relief to employees.

Under Trump's executive order, employees earning no more than $4,000 every two weeks are eligible for a deferral of the 6.2% tax that is deducted from their paychecks toward Social Security. The tax holiday lasts from Sept. 1 to Dec. 31.

That means an eligible worker making $938 every two weeks will take home a paycheck worth $1,000, or $62 more than usual.

But once the holiday is over, according to IRS guidelines, employers have until April 30, 2021 to collect the deferred tax in addition to the regular deduction.

"Employees are going to notice a reduced net pay in 2021 that's pretty much equal to the increase they'll enjoy in the next few months if they take this deferral," Pete Isberg, vice president of government affairs at payroll giant ADP, told CNBC.

Garrett Watson, a senior policy analyst for the Tax Foundation, said the tax holiday may not be worth the hassle.

"Overall, it is likely that many employers will judge this deferral to be either too complex or impose too much potential liability on their end to be worth taking advantage of, mitigating much of the limited benefit of the deferral."

Trump said in his order that Treasury Secretary Steven Mnuchin can decide to forgive the deferment but more than a dozen national business organizations wrote Mnuchin, saying many of their members "consider it unfair to employees to make a decision that would force a big tax bill on them next year."

"Therefore, many of our members will likely decline to implement deferral, choosing instead to continue to withhold and remit to the government the payroll taxes required by law," the letter stated.

According to Isberg, a minimum wage employee who is working full time and earning about $580 per biweekly pay period would lose about half of their paycheck if all the deferred taxes were paid at once. | M.H.

Getty Images(4)

STRATEGY

Coca-Cola to Cut Workforce

Coca-Cola is offering voluntary layoff packages to about 4,000 workers in the U.S. and Canada as part of a strategic reorganization.

The severance program will be initially offered to workers in the U.S., Canada, and Puerto Rico who were hired on or before September 1, 2017.

Coca-Cola had about 86,200 employees at the end of 2019, with more than 10,000 in the U.S. The severance program is expected to cost between $350 million and $550 million.

The company also announced nine new divisions to replace its 17 current operating units, and is creating a new unit focused on efficiency and maximizing the advantages of its global scale.

"We have been on a multi-year journey to transform our organization," chief executive officer James Quincey said. "The changes in our operating model will shift our marketing to drive more growth and put execution closer to customers and consumers while prioritizing a portfolio of strong brands and a disciplined innovation framework."

Under the new structure, the company's operating heads will report to chief operating officer Brian Smith. The heads of the new categories will report to chief marketing officer Manolo Arroyo.

The platform services organization will be headed by chief information and integrated services officer Barry Simpson.

The company reported a drop in earnings of 33% for the second quarter on a 16% drop in global unit case volume, its largest quarterly revenue decline in at least 30 years. It saw improvements in case volume in June and July as COVID-19 restrictions were lifted. | WILLIAM SPROUSE

THE ECONOMY

Consumer Confidence Drops to Six-Year Low

U.S. consumer confidence fell in August to its lowest level since 2014, according to the Conference Board.

The consultancy said its Consumer Confidence Index was 84.8 in August, down from 91.7 in July. Its Present Situation Index, which is based on consumers' assessments of current business and labor market conditions, fell even more sharply, from 95.9 to 84.2 for the month.

"Consumer confidence declined in August for the second consecutive month," Lynn Franco, senior director of economic indicators at the company, said. "Consumer spending has rebounded in recent months but increasing concerns amongst consumers about the economic outlook and their financial well-being will likely cause spending to cool in the months ahead."

Franco said consumers' optimism about their short-term financial outlooks continued on a downward path.

Results of the monthly survey come even as the Census Bureau reported sales of new single-family homes rose 14% from June to July and 36% year-over-year.

"Today's data is telling us that while some lucky workers are able to buy new homes, millions of others are unable to afford life's necessities and pay the rent especially after the federal government canceled those $600 checks," Chris Rupkey, chief economist at MUFG in New York, said.

"The consumer is the most worried they have been all year, which pours cold water on the idea that the economic recovery is sustainable," Rupkey said.

Meanwhile, economists said a cut to the weekly unemployment supplement is likely to reduce retail sales by about $50 billion in August.

"We are clearly in the second phase of the recovery, driven by underlying fundamentals rather than purely the surge in activity as households reengaged," James Knightley, chief international economist at ING in New York, said. "This reinforces our view that a V-shaped recovery will not happen; the U.S. economy is unlikely to recover all of its lost output until mid-2022."

U.S. GDP fell at its sharpest rate in 73 years during the second quarter. Economists said the economy has been in recession since February. | W.S.

Getty Images(2)

M&A

AmEx Buys Kabbage

American Express is buying most of cash flow management startup Kabbage to boost its financial technology offerings to small businesses.

Kabbage, which started out in 2009 as an online lender, uses machine learning to determine a business's eligibility for a loan and the chance of repayment. It also provides small business solutions including online banking, payments, and analytics for making cash-flow decisions.

The acquisition continues AmEx's push into fintech services, adding Kabbage's 500,000 clients to its base of 2.5 million small-business credit customers.

Terms of the deal were not disclosed but reports put the value at up to $850 million. The deal does not include Kabbage's pre-existing loan portfolio, which will be handled by a separate entity that has yet to be established.

"This acquisition accelerates our plans to offer U.S. small businesses an easy and efficient way to manage their payments and cash flow digitally in one place, which is more critical than ever in today's environment," said Anna Marrs, president of global commercial services at American Express.

More than 225,000 U.S. small business clients have accessed more than $9.5 billion of working capital through Kabbage, the company said in March. But according to TechCrunch, "things have been tricky since February, with business dropping off a cliff after many SMBs were forced to shut their doors at the start of the [coronavirus] pandemic."

The company furloughed staff at the end of March, abruptly shut down its SMB credit lines in April, and then began processing Payment Protection Program loans.

"By joining American Express, we can help more small businesses succeed with a fully digital suite of financial products to help them run and grow their companies," Kabbage CEO Rob Frohwein said. | M.H.

THE ECONOMY

Business Optimism Recovers From Virus

U.S. business executives are feeling a bit better about their companies' prospects but are still deeply concerned about the economy amid the coronavirus pandemic, according to the Association of International Certified Professional Accountants.

In the AICPA Economic Outlook survey for the third quarter, 43% of respondents said their companies plan to expand in the next 12 months, up from 24% last quarter, while optimism about their companies' prospects rose from 30% to 41%.

Twenty-four percent of respondents had an optimistic view of the U.S. economy over the coming year, a slight increase from 20% in the second quarter, which represented the dimmest outlook since the fourth quarter of 2011.

The CPA Outlook Index—a comprehensive gauge of executive sentiment within the AICPA survey—moved back into positive territory with a reading of 54 after hitting 38, the lowest level since early 2009, in the previous quarter.

A year ago, however, 61% of respondents were optimistic about their companies' prospects.

"In the midst of most trends being upended, we're seeing improvement in a number of categories this quarter but it's worth remembering we're digging out of a very deep hole of pessimism. Comparisons are still tracking with the years immediately following the Great Recession," said Ash Noah, managing director of CGMA learning, education, and development for AICPA.

"We're also seeing the usual uncertainty over the outcome of the presidential election, which—given our current state of political polarization—adds to businesses' sense of unease, uncertainty and volatility," he added. | M.H.

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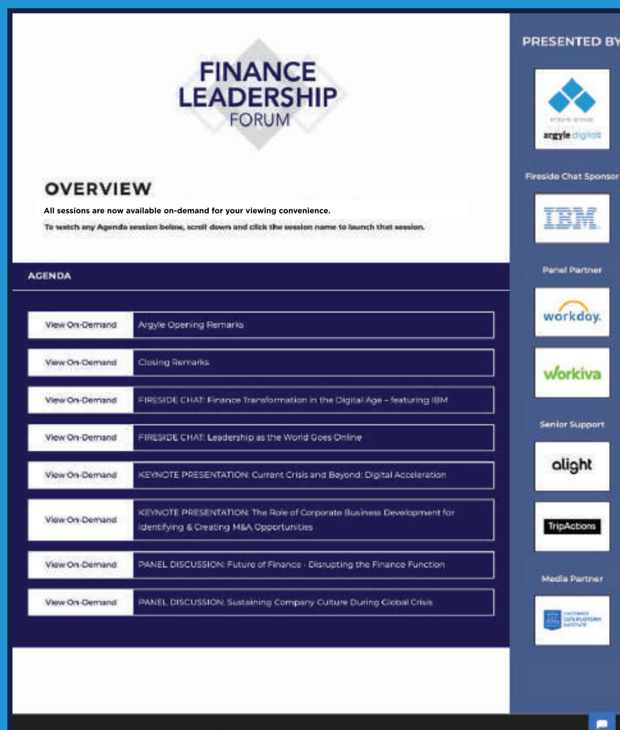

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FRAUD

Feds Net 57 People in PPP Loan Scams

The Department of Justice said it had uncovered widespread fraud in the Paycheck Protection Program, with 57 people, including an NFL player, being charged so far with trying to steal a total of $175 million in coronavirus relief loans for small businesses.

The spectrum of fraud has ranged from individuals allegedly receiving money on behalf of fake companies to legitimate business owners accused of spending funds on luxury items for themselves rather than paying employees. Some suburban homeowners allegedly pretended to be farmers.

Jerome Bellamy, who was released by the New York Jets, has been charged with fraudulently obtaining a $1.2 million loan from the PPP for his Drip Entertainment company and spending the proceeds on luxury goods and at a casino in Hollywood, Fla.

When applications for the program closed in August, 5.2 million loans had been made totaling more than $525 billion. It was open to any business with fewer than 500 employees per location, with the government forgiving the principal and interest on loans as long as 60% of the money went toward maintaining payroll.

As the Washington Post reports, the PPP had been a "fraud concern since its launch in early April. Funds were disbursed with relatively little vetting, and businesses were allowed to certify their own eligibility."

According to prosecutors, the program has attracted large groups of individuals who coordinated to defraud the program on a massive scale across numerous loan applications. Bellamy allegedly conspired with 10 other defendants who collectively filed at least 90 fraudulent loan applications seeking more than $24 million in loans.

Officials said the total amount of fraud is unclear at this point, and more charges are expected over the coming months and years. | M.H.

REGULATION

Super Micro Fined $17M for Improper Accounting

Super Micro has agreed to pay $17.5 million to settle charges that the computer server maker and its former CFO engaged in improper accounting practices to accelerate the recognition of revenue.

According to the U.S. Securities and Exchange Commission, former CFO Howard Hideshima pressured employees to maximize revenue at the end of quarters, typically sending dozens of emails to salespeople and other executives to try to boost sales.

As a result, the SEC said in an administrative order, Super Micro improperly and prematurely recognized revenue for fiscal 2015 through fiscal 2017 by recognizing revenue on goods it had yet to deliver to customers, shipping goods to customers prior to customer authorization, and shipping misassembled goods to customers.

To settle the charges, the company agreed to pay a $17.5 million civil penalty while Hideshima agreed to pay disgorgement and prejudgment interest totaling more than $300,000 and a $50,000 penalty. The government said he sold Super Micro stock at a profit while the improper accounting was occurring.

Hideshima, 60, served as Super Micro's CFO from 2006 through 2018. The SEC said he was "on notice that Super Micro employees engaged in a number of improper practices to accelerate revenue recognition and reporting" but "failed to adequately address the internal accounting control failures and stop these practices going forward."

In some instances, Super Micro allegedly recognized revenue before delivery by sending goods to storage facilities controlled by third parties at quarter-end and paying storage fees until the goods were delivered to the customer. | M.H.

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CAPITAL MARKETS

Opendoor to Go Public Via SPAC

- Online residential real estate platform
- Opendoor is listing shares publicly through a reverse merger that values the company at $4.8 billion.

Opendoor said it entered into a definitive business combination agreement with Social Capital Hedosophia Holdings II, a publicly traded special purpose acquisition company (SPAC).

The deal will result in $1 billion in cash proceeds, including a $600 million fully committed public investment in private equity (PIPE) and $414 million in a trust account held by the special purpose vehicle.

Opendoor offers an on-demand, digital experience to buy and sell a home. Since its founding, the company has had 80,000 customers and sold over $10 billion of homes. Last year, the company sold more than 18,000 homes, generating $4.7 billion in revenue.

"This is one of many milestones towards our mission and will help us accelerate the path towards building the digital one-stop-shop to move," Opendoor chief executive officer Eric Wu said.

Following the deal, Wu will remain with the company as CEO. Adam Bain, a director at SCH, will join the board of directors of the merged company.

Opendoor announced it was laying off 600 employees, 35% of its workforce, in April.

The company said the COVID-19 crisis, "had an unforeseen impact on public health, the U.S. economy, and housing," and it had "seen declines in the number of people buying, selling, and moving during this time of uncertainty."

In April, investor Chamath Palihapitiya announced he had raised $720 million for the blank-check company, 20% more than its original target. Last fall, his first SPAC merged with Richard Branson's Virgin Galactic in a deal that valued that company at $2.3 billion.

A report from the National Association of Realtors said sales of existing homes increased 25% from June to July, the biggest monthly jump in the history of the survey. | W.S.

STRATEGY

Moving Beyond Quick Fixes to Sustainable Value Creation

What else can companies do to help drive their businesses' short-term cash flows and fund their long-term ambitions? By Gregory W. Schooley

Most companies have exhausted their first set of actions in response to COVID-19—"low-hanging fruit," so to speak—to stabilize cash flows, increase liquidity, and manage their business through the pandemic. The question now is what else can companies do to help drive their business's short-term cash flows and fund their long-term ambitions?

At the onset of the COVID-19 crisis, executive teams acted fast to increase liquidity and protect their businesses. However, those actions are often only temporary fixes. Companies now face the task of balancing competing goals: improving cash flow and implementing sustainable value creation strategies, while simultaneously ramping up for increased business activity.

CFO's can lead the focus on several areas to achieve longer-term stability:

- Reducing indirect taxes, which can represent up to 25% of total personnel costs
- Cutting third-party spend by launching sourcing programs
- Reviewing real estate footprint, leases, and facility management services
- Outsourcing back-office activities to reduce cost and shift to variable cost structures
- Optimizing working capital to release cash in accounts payable, accounts receivable, inventory, and other areas

Costs of Goods Sold

COGS typically represent the largest portion of operating expenses for most businesses, and they are an important area for reductions and optimizations. Some of these costs, such as manufacturing, can be complex because they involve executing Lean Six Sigma practices across diverse manufacturing sites. The biggest expense for many companies is purchased components and materials. Companies can address it by reducing purchasing costs through sourcing programs that consolidate spend with fewer, more aggressive suppliers.

Indirect Taxes

Most executives are surprised to learn that indirect taxes are a major cost area, particularly in the post-COVID-19 environment. The total indirect tax burden of most companies is roughly 25% of their total personnel expenses.

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Indirect tax costs reside in many areas of an organization, including procurement, research and development, labor expenses, and manufacturing. By taking a holistic review and establishing a program focused on indirect taxes, companies can reduce these costs by 10% to 20%. These savings can be realized within three to four months. Often these savings also have "lookback" provisions, meaning businesses can claim savings on past tax payments as well.

Real Estate

Real estate costs represent about 3% to 5% of a company's overall revenue. The COVID-19 pandemic has prompted many companies to review their real estate footprint, leases, and facility management services to significantly reduce expenses, better align with changing customer behavior, and evolve their workplace strategy. Real estate costs can be reduced through rooftop consolidations, reducing vacancies, improving lease terms, and reviewing facility management services, such as cleaning and repairs. Lease restructuring reviews can identify ways to reduce rent or terminate leases as we face imminent declines in real estate values and rents for a number of years. Developing an overarching workplace strategy can help enhance productivity and engagement while highlighting offices that can be shed or that may need improvements for continued use.

Customer and Product Optimization

Pricing is one of the most powerful levers available for improving margins and driving quick profit growth. Investing in pricing tools and new strategies powered by big data and analytics can help to increase gross margins. Rationalizing products can also drive significant profit growth

Gregory W. Schooley

by focusing on more profitable segments. Most companies have experienced a dramatic product or SKU proliferation.

For example, grocery stores that carried 7,000 SKUs in 1970 now have 40,000. More SKUs often lead to increased complexity, higher inventory levels, larger store footprints, and ultimately higher operating expenses. Companies may also look to grow their more profitable customers while assessing pricing changes among their low- or no-margin customers.

Labor Productivity

Labor is a large component of a company's operating expenses, both in terms of selling, general, and administrative (SG&A) functions, as well as supply chain. Actions to address labor productivity include enhancing workflows for increased efficiency, utilizing automation for improved productivity, shifting some operations offshore to capitalize on low-cost labor, and possibly outsourcing non-strategic functions like accounts payable. These strategies can often deliver savings of 20% to 30% even for larger, "lean" companies.

Working Capital

Companies typically carry too much working capital in the range of 5% of revenues. In good times, when capital is plentiful and cheap, working capital may not be a strategic focus.

In economic crises, companies need to carefully manage cash to survive and grow. Companies should assess the supply base to understand which suppliers are not providing market-competitive terms. While some suppliers are "mission-critical" and should be handled with care, most are not. Many suppliers would be willing to extend terms in exchange for continued business.

Similarly, companies can assess their AP processes to understand where opportunities exist to leverage AP more strategically to release cash. Accounts receivable processes also deserve a close look to understand which customers can improve payments with additional attention and incentives.

Cash Management Office

Establishing a cash mangement office (CMO) can help focus efforts that may increase the odds of success for a value creation program. A CMO typically involves several elements, including the use of analytics to determine achievement levels. Once opportunities have been qualified and prioritized, common project charters can be established. This often helps provide accountability for the agreed-upon changes and results.

Another element involves a realignment of key performance indicators, metrics, and incentives. To instill a cash culture within an organization, teams may need to understand the role they play and understand how to make effective decisions. A final element is cash forecasting to seek benefits from changes implemented and so that cash can be deployed effectively in the future.

The COVID-19 pandemic and subsequent shutdown of the global economy represents the biggest collective challenge faced by companies in the past century. In these extraordinary times, companies must take decisive actions quickly to provide for survival and future viability. CFO

Gregory W. Schooley is U.S. value creation leader at EY.


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CREDIT

How to Respond When Your Banker Requests a Visit

Borrowers should not be surprised when their lender requests a "checkup," financial review, or audit. By Kenneth A. Rosen

Lenders are nervous. Despite long-term institutional relationships with customers, many banks are seeking to reduce financial exposure to borrowers because of uncertainty in the current economic environment. This has been especially so with vendors to the retail, hospitality, and travel industries, many of which have suffered tremendous losses in 2020.

Borrowers should not be surprised when their lender requests a "checkup," financial review, or audit. It should be anticipated that the lender may become stricter in its interpretation of covenants: there may be less forgiveness or flexibility than in the past for reduced profitability or losses that management firmly believes are temporary. Long-term relationships mean less.

Borrowers should anticipate the questions likely to be asked by their lenders and prepare appropriate responses that will give the lender comfort that it should be patient and not become more restrictive.

Creating an Action Plan

If a borrower has experienced declining sales or losses, it must demonstrate that it has a well-developed turnaround plan which is already being implemented. This includes reducing unnecessary expenses, cutting payroll, bringing books and records up to date, remediating accounting deficiencies, aggressively collecting accounts receivable, replacing lost customers with new customers, and taking the steps to assure that the business is competitive in the changing marketplace.

This "action plan" can be a key indication of the borrower's determination to conserve assets and mitigate any further losses. It gives the lender the justification for continued support of the borrower.

Lenders will scrutinize accounts receivable closely because they are a principal form of collateral. Lenders view aging accounts receivable as a devaluation of their borrowing base and may respond by reducing the advance rate or modifying the definition of eligible receivables.

If receivables have aged out, a borrower should be prepared to explain efforts to bring them current—commencement of litigation, retention of a collection agency, suspension of shipments, or reduction of the credit line. The bank will be critical of customers that are slow payers but that continue to receive

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trade credit. If necessary, the borrower should be prepared to justify its leniency towards late receivables.

Kenneth A. Rosen

A lender is likely to request financial projections that demonstrate that the lender will be adequately collateralized despite the borrower's temporary difficulties. It is often requested by the lender that a third party, such as a turnaround or financial advisory firm, assist management in the preparation of the projections. This provides reassurance to the lender that the projections were prepared by someone who is able to see the forest for the trees and who is not jaded by closeness to the situation. A fresh face often is able to cut additional expenses where management has not been able to do so. Lenders have greater confidence in third-party prepared projections than in the projections prepared internally by management.

Implications of Bankruptcy

One goal of a successful restructuring is to avoid bankruptcy. The best way to avoid bankruptcy is to understand the impact that it will have on all parties in interest—including the lender.

Bankruptcy is expensive. It causes a devaluation of collateral. Selling a business as a going concern in Chapter 11 will bring forth scavengers and bargain hunters. Selling the business at a multiple of earnings as opposed to liquidation value is impossible in most instances. Going-concern value is difficult to achieve in bankruptcy.

It is important to validate to the lender that forbearance enables the borrower to generate greater recovery for the lender—which may include a replacement lender—than if the lender takes action that may precipitate a Chapter 11 filing. It is also important to prove the potential downside to the lender of excessively tightening the reigns on the borrower—an inability to find a replacement lender or forcing a chapter 11.

Assessing Value

In liquidation, raw materials and work-in-process typically have nominal, if any, value. Depending on the kind of finished goods produced, they also may have minimal liquidation value. Products sold to retailers may be more saleable than products sold to other manufacturers as components. But, most retailers are cutting back on purchases because of the uncertainty about having to close their stores again due to another potential wave of the pandemic. Vendors who supply to end-manufacturers also are anticipating declining purchases due to a recession.

Certain assets of the borrower that do not have material value on its balance sheet may nevertheless have much value as collateral. A prime example is intellectual property, including customer lists, patents, and registered trademarks. Those assets may have dramatically increased in value since the inception of the loan. This incremental value should be acknowledged in establishing the "price" of the bank's forbearance. The retention of a valuation consultant may be worthwhile to support a greater worth of assets.

Lenders represented by sophisticated insolvency counsel are aware that in bankruptcy there is likely to be much delay in the bank's ability to obtain possession of its collateral. Further, the bank may be forced to fund losses for a period of time because bankruptcy judges are loath to shut down a debtor's business too early. They typically rule in favor of preserving jobs. Further, in most Chapter 11s, a committee of unsecured creditors will be appointed whose mission is to extract money from the bank.

Utilizing Collateral

Lenders are more likely to be cooperative if additional collateral is being offered in exchange for forbearance. Alternatively, the guarantee by the principal of a debtor/borrower can be offered (if not already in place). However, the length of the forbearance period should be sufficient to achieve the borrower's goals. Too short a forbearance period will enable the lender to repeatedly ask for more collateral every time that the forbearance period expires.

The savvy borrower will negotiate at the onset the price of additional forbearance time periods which may be required provided that the lender's collateral position has not materially eroded during the interim. If additional security is being provided in the form of collateral provided by a third party—such as a shareholder—the safest means of doing so is for the third party to acquire a "last out" position in the lender's existing loan facility rather than the third party making a new, subordinate loan to the borrower. This reduces the likelihood of a creditors' committee attack in the event of bankruptcy.

Prior to embarking upon negotiations with the secured creditor or bank, it is imperative to review all of the loan documentation and to analyze whether the lender has a valid and perfected security interest in all of the assets described in the security agreement. In the event of an error or omission, forbearance may be the price that the lender must "pay" for a cure. CFO

Kenneth A. Rosen is chair of the bankruptcy department at Lowenstein Sandler LLP.

Courtesy of the author

HUMAN CAPITAL

Remote Work Future Exposes Holes in Operational Strategy

Businesses need to take a hard look at their corporate strategies and operational structures to make sure they can handle a dispersed work environment. By Brian Peccarelli

By 2030, Facebook will have at least half of its 50,000 employees working from home. Twitter and Square's employees will be allowed to work wherever they feel most creative and productive, even once offices begin to reopen. In the United Kingdom, lawmakers are considering making it mandatory for employers to allow employees to work from home.

With work-from-anywhere likely to become the norm, many companies are struggling with how to maintain continuity, encourage collaboration, and maintain their cultures in a dispersed work environment.

There is no doubt that work-from-anywhere arrangements are going to represent a larger portion of the workforce than ever before. But that does not mean office buildings have seen their day. What it does mean is that businesses of every type are going to take a hard look at their corporate strategies and operational structures to make sure they are adaptive enough to handle the diverse nature of the future of work.

Along the way, they are going to have to confront some operational challenges as well.

Weighing the Tax Implications

In the grand scheme of the COVID-19 pandemic, an issue like tax nexus may seem like a trivial technicality, but when you start to realize that the vast majority of large corporations have already had their employees working remotely for six months, and many plan to keep them there for the foreseeable future, it suddenly becomes a real management issue.

Under normal conditions, a corporation's tax nexus is based on where its employees physically perform services. For example, an employee at a New York City-based business will have income tax withheld for New York, and the business will also have income tax nexus in New York because its workers are physically housed in the city.

However, when that New York City business suddenly has a large portion of its workforce operating out of their homes in the suburbs of Connecticut and New Jersey, it now has a nexus in all three states.

Managing this situation can get very complicated in states that have similar income tax laws but different tax rates. For example, California has a much higher tax rate than its closest neighbors. The same can be said for Illinois.

As the work-from-anywhere concept continues to take root, allowing employees to work from not only neighboring states, but entirely different regions and even different countries, corporate tax departments are going to need to not only adjust their formulas and forecasts but also keep close tabs on the diaspora of their employees. That will be true even if some of those employees end up embracing the nascent #vanlife movement and do not have physical addresses.

New Challenges for Auditors

The growth of remote work is also forcing a wholesale rethink of the internal audit process. The Public Company Accounting Oversight Board (PCAOB) recently convened a meeting of audit committee chairs of large U.S. companies. It found that risks associated with remote work were by far the biggest concern.

Specific risks included issues related to cybersecurity, ongoing communication with auditors, and overall pro-

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ductivity of the audit team. The concern, of course, is that with large swaths of the employee population working remotely, the ordinary checks-and-balances that would be in place for corporate IT systems and individual workstations are now being forced to operate within the confines of residential WiFi networks and across a geographically fragmented group of employees.

Brian Peccarelli

Audit committee members have understandably been concerned about developing the controls necessary to monitor and test for these risks, all of which takes time, resources, and collaboration capabilities that have been strained during the pandemic.

The fact that the PCAOB is aware of these issues and working closely with internal audit teams to establish new standards and best practices is a good thing, but the fact remains that many companies are still flying by the seats of their pants when it comes to managing the audit process remotely.

Fluid Standardization

Ultimately, the evolution that's currently unfolding is one where corporations will need to have the best of both worlds. They'll need the flexibility of remote, work-from-anywhere capabilities, along with the reliability of proven standards of audit control and predictable tax provision. Until this year, those would have been contradictory ideals, but, today, they are the new normal.

As we continue down this path, it will be critical for corporations to strike the right balance, keeping a close eye on best practices, while also staying adaptive enough to flex when the situation demands it. That's going to require a rethink of the status quo for many operational processes that have been rooted for decades in the idea of a centralized workforce. While companies have generally done a great job getting things to work in a stop-gap fashion in response to the pandemic, developing these ad hoc processes into sustainable, long term management strategies is going to take some creativity.

Brian Peccarelli is co-chief operating officer of Thomson Reuters.

'High Potentials' Could Jump Ship

CFOs are at risk of losing their most senior direct reports.

By John Touey

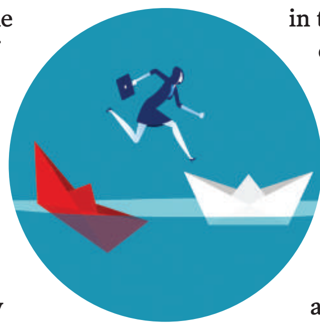
Salveson Stetson Group conducted a survey of executive attitudes to making a job change in the middle of the pandemic. As you might imagine, the appetite for change has shrunk significantly. In fact, we estimate that interest in switching companies has decreased by 50% since March.

As a CFO, this might give you some comfort that your best and brightest are in no danger of jumping ship at a time when you probably need their talents more than at any other time.

By and large, you would be right, except in the case of your "high potentials." In fact, the only group of executives where a plurality of respondents maintained a high degree of interest in making a change were those at the level just below the C-suite. In other words, your most senior direct reports are the team members you are at the highest risk of losing right now.

There are several reasons why this might be the case. High potentials may see the time horizon for advancement extended due to the pandemic or they may have some concerns about the long-term impact of the crisis on your industry or company. They may simply be impatient, as many ambitious executives are when they feel like their career advancement has stalled.

So, unless you are looking forward to the possibility of replacing some key roles during the worst economic crisis of a generation, here are some suggestions for to how to keep your high potentials.



• **Communicate regularly and one-on-one.** With everyone working flat out, it's easy for CFOs to keep their heads down and focus on the critical tasks at hand. However, checking in with your directs regarding their challenges and the personal impact the crisis is having on them as leaders and individuals goes a long way to instilling loyalty.

• **Offer opportunities to learn.** If anything, the crisis has presented chances for you and your organization to do things differently. Make sure that your directs are not just doing the same things better but are offered chances to broaden their skill sets.

• **Be future-focused.** There will be life after the pandemic and getting your high potentials involved in planning for that future keeps them engaged.

• **Be open.** If plans have changed due to the pandemic, let them know. If the prospects for advancement in the company will be limited over a duration of time, better your high potentials know that, too.

If the high potentials on a CFO's team aren't getting this type of interaction, they may well be thinking it's a good time to evaluate their career priorities over the near- and intermediate-term. We all serve at the pleasure of our employers, but if it feels like your employer is stuck in place, high potentials may feel compelled to take a look outside. CFO

John Touey is a principal at executive search firm Salveson Stetson Group.

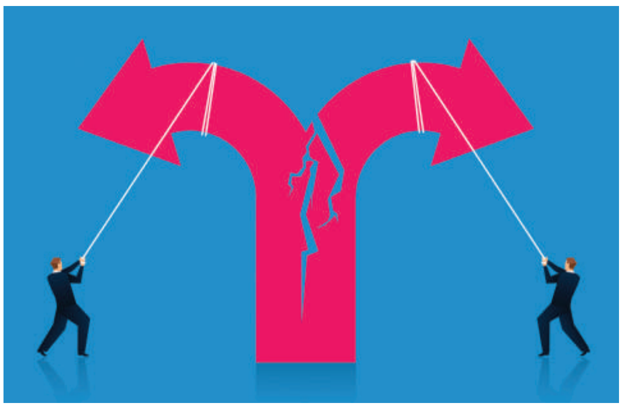
Top: Courtesy of the author; Bottom: Getty images

M&A

Don’t Let COVID-19 Kill Your Deal

Tech startups eager to complete M&A and venturing financings during the pandemic will want to follow these best practices. By Karen A. Abesamis and John Park

Time tends to be the enemy of all deals. Particularly in a merger or acquisition, the longer the process drags on, the greater the likelihood a deal falls apart. And those seeking venture financings are finding the longer a deal takes, the lower the valuations and investor interest. So, in the era of COVID-19 when the unexpected has become common, time is even more precarious. Tech startups looking to mergers or acquisitions as their exit strategy should recognize that the clock is ticking and prepare accordingly to ensure the fairway to signing is as clear as possible.



Here a few best practices to help make sure an M&A transaction gets done.

• Ensure that the letter of intent has a limited exclusivity provision to help drive a steady timeline for due diligence and negotiation of the agreements. Although the exclusivity period can later be extended by the parties, applying pressure at the onset can help push a buyer to sign.

• While communication is vital to any business or transaction, clear communication in cross-border M&A during a global pandemic when the parties cannot meet face to face can be the difference between a deal signing and the parties going their separate ways. Tech startups should avail themselves of video technology to create transparency and alignment of goals with the buyer. Ensure that the deal data room is complete and conforms to the buyer’s specifications.

• Be as detailed as reasonably possible as to what has not been done in the ordinary course as a result of COVID-19. Ordinary course is a term frequently negotiated in M&A agreements, but in the era of COVID-19, the term has led to greater negotiation between parties. For example, do reps and warranties or covenants reference back to business pre-global pandemic or do they take into account the new norm? Have a clear list of what has changed for a tech startup, whether it be as significant as a loss of revenue to as mundane as a new software application to better help remote workers connect to meetings. Doing so will enable the startup to respond to buyer inquiries and to bargain for better deal terms.

• Revisit as early as possible existing commercial agreements to determine whether a tech startup can fulfill existing contractual obligations in light of COVID-19. In particular, assess the “force majeure” clauses and determine whether there is any reprieve for either party in fulfilling its obligations. The interpretation of force majeure provisions depends on jurisdiction and country. So parties will want to ensure they understand the applicable rules and available remedies in the relevant jurisdictions and countries, particularly when negotiating with a non-U.S. buyer in cross-border M&A.

With respect to venture financings in the current COVID-19 market, companies without a path to revenue in the next year are confronting reduced valuations and investor interest.

Here are several of the key action items for startups in this category.

• Coordinate a bridge financing round with existing investors by consulting with investors as early in the process as possible.

• Consider offering warrant coverage and liquidation premiums as an incentive for existing investors, and ini-

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Karen A. Abesamis

John Park

tiate discussions with investors as early in the process as possible, since lead times to closing will be extended given the virtual deal environment.

• Given current market conditions, communicating the value proposition and business progress to investors and other stakeholders is even more important than normal.

• Consider valuation adjustment mechanisms tied to milestones and performance objectives to allow for upward or downward adjustments as a means to bridge valuation gaps in discussions with prospective investors.

• Review compensation terms and headcount and evaluate adjustments within the context of labor and employment law requirements.

• Prepare for virtual due diligence and develop strategies to present company data and documents on a real-time basis through virtual document rooms. Invest in available robust data room products.

• Streamline financing document terms with an eye towards limiting investor concerns as a gating item since closing on a timely basis will be the priority.

• Consider alternative sources of funding, including non-recurring engineering (NRE) and other custom development work.

With the degree of uncertainty in the markets, these steps will help prepare all stakeholders involved for the various scenarios in a financing or M&A exit.

Karen A. Abesamis and John Park are both partners at law firm Morgan Lewis.

Prospect of Higher Taxes Could Spur Rush of PE Deals

PE players are assessing which way the political and fiscal winds are blowing.

By Brian Richards

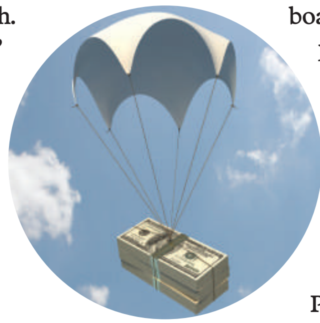
No matter one's political affiliation there's a lot riding for businesses and the economy on the results from the presidential election.

For the private equity marketplace, hollowed out by the COVID-19 pandemic and the drying up of leveraged lending, the signals we get on November 3 may tell us whether PE limps to the end of a year to forget or finishes with a flurry that retrieves hope and momentum from the ashes of 2020.

Which investors look the likeliest to wade into the PE marketplace with an eye on possible adverse tax consequences if they don't? Here is what my quarter-century in the field, in good times as well as turbulent, tells me.

Family-owned and entrepreneurial businesses may seek an exit, even with depressed valuations, along with PE-owned portfolio companies in which investors are substantially "in the money."

Bread-and-butter company roll-ups will occur. These roll ups will involve entities such as local service businesses and niche brands that aren't particularly sexy or cutting edge but make money and need capital for expansion and growth.



"Made in America." As the political desire grows for more goods to be manufactured stateside, production and even service businesses that make that pledge will find an easier path to needed capital—and may find tax, trade, and other regulatory advantages.

Many companies hit hardest by the pandemic, such as in retail, transportation, and hospitality, are in grave need of capital; such deals could be pegged to longer-term secular trends or might amount to short-term turnarounds or comebacks.

Sound environmental, sustainable, and/or good-governance policies are sometimes in the eye of the beholder, but companies that integrate financial returns with social outcomes should be able to attract investor interest.

Deals driven or underpinned by government policy—including renewables and other aspects of green technologies—should be viewed favorably in a resurrected PE market.

It is impossible to predict the course of the campaign, or the economic leverage the winner (or winners, if the government remains divided) might boast. A change of course in tax policy might not in the end be as far-reaching or complete as Democratic proposals advocate.

The ongoing effects of the coronavirus pandemic are easier to envision, as is their influence on the PE market as we get closer to understanding the virus and perhaps developing a vaccine. Private equity cannot remain dormant—there is too much money sitting on the sidelines and too many places where it could do good. It could reverse the terrible economic costs of the pandemic, bringing large numbers of unemployed back into the workforce and jump-starting consumer spending and other essential activity.

Private equity has a role to play in righting the economy and the millions of lives the pandemic has disrupted, and there are lots of places to start. CFO

Brian Richards is chair of the global private equity practice at law firm Paul Hastings.

Top: Courtesy of the author; Bottom: Getty images

RISK

Control Climate Risk Even If The Climate Is Beyond Control

Although the climate seems monolithic, climate risk is local and absolutely manageable.
By Kevin Ingram

A hurricane striking the United States and a wildfire raging on the West Coast recently presented what The New York Times called "a preview of life in a warming world and the steady danger of overlapping disasters." ¶ Although no individual meteorological event can be solely attributed to a changing climate, trends in weather patterns continue to be unpredictable. Flood risk has increased in some parts of the world due to precipitation changes as well rises in sea-level, while wildfires have been more numerous as a result of extended droughts. Global leaders are taking notice. For the first time in the World Economic Forum's 10-year outlook, the top five global risks in terms of likelihood are all environmental.

Although the climate seems monolithic, climate risk is local and absolutely manageable. Climate risk is the potential adverse financial impact of climate-related disruption. Addressing it is imperative. And the senior finance executive's responsibility isn't abdicated because a pandemic is dominating attention.

Getty images

Insurance Isn't Enough

Property insurance is necessary to transfer climate risk in a large business but not sufficient to fully address it. Although a good insurance policy will cover the immediate property and revenue loss in a disaster, the financial impact of a disruption can endure long after coverage for an event has concluded. Nothing can fully replace lost market share, growth, and investor confidence.

Value at Risk

Researchers have tried to measure some of these enduring losses.

Consider flood. An independent analytics advisory firm we commissioned recently looked at 71 large publicly traded companies that had reported financial damage in their 10-K statements from a major flood event. Twelve months after the event, their shareholder value had declined by an average of 5%, equivalent to a collective $82 billion. Other companies surely experienced the same events but did not have to report financial damage.

This loss in shareholder value is a relatively new phenomenon. Shareholders used to give companies a pass on natural hazard damage, attributing it to bad luck. The relatively new shareholder value penalty is a sign that companies that fail to prevent damage lose shareholder confidence. Organizations are now expected to be resilient, and rightfully so.

We saw more evidence of how resilience works in hurricane research we commissioned last year. The shareholder value of companies that had implemented all of our storm-protection recommendations prior to Hurricanes Harvey, Irma, and Maria outperformed those that hadn't finished doing so by 10% in terms of shareholder value.

Not every company has acted accordingly. More than 3 in 4 (77%) CEOs and CFOs of the largest companies in the world recently acknowledged that their firms are not fully prepared for the adverse financial impact of a changing climate. And more than 8 in 10 (82%) believe their companies have somewhat to no control over such an impact on their business.

Control What You Can

I believe you do have control over climate risk.

Although the future of the climate is uncertain, natural hazards are the same ones businesses have faced for centuries: flood, wind, drought, and fire. Businesses know—or can find out—how likely they are to experience these kinds of disruptions, how severe they might be, how they could affect their bottom lines, and how to cost-effectively engineer resilience into their operations. Climate risk is a traditional natural hazard risk, just in a different package.

Kevin Ingram

To address it, your team needs to assess, quantify, and mitigate the threat.

Assess. I'd suggest ordering engineering reviews of all of your properties to fully understand vulnerabilities to water, wind, and fire. With flood, for example, someone needs to understand how much water you are likely to get, how rapidly it will flow, in which directions, how long it will linger, and what contaminants it may introduce. Flood risk maps can help.

Quantify. Look at every potential loss and estimate the cost in terms of replacement, repairs, revenue, and business value. Calculate every site's contribution to your profit. Now you can prioritize mitigation steps.

Mitigate. Use your financial analysis to determine the most cost-effective ways to protect your profit. Mitigation can range from temporarily elevating critical equipment when a nearby river is rising to deploying inflatable dams or rebuilding an entire division at a less vulnerable site.

Finally, create an emergency response team that can develop sufficiently detailed emergency response plans and defined triggers to activate them. These plans are good to have for all hazards, including those unrelated to climate, such as earthquakes, chemical spills, or disease outbreaks.

Although the climate is a global phenomenon, the risk is very local. It's focused on your property and your investment. And you have the control.

Kevin Ingram is executive vice president and CFO of FM Global.

Planning for The Next Crisis

Scenario planning positions companies to benefit from disruption.

By Jim Hsu and Loren Garruto

If the pandemic has shown us anything, it's that corporate scenario planning may need to account for events that executives have never dreamed about.

Going forward, the most strategic CFOs must be willing to challenge the assumptions being used in the forecast models that drive scenario planning, both for the current pandemic and for future crises.

CFOs will play a key role in determining how various scenarios will impact revenue, cost structure, the balance sheet, and liquidity. These key areas can shape how companies prepare for and respond to the uncertain environment ahead.

1. Identify new data inputs. It is difficult to forecast and plan for various scenarios without the right data. But typical metrics, such as revenue and foot traffic, are now less available or relevant for future planning. Businesses are just beginning to reopen (or shut down again) and some revenue has been propped up by government stimulus programs that may not continue.

The CFO can take the lead in determining which inputs are most relevant and predictive for the business, with the finance team performing a regression analysis to see which metrics show correlation and determine which represent actual causation.

2. Model the data to understand how the business may behave under different scenarios. Once the CFO has identified relevant data inputs, the inputs can be run through various forecasting models, including decision trees and Monte Carlo simulations, to determine how changes in the data under different scenarios will affect the business.

This process can incorporate information from different functions, but there may be a need for the CFO to be empowered to challenge the assumptions going into the models.

It is essential to build "black swan" events into scenario planning, as we have seen that these events may not be as rare as executives assume.

3. Act now to allow for flexibility under different scenarios. Proper scenario planning can help companies gain better transparency into the risks they face in different situations. The CFO can then use the various scenarios to help guide decisions around the company's cost structure, working capital policies, dividend policy, backup sources of liquidity, and other near-term measures.

4. Use the crisis to develop a playbook. One lasting project the CFO can lead is to use information and lessons learned from the current crisis to develop a crisis playbook. This playbook may include specific actions to take in response to specific shocks to the business.

By improving forecasting and scenario–planning now, and preparing a plan for the next crisis, CFOs can help improve their company's resilience, position it to weather market disruptions, and take advantage of the opportunities that come with any crisis. CFO

Jim Hsu is global EY-Parthenon strategy leader and Loren Garruto is EY's global and Americas corporate finance leader.

Top: Courtesy of the author; Bottom: Getty images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Remote Possibilities

CFOs are using months of experience with remote work and the uncertainty of COVID-19's path to plan for a post-pandemic workplace.

By Sandra Beckwith

At Ping Identity, CFO Raj Dani has noticed a distinct lack of "on-the-spot learning" opportunities since the coronavirus pandemic forced the cybersecurity firm to shift employees to remote working. "A lot of that comes through spontaneous conversations in hallways or at the water cooler. Those sessions don't happen when you have to schedule a Zoom call and wait three days," he laments.

Then there's all those video conferences that have replaced in-person meetings. "I've sat through a full day of them on Zoom, and it's just incredible the amount of fatigue you feel," Dani says.

Empty hallways and Zoom fatigue notwithstanding, as CFOs look ahead to a post-pandemic workplace, there's general agreement that telework is here to stay. Seventy-four percent of finance chiefs surveyed by Gartner at the end of March said they planned to permanently shift at least 5% of employees who previously worked on-site to remote positions. And after five months of testing the remote-working waters, CFOs interviewed for this story expect that their post-pandemic workforce will include a larger number of permanent work-from-home positions than before.

Getty Images

Daily stressors for many work-at-home employees include finding child or elder care, reduced access to colleagues, and fatigue. "You used to go home and recharge, but now you're working at home with your family, which can bring new anxieties and stresses. You never get a break," Lloyd Howell, CFO of consulting firm Booz Allen, says, adding, "People are starting to get fatigued—physically, mentally, and emotionally." But virtual workers are also benefiting from schedule flexibility and commutes measured in steps rather than miles. Around the country, some daycare centers and schools have reopened, easing child care concerns.

Productivity trends, employee feedback, and marketplace realities are pushing CFOs to reimagine their businesses and workplaces. "Be positive that there's a bright future ahead," says Barb Harwood, CFO of content production studio Thunderbird Entertainment Group. "It's just not going to look like the bright future you envisioned in February."

Making Room

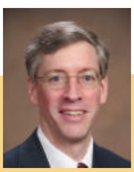
The productivity of remote workers has always been a concern for employers. "The CFOs in most organizations want to make sure they get the best return they can per dollar spent on employees," observes Alexander Bant, vice president, research, for Gartner's finance practice. With the pandemic, employees have faced the challenge of remaining productive while often using a makeshift home workspace.

"Not everybody has the home space naturally conducive to telework. I've talked with teleworkers during this pandemic who say that their desk is their ironing board," says Tim Golden, a Rensselaer Polytechnic Institute professor

Heed This Advice

CFOs and experts offer the following recommendations for strategizing about a post-crisis workplace.

"This is an opportunity to rethink the way work is done and what employees can stop doing as opposed to just transferring what was done in the office to a remote environment."
—Alexander Bant, Gartner



"For the organization to work effectively together, people need to identify with it and its mission and feel connected to the work they do and the people in the organization."
—Tim Golden, Rensselaer Polytechnic Institute

"Be adaptable by thinking outside the box, breaking down conventions, and being nimble."
—Barb Harwood, Thunderbird Entertainment Group

"Come out of the numbers and think about people not as an asset but as people."—Lloyd Howell, Booz Allen Hamilton

"Take this time to change and adapt for what is looking like our new normal. Employees and the market are expecting to change."
—Traci McCready, Alvarez & Marsal

"Don't underestimate the resiliency of the staff. Be cautious, but don't lose sight of your post-COVID business."
—Kirsty Godfrey-Billy, Xero

"Never have just one plan—have a plan A, B, and C. You can pivot so much quicker and better if you have that plan developed and in your drawer to pull out and execute."
—Max Broden, Aflac

"We're constantly pulsing our employee base to make sure we're understanding their perspective. I do think it's evolutionary. People's views will keep changing."
—Raj Dani, CFO, Ping Identity

who has studied teleworking for more than 20 years.

Nevertheless, people seem to have adjusted. "Many organizations are saying virtual work is working out better than they anticipated," reports human resources specialist Traci McCready, managing director of consulting firm Alvarez & Marsal's corporate performance improvement practice. Some of the firm's clients are saying that productivity has improved, she adds, with one company reporting it has increased by about 15%.

At insurance company Aflac, CFO Max Broden says productivity went up initially. "Not having to commute meant people gained some time," he explains. "We also probably have more water cooler talk in the office than is sometimes necessary from a productivity standpoint, and that went away."

Thunderbird Entertainment, meanwhile, helped employees maintain productivity by investing about $280,000 in a software program that allows animators to do their work remotely with the secure protocols that clients require. "If they don't have the tools they need to work efficiently, productivity goes down, schedules get stressed, projects cost more money, and financial performance decreases," Harwood says.

Fatigue Factors

Many companies are also addressing the stress of virtual work by increasing spending on benefits that include mental health support for staff and paid time off. Ping Identity took that a step further when CEO Andre Durand created "artificial holidays" in July and August that forced all employees to stop working.

"We're seeing fatigue in our employees because some don't know how to balance work and life, especially with no physical separation of work and home. The two company-wide holidays helped people get away from it," says Dani.

Aflac is taking a similar approach by having managers urge people to use their paid time off. The company has also donated to organizations that offer free mental health counseling, and CFO Broden encourages his staff to take Friday afternoons off. "We can see that people are logged in for longer hours than before, so as long as all tasks continue to get done, everybody is free to log off at noon on Fridays," he says.

Thunderbird hosts mental health and workplace stress webinars, communicates about the mental health benefits included in the employee assistance program, and provides 24-hour access to a nurse hotline for workers suffering anxiety.

Playing It Safe

Going forward, companies don't seem to be in a hurry to have employees return to their offices, particularly with no definite end to the COVID-19 crisis in sight. "Risk tolerance is pretty low with regards to allowing people back in while the virus is running rampant without a vaccine," Bant says.

Most Aflac employees won't return to their offices before 2021. "The one thing that really worried us was the concept of a second [virus] wave coming in the October-November timeframe," says Broden. As management began considering bringing "a decent portion" of the staff back after Labor Day, several states where the company has offices had a COVID-19 resurgence. That plan was scrapped.

"We're functioning well, and the safest option now is for our employees to continue to work from home," Broden adds.

Not every company is waiting. By some reports, Wall Street banks have brought about half of their workforces back into the office on a rotating basis.

Like many other companies, Ping Identity will seek employee input as it decides how its post-pandemic workplace will look. "We'll put a lot of thought into it," says Dani. For now, the finance chief is looking forward to resuming the face-to-face interactions that he feels are helpful for his own development. "It's about what I learn from walking about and engaging with folks," he says.

And a cure for Zoom fatigue? That might be too much to ask for. CFO

Sandra Beckwith is a freelance business writer.

Productivity by the Numbers

- **PwC reports that while 63% of CFOs were concerned about productivity in March, that number dropped to 26% by June.**
- **According to a June Korn Ferry survey, 64% of professionals say they are more productive working from home than in any office.**
- **A July Azurite Consulting survey reveals that 43% of managers and 50% of employees say they are more efficient working from home.**
- **Gartner reports that just 13% of executives surveyed in June are concerned about sustaining productivity. This might be because 61% have implemented more manager-employee check-ins.**
- **According to a July Chubb survey of workers, 70% say their productivity at home is equal to (37%) or greater than (33%) working at the office.**

Cloud Security: A Work In Progress

Companies are rapidly adopting cloud services, but many are failing to put proper security measures in place.

Mountain View, Calif.-based Egnyte provides file sharing via the cloud to its customers, so its security practices have to be top-notch. But the company also has all of its internal finance applications in the cloud, including those handling employee expenses and payment processing for contractors, says Suzanne Colvin, CFO. Its sales team relies heavily on Salesforce's cloud-based customer relationship management (CRM), and the marketing team uses a mix of cloud-based applications to communicate with prospects and customers.

"As our chief security officer Kris Lahiri likes to remind us, [on-premise] infrastructure isn't inherently more secure than the cloud; it comes with its own set of vulnerabilities and risks," Colvin says. "We adopted cloud technology early and never looked back."

Many organizations have trod the same path. But any organization launching a cloud computing initiative or in the middle of moving more data and workloads to the cloud has likely been worried about the accompanying cybersecurity risks. It turns out, they are just as prevalent as those in on-premise systems. Entrusting valuable information resources to an outside service provider always comes with hazards.

Wisely, many enterprises, like Egnyte, are investing in cloud and remote worker security, especially as more of the global workforce toils from home. Indeed, cloud security spend is expected to rise by 33% in 2020, Gartner forecasts.

BY BOB VIOLINO

Getty Images

Cloud Security: A WORK IN PROGRESS

Unfortunately, spending on solutions doesn't necessarily translate into bulletproof systems. Recent studies find that while companies continue to adopt cloud services rapidly, many fail to put in place proper cloud security measures. That's troublesome for several reasons, not the least of which is that bad actors use weaknesses in the cloud as an entry point for malicious attacks.

In addition, many enterprises that do get attacked point fingers at cloud service providers, saying their systems lack built-in security measures. One recent study found that about 8 in 10 IT professionals are concerned that cloud providers are too self-assured about the security of their platforms.

Shoot, Then Aim

Recent research by consulting firm KPMG and software giant Oracle notes that as business leaders digitally transform their operations and move what's left of on-premise systems to the cloud, adequate security controls are all too often an afterthought.

"Companies [often] eschew proven best practices and make it difficult—if not impossible—for the business to accurately assess and manage enterprise risk," the report says. "Organizations are simply not ready to secure [their systems] at the rate at which the business [is adopting] cloud services, creating a palpable cloud security readiness gap."

The basics of cloud security are still not understood by many organizations, and worsening confusion over the shared responsibility security model is a pivotal contributor to the readiness gap, the study says. Many IT executives also believe that cloud security requires a different employee skillset than on-premise security.

As part of their research, KPMG and Oracle conducted an online survey of 750 cybersecurity and IT professionals worldwide in December 2019 and January 2020. They found that 81% of those surveyed are concerned about the potential for complacency among cloud service providers. And a majority of organizations (70%) say too many specialized tools are needed to secure their public cloud footprint. On average, organizations use more than 100 discrete products for cloud security.

2019 Breach Facts

86%
Of data breaches were financially motivated

43%
Of breaches involved web applications

28%
Of breaches had small businesses as the victims

55%
Of the breaches were perpetrated by organized criminal groups

30%
Of breaches involved internal actors

Source: 2020 Verizon Data Breach Investigations Report. Analysis of 3,950 data breaches in the United States.

Buying Protection

Some of the big cloud companies have been adding to their security prowess with significant bolt-on acquisitions. They're doing so because most of their customers expect cloud security to be "baked into" services, says Lawrence Pingree, a managing vice president at Gartner.

"[Businesses] expect that cloud providers can provide a basic level of due care for security," Pingree says.

In October 2019, virtualization software provider VMware bought Carbon Black, which offers cloud-native endpoint and workload protection. Carbon Black will form the nucleus of VMware's security offering, focused on helping VMware customers with advanced cybersecurity protection and in-depth behavioral insight to both help stop sophisticated attacks and accelerate response times.

Despite the massive spending on cybersecurity by enterprises, "the last two years have seen some of the largest security breakdowns in IT history, with major data breaches making headlines nearly every week," says Sanjay Poonen, chief operating officer, customer operations, at VMware.

> **"[Businesses] expect that cloud providers can provide a basic level of due care for security."**
>
> —**Lawrence Pingree**, managing vice president, Gartner

As businesses continue to shift toward hybrid cloud environments and more dynamic endpoints, rethinking cloud security is critical, Poonen says. "As the threat landscape expands in the age of multi-cloud, modern apps, and modern devices, cybersecurity should not be an afterthought or an 'add on;' it should be baked into the fabric of tools, processes, and business," he asserts.

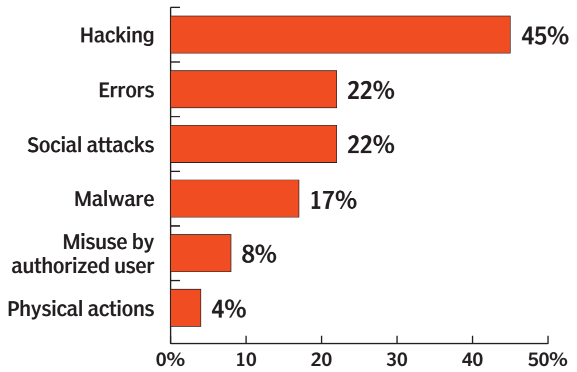
In a similar move in June, IBM announced it had signed a definitive agreement to acquire Spanugo, a provider of cloud cybersecurity posture management products. To further meet the security demands of its clients in highly regulated industries, IBM will integrate Spanugo software into its public cloud.

The addition of Spanugo software will enable organizations to define compliance profiles, manage controls, and monitor compliance, IBM says.

As clients move increasingly significant and sensitive workloads to the cloud, management of security and compliance becomes more complex, IBM says. For businesses

Breach Tactics and Causes

Errors, including misconfiguration by systems admins, were part of many data breaches.



Source: 2020 Verizon Data Breach Investigations Report. Analysis of 3,950 data breaches in the United States.

in highly regulated industries, including financial services, health care, insurance, and telecommunications, cloud environments are most useful when they are approved for sensitive information.

"When it comes to hosting sensitive and regulated workloads on the public cloud, enterprises are being forced to take a hard look at their approach to managing security and compliance," says a spokesperson for IBM.

Human Problems

Complex deployments open the door to a range of cloud cyber threats, but so does human error, according to research by Trend Micro, a multinational IT security provider. The company found that misconfigurations are a primary cause of cloud security issues. A misconfiguration is when a system administrator does not secure a cloud storage system or a database correctly on a cloud service. (For this and other definitions, see "Knowing the Parlance," below.)

Such errors have been increasing since 2017, according to the 2020 Data Breach Investigations Report (DBIR) by Verizon. The trend can be in large part associated with internet-exposed storage discovered by security researchers and unrelated third parties.

"These are the kinds of incidents that you hear security researchers discovering through simple trawling of the internet to see what's exposed," according to the DBIR. DivvyCloud, a security and compliance platform provider, found nearly 33.4 billion records were exposed in breaches due to cloud misconfigurations in 2018 and 2019. Those breaches

Knowing the Parlance

The following terms are often used in discussing cloud security.

- **Cybersecurity posture**
An organization's overall defenses against cyberattacks; the resources and capabilities in place to defend the enterprise's networks, information, and systems, including security solutions deployed and policies, like employee training programs.

- **Data exfiltration**
A form of security breach in which a company's data is copied, transferred, or retrieved from an individual computer or server without authorization. Sometimes referred to as data extrusion, data exportation, or data theft.

- **Endpoint**
Any device that is physically an endpoint on a network. Laptops, desktops, mobile phones, tablets, servers, and virtual environments can all be considered endpoints.

- **Identity and access management (IAM)**
Products, processes, and policies used to manage user identities and regulate user access within an organization. Systems used for IAM include single sign-on, two-factor authentication, and multifactor authentication.

- **Infrastructure as code**
An IT setup in which developers or operations teams automatically manage and provision the technology stack for an application through software, rather than using a manual process to configure discrete hardware devices or operating systems.

- **Misconfiguration**
A cloud misconfiguration occurs when IT has not configured a cloud-related system, asset, or tool correctly. Common forms include leaving an unencrypted data store exposed to the public internet without any form of authentication required to access it; exposing data to all global users of the same cloud platform; and leaving encryption keys and passwords in open repositories.

- **Security readiness gap**
The difference between the eagerness of organizations to move to public cloud services and their ability to secure enterprise data within those services. Many IT executives are not comfortable with the security implications of moving workloads to the cloud.

Sources: Digital Guardian, Webroot, Wikipedia, InformationWeek, Security Boulevard

Cloud Security: A WORK IN PROGRESS

cost global enterprises almost $5 trillion. (Only breaches that were definitively attributed to cloud misconfigurations were included in the report.)

Cyber criminals that capitalize on misconfigurations have gone after companies via ransomware, crypto-mining, data exfiltration, and other methods.

Accidental Exposure

In May 2020, a report by cloud software company Accurics stated that current security practices are "grossly inadequate" for protecting cloud infrastructure in development environments.

The report shows that there is a significant shift toward provisioning and managing cloud infrastructure through code, which allows organizations to embed security earlier in the application development lifecycle. However, infrastructure as code is not adequately secured, thanks in part to a lack of tools that can provide complete protection.

Even in scenarios where infrastructure as code is being governed, there are ongoing problems from privileged users making changes directly to the cloud once the infrastructure is provisioned. This creates a drift from the secure baseline established through code, the study says.

"When you're talking data in the cloud, there is always the threat of ransomware, malicious insiders, and accidental exposure often caused by poor access control."

—**Suzanne Colvin**, CFO, Egnyte

"The dangers are undeniable: high-severity risks such as open security groups, overly permissive identity and access management roles, and exposed cloud storage services constitute 67% of the issues," the report says. "This is particularly worrisome since these types of risks have been at the core of numerous high-profile cloud breaches."

While cloud security will likely continue to broaden and improve as customer needs evolve, it may continue to be one of the biggest resistance factors in cloud adoption.

"When you're talking data in the cloud, there is always the threat of ransomware, malicious insiders, and accidental exposure often caused by poor access control," says Egnyte's CFO Colvin. "As an organization, we thoroughly evaluate the tools we bring into our digital workplace, continuously vet them, and educate our workforce on security practices."

Translation: there are plenty of things organizations can do on their own to bolster cloud security, even if cloud providers are playing catch up. CFO

Bob Violino is a freelance writer based in Massapequa Park, N.Y.

No Spending Lull

Cloud security investment will most likely prove resistant to the COVID-19 economic shock.

Given the issues swirling around cybersecurity, it's no surprise that a June report by Gartner noted that demand for cloud and remote worker security is boosting worldwide spending on information security and risk management technology and services.

Such spending is expected to grow 2.4% to reach $124 billion in 2020, although spending in other segments of IT will likely show little growth thanks to the coronavirus pandemic. Cloud security spending specifically is expected to rise 33% from 2019 to this year, Gartner says. That's by far the most significant increase for any IT segment.

Spending is expected to grow 2.4% to reach $124 billion in 2020.

According to Forrester Research, cloud security spending in the United States is expected to reach $1.93 billion by 2021, tripling since 2016.

The ongoing shift to a cloud-based delivery model makes the security market somewhat more resilient to a downturn, Gartner says. As of late, cloud-based delivery models have reached well above 50% of the deployments in the areas of secure email and web gateways.

In the meantime, however, companies continue to get hit.

Cloud assets were involved in about 24% of the data breaches examined by the Verizon research team that occurred in 2019. A large majority of cloud-based breaches involved email or web application servers.

One of the most notable attacks targeted credit card applicants at Capital One. A hacker accessed 100 million card applications, which included Social Security and bank account numbers, that were improperly secured on Amazon cloud storage.

A recent study by IDC found that 79% of companies had experienced at least one breach in the past 18 months. Within that group, 43% had experienced 10 or more cloud security incidents during that same timeframe. One of the nagging issues for organizations? The lack of visibility into live cloud environments, according to the chief information security officers surveyed. —B.V.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Anti-Trust

China-based companies are still not complying with PCAOB audit inspections. Does Congress have the answer? By Ramona Dzinkowski

In a period when China-U.S relations are fractious, it was perhaps inevitable that a perennial issue with Chinese companies listed in the United States would rear its head.

But China-based companies are also making headlines this year, and not in a good way. Luckin Coffee, iQiy, GSX Techedu, and TAL Education are but a few of the better-known entities that have come under increased scrutiny from the Securities and Exchange Commission for alleged inaccurate filings and (in some instances) outright fraud.

Luckin Coffee is the mothership of such cases. Its corporate officers are charged with falsely reporting over $300 million in sales (or half of its total) during the last three quarters of 2019. Just in September, online education company GSX Techedu confirmed it was being investigated after short sellers called out huge second gains in revenue and K-12 course enrolment.

While it's unfair to paint all China-based companies with the same brush, the high incidence of investigations is underscoring the need for U.S. regulators to finally tackle a longstanding problem: the lack of audit transparency of Chinese firms listed on U.S. exchanges.

"Although Chinese companies have been improving over the years, it's characteristic of Chinese firms, on average, to perform worse in terms of transparency and unmanaged risk than other emerging market companies," says Wilco Van Heteren, executive director of ESG research at Sustainalytics, a global provider of environmental, social and corporate governance assessments. [Unmanaged risk is material ESG risk that has either been insufficiently managed or not managed at all.]

As Roger Robinson, president and CEO of research firm RWR Advisory Group, told an SEC emerging markets roundtable in early September, issuers based in China and listed in the United States are "not subject to [Public Company Accounting Oversight Board] audits … they're not compliant with Sarbanes Oxley/Dodd-Frank; their finances are kept in a black box and they're not disclosed because of the status they hold as state secrets … these make for a golden invitation for fraud and investor-protection problems."

While Robinson overstates the level of secrecy somewhat, Congress and at least one U.S. stock exchange are taking the problem seriously. The question is whether they will be successful at finally getting Chinese firms to open up their audits—or whether their actions will drive Chinese firms out of U.S. public markets.

Long History

More than seven years ago, the PCAOB signed a memorandum of understanding on enforcement cooperation with the China Securities Regulatory Commission (CSRC) and the Ministry of Finance. It provided for the exchange of auditors' workpapers between the two countries. However, the PCAOB says "Chinese cooperation has not been sufficient for the PCAOB to obtain timely access to relevant documents and testimony necessary for the PCAOB to carry out enforcement matters." The PCAOB says that it has been denied access to conduct inspections at 133 of the 145 publicly held Chinese companies, whose auditors are located in China and Hong Kong.

Most state-owned and formerly state-owned Chinese enterprises (private companies) are stuck between a rock and a hard place. Chinese law prohibits them from complying with PCAOB audit inspections on the grounds that they may reveal state secrets. The Chinese branches of the Big Four accounting firms also argue that sharing workpa-

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pers would violate Chinese laws prohibiting anyone from providing documents about securities business activities to overseas regulators.

Fast-forward to this year. The SEC and the PCAOB jointly issued a statement in April warning investors about investing in "emerging market" (i.e., Chinese) companies given the absence of PCAOB inspections, among other things. And then in May Congress finally acted.

The U.S. Senate unanimously passed the Holding Foreign Companies Accountable Act. The act would amend Sarbanes-Oxley to require certain issuers to disclose information regarding foreign jurisdictions. If the PCAOB were unable to inspect an accounting firm's audits for three consecutive years, the issuer's securities would be banned from trading on a U.S. national exchange or on over-the-counter markets. The bill would also require issuers to disclose ownership and control by non-U.S. governmental entities and identify Chinese Communist Party officials on their boards of directors. President Trump has backed the potential delistings.

Nasdaq Restrictions

Nasdaq has responded by putting added restrictions on initial public offerings. In its "Proposed Rule Change to Apply Additional Initial Listing Criteria for Companies Primarily Operating in Restrictive Markets," Nasdaq is targeting companies "primarily operating in a jurisdiction that has ... national security laws or other laws or regulations restricting access to information by regulators of U.S.-listed companies."

The proposal requires a minimum public float for such companies. The aim is to ensure that the issuer has "adequate liquidity, distribution, and U.S. investor interest to support fair and orderly trading in the secondary market, which will reduce trading volatility and price manipulation, thereby protecting investors and the public interest."

The New York Stock Exchange has been relatively silent on the subject. Its only public comment came from NYSE president Stacey Cunningham in August. She said that all issuers need to operate under similar standards, but that the NYSE also wants to ensure American investors don't lose out on access to leading companies.

Not lost to any exchange must be that Chinese issuers are a source of revenue. The 145 companies currently listed are about evenly split between the NYSE and Nasdaq and have a market capitalization of more than $1.2 trillion. And more continue to list in the United States, despite the controversy. During the first half of 2020, 17 Chinese companies went public on NASDAQ and NYSE, up from 11 in the same period last year.

By the Numbers

China-based companies make up a significant slice of global public companies.

145
China-based issuers listed on U.S. stock exchanges

25
Chinese issuers went public in the U.S. in 2019

$4 trillion
Market capitalization of Shanghai Stock Exchange, 2018 (4th largest globally)

$39.8 billion
Exposure to domestic Chinese issuers within major U.S. index funds

$1.2 trillion
Combined market cap of China-based issuers on U.S. exchanges (2019 end)

"Although Chinese companies have been improving, it's characteristic of Chinese firms, on average, to perform worse in terms of transparency and unmanaged risk."

—Wilco Van Heteren, executive director of ESG research, Sustainalytics

The Fallout

What would the fallout be should Chinese companies be blocked from listing on U.S. exchanges by legislation or otherwise? Some say they will easily go elsewhere. According to Agathe Demarais, global forecasting director of The Economist Intelligence Unit, America's loss will be Hong Kong's and Europe's gain.

"London [with its large and liquid capital markets] is the obvious choice, and potentially Hong Kong—although the situation around Hong Kong makes things more complicated," she notes. "In the long term [losing Chinese companies] would erode the global financial dominance of the U.S."

Neither Hong Kong nor Shanghai are equity market backwaters. They were right behind the Nasdaq in terms of the number of global IPOs in the first half of 2020. Shanghai had 76 new listings that raised $13.6 billion. The exchange's new STAR market dedicated to high tech companies is doing particularly well.

The move in late summer by payments warehouse Ant Group to list on the Hong Kong Stock Exchange and Shanghai instead of the NYSE or Nasdaq suggests that Chinese companies are already wary of the political risks. Ant cited "geopolitical tensions, regulatory challenges, and protectionist policies that may support domestic players" as risk factors in public markets outside of China. Missing Ant Group's IPO is a big loss for the U.S.: its

Photo courtesy of the company

potential $30 billion capital raise would surpass Alibaba's $22 billion in proceeds raised on the NYSE in 2014.

Should Chinese companies be forced to exit the US capital markets, will investors follow them to other exchanges? Potentially, yes. Sustainalytics points to the unexpected behavior of investors in China-based companies.

"Comparing ESG risk levels against price-earnings ratios, our data didn't show the pattern that we expected, " says Van Heteren. "For Chinese companies with low unmanaged risk levels, it shows shares trade at a very low premium in terms of price-to-book values. Companies in our high unmanaged risk categories seem to trade at a larger premium, which would suggest lower risk to investors. The numbers don't add up when it comes to investing in Chinese stocks."

A Standoff

One of the other problems with forcing existing Chinese issuers out would be the work of decoupling Chinese companies from the U.S. capital markets. Demarais says it would be a near-impossible task. "There is a high chance that [the Holding Foreign Companies Accountable Act] is going to go through; however, the enforcement of the bill is going to be very tricky. It's like a messy divorce with a lot of assets and a lot of legal tricks. So, I would say that the value of the bill would be mainly for signaling purposes."

While the potential long-term impacts of the act are heatedly debated, other options have been put on the table.

A counterproposal to the act was submitted by the Chinese securities regulator in August. Fan Xinghai, vice chairman of the CSRC, said in an interview with Bloomberg that the commission is "sincere" in wanting to solve the standoff over accounting issues. The concessions made would include letting U.S. regulators see the audit workpapers of some of China's most sensitive state-owned companies, but the CSRC would still redact information concerning national security.

As of mid-September, the PCAOB had rejected the proposal on grounds that "for more than a decade we have sought to establish a cooperative relationship with China that is consistent with others around the world. Such a relationship, however, cannot be meaningfully pursued without the Chinese first embracing our core access principles. Despite the CSRC's recent claims, its proposals remain materially deficient."

Might there be a private-sector solution? In statements at the SEC Emerging Markets Roundtable in September, Carson Block, founder and chief investment officer of Muddy Waters Capital, suggested a financial incentive to improve the audits of Chinese companies.

"We propose that the U.S. parents of these global auditing firms effectively provide collateral for audit failures of their PRC [People's Republic of China] affiliates in the form of financial guarantees. ... That's the most important proposal that we have that we think can help rectify the situation and give investors greater assurance without delisting en masse."

With the Big Four only coming around recently to the notion that a public company audit should catch fraud, that proposal seems unlikely to go much further.

The Big Four and other auditing firms profit from having large, publicly held Chinese clients, But the ongoing politically charged fight is risky for them as well. In 2017, Hong Kong-based Crowe Horwath CPA Limited was sanctioned by the PCAOB for refusing to cooperate with a PCAOB investigation of a publicly traded Chinese company. The sanctions agreed to included being censured by the PCAOB and having the audit firm's registration revoked for at least three years. That's not a situation any audit firm would want to be in again. CFO

Ramona Dzinkowski is a journalist and president of RND Research Group.

Under Investigation

Short-sellers and the SEC are questioning the financials of several China-based issuers.

Luckin Coffee
Was delisted from Nasdaq after an internal accounting investigation revealed that COO Jian Liu allegedly fabricated $310 million in fraudulent transactions to boost the company's sales in the second quarter of 2019. A director and other employees were allegedly involved.

TAL Education
The NYSE-listed firm is under investigation by the SEC. In April it said its internal auditing process discovered employee wrongdoing. The employee conspired with external vendors to inflate sales of a certain product by forging contracts and other documents.

iQiy
The streaming service, a spinoff of Baidu, is under investigation by the SEC. The commission is seeking the production of certain financial and operating records dating from January 1, 2018. It also wants to see documents related to certain acquisitions and investments that were identified in a report issued by short-seller firm Wolfpack Research.

GSX Techedu
Reports of an SEC investigation of the education company were revealed in September. Muddy Waters Research has claimed that almost 80% of the users in the GSX platform were fake. The SEC notice apparently asked for financial and operating records from 2017 onward.

CFOs to the Rescue

Leading finance chiefs showed their companies how to adapt, transform, and sustain performance through the worst of COVID-19. By Keith Button

Finance chiefs played a critical role in shepherding their organizations through a global economic crisis in 2020, and a recent survey shows how.

CFO Research (part of Argyle Advisory and Research Services) and FTI Consulting surveyed 325 chief financial officers and other senior finance executives in August to understand better how the finance function drives enterprise value.

Five key themes emerged from the survey results:

1. The CFOs' work during the pandemic has earned them the right to be strategic leaders in their organizations. The pandemic shined a spotlight on finance chiefs' ability to lead via an essential and often overlooked task: corporate scenario modeling and planning.

2. In the face of a "new normal" economy, CFOs maintained productivity with remote teams. In response to COVID-19, a whopping 71% of finance team members worked in a remote or mostly remote workforce model, the survey showed.

3. The digital workforce continues to grow. While most chief financial officers have started to adopt automation, the survey results suggested automation has not reached its full potential in most organizations.

4. The corporate finance service delivery model is evolving. Forty-one percent of the survey respondents indicated their finance work was performed by a shared services organization (SSO), but 48% said they used business process outsourcing (BPO) or hybrid models, such as BPO hybrids.

5. Looking ahead, the CFO is well-positioned to lead the way as an enterprise value creator. The finance function's ability to provide insights on predictability in an ambiguous market will guide company decisions on cost, working capital, liquidity, risk, and capital structure.

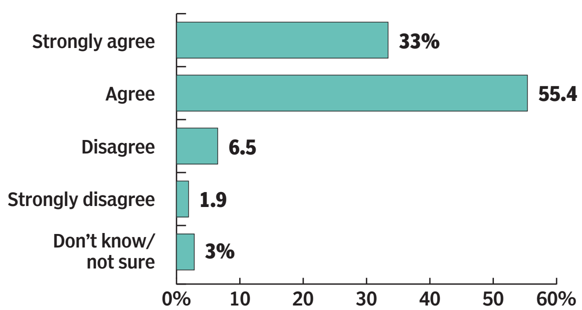
Strategic Leaders

Strategic CFOs have demonstrated the ability to provide forecast models based on different scenarios, to adjust and adapt, to make informed decisions, and ultimately to lead their companies past the worst of COVID-19 and into the recovery period. Leading finance chiefs showed their companies how to adapt, transform, and sustain performance going forward.

Overwhelmingly, the surveyed finance executives portrayed their chief financial officers and finance teams as

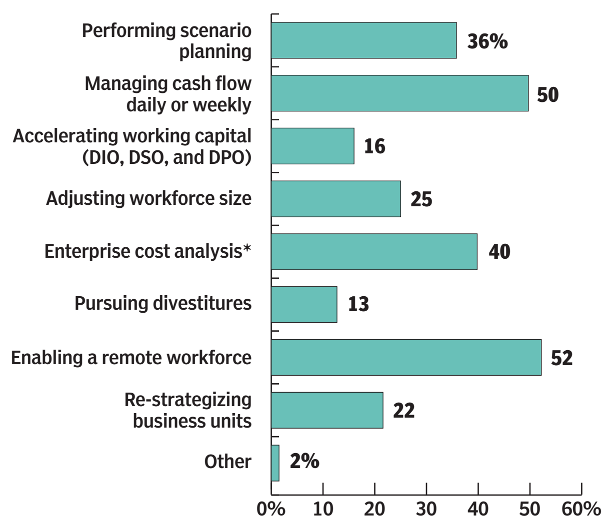
COVID-19 has forced the CFO and the finance function to reevaluate transformation initiatives to drive enterprise value.

Respondents could only choose a single response.



In response to the COVID-19 pandemic, what were the CFO and finance function's most immediate priorities?

Respondents could choose multiple responses.



*e.g., discretionary spending, evaluating supply chain, re-evaluating contracts rising to the task across the domains of strategic leadership, planning and analysis, use of technology and automation, and identifying risks. More than nine out of every 10 of the survey respondents said their CFO and finance functions:

• Played prominent roles in guiding business strategy, making operational decisions, and driving enterprise value across the organization;

• Drove value by regularly identifying areas and leading efforts to reduce and optimize enterprise costs; and

• Used digital technologies like predictive analytics and intelligent automation to deliver timely, accurate, relevant information.

71%

Finance team members that worked in a remote or mostly remote workforce model

Remote Workforces

CFOs needed to adapt to remote workforces, cultural changes, and talent challenges. The survey data suggested that leading CFOs were prepared with automation-assisted support and reacted quickly by revising priorities, facilitating processes remotely, and preserving talent and culture in their teams.

The most immediate priority for the CFO and finance function in response to the coronavirus pandemic was to enable a remote workforce, according to the survey. Forty-three percent of the survey respondents said their finance teams adopted a remote workforce model, with an additional 28% working mostly remotely, and 14% working partially remotely but mainly in an office.

The issues that the newly forged remote finance workforces had to contend with were wide-ranging. More than 40% of the surveyed executives said the pandemic had a significant impact on cost management, financial planning and analysis, and budgeting and forecasting. And more than one-third of the survey respondents said that risk management, treasury and working capital management, technology adoption, and accounting and financial reporting were significantly impacted.

Bot Workforces

While CFOs have made advancements in robotic process automation (RPA) for the finance function, there are still opportunities to improve. Most CFOs have started to adopt automation. More than three-quarters (77%) of the survey respondents said that at least 1 in 20 members of their finance team were "virtual," meaning they were using RPA and other automation capabilities.

But only 27% said that at least one in five members of their finance team were virtual, which suggests that automation has not reached its full potential in most organizations. Eliminating and automating manual processes was a high priority or critical priority for 52% of the surveyed executives.

Service Delivery Evolves

The survey results showed that BPO is still going strong despite the impact of automation on the scope of work outsourced. The finance function delivered most of its services through BPO for 25% of the survey respondents, compared with 22% mostly through global business services (GBS), 18% primarily through captured shared services, and 23% through hybrid models.

GBS adoption by organizations was being led by CFOs and finance. Finance was overwhelmingly the most included function for GBS service delivery, with 86% of the GBS organizations including it. IT was the second-most included function, at 35%, followed closely by human resources and procurement, at 33% and 32%, respectively. Most of the GBS organizations represented in the survey, 55%, reported to the CFO.

Cost containment is still a dominant concern for CFOs. Almost one-third of the surveyed executives said they planned to increase the use of either captive shared services, BPO, GBS, or a hybrid model to leverage their variable cost models in this uncertain business climate.

Enterprise Value Creator

About two-thirds of the surveyed executives defined the current role of their CFO as a finance and accounting leader. Most of the survey respondents also selected an additional role for their CFO, split nearly evenly between three types: an efficiency and effectiveness driver, a business partner and adviser, and an enterprise value creator and organizational leader.

The survey indicated that the enterprise value creator role was an expanding one for CFOs. Eighty-nine percent of the surveyed executives said that the CFO and finance function had the talent and skills to drive enterprise value for the organization.

In the short term, CFOs showed their companies how to sustain their businesses through the initial stages of the pandemic. Over the long term, CFOs will look to transformation initiatives to sustain cost savings. Sixty-four percent of the surveyed executives said that improving planning, scenario modeling, and forecasting was a high or critical priority for the CFO and finance function over the next 12 to 18 months.

To achieve strategic goals and drive value, 84% of the survey respondents said they were evaluating, implementing, or already using planning, forecasting, and budgeting technologies, and 86% were doing the same for performance reporting and analytics technologies. And 79% said they were evaluating, implementing, or already using enterprise performance management (EPM) technologies. CFO

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THE QUIZ

Into the Sunset

Spending more time at home during the pandemic may have many desk workers contemplating what their post-employment life might look like. However, while there is plenty of information and advice available on planning for retirement, not all of it is accurate or good. To gauge your knowledge of some basic retirement-related facts, take our quiz below.

1 After "defined benefit pension plan," what form of retirement savings is the second most popular among non-retirees?

A. Savings not in retirement accounts
B. Real estate
C. IRA
D. Defined benefit pension

2 What percentage of people 30 to 44 years of age in the United States have no retirement savings?

A. 35%
B. 15%
C. 26%
D. 44%

3 According to a TD Ameritrade survey this year, by which age do most Americans hope to retire?

A. 55
B. 63
C. 70
D. 67

4 The Congressional Budget Office has projected that the Hospital Insurance Trust Fund, which finances Medicare Part A, will become insolvent by which year?

A. 2022
B. 2024
C. 2030
D. 2028

5 The number of retired workers receiving Social Security benefits in the U.S. rose by almost 12 million in the 2009-2019 period. How many were receiving such benefits in 2019?

A. 33 million
B. 35 million
C. 45 million
D. 70 million

6 The Social Security Administration's formula for calculating cost of living adjustments to benefits is based on increases in which economic metric?

A. Unemployment rate
B. Personal income
C. Gross domestic product
D. Consumer price index

7 What percentage of Fortune 500 companies still offer a defined benefit (pension) plan to new hires?

A. 25%
B. 14%
C. 32%
D. 8%

8 What percentage of Fortune 500 companies still employ workers who are actively accruing pension benefits?

A. 32%
B. 35%
C. 81%
D 46%

Sources: Fed "Report on the Economic Well-Being of U.S. Households," T.D. Ameritrade, CBO, Social Security Administration, Willis Towers Watson

Answers: 1) A; 2) C; 3) D; 4). B; 5) C; 6) D; 7) B; 8) D

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CFO UPCOMING EVENTS

CFO Magazine, in conjunction with Argyle Digital, is holding a series of virtual events this fall catering to chief financial officers and other finance executives.

CFO Live: M&A Leadership Forum
October 20

How political, regulatory, and economic conditions will impact deal activity in 2020 and 2021 and which deal-making skillets will be critical to success.

CFO Live: FP&A Leadership Forum
October 27

How FP&A is evolving beyond just serving the finance function, and what skills FP&A teams need to broaden the function's purview to support strategic decision-making.

CFO Live Conference
November 3, 4 & 5

The twice-a-year, multi-track event covering topics critical to CFOs and other senior finance executives.

CFO Live: Finance Leadership Forum
December 17

Strategies and ideas to help spark growth, boost profits, and turn finance into a strategically important partner for other areas of the organization.

For more information on these and other conferences, please visit argyleforum.com and click on "Events."

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