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NAILING THE SALES FORECAST

CAN BIG RETAILERS SURVIVE?

"The SEC Falsely Accused Me of Fraud"

A CFO speaks publicly of his four-year ordeal battling accounting fraud charges

IN THIS ISSUE

February/March 2020
Volume 36, No. 1

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IN THIS ISSUE

February/March 2020
Volume 36, No. 1


24


14


18


26

Up Front

By the Numbers

Getty Images (3)

FROM THE EDITOR

Why We Published Greg Law's Story

A few months ago, I got an email from Gregory Law, a former CFO. In November 2017, he had been charged with improper accounting practices and misleading investors. The Securities and Exchange Commission dismissed the case against him in September 2019. Law was trying to win back his reputation, but our 2017 story on the charges was appearing high up in Google search, and it wasn't helping.

He asked me to take down the story. I politely declined, explaining that (1) it was true, he had been charged (2) it was absolutely against journalistic practice and our own ethical code to remove stories from the web, however old and (3) it probably wouldn't help much anyway, since the SEC's press release on the case and a story from Reuters also appeared on the first page of the Google search results.

Law was gracious in his understanding. I then suggested he write his side of the story, tell us what really happened, and perhaps we would publish it.

I didn't expect to hear from Greg Law ever again. But in January, I received another email from Law. It was his 5,773-word account of being accused of fraud, fighting back, and eventually proving the charges were false.

The story was eye-opening. Some might ask why we devote so many pages of this issue to telling Greg's story. Here's my answer:

- Because a civil suit against a CFO brought by the Securities and Exchange Commission can be the death knell of that person's career in corporate finance.
- Because most CFOs, undoubtedly, are honest, hard-working people who want to abide by the law.
- Because CFOs need to know what it's like to be the subject of an SEC investigation.
- Because while we highly respect the work of the SEC and the Public Company Accounting Oversight Board, they don't always get it right.
- Because to preserve the integrity of our capital markets, I believe that sunlight is the best disinfectant.
- Because I believe Greg Law's story to be an honest depiction of the Osiris Therapeutics case.
- Because, ultimately, this story needed to be told.

Vincent Ryan
Editor-in-Chief

EDITOR'S PICKS

NETWORKING
Do you wish you were more plugged-in at your organization? Harvard Business Review's advice podcast, featuring Robin Abrahams, looks at why you shouldn't get wrapped up in the idea of "you scratch my back, I scratch yours." See more on the HBR website.

M&A
In **"Mismatch: Why Workers Don't Stay After an Acquisition,"** a Wharton professor discusses his research that shows workers are twice as likely to leave an acquired firm, and this "departure effect" is strongest for the very best employees. Read or listen to the discussion on the Knowledge@Wharton website.

TECH
In **"What Do We Do About the Biases in AI?"** three McKinsey executives explain how AI can reduce the impact of human bias but also make the problem worse by baking in and deploying biases at scale in sensitive application areas. How can top management lead the way on bias and fairness? Among the steps recommended: invest in diversifying the AI field itself. Read more on the HBR website.

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INBOX

In "Audits Are Broken, Here's a Radical Way to Fix Them" (CFO.com, Nov. 27), Michael Whitmire, CEO of accounting software maker FloQast, suggested that public company audits be turned over to the Public Company Accounting Oversight Board.

Why? Because **audit firms have a financial interest in providing their clients with clean audits**, so as to retain their business, Whitmire argued. Predictably, that contention irked some readers.

One offered an alternative, three-step solution to the issue of auditor independence:

1. Have pools of auditing firms based on the size of companies they can handle and the industry/segments they have expertise in.
2. Have companies that need audits fund a pool based on the above (some pay more, others less based on their size/industry/segment).
3. Limit the life of a client to three years.

Another audience member was even more direct: "This is absolutely absurd. **We need less government intervention, not more. Policy changes, yes. Another governmental agency? No way."** A sarcastic version of that viewpoint said, "Yes, we should let the government take it over—at five times the cost and 50 times the employees."

"Ring Suit Alleges Cameras Vulnerable to Hacker" (CFO.com, Dec. 27) told of a class-action lawsuit against the home security service provider over its allegedly "fatally flawed" camera systems.

One reader, without directly commenting on the merits of the case, offered some sage advice.

"Many hacks, maybe most, happen because the purchasers of these items do not change the factory password. If your password is 'admin,' 'user,' '1234,' or several others, you deserve to be hacked. Same story if you use obvious passwords such as your or family members' birthdates or names. **Come on, folks. Stop thinking the world will protect you from your own ignorance."**

"Finance Matchmakers" (*CFO*, November 2019) addressed a variety of online resources for finance professionals seeking freelance work.

Observed one audience member, "One thing people underestimate when they go solo is the amount of time you have to spend marketing. **We all have the technical skills, but they're worthless if no one is paying you to use them.** Scan all the gig work sites, publish content, and network, network, network. It's a full-time job—and then you get to do the actual work!"

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E-mail us at letters@cfo.com. Please include your full name, title, and company name. Comments are subject to editing for clarity and length.

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STATS OF THE MONTH

MIDMARKET DEAL RESTRAINT

44%
Midmarket companies engaged in or open to a sale

34%
Sellers extremely confident in completing a deal this year

27%
Interested in selling their entire business

55%
Consider their companies active buyers (all respondents)

10%
Expect valuations to fall in the year ahead

Source: 2020 Citizens Bank Middle Market M&A Outlook

TOPLINE

TECHNOLOGY

Will Automation Cause Job Losses After All?

Seventy percent of what finance does today can be automated, and "some jobs are just going to go away," says Lee Coulter.
By David McCann

Ask any automation expert or CFO who's implementing automation, and you'll get the same story: no, automation isn't going to take finance jobs away. Instead, finance workers will have time freed up for higher-level, strategic, value-add work.

But does that statement actually pass the smell test?

One expert, Lee Coulter, speaking at CFO Live, sprinkled some doubt on that dreamy view of the future of finance workers.

"There are near-term use cases where we're going to see significant levels of automation being used in finance," said Coulter, CEO of transformAI and chair of an IEEE working group on standards in intelligent process automation. In fact, he claimed, "70% of what finance does today can be automated. Some jobs are just going to go away."

He continued, "The risk management function will be dramatically reduced, because compliance will be managed by automation. The fraud department will be meaningfully nonexistent in the future. Credit analysts will no longer exist." And, "If you know somebody in underwriting, send them back to school."

These forecasts represent a five-year view, Coulter specified.

Other roles, such as many in accounts payable, accounts receivable, and payroll, may survive massive automation deployment, at least in the immediate future.

"It may take over 9% of their job, or 3%, or 6%," said Anjan Roy, CFO of global finance for General Electric, who spoke at the same conference as Coulter.

But such workers will still need to be upskilled to take on new value-added duties enabled by their freed-up time.

In fact, retraining likely will emerge as an increasing theme. PricewaterhouseCoopers, for instance, announced plans to invest $3 billion to $4 billion in employee training over the next three to four years. Other big employers, like Amazon, have voiced similar commitments.

Such companies "have a lot of people whose jobs are going to go away" because of automation, in Coulter's view.

He suggested that companies should be clear with employees about their plans for automation. "I encourage you to be very explicit about your intentions. And add supporting facts that people can point to that say, 'They're serious about this.' If you don't, it's going to be really hard to get people to show up for meetings and be active participants in the work."

Meanwhile, Coulter exploded some misconceptions about intelligent automation.

AI is easy. "No, it's actually really hard," he said. "I recommend that you start with simple task automation, so that you begin to learn more about the data dependencies for machine learning and augmented intelligence."

Even robotic process information, which is much less complex than AI, usually requires a measured approach. "I've seen organizations go in and deploy a thousand bots in a year. It's generally disastrous. Humans are not ready to change at that pace. It's very risky to let this go viral."

We can wait. "No, you can't wait. Automation has been part of almost every conversation I've had or listened to [recently]. Be on the front end of this wave or be materially disrupted. And I don't mean that as a parable."

Someone else will own this. "No, they won't. Intelligent automation is a business-led project. Don't let IT try to own it—that's not a formula for success. Would you hire IT to input payroll to general ledger entries or do cash applications? No. This is digital labor."

It's a hyped fad that's going to fade away. "No. This is very, very real," Coulter said, solemnly. CFO

AUDITING

SEC Loosening Independence Rules

The change would keep the SEC and auditor committees from spending time on "nonsubstantive" rule breaches.

U.S. auditors may be getting a break on some of the rules governing impartiality and objectivity.

In January, the Securities and Exchange Commission proposed loosening some of the restrictions around whether an auditor's objectivity and impartiality are compromised because it has nonaudit ties to a client.

The rule changes would increase the number of qualified audit firms an issuer could choose from and "permit audit committees and commission staff to better focus on relationships that could impair an auditor's objectivity and impartiality," said SEC Chair Jay Clayton, and avoid "spending time on potentially time-consuming audit committee review of nonsubstantive matters."

One of the proposals would change how an affiliate of an audit client is defined. Currently, if a firm audits a portfolio company in a private fund, the independence rules restrict its relationships with other portfolio companies controlled by the same fund. The new rules would provide a materiality exception. If the auditor determines that a portfolio company is not material to the fund, the firm can provide non-audit services to that company without violating independence standards.

Other changes include:

- Amending the definition of the audit and professional engagement period to shorten the look-back period to one year from three years for domestic first-time filers in assessing compliance with the independence requirements
- Adding certain student loans and de minimis consumer loans to the categorical exclusions from independence-impairing lending relationships
- Replacing the reference to "substantial stockholders" in the business relationship rule with the concept of "beneficial owners with significant influence"
- Introducing a transition framework to address inadvertent independence violations that arise from merger and acquisition transactions.

The proposed amendments, said the SEC, primarily focus on "fact patterns" presented to commission staff through consultations. Those consultations often involve a relationship with, or services provided to, an entity that has little or no relationship with the entity under audit, and no relationship to the engagement team conducting the audit.

In these scenarios, "the SEC staff regularly observes that the audit firm is objective and impartial and, as a result, [the SEC] does not object to their continuing the audit relationship with the audit client."

Most large auditing firms have policies, systems, and controls to try to avoid independence violations. They require certain internal approvals and reviews of transactions and services that have independence implications.

The current auditor independence framework in the United States was adopted in 2000 and underwent revisions in 2003. | VINCENT RYAN

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INVESTOR RELATIONS

Activists Active in 2019

Across the globe, a record 147 investors (up from 131 in 2018) launched new activist campaigns in 2019, including 43 "first-timers" with no prior activism history, according to Lazard's annual shareholder activism review.

Those activists targeted 187 global companies, down 17% from 2018's record but in line with multiyear average levels, Lazard said. (The numbers reflect only campaigns aimed at companies with $500 million in market capitalization or higher.)

AT&T became the largest targeted U.S. company of 2019 last fall, when its management resolved a dispute with Elliott Management by promising "significantly enhanced operational efficiency with meaningful margin expansion," a "full review of the portfolio," and "no more major acquisitions."

A record 99 campaigns globally had an M&A-related thesis, accounting for about 47% of the year's activity, up from an average of 35% in prior years.

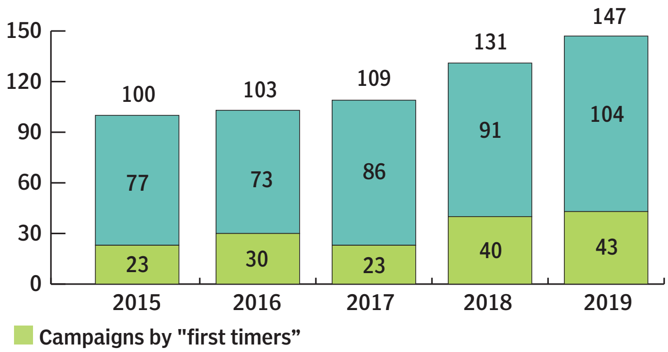
Investors deployed $24 billion in those merger-related campaigns (out of an aggregate $42 billion for all campaigns during the year). The technology sector saw $7 billion deployed in M&A-related activist moves (out of a total $9.3 billion in new activist positions for the sector).

Overall European activity decreased in 2019 (48 campaigns, down from a record 57 in 2018), driven primarily by 10 fewer campaigns in the United Kingdom.

Across all geographies, activists won 122 board seats, in line with the multiyear average. The majority of board seats were secured via negotiated settlements. One-fifth of the seats went to female directors, compared with a rate of 46% for all new S&P 500 director appointees last year. | V.R.

Investors Launching Campaigns

The number of funds engaging in activism continues to grow.



Source: FactSet, press reports, and public fillings as of 12/31/2019.

Note: All data is for campaigns conducted globally at companies with market capitalization greater than $500 million at time of campaign announcement.

STRATEGY

Companies Run by Billionaires Outperform

Companies that are controlled by billionaires have significantly outperformed global market averages over the last 15 years, according to a report from UBS and PwC.

The report, which looked at 603 public companies controlled by billionaires, said the companies' annualized gain was 17.8% over the 15-year period, compared with a 9.1% gain for the MSCI All Country World Index.

It found the billionaire-controlled companies were more profitable as well.

"In our view, billionaires have three distinct personality traits that benefit businesses—smart risk taking, business focus, and determination," the report said. Billionaires' enterprises tend also to "pursue a long-term strategy that benefits from an exceptional alignment between performance and management incentives."

Josef Stadler, an executive at UBS Global Wealth Management, said in an interview with CNN that increasing taxes on super-wealthy individuals could curb risk-taking.

"Millions of jobs have been created by people who take outlandish risks. If you cap the upside, billionaires will manage their risk appetite downwards, [and] the impact will be detrimental to society," Stadler said. "Think about what a world without billionaires would look like."

The study found the number of female billionaires grew from 160 to 233 for the five years ended 2018. Over the same period, billionaires saw their total wealth grow by 34.5%, though they saw a 4.3% drop in 2018. | WILLIAM SPROUSE

COMPENSATION

A New Job Pays Dividends

With a tight supply-and-demand situation favoring executives inclined to switch jobs, the average pay increase for those who did so in 2019 shot up by 28% from the prior year, according to new research.

In 2018, the average pay hike for job-switching C-suite and VP-level executives was 11.42%, based on compensation data related to several dozen placements in 2019 by executive search firm Salveson Stetson Group. Last year, that figure climbed to 14.64%.

The study took into account executives' base salary and bonus but not equity awards.

"Continued upward pressure on executive compensation is to be expected given the tightness of the labor market," said Sally Stetson, a Salveson Stetson principal and leader of the firm's human resources practice.

Still, the premium commanded by executives upon switching employers has, overall, been significantly less in the past few years than it was from 2011 to 2016, when increases trended toward 20%.

The pullback could be the result of a combination of factors, suggests John Touey, leader of Salveson Stetson's financial officer practice. For one, companies may be thinking, "How high can we go? Have we reached a ceiling for the premium that top talent can command at this point?"

Touey stresses that in many cases executives aren't necessarily looking to maximize their compensation.

"A company that's not competitive from a pay standpoint will not be able to compete for the best talent—that is, unless there is something else compelling about the organization," he says.

Career development opportunities, flexibility on working arrangements, and a reputation as an employer of choice can also lessen the need for a company to be in the top quartile or higher in base pay and bonus.

"If the data shows us anything, it's that someone is always willing to pay more for talent," Touey says. "A company that's competing for people solely on compensation is most likely in a losing position. There must be other anchors beyond compensation to engender stickiness with the executive population." | D.M.

ARTIFICIAL INTELLIGENCE

Can Companies Come To Grips With AI Hype?

Companies are using more artificial intelligence tools and starting to realize some quantifiable benefits. At the same time, the wild proliferation of technology firms claiming to offer AI solutions is hindering companies' efforts to attain game-changing ROI.

That's one conclusion of a new KPMG study of 751 business decision-makers with at least a moderate knowledge of AI in their industry, across five industries.

In four of the five industries, a majority of participants said they feel that at present AI is still more hype than reality. The most skeptical industry was transportation (69%), followed by retail (64%), technology (57%), and health care (52%). Financial services was the only industry that viewed AI as more reality than hype, with just 42% selecting the latter option.

"There's an absolute flood of boutiques and startups with the next tool," says Traci Gusher, principal and U.S. lead for innovation and enterprise solutions at KPMG. Often, the tool "has an AI label slapped on it because there's a machine learning model somewhere in it, but it doesn't deliver the promised value because it's not really an AI solution, just a solution packaged as AI."

The unfortunate trend is "creating disruption in companies' ability to capitalize on the benefits of AI. There is distrust, which makes it even more difficult to understand what's a real benefit vs. what might be fake."

But while the flood of new tools certainly won't abate, Gusher says there's reason to hope companies will get better at making such distinctions.

For one thing, there hasn't been enough training. Whereas many companies look at AI as simply a technology play, it really should be viewed as a strategic initiative that requires building AI capabilities across the organization.

Only 47% of survey participants from health care companies and 52% of retailers even offer an AI training course. The other industries are doing better—65% of both technology and transportation respondents and 57% of those in financial services offer such a course. | D.M.

Getty Images(3)

REGULATION

Voluntary Lanes for Autonomous Vehicles

The Trump administration unveiled updated guidelines for self-driving vehicles, saying it wanted to encourage innovation without compromising safety.

In the so-called AV 4.0 guidance released in January, the Department of Transportation said it will adopt and promote "flexible, technology-neutral policies that will allow the public, not the federal government or foreign governments, to choose the most economically efficient and effective transportation and mobility solutions."

The guidelines are voluntary, reflecting the administration's intent to "help foster an environment for innovators to advance safe [autonomous vehicle] technologies," White House technology adviser Michael Kratsios said. Among other things, automakers would be allowed to submit self-assessments on safety.

Safety advocates said the voluntary approach puts the public at risk.

"Without strong leadership and regulations ... AV manufacturers can and will continue to introduce extremely complex supercomputers-on-wheels onto public roads, in direct contact with vehicles, bicyclists, pedestrians, and other road users, with meager government oversight," said Advocates for Highway and Auto Safety president Cathy Chase.

"Voluntary guidelines are completely unenforceable, will not result in adequate performance standards, and fall short of the safeguards that are necessary to protect the public," she added.

According to the DOT, AV 4.0 has three core aims—prioritizing safety and security, promoting innovation, and ensuring a consistent regulatory approach across federal agencies.

But Rep. Jan Schakowsky, who chairs the House subcommittee responsible for driverless car legislation, said DOT "should establish meaningful rules, not just guidelines, to ensure innovative transportation technologies are safely deployed." | **MATTHEW HELLER**

FRAUD

DOJ to Scrutinize Government Contractors

The Justice Department announced the formation of a new unit aimed at deterring, detecting, investigating, and prosecuting procurement-related antitrust crimes such as bid-rigging and price-fixing conspiracies.

Such fraud undermines competition in government procurement, grant, and program funding, the DOJ said.

The new Procurement Collusion Strike Force (PCSF) will be an interagency partnership. It will consist of prosecutors from DOJ's Antitrust Division and 13 U.S. attorneys' offices, FBI investigators, and inspectors general offices of the Defense Department and the Postal Service, among others.

Rigging bids and "allocating market share" during the procurement process inevitably causes a rise in prices offered to the government, according to the DOJ.

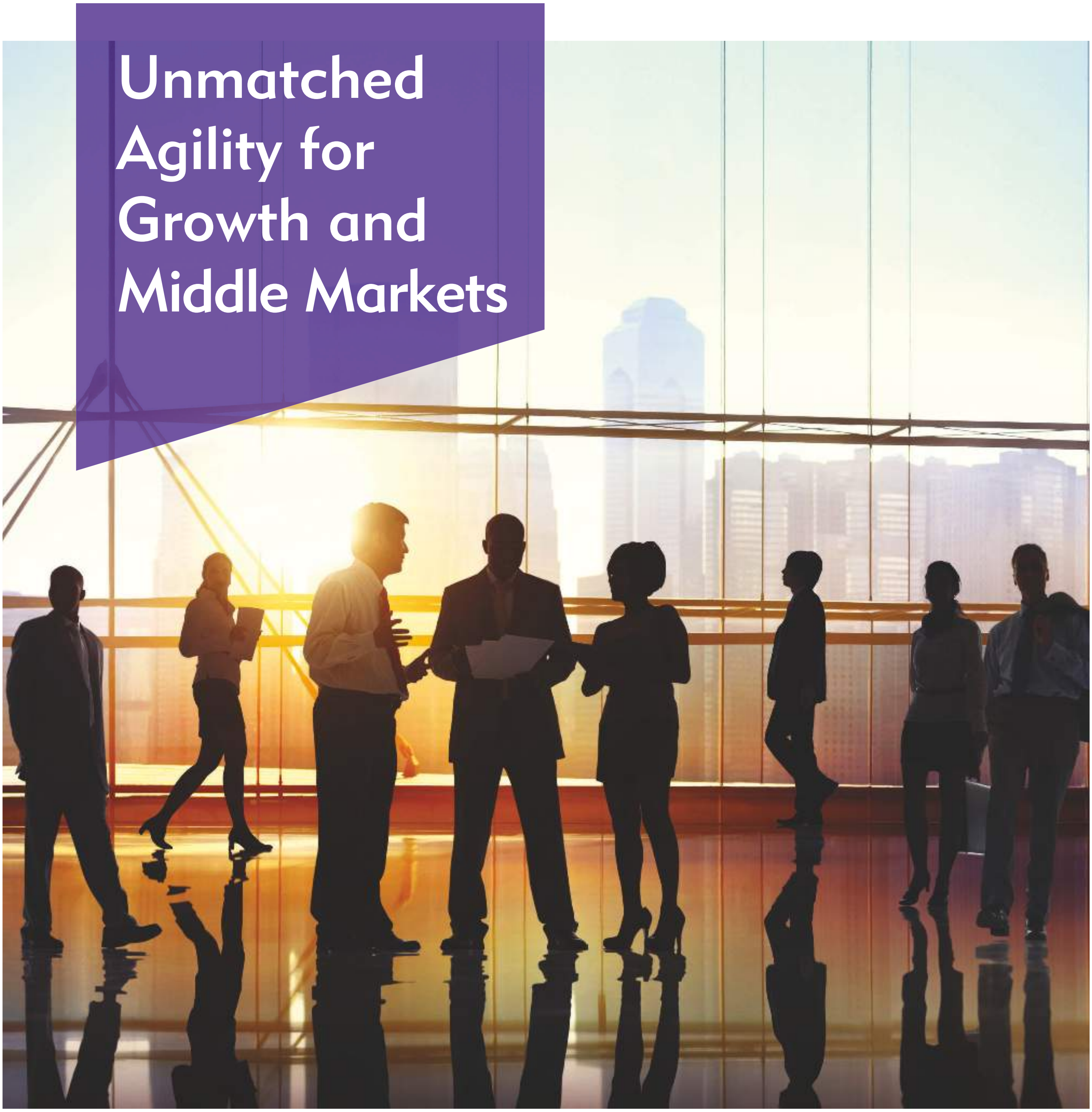
"The PCSF will train and educate procurement officials nationwide to recognize and report suspicious conduct," said Assistant Attorney General Makan Delrahim. "We will aggressively investigate and prosecute those who violate our antitrust laws to cheat the American taxpayer."

The PCSF will protect taxpayer-funded projects at the federal, state, and local levels from antitrust violations and related crimes.

"Companies should understand that the shifting of resources to closer examine this industry indicates a greater likelihood of the DOJ reviewing bids and making inquiries of government contractors," said Jeff Martino, a partner with law firm BakerHostetler and former chief of the department's antitrust division in New York.

He added, "It is unique and commendable that the division proactively sought out other enforcement and prosecution partners. This strike force will have the resources to address a broader range of crimes that fall into public procurement and increase the efficiency of investigations." | **D.M.**

Getty Images(2)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Growth and
Middle Markets

TAX

International Reporting Standard Finalized

Thousands of companies may soon be reporting tax-related and other financial information on a country-by-country basis, following the finalization of a proposal by the Global Reporting Initiative (GRI), a sustainability standards-setting body.

Three-quarters of the world's largest companies that report their sustainability results use GRI's reporting standards.

The new standard—GRI 207: Tax 2019—calls for companies to report on tax practices as part of their sustainability reporting. The requested information includes disclosures on tax strategy, governance, and risk management that meet different stakeholder expectations of reporting.

Companies adhering to the standard also will publicly provide country-by-country reporting of business activities, revenues, profits, and tax.

The standard also promotes disclosure of the reasons for any difference between corporate income tax accrued and the tax due if the statutory tax rate is applied to profit/loss before tax.

According to the GRI, investors strongly supported the proposal during the comment period.

"More nations are scrutinizing and cracking down on profit-shifting schemes and other aggressive tax avoidance strategies," said Gary Kalman, executive director of the FACT Coalition.

"The resulting changes to tax planning and growing liabilities mean rising risk for investors," Kalman said. "Company valuation estimates have varied by as much as 120% because of uncertain offshore tax liabilities."

He noted that GRI received more comments from investors on this issue than on any other in its history.

"The required information is already known to company management and, in various forms, to national tax authorities," said Kalman. "Prior to the release and adoption of this standard, the only ones left in the dark were the investors putting their money at risk. This standard rights that wrong." | D.M.

THE ECONOMY

Go For a Walk and Boost the Economy

As most people know, exercise is a healthy activity. It lowers the risk of hypertension, cardiovascular disease, and diabetes, and has been associated with positive effects on mental health.

Oh, and more exercise would help the economy, too.

If all adults aged 18 to 64 worldwide walked 15 additional minutes per day, it would inject an average of $100 billion per year into the global economy through 2050, according to an academic study commissioned by health and wellness solutions provider Vitality and performed by RAND Europe.

The gains would derive from a reduction of premature deaths in the working-age population and increased productivity driven by reduced absenteeism and presenteeism.

Further, the findings show that if all physically inactive adults were to reach the World Health Organization's recommended exercise levels, employees would gain up to five additional days of productive time each year and the world economy would grow by an estimated $220 billion annually.

And if people who are currently active increased their physical activity by 20%, the global economy could grow by more than $360 billion every year, equivalent to the size of Singapore's economy, according to the study. Economic gains for the U.S. economy would be $95 billion a year until 2050.

Those who are not physically active are absent from work between 0.44 and 0.86 days per year more than are those who are inactive. The effect on presenteeism is much larger, though, with physically inactive individuals losing the equivalent of 2.6 to 3.7 days of productivity per year.

The study used statistical modeling to examine the associations between physical activity and a number of outcomes such as productivity, mortality, and health care costs. | D.M.

Getty Images(3)

REGULATION

Closing the '8-K Trading Gap'

The House of Representatives overwhelmingly passed a bill in January to close a loophole that allows corporate insiders to trade company shares before the public disclosure of a significant corporate event.

According to a 2015 study, the loophole has created an opportunity for insiders to make "meaningful" profits during the four-day window that the U.S. Securities and Exchange Commission gives companies to file a Form 8-K reporting a significant development.

Under the 8-K Trading Gap Act passed by the House on a 384-7 vote, public companies would be required to have policies and procedures reasonably designed to prohibit insiders from trading company stock after the company has determined that a significant corporate event has occurred, but before it is publicly disclosed.

"Corporate executives shouldn't be allowed to trade on significant information ahead of the public and investors, but that's exactly what's happening because of this legal loophole," said Rep. Carolyn Maloney, New York Democrat, who is the sponsor of the bill known as H.R. 4335.

Sen. Chris Van Hollen, Democrat from Maryland, has introduced the Senate companion bill. "When a corporation faces a big change—like a data breach, merger, or acquisition—public transparency is crucial to prevent insider trading and protect retail investors," he said. "But under the current system, corporate insiders have a head start on the public, allowing them to sell off stock or cash in on private information. This is a total abuse of the public trust."

Researchers at Columbia and Harvard universities reported in the 2015 study that corporate insiders have "earn[ed] economically and statistically meaningful profits" from stock trades during the 8-K trading gap.

On average, insiders netted about 0.4 percentage point over a broad market index between the time of their trades and the market close after the 8-K disclosure, with those gains, realized over the span of a few days, being much larger on an annualized basis.

The study recommended that firms consider extending trading "blackout" periods to significant reportable events. | M.H.

The 3 Steps CFOs Must Take to Lead a Digital Transformation

New and emerging technologies—including AI, robotic process automation, advanced analytics, and machine learning—are the catalysts of unprecedented change in today's business climate. Digitalization is sparking the shift to customer-centric business models, putting greater responsibility on the finance function.

"We have not seen this level of change before, and organizations need to be thinking about developing the tools and platforms for the 21st century CFO to navigate the current industrial revolution and world economy," said Ash Noah, CPA, CGMA, Managing Director, CGMA Learning, Education and Development, at the Association of International Certified Professional Accountants (AICPA & CIMA). "Companies need to view technology as an ally in this new paradigm, not a disruptor."

Organizations increasingly rely on the office of the CFO to provide strategic insight to guide critical business decisions. Senior finance executives, in turn, must leverage the unprecedented opportunity that modern tools provide to establish themselves as key advisers to the business.

While transformation is essential to survival, many organizations still struggle when it comes to implementing emerging technologies, according to Agile Finance Unleashed: The Key Traits of Digital Finance Leaders, a new report from the AICPA, CIMA and Oracle. About one-third (32%) of 700-plus senior finance executives identify as digital leaders.

To meet this new imperative, Noah outlined three steps CFOs can take to plan and execute digital transformation.

Achieving Operational Excellence

Incorporating intelligent technologies such as process automation, artificial intelligence and machine learning is necessary to make progress in improving operations. It's important to embrace technology to fundamentally reengineer, rethink, and reimagine work, Noah said.

Take an "adopt" rather than "adapt" approach when it comes to technology, Noah suggested. "If you're simply applying automation to the same processes, you won't achieve the desired results and benefit from the complete functionality that technology enables. You have to see the power of the possible to transform the fundamental structure and processes of the accounting and finance engine."

It's also essential to have people with a strong understanding of automation, machine learning, and the cloud.

Enabling Digital Intelligence

This step involves building the analytical skills and personal capabilities needed to interrogate data effectively. This means assembling the right technology and finance teams to enable digital intelligence across the enterprise.

A robust platform ensures that all stakeholders are accessing a single version of data.

Data analytics has to be positioned as a value-generating function, according to Noah. "Digital intelligence enables the finance function to transform from a back-office cost to a value creating part of the business. Using external data-sets such as geo-positional data, demographic data, and weather data combined with the enterprise financial and non-financial data provides rich insights that enable the organization to serve the customer in new ways."

Influencing Strategy

The Agile Finance Unleashed report concluded that the biggest barrier to finance teams playing a strategic role is having to focus on core compliance and control responsibilities. But once organizations have done the first two steps, they free up talent to focus on digital strategy.

"Strategic influence is about CFOs becoming more effective partners to the business and identifying innovative ways of serving the customer," Noah said.

While the adoption of these transformative technologies is an imperative, CFOs also need to turn their attention to the skill sets within their teams. With technology improving the assembly, analysis and insight generation, Noah says there is an unprecedented need for skills such as strategic thinking, collaboration, communication, negotiation, and influence. Programs such as the CGMA Finance Leadership Program have enabled organizations to develop these specific competencies. The program's online, personalized learning experience helps finance professionals to develop the necessary digital, technical, business, leadership, and people skills.

"Programs that enable the building of strategic, collaborative and communicative skills are essential to becoming a 21st century CFO," Noah concluded.

> For more information, visit **www.cgma.org/cfo**

Plastics Maker's CFO Balances Cyclicality vs. R&D Imperative

Covestro, pressed by low pricing for its products, continues its focus on sustainability-oriented applications that don't necessarily convert quickly to profit. By David McCann

Think fast: What's the difference between cyclicality and circularity? ¶ Both are key concepts in the business of Covestro, the big German chemical company and plastics maker that spun off from Bayer in 2015. ¶ Many industries are subject to cyclical business patterns, of course. For Covestro and its competitors, cyclicality in the supply-and-demand equation is particularly important.

It typically takes seven years from a decision by the company to build a new production facility until the first products roll out, notes Thomas Toepfer, the company's finance chief.

"We're convinced that spending money on new installations is the basis for future profitable growth," Toepfer says. "But on the supply side, there are peaks, where, for example, two new plants hit the market at the same time."

That's just what happened at the end of 2018 when new production capacity in Asia caused a glut in the supply of materials Covestro produces that are used in the manufacture of products as diverse as building insulation, electric vehicles, and mattresses. Consequently, market pricing for such materials fell sharply.

This Covestro reactor in Krefeld-Uerdingen, Germany, replaces up to 20% of the crude oil otherwise needed to produce MDI, a precursor material used in manufacturing soft foam for mattresses and car seats.

That put pressure on Covestro's margins—a situation that is likely to continue in 2020, with much excess supply still to be absorbed. In response, Toepfer has stepped-up attention to cash flow with new cost-control and working capital initiatives.

"The trick is how to match a seven-year capex cycle with much shorter cyclicality in profitability and maybe even shorter-term expectations from investors," says Toepfer.

Because of potential investor sensitivity, Covestro is committed to keeping its dividend at least stable, regardless of economic conditions and profitability.

Part of the messaging to investors is about the necessity to invest in research and development efforts that aren't quickly converted to profit. "It's a delicate balance that we have to strike, which is a challenge for all the leaders in our company," Toepfer says. "We're pressuring people on costs and, at the same time, telling them to come up with new ideas and projects."

As it happens, R&D is a critical element of what's known as economic circularity, which can be considered a subset of sustainability.

Courtesy of Covestro

The term refers to the creation of systems designed to minimize waste through the continual reuse of resources.

Covestro's strategy calls for 80% of its R&D spending to contribute in some way toward the United Nations' Sustainable Development Goals initiative.

End-to-End Strategy

Considering that BlackRock, the world's largest asset manager, is changing its investment strategy because it considers sustainability to be a defining factor in companies' long-term prospects, Covestro may be quite well-positioned.

A core element of the company's purpose "is to find more applications for our materials that help save energy and make the world more sustainable and efficient," Toepfer tells *CFO*.

"We're pressuring people on costs and, at the same time, telling them to come up with new ideas and projects."

— Thomas Toepfer, CFO, Covestro

Covestro makes foam for the insulation used in energy-efficient buildings. Also, its polycarbonates are used in making high-performance lightweight materials that can replace steel and iron in electric vehicles.

And the company has a coatings and adhesives business that makes hundreds of products geared toward sustainability. For example, it manufactures coatings for windmill blades that allow the blades to be replaced less frequently. "If the blades last 12 years instead of 7 years, it changes the entire business case for wind energy," the CFO says.

The company is making increased use of wind energy itself. Much of the energy generated in Germany is still coal-based, so Covestro has entered a power purchase agreement with a wind park in Denmark that so far is generating about 6% of the energy the company uses in Germany.

The wind deal was a perfect example of the tradeoffs Toepfer has to make in balancing short-term profitability with long-term attention to sustainability. "It was probably proposal No. 3 on wind energy, because Nos. 1 and 2 were declined—they weren't profitable enough," he says.

That's one of many efforts to promote sustainability in procurement, logistics, and production activities. Covestro also is working on a bio-based replacement for crude oil in the production of aniline, a vital precursor product to polyurethane and other industrial chemicals. And it's refining the energy-intensive process of breaking down saltwater into nitric acid and chlorine, another key precursor.

But true circularity involves more than sustainably producing products aimed at enhancing sustainability. Covestro is moving toward playing a meaningful role in the recycling of its materials.

The company doesn't produce any single-use plastics of the types that wind up in the ocean. Instead, all of its materials go into products designed for long-term use. "But they do come to the end of their lifetime at some point," Toepfer says. "What should happen with insulation material, for example, even 40 years after it was used?"

Covestro's customers are asking for help in figuring out how to recycle obsolete materials. "Somebody else has to collect the materials, and yet somebody else might have to do the actual recycling procedures, but with our knowledge about our products, we can contribute a lot to those solutions," says the finance chief.

He notes that people tend to think simplistically about recycling as being all about mechanical recycling—in essence, shredding materials to make new products out of them. That works for only a small portion of plastics because product quality deteriorates with each round of recycling.

Potentially more useful is chemical recycling, which involves breaking down materials' molecular structure. Toepfer calls it "a great opportunity" that hasn't been tapped into much.

The Big Picture

About 8 million metric tons of plastic enter the world's oceans each year, according to experts. Even more is dumped into landfills.

Almost all of that is single-use plastics, but Toepfer says that as part of the plastics industry Covestro has a responsibility to help address those problems.

"Plastic is a great material that can be super helpful in promoting energy efficiency, but it doesn't belong in the oceans or landfills," he says. "It's way too valuable to be thrown away. So we engage heavily with efforts like the Alliance to End Plastic Waste and German recycling initiatives."

At stake in the way Covestro sources, produces, and takes post-sale responsibility for its products and, more broadly, global environmental risk is nothing less than the company's viability, according to Toepfer.

"As a chemical company, a medium- to long-term view is that our [social] license to operate depends on our ability to be sustainable, and to be sustainable in the sense of being circular," he says. "The message from society is loud and clear. For us, there is no way around dealing with these issues." CFO

Courtesy of the author

HEALTH CARE

What I Wish I'd Known About Health Care as a CFO

Here are four ways to rein in health care expenses while still providing quality benefits to employees. By Mike Burnett

Health care represents one of a business's largest, most unpredictable, and growing expenses. Employers' benefits have risen dramatically over the past two decades, and the cost of employee health benefits is projected to rise 5% in 2020, topping $15,000 per employee. ¶ With proper knowledge, smart health care decisions, and awareness of cost-saving solutions, an organization can reign in these expenses while still providing quality benefits to employees. The key is to treat health care like any other business expense.

As a previous CFO of a fast-growing midsize company, I discovered four things that can shape the future of a company's health plan.

The Details Matter

Like many employers seeking to lower costs, our business chose a self-funded health care solution and backed the plan with stop-loss insurance. Stop-loss is a policy designed to financially protect organizations from catastrophic claims. But as I found out, stop-loss insurance is not a catch-all; it has its limitations.

Near the end of a calendar year, one of our employees was facing a complex, high-cost health issue. Our stop-loss policy kicked in and covered the initial catastrophic claims. However, while renewing the policy for the following year, our provider created a "carve out" for any future care this employee needed. We unexpectedly were on the hook for the full cost of the employee's ongoing care.

Costs Vary — Significantly

As finance executives, we understand all our organization's costs. We can research and know in advance what it will cost to lease office space or buy data processing services. We establish a process for purchasing the approved selection, and reject or require exceptions for other requests.

Not surprisingly, many CFOs assume the cost of a hip operation, for example, will be generally consistent, regardless of which hospital an employee selects. In fact, the cost of identical treatments can vary by as much as 1,000% among providers in a given region. And because you don't know what you're going to be charged until after care has been delivered to your employees, you don't realize just how inflated these charges may be.

Had I known this, I could have designed our self-funded health plan to incentivize employees to select providers and facilities that charge lower rates.

Hospitals May Be Open to Negotiation

Within a self-insured health care model, employers essentially pay all of an employee's health care costs, outside of employee deductibles and copays. That means when an employee receives treatment or undergoes a procedure, the hospital or physician will bill the plan for the remainder of the charges.

With little transparency into the true cost of treatment, businesses often blindly pay for medical services incurred by their employees.

Just because you're billed for a certain amount doesn't automatically mean that's what you'll have to pay. In some cases, hospitals may be flexible and accept a lower payment.

The Role of TPAs

Like many organizations, we used a third-party administrator (TPA) to process insurance claims. The TPA would send us a weekly funding

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request for costs incurred, we would pay them, and they would pay the claims received from our employees' doctors, hospitals, and pharmacy benefit managers.

Mike Burnett

While TPAs play a valuable role in the benefits administration process for self-insured companies, it's not their responsibility to review charges. Rather, the finance department should be scrutinizing and understanding cost trends in health care claims just as they do any other business expenses.

With Knowledge Comes Great Power

Had I known any of this information at the time, I probably could have saved the organization hundreds of thousands of dollars on health care. I was confident that we were already saving money with a self-funded insurance model, but I didn't know there was potential for even greater savings.

Reference-based pricing, for instance, allows a self-insured employer to set a fixed limit on the amount a plan will cover in expenses. Most reference-based pricing solutions use Medicare reimbursement rates as the benchmark, since Medicare is widely accepted among providers. This solution removes the wildly variable costs associated with other plans.

As CFOs, we have a financial responsibility to our organization to understand everything about our health plan and to make no assumptions. We don't have to sit idly and accept skyrocketing expenses. CFO

Mike Burnett is the CFO for ELAP Services, a health care solution for self-funded employers across the United States.

How CFOs Can Help Control Health Care Costs

CFOs should challenge HR leaders on whether employees can afford costlier benefits and negotiate health care contracts.

By David McCann

A slowdown in companies' annual exercise of raising employees' health care costs was a key discussion point during a session at CFO Live, a *CFO*-hosted conference in New York.

Although companies' own costs continue to rise, the burden on workers has reached a point where health benefits are losing some of their effectiveness as a hiring and retention tool.

How serious the issue is depends to a large extent how well a company's workforce is paid. Michael Thompson, CEO of the National Alliance of Healthcare Purchaser Coalitions, noted that during his former tenure as a consultant at PricewaterhouseCoopers, the firm didn't have to worry about it because the employees could well afford their premium costs and deductibles.

"But the reality is that the average American has only $400 in the bank," Thompson said, "while health-plan deductibles are over $1,000. The result is that lower-income workers defer care—and often, it's necessary care.

"I think we have to get sensible and think about this in the context of all our employees, not just the highly paid ones," he continued. "People are not ready to absorb costs that are growing [faster] than their compensation."

He said finance chiefs should challenge their benefits and human resources leaders—not just on reducing costs, but also on whether employees can really afford the health plans they're offered.

Engagement by CFOs also can drive a company toward smart alternative strategies such as differentiating among health care providers, Thompson recommended. Finance chiefs, he said, should insist that those populating the company's network "be more efficient, provide a better service relationship, and deliver an overall less costly package."

Of course, changes in the roster of providers in the network can be traumatic for some employees. "It doesn't feel good when a doctor who an employee had seen for 20 years and thought was good quality suddenly falls out of the network," noted Ellen Kelsay, chief strategy officer for the National Business Group on Health.

But too often, she said, objections can derail network changes when, for example, they come from the CEO—or the CEO's spouse. That makes no sense, because that's someone who could easily afford to go out of network for care.

How Else Can CFOs Help?

Kelsay recommended that CFOs be involved in negotiations for value-based care arrangements, where a health system or physician group takes on risk by agreeing to be paid at least partly on the basis of health outcomes rather than the traditional fee-for-service model.

"It's a financial negotiation, and you need a very acute financial orientation as well as a good data orientation," she said. "A CFO who has partnered with their HR team is at the table having these conversations, and is assessing the data, the measurements, and the risk-reward factors—all of that is hugely important when you're in a negotiation with the big health system in town or a behemoth insurance company." CFO

Top: Courtesy of the author; Bottom: Getty images

ONLINE LENDING

Online Lending Platform Refines The Science of Underwriting

Upstart's loan securitizations are performing far better than Kroll, the leading credit rating agency for marketplace lenders, had expected. By David McCann

For lenders, predicting whether potential borrowers are likely to pay them back is the core of their business. That fact, in conjunction with technology advancements, has paved the way over the past several years for the new field of marketplace lending. ¶ The term generally refers to companies that operate online platforms that underwrite borrowers—usually those without pristine credit histories. The companies are either lenders themselves or connect borrowers with lenders.

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Enabled by advanced technology that crunches loan applicants' credit data and spits out predictions on their likelihood of default, the approval process typically takes only a day or two. Increasingly, in fact, applications are approved (or not) the same day they're made.

Usually, the providers of such platforms package the loans they process into securitizations for sale to institutional investors and hedge funds.

The providers may be differentiated by the depth of their dive into applicants' histories. For example, one lender, Upstart, which provides consumers with access to bank-originated loans through its website, has attracted attention for factoring in not only credit data but also such nontraditional variables as employment history and education to predict creditworthiness.

Through the use of artificial intelligence, Upstart examines about 1,600 variables pertaining to loan applicants, says CFO Sanjay Datta. But he doesn't like to draw attention to the artificial intelligence per se.

"We live in a world of noise," he tells *CFO*. "Everyone is using the terms AI and machine learning as buzzwords, to the point where they're almost meaningless. So I don't use them anymore. What I increasingly tell investors is to look at results."

By the Numbers

One way to view the results Datta refers to is through reporting by Kroll Bond Rating Agency.

In a Nov. 8, 2019 report, Kroll rated the performances of five loan securitizations, worth a cumulative $1.5 billion, that Upstart offered from mid-2017 through early last year. Each one significantly outperformed Kroll's forecast at the time of the deal.

Kroll predicted that Upstart's first securitization, dated June 21, 2017, would experience 13.07% credit losses by October 2019. But the actual losses were only 9.96%, 24% better than forecast.

Subsequent Upstart deals have done better and better. By November 2019, the second through fifth securitizations had outperformed Kroll's initial expectations by 40%, 42%, 49%, and 71%, respectively.

"If in one deal we're beating [a rating agency's] loss expectations by 50%, on the next deal they'll bring their assumptions in a little bit and give us credit for that," says Datta. "But the reality is that our loss performance is also a moving target. It's getting better over time as the models adjust for data and get more sophisticated."

Kroll also published reports this year on the performance of securitizations issued by Lending Club, SoFi, Prosper, Avant, and Marlette, among other marketplace lenders. For each of those five, the gaps between expected and actual results were much narrower than was the case for Upstart, and in most cases were fairly negligible.

"I could talk to investors about machine learning until I'm blue in the face and try to describe our algorithms," says Datta, "but at the end of the day, if we're doing something meaningful, it's going to show up in the results."

Datta acknowledges that the "performance-to-Kroll" data doesn't necessarily imply that Upstart's securitizations have had lower actual losses than those of the company's marketplace lending peers.

"Less than half of adult Americans have access to bank-quality credit. But we think that if they all received credit, the majority would pay back their loans."

— Sanjay Datta, CFO, Upstart

"The key point here is that Kroll has a very standard way of predicting how a portfolio of loans will perform, typically based on FICO buckets," he says. "That method works pretty well, but when they use it to proxy our portfolio of loans, they don't come close to predicting what actually ends up happening. We believe this indicates that Upstart is doing something different in the underwriting of its loans than the rest of the industry."

More good news for Upstart came recently from the Consumer Financial Protection Bureau.

In 2017, the CFPB issued a no-action letter to Upstart, confirming that the agency would not take legal action should the company use nontraditional data in its creditworthiness evaluations. (Companies request no-action letters from government agencies so that they can go ahead with their business plans without fear of prosecution.)

In August of this year, the CFPB issued an update to the letter, following simulations and analyses of Upstart's underwriting model performed by the bureau, specifically probing the areas of access to credit and fairness of lending.

In the update, the CFPB wrote that "the results provided from the access-to-credit comparisons show that the tested model approves 27% more applicants than the traditional model, and yields 16% lower average APRs for approved loans."

As to the fairness of lending, the CFPB said that "this reported expansion of credit access reflected in the results occurs across all tested race, ethnicity, and sex segments."

The bureau added that Upstart approves consumers with FICO scores from 620 (the minimum Upstart will accept) to 660 twice as frequently as traditional lending models do; that applicants under age 25 are 32% more likely to be approved; and that consumers with incomes under $50,000 are 13% more likely to be approved.

"Today there is a huge access problem," says Datta. "Less than half of adult Americans have access to bank-quality credit. But we think that if they all received credit, the majority would pay back their loans. Banks' traditional lending models are not good at identifying risk, so banks are too conservative in providing access to loans."

Two Customer Groups

Upstart's securitizations include multiple instruments—conservative ones with low yield and low risk, targeted at institutional investors, and risky ones with high yield aimed at hedge funds.

There are more investors interested in the conservative ones, which creates a key challenge for Datta.

"If you're a pension fund that's buying credit, you want to see stability," he notes. "And some of our peer companies in the marketplace lending space look relatively stable.

"We're more of a bucking horse," he continues. "So in talking to investors, trying to marry the fact that our technology is creating change and innovation in our underlying products almost in real time, with the fact that a lot of the investors that want this yield are looking for stability and conservatism, is just a real communication challenge."

Not only investors but also banks are customers of Upstart. They fund the loans that consumers apply for, and they also can use Upstart's technology on their own online lending platforms.

The company targets what Datta calls the "torso" of the U.S. banking industry—from about the 6th bank to the 150th in size. "They're either regional or super-regional, or they're trying to expand their footprint," he says. "They can't necessarily attract the technology talent to build digital businesses in-house."

While the banks originate the loans (which have either three-year or five-year terms, with no prepayment penalties), Upstart sets the interest rates, which range from 5.69% to 35.99%.

A New Journey

Upstart was founded in 2012 by former Google executives. Originally, it was a crowdfunding website for recent college graduates, who contracted to share a percentage of their future income in exchange for funding.

The company switched to its present business model in 2014 and offered its first securitization in 2017, a few months after Datta came on board. He'd worked at Google for 11 years and was head of finance for the technology giant's global advertising business before joining Upstart.

Datta's experience at Google dovetails with his current role. "It seemed to be obvious that there was an application of the types of technologies we worked with at Google, which were core predictive technologies, and applying them to better ways of running financial services models," he says. CFO

Courtesy of the author

3 Considerations for New Cloud Computing Rules

In their next fiscal year companies must begin to capitalize certain costs associated with deploying cloud software. By Chris Chiriatti, Matt Hurley, and Sean Torr

Despite rapid growth in cloud services, global revenues for which Gartner pegs to hit $331 billion by 2022, updated cloud computing accounting rules have been a back-burner issue for many companies. ¶ More significant new accounting standards—for leases, credit losses, and hedges—that have been commanding CFOs' attention recently could be to blame.

However, the updated cloud computing accounting rules—the Financial Accounting Standards Board's ASU 2018-15—will change how CFOs at companies looking to deploy or already engaged in cloud computing arrangements approach these investment decisions.

The new standard—effective for public companies in their fiscal year beginning on or after Dec. 15, 2019—requires companies to capitalize certain costs associated with implementing a cloud arrangement.

Historically, companies have had to expense most of those costs as incurred. The new standard generally brings the accounting for implementing cloud arrangements in line with that for internal-use-software costs, which have always been capitalized.

There will be nuances in how the capitalization of costs for cloud computing arrangements, internal software, and hybrid arrangements are reflected on the balance sheet and income statement.

That's likely to push companies to have more thoughtful discussions on the best way to deploy to the cloud.

Following are three key considerations for CFOs as they work through implementation of the new guidance.

EBITDA and Balance Sheet Metrics

Depending on a company's industry or business strategy, some CFOs may be more interested than others in how certain metrics impact their investment decisions under the new standard.

Two examples of key metrics that CFOs may monitor in relation to this standard are earnings before interest, taxes, depreciation, and amortization and balance sheet ratios.

Until now, cloud-service arrangement costs typically have resulted in a reduction in EBITDA when incurred. The new guidance defers some of these costs as assets and requires them to be recognized over the period of service, thereby reducing the immediate impact on EBITDA.

Depending on the type of cloud deployment a company is running or exploring, and the breakdown of capitalized versus operating costs under the new guidance, some CFOs may find that a cloud service arrangement or hybrid solution could now be a more appealing option, since the immediate impact to EBITDA can be somewhat mitigated.

For companies where balance sheet metrics such as current ratio or net working capital are important, the new guidance could provide CFOs and CIOs with an additional consideration in their on-premise-versus-cloud decision process.

Under current guidance, certain qualifying costs associated with on-premise solutions are capitalized as intangible assets during the imple-

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mentation period while costs associated with cloud services are expensed. Under the new guidance, cloud arrangement costs may also result in capitalized implementation costs presented in a different location on the balance sheet.

Further, depending on the size of cloud projects and their related financial implications, it may be worth considering how best to communicate the impacts of the updated standard to stakeholders such as investors and audit committees.

Collaboration with the CIO

Given the nuances of the new standard, it is important for the CFO and CIO to make sure that members of their respective organizations are collaborating to maximize the deployment of cloud solutions going forward.

CIOs will need to involve the finance department, especially those colleagues closest to financial planning and analysis, early on, as internal budgeting could have an impact on the type of solution the company ultimately pursues.

Depending on how new capitalized costs impact ongoing budgeting, CIOs and CFOs may find that the ability to defer costs makes moving forward with cloud projects more attractive.

Data Gathering and Business Processes

While many companies already have policies in place to account for internal-use software based on existing guidance, these policies historically have not applied to cloud computing arrangements.

In addition, companies will need to adapt existing processes or establish new ones to gather the right data for reporting. This information could come from the vendor, internal teams (including legal), or other sources.

While the CFO may be able to leverage existing processes for data gathering, it's more likely that new processes will need to be established to ensure the finance team has the right data to report under the new cloud computing accounting guidance—and, importantly, drive investment discussions with senior leadership.

Companies may look to potentially leverage contract review workflow or a center of excellence, similar to what many organizations implemented with adoption of other recent new standards, such as lease accounting.

Companies that don't have to deal with this issue in short order—for example, private companies that are not required to comply until 2021 but are permitted to early-adopt, and companies that aren't currently using cloud—should still pay close attention to this standard, given the rapid growth expected in cloud adoption.

Although many companies still use on-premise solutions today, many others are moving to the cloud or have deployed hybrid infrastructure arrangements. We're seeing a range of business factors driving cloud computing growth and even accelerating it.

This growth is unlikely to abate, making this an accounting standard that more and more companies will need to get comfortable with in the near term, especially when considering how to drive better investment decisions related to technology.

Chris Chiriatti is an audit and assurance managing director at Deloitte & Touche LLP. Matt Hurley is a senior manager and Sean Torr a managing director with Deloitte Risk & Financial Advisory.

EY Partner Named New FASB Chair

"Rich Jones brings together all of the important qualities we were looking for in FASB's next leader," said FAF Chairman Charles H. Noski.

By Vincent Ryan

The board of trustees of the Financial Accounting Foundation (FAF) announced on Dec. 17 that it had appointed Richard R. Jones as the next chair of the Financial Accounting Standards Board (FASB).

Jones is chief accountant and a partner at Ernst & Young LLP (EY), having spent his entire career at the Big Four firm. In his role at EY, he helps the firm's clients and engagement teams understand accounting requirements, develops the firm's views on proposed accounting standards, and oversees EY's accounting publication efforts across all sectors.

Jones previously served on the Financial Accounting Standards Advisory Council (FASAC) from 2016 to 2018. He was also a member of the accounting standards executive committee of the American Institute of Certified Public Accountants (AICPA) from 2003 to 2008.

Richard R. Jones

Jones is the first EY executive to be appointed to a full term as FASB chair since Dennis Beresford left EY and took the helm in 1987. Russell Golden, who is stepping down when Jones takes over on July 1, 2020, was a Deloitte partner before joining the FASB staff. He was first appointed a three-year term in 2013.

Jones will serve a seven-year term with no option for renewal, according to FAF rules.

"Rich Jones brings together all of the important qualities we were looking for in FASB's next leader," said FAF Chairman Charles H. Noski. "He is an outstanding accountant, deeply knowledgeable about our diverse stakeholders, and an experienced leader who can drive consensus in the complex world of accounting standards and financial reporting."

Courtesy of FASB

FINANCIAL PLANNING & ANALYSIS

Break the Bad Habit of Overreacting to Metrics

Quarter-to-quarter fluctuations may be no reason to pull out your hair, and other tips for evaluating data points. By Mark Graban

CFOs, of course, play a key role in overseeing financial metrics and, increasingly, operational performance measures. They pay a great deal of much-needed attention to the question of what to measure. But an opportunity typically remains for getting better at evaluating metrics. ¶ The methods and mindsets below should save time, improve focus, and thereby drive greater performance this year and beyond.

A common challenge arises when a CFO overreacts to the latest data point. Say, for example, that the "inventory turns ratio" has decreased from 4.1 for the previous quarter to 3.9 for the just-ended one. Is it time to look for a root cause, or to read someone the riot act? Does this decrease indicate a meaningful trend?

Not necessarily.

It's possible that a metric might just be fluctuating around an average, within a typical range. We can call that "routine variation." It exists in business metrics as well as personal measures like our weight or blood pressure.

Reacting to routine variation (or asking others to investigate or explain it) results in a lot of activity that doesn't really help improve the business. If inventory turns are just fluctuating, the next reporting period might show an increase to 4.3. Is that change worth celebrating? Is it a new, more positive trend? Again, not necessarily.

Here's a recommendation: Look at more than two or three historical data points to get a better sense of whether a metric is simply fluctuating or there is a meaningful trend or shift that must be understood.

Since quarterly metrics provide four data points a year, it takes a long time to detect trends. Additionally, sometimes-meaningful variations in monthly or weekly numbers get averaged out and lost in quarterly numbers, which hampers analysis and response.

Recognizing that two (or three) data points are not a trend, some finance organizations utilize a so-called "dashboard" showing a large table of numbers. It actually looks more like a spreadsheet than a dashboard.

Much too often, finance shares financial and operational metrics in overly detailed tables, even though it's difficult (if not impossible) for people to separate routine variation (a.k.a. "noise") from exceptional variation (a "signal" in the metric) when data is displayed this way.

I recommend visualizing metrics using a simple chart of the last 18 monthly data points, as it's easier to see trends and shifts over time.

Another recommendation: When displaying time-series data, avoid bar charts (in Excel they're called "column charts"). Even though businesses and financial news publications commonly use them. But research shows that they can be misleading because they draw the human eye to the middle of each bar, while the actual data point that should be taken in resides at the top of the bar (in a vertical bar chart).

It would be better for finance organizations to use "line charts" (as they're called in Excel), which draw eyes to the data point in question.

Sometimes a line chart shows an undeniable trend or massive change in, for example, accounts receivable or net cash flow. Or, there might be a single data point that looks like a temporary outlier (good or bad) or a shift that, after a few data points, seems

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permanent. And, as suggested above, there might also be data points that look like fluctuations around an average over time.

Mark Graban

Outer Limits

If CFOs can break the habit of reacting too often to a metric's ups and downs, a little bit of simple (but valid) math can help them avoid guessing or using "gut feel" to determine whether there's a meaningful change (a signal) in the metric.

A proven statistical method called "process behavior charts" (a phrase coined by Donald Wheeler, a leading academic in the field of business analytics) adds three calculations to the run chart (a graph that displays observed data in a time sequence) of a metric's historical performance: the average, a "lower limit," and an "upper limit."

A signal is a message from the metric that says something worth understanding has changed significantly in the business. The signal may suggest it's time to do root cause analysis or it may be a confirmation that a change made to the business is creating different results.

There are three rules for finding signals. First, any single data point that's outside of the lower or upper limit is a signal. Second, eight consecutive data points that are all above or below the average is a signal of a sustained shift in performance.

Third, any three out of four consecutive data points that are closer to a limit than the average signals that the metric does not reflect simply a fluctuation around an average.

As a final opportunity for improvement, be sure to display charts that show, on a rolling basis, the last 18 months of data. I've seen companies that dutifully track metrics each month (or week) throughout the year, only to start the new year with a blank chart. It doesn't make sense to go into February with charts that show just one data point; it's then impossible to separate signal from noise. CFO

Mark Graban is a consultant, speaker, blogger, and author of management books.

Why Procurement Savings Get Lost in Translation

Create a "closed-loop" system so business units don't eat up all the savings before corporate leaders can decide what to do with the gains.

By David Schannon and Chuck Miller

It's a frustrating scenario at many companies: The procurement chief announces major savings from a new initiative, but the gains never make it to the bottom line.

The problem is pretty obvious: two accounting systems that don't mesh.

Procurement departments calculate savings based on categories of goods, but business unit leaders spend based on their budgets. So savings are easily lost in translation. When the procurement team scores some gains, business unit leaders often use them quickly to plug a hole elsewhere or fund a priority project.

Successful companies track these savings rigorously and capture them before they disappear. They make sure the heads of procurement, financial planning, and accounting as well as budget owners are all seeing the same numbers. As soon as the savings are booked, they reduce business unit budgets accordingly.

We call this a closed-loop process. With savings visible to all, leadership teams can determine the best use of the savings—whether it should fill budget gaps, fund new investments, or bolster the bottom line.

In our experience, the most effective approach is to anticipate procurement savings in advance and incorporate them when the budget is being set up. That provides an incentive for business unit leaders to work closely with the procurement team throughout the year to achieve targeted savings.

Companies that want a more systematic approach to cost control, of course, are turning to zero-based budgeting, a process that reviews all decisions on spending annually. They may also create budgets by category. But for companies that don't have zero-based-budgeting, closing the procurement savings loop can deliver a big improvement in transparency and performance.

It's not surprising that procurement savings disappear into thin air, given the way companies are structured.

Skilled leaders bridge the communication gap between procurement, finance, and business unit managers by creating a closed-loop system to track and capture those gains. The benefits are compelling: increased efficiency and new opportunities to reinvest gains in strategic priorities.

David Schannon and Chuck Miller are partners with Bain & Co.'s performance improvement practice.

Top: Courtesy of the author; Bottom: Getty images


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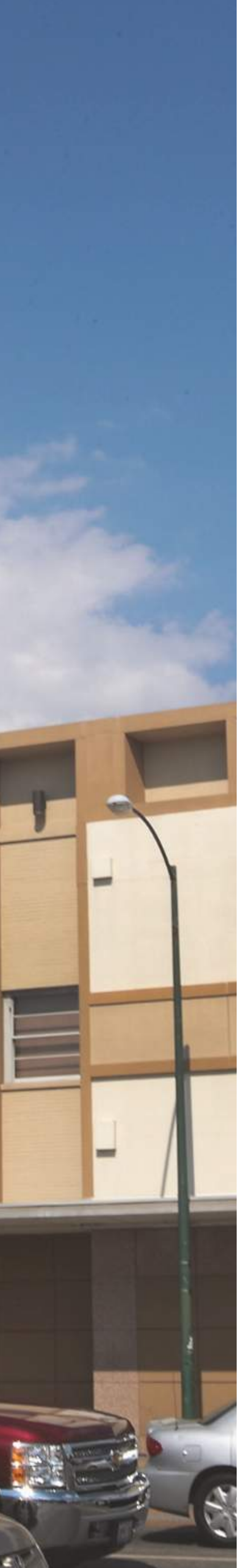

Can Big Retailers Be Saved?

Innovative store concepts are buying some time, but brands like Macy's and J.C. Penney need a lot more to reverse the falloff in sales.

By Russ Banham

Five of Canada Goose's 11 stores feature a "cold room," where the temperature is -27 degrees Fahrenheit. Inside, walls look and feel like icy rock formations. The floor simulates the sound of cracking ice, and holograms and laser projections reproduce frigid 3-D environments like the Arctic, replete with falling snow.

Menswear clothing company Todd Snyder just opened a store in a landmark 1809 building in New York. The store hosts member events such as curated art exhibits and rare wine and whiskey tastings. So-called "private client style advisers" are available to provide personalized shopping experiences and bespoke suiting. "It's part clubhouse and part clothing store, offering customers the opportunity to immerse themselves into what we're all about," says Alejandro Rhett, vice president of merchandising at Todd Snyder.

These two retailers are not alone in trying to turn the conventional notion of a store upside-down. "Almost every retail client in our portfolio is trying something unusual," says Rod Sides, vice chair of Deloitte and leader of the firm's retail and distribution consulting. "The old growth trajectory called for opening more stores. Today, growth is about opening an innovative store concept and seeing if it will scale."

The risk of failure is not dampening the wildest imaginings of today's chief merchandising officers (CMOs), who are determined to "wow" customers. "Merchandising and marketing keep coming up with ever-more outlandish experiments to entice customers

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Can big retailers be saved?

in the door," says Craig Rowley, a senior partner in Korn Ferry's retail practice.

Customer experiences, however, are costly, says Antony Karabus, CEO of retail consulting firm HRC Advisory. "The CMO needs a robust business case before rolling out a concept. Finance has to hold the executive team accountable for the investments they're promoting."

Indeed, the survival of traditional brick-and-mortar retailers that are ailing financially will require a lot more than attractive stores: these companies have to reverse falling sales while cutting expensess ruthlessly. That will be tricky. Only the most exceptional of the 90 or so CFOs Karabus has worked with can counterbalance the wishes of a CMO, holding their feet to the fire "before rolling out every wild idea. It's a very delicate balance."

THIN ICE

Precarious might be a better word than delicate. The long-predicted retail apocalypse has dawned. A record 9,300-plus retail stores closed in the United States in 2019, a near-60% jump from the year before. Shoe store Payless, in liquidation, is shutting thousands of locations. Luxury retailer Barney's New York has said goodbye to all but its outlet stores, while Gap is bringing down the curtain on 230 stores. Forever 21 is closing 111 stores, Dress Barn 650, Shopko 371, and Gymboree more than 800. Bankrupt Sears closed 96 stores in 2019, leaving 182 in a portfolio that once boasted 3,500. In total, nearly 5,000 more retail stores closed than opened in 2019.

Saddled with debt and plagued by shrinking margins, many of these companies displaced by the online retail explosion are exiting once-core product and lowering capital expenditures to right-size their businesses.

J.C. Penney, for example, is $4 billion in debt and had a debt-to-EBITDA ratio of 8.3x as of last November; it projects same-store sales to drop 7% to 8% in 2020.

CFO Bill Wafford says the retailer is taking "positive and proactive" measures to improve the long-term health of its balance sheet. That means closing six more stores this year and mothballing a 234-employee call center in Lenexa, Kansas. Near-term debt maturities, fortunately, are low—$105 million in unsecured debt comes due in June.

Once-venerable Macy's is in even hotter water. Net decreases in cash and operating cash flow are an ominous sign, as is management's decision to stop paying down its long-term $5 billion debt, according to Kenra Investors. While Macy's stock nearly halved in mid-2019, it kept paying its $465 million in dividends to shareholders. It desperately needs its multi-year productivity program, "Funding Our Future," to lift operating margins. As part of the program, Macy's is cutting and reallocating marketing resources. In the supply chain, it's building a third-party vendor base to outsource product packaging and shipments. The company is also testing in-store self-service solutions.

SLIVER OF HOPE

For a model of how to run an oldline retailer in the web era, CFOs could do worse than look to Nordstrom. The 119-year-old upscale department store has closed some 140,000-square-foot retail spaces, but it is opening smaller, more focused locations. For example, Nordstrom has been launching "off-price," or discount stores. Sales at the those stores grew 1.2% in the third quarter, while full-line store sales fell 4.1%. Nordstrom is also opening small-footprint full-price stores in high-priced locales like Manhattan and Beverly Hills. These boutique shops are 2,000 to 3,000 square feet. Personal fashion stylists greet shoppers with a free glass of wine, espresso, or a cold-pressed juice, then sit down for a consultation. Sales associates suggest clothing based on the customer's interests. A tailor measures for fit, and since there is little in the way of inventory to take home, the item is shipped for same-day delivery.

> **"Merchandising and marketing keep coming up with ever-more outlandish experiments to entice customers in the door."**
>
> **—Craig Rowley,** senior partner, Korn Ferry

"People don't want to spend time going through racks and racks of clothes," says Deloitte's Sides. "Stores trade in the cost of holding inventory for personal stylists that help customers find what they need and then ship it. This high-touch customer experience burgeons into a relationship that increases the shopper's loyalty, sort of like the way retail was 50 years ago when it was local."

These local Nordstrom's also serve as service hubs for shoppers to return items, pick up merchandise, and request alterations. In-store order pickups from transactions online drove two-thirds of the company's digital sales growth in the third quarter of 2019, according to CEO Erik B. Nordstrom. (Digital sales represent 34% of Nordstrom's business, far ahead of some competitors.)

DIGITAL INVASION

Clues to how brick-and-mortar retailers will adapt are also visibile in the way digital-only brands are popping up on Main Street. Digital natives Bonobos, Wayfair, Warby Parker, Alibaba, and Casper and others will open 850 stores in the next five years, mostly in the largest cities, experts predict.

Digital brands see a physical store as a place to reinforce the online brand, says Will Decker, vice president, brand and retail innovation, at investment firm Plug and Play. "They already have mindshare; now they can give their customers a space to meet, share stories, and post about their experiences online. The physical stores become a massive discovery vehicle for reaching new customers with a low capital investment."

Costco Stays the Course

Costco remains true to its philosophy, which has worked no matter what the competition does.

Longtime Costco CFO Richard Galanti remembers the last reinvention of brick-and-mortar retail, not surprising since Costco lead it. The membership-only chain of warehouse-sized stores opened its first location in Seattle under the Costco name in 1983, one year before Galanti was hired on as vice president of finance (he became CFO in 1985). With its heavily discounted consumer goods and grocery items, Costco hit the ground running, changing the retail landscape.

Through it all, Costco, which tallies 98.5 million members at 776 stores worldwide (up from 592 in 2011), has stuck to its knitting. From the outset, the company has prized the idea of customer experience, well before other retailers gave it much thought. Galanti defines the Costco experience as a "treasure hunt" through the stores' extra-wide aisles. "Very few product signs are visible—on purpose," he said. "We want people to take their time browsing each aisle, turning a corner to find something they didn't expect, like scuba gear or wedding dresses or ski wear in the middle of August. You walk around and go 'Wow!'"

> **"We're investing capital into becoming more vertically integrated. For instance, we're experimenting with owning chicken farms. If we can save ten cents per bird for members by doing it ourselves, we'll do it."**
>
> **—Richard Galanti,** CFO, Costco

As other retailers copied its ideas and Amazon sought to dislocate it altogether, Costco remained true to its philosophy, which worked no matter what the competition did. "Six years ago, a survey came out indicating 25% of Costco members had become Amazon Prime members. The next year it was 38%, and the year after that, it was 52%," Galanti recalled. "One of the company's analysts asked me how we could compete against Amazon. I told him my family also has Prime."

His point? "We're steady as she goes," he said. "Our quarterly revenues might kick down a tenth of a percent here and there, but—knock on wood—we continue to drive value in what we provide. Our last two quarters produced our highest member renewal rates ever, at 90% or more. We're in the enviable position of generating more cash to spend in growing the business and trying new things."

Non-members often think Costco sells everything, which is far from the case. "A supermarket has about 40,000 active items; we have about 3,800," Galanti said. "We preselect good merchandise that's popular, taking our buying power and putting it into fewer items, passing down the cost efficiencies as lower prices."

Costco's prices are hard to beat, but they often require buying products in bulk—enough paper towels to last months or a giant tub of ketchup to garnish a million burgers. Vast quantities don't seem to bother Costco members heaping goods in carts the size of Jeeps.

Recent innovations at Costco are predicated on lowering prices further while improving quality. "We're investing capital into becoming more vertically integrated," Galanti said. "For instance, we're experimenting with owning chicken farms [it recently opened a $400 million poultry complex in Nebraska]. If we can save ten cents per bird for members by doing it ourselves, we'll do it." | **R.B.**

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Can big retailers be saved?

SMALL FORMATS, BIG DATA

The value in these new retailing concepts is twofold: one, small-format physical stores at 1,000 to 2,000 square feet do not require the supply chain infrastructure that large format locations do. At the same time, they allow for a higher-touch experience, which can mean a better opportunity to harvest information: in-store experiences are a subtle way to capture digital knowledge about a customer.

Service-oriented interactions can collect data on shopper needs, questions, and concerns. Some retailers track in-store customer behaviors using object tracking, emotion recognition, pressure sensitive floors, RFID tags, and gaze tracking software. The tools suggest a customer's singular shopping interests, much like the movements of a mouse cursor on a website.

"Many in-store merchandising models are extremely innovative, but they're designed in part to acquire data about the customer experience," says Joanne Joliet, a Gartner senior research director.

> **"CFOs need to be more in tune with how sales actually originate today to inform their capital allocation decisions."**
>
> **—Dave Richards,** principal and Americas retail leader, EY

At Ulta Beauty, for instance, associates are trained to respond to sensitive customer questions about personal appearances, such as thinning hair or skin blotches. The associates use hand-held mobile devices to search for products addressing the problem. The same tool captures these interactions as data. "This is all about customer touchpoints," says Scott Settersten, CFO of the 1,100-store chain. "Our associates are trained to read customer body language to know when to engage with the guest."

The information collected may include the person's name, email address, phone number, and a physical address to ship the product for home delivery. "In-store technologies

A Broken Yardstick

The "same store sales" metric may go the way of the records bin.

In the days of "five and dime" retail stores, figuring out how a retailer was doing was simple. Finance relied on comparable store sales metrics—the revenue generated in the most recent accounting period by a retail location, compared with the revenue generated by the location in a similar, prior period. But that metric is increasingly outdated.

Online purchases, ship-to-store, and ship-from-store omnichannel practices skew the numbers. And with customer product returns no longer contained within one channel, measuring costs across channels is daunting. "Comparable store sales just doesn't work as a metric in omnichannel," says Craig Rowley, senior client partner in Korn Ferry's retail practice.

"Everyone wants an easy metric," says Crowley, that takes into account growth (or contraction) of top-line sales, gross margins to gauge product profitability, and SG&A (selling, general, and administrative expenses). "Unfortunately, no one has been able to put a finger on it."

Other retail consultants agree that a new metric is elusive. Rod Sides, who heads up Deloitte's retail and distribution consulting practice, says the traditional metrics "just don't paint an accurate picture of financial and operational performance realities." And Dave Richards, America's retail leader at EY, says, "The entire retail industry is looking for better ways to evaluate internal performance and report it externally."

Only 8% of CFOs in a Deloitte survey believed the traditional retail metrics provided analysts, investors, and management with an accurate picture of performance. For example, "no retailer is set up yet to track local market e-commerce sales and social media posts," says Praveen Adhi, a partner and leader of McKinsey's retail operations. "It's up to the CFO to push for more holistic metrics that quantify broader brand-building efforts."

Richards agrees: "By getting more specific about where and how sales originate, CFOs can help create truer estimates of revenues and profits across different customer touchpoints." | **R.B.**

MEASURING BETTER

Old Metrics
Same store sales
Sales per square foot
Average unit retail
Average shopper dwell time

New Metrics
Retail profit per transaction
Sales per unique customer
Comparable customer segment growth
Free cashflow
Path to purchase

Getty Images

are generating a sea of customer data and analytics, offering up insights that help retailers become more preemptive and prescriptive in their customer approaches," says Joliet.

FALLING FARTHER BEHIND?

Tweaking store concepts, closing large sites, and redesigning supply chains will, of course, take a lot of time. While traditional retailers attempt their pivots and rebuild their balance sheets, though, they may be losing more ground to Amazon, the company that created more efficient and cost-effective ways for people to buy pretty much anything.

Consumers spent $517 billion online with U.S. merchants in 2018, up 15% from $450 billion spent the year prior, and about 40% of that spending was on Amazon. The 2019 holiday season was a bust for many brick-and-mortar retailers, but overall digital sales globally rose to $723 billion.

"Both online and offline, every company must prepare for Amazon's next moves," says Paul Prendergast, a managing director at Accenture.

Each move Amazon makes forces traditional retailers to ponder following suit—which is what happened with e-commerce fulfillment centers. "Longtime retailers that started selling online built these large and expensive fulfillment centers to move goods because that's what Amazon did," says Rowley. "Once Amazon started offering next-day and same-day deliveries, they couldn't keep up."

Even when they partner with digital natives like Amazon, traditional retailers don't seem to win. In 2017, Kohl's and Best Buy signed a deal to allow Amazon customers to return products to their stores. The idea was Amazon could reduce shipping costs related to returns, and Kohl's and Best Buy would generate foot traffic that could convert into a product sale. However, at least for Kohl's, the partnership has yet to bear fruit. Comparable sales at Kohl's slipped 0.2% year over year in 2019, and in the third quarter Kohl's CEO Michelle Gass admitted that the labor-intensive Amazon returns program added to operating costs.

Wowing customers with unique experiences might draw shoppers back to physical stores, but the formula for retail sales growth will be more about technology and data analytics. Traditional retailers, unfortunately, often have "five or six legacy systems that don't interact," Accenture's Prendergast says. "That creates substantial challenges to collect and analyze customer, supplier, and distributor data to make more informed and accurate decisions."

If they get their hands on the right data, retailing CFOs might be able to predict customer behavior better and "be more in tune with how sales originate today to inform their capital allocation decisions," says Dave Richards, principal and America's retail leader at EY.

That's a big "if." Traditional retailers might run out of time and capital before they can make that happen. CFO

Russ Banham is a Pulitzer-nominated financial journalist and best-selling author.

Tough Positions

Many of the CFOs of troubled retail companies have three years or fewer in their jobs and a big challenge ahead.

Nordstrom

Anne Bramman joined the retailer as CFO in June 2017 from adhesive manufacturing company Avery Dennison. She was previously CFO of Carnival Cruise Line and Henri Bendel, a subsidiary of L Brands.

Gap

Teri List-Stoll joined Gap in January 2017. She came from top consumer goods brands Dick's Sporting Goods and Kraft Foods. She serves as an independent director on Microsoft's board.

Kohl's

The bargain retailer tapped **Jill Timm** in October 2019. She was promoted from her role as executive vice president of finance. Timm joined Kohl's in 1999.

Forever 21

Brad Sell joined the fast-fashion retailer in March 2019, six months before the company filed for bankruptcy. Sell held CFO roles at surf-inspired apparel company Quicksilver and children's product manufacturer Kid Brands.

Gymboree

Children's retailer Gymboree will come back this year as part of The Children's Place. **Mike Scarpa**, chief financial officer and chief operating officer at The Children's Place, joined the retailer in 2012. Previously, he was CFO and COO at Talbots and COO at Liz Claiborne.

Macy's

Paula Price was named Macy's CFO in July 2018. Price worked primarily in the retail and consumer products industries for 30 years before becoming a senior lecturer at Harvard Business School. She was previously CFO at Dutch retailer Ahold USA.

JC Penney

Bill Wafford became J.C. Penney's chief financial officer in April 2019. He joined the company from The Vitamin Shoppe.

Courtesy of the companies


U.S. SECURITIES AND EXCHANGE COMMISSION
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IT COULD HAPPEN TO YOU

FIRST PERSON
BY GREGORY LAW

How I proved the SEC wrong after it falsely accused me of fraud.

It should go without saying that CFOs should be ethical. Most of the ones I've met are.

But if you're a public company CFO, you should be aware that there are circumstances in which the enforcement division of the Securities and Exchange Commission may assume there's a good chance you are not ethical. Even if you are.

I spent almost four years dealing with the real-world consequences of that mindset. I recently emerged from that experience, which was frustratingly bizarre. My story should serve as a warning to all public company executives.

The Background

I'd been with Osiris Therapeutics, a fast-growing public biotech company, for nine months as vice president of finance before being appointed CFO in September 2015. During those first months I was tangentially involved with day-to-day accounting. My focus was implementing new accounting, financial reporting, and management reporting systems and processes for a company that was transitioning from a research and development focus to commercializing three new products with a new 100-person sales organization.

Shortly after I became CFO, an employee responsible for revenue accounting presented me with a concern over the accounting for a particular sales agent. It led to me telling the employee to reverse, in the third-quarter financials, an immaterial amount of revenue that had been recognized in the previous two quarters.

About four weeks later, I was presented with questionable documentation of a sale to a distributor. I immediately began investigating the sale's legitimacy and shared my concerns with a trusted member of the senior executive team.

A few days after that, the company's external auditors notified me that the Public Company Accounting Oversight Board had selected the

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EDITOR'S NOTE: *The viewpoints in this article are the author's and do not necessarily represent those of CFO.*

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GREG LAW'S ODYSSEY

2015

January
Law joins Osiris Therapeutics as vice president of finance and chief accounting officer.

September
Law is appointed CFO of Osiris Therapeutics.

October
Osiris's auditor tells the company that its fiscal 2014 audit has been selected for inspection by the PCAOB.

November
In its 10-Q, Osiris announces revenue restatement for Q4 2014 and Q1 and Q2 2015, amounting to about a $3 million reduction in revenue.

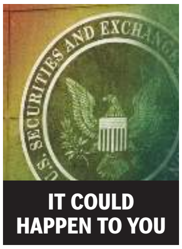
December
Osiris decides to switch to a Big Four audit firm; original audit firm resigns.

2016

January-February
Internal investigation into revenue recognition; CEO resigns, COO leaves company.

March
Osiris receives a subpoena from the Securities and Exchange Commission.

May
U.S. Attorney's Office for the Southern District issues a subpoena.



company's previous year's audit for inspection.

The inspection didn't go well for the auditors. The PCAOB asked a number of questions they couldn't answer, which led the auditors to pose a flood of questions to the company. The pushback from the PCAOB inspection led the auditors to change their position on the recognition of revenue for several of the company's distributors.

Many of the revenue adjustments were based on the PCAOB inspectors challenging the external auditors' workpapers. Ultimately, Osiris announced in its 2015 third-quarter earnings release that it would restate revenue for the fourth quarter of 2014 and the first two quarters of 2015.

The experience of providing support to the external auditors during the PCAOB inspection, and later the nature of their questions about the company's distributors during the third-quarter financial statement review, demonstrated to me that they didn't understand the company's business. They asked such basic questions that I questioned whether they had gained enough evidence during prior audits to issue valid opinions.

All of this made it clear that a change of auditors was required. Working with the company's audit committee, a determination was made to switch to a Big Four audit firm. We selected Ernst & Young. In December, just before the date we planned to notify the existing auditors of the decision, they resigned as our auditors.

Two Investigations, Three CEOs, Two Subpoenas

In early 2016 the company began a review, assisted by an external forensic accounting firm, into a number of the distributor revenue recognition issues that created the need for a restatement.

The forensic accounting firm began to report the results of their findings to me as I continued to review the previously reported revenue accounting. The company continued to work with the external auditors that had resigned to restate the previously issued financials in the pending 2015 10-K.

Turmoil began to hit the executive management team. The CEO resigned in early February, which, coming after the announcement of a revenue restatement and resignation of the auditors, led to rampant speculation from Wall Street and others following the stock. The chief business officer was named interim CEO, and about a month later he became permanent CEO. In rapid succession, two respected members of the executive management team left the company, which left me very concerned.

It was around this time, in March 2016, that the company received a subpoena from the SEC.

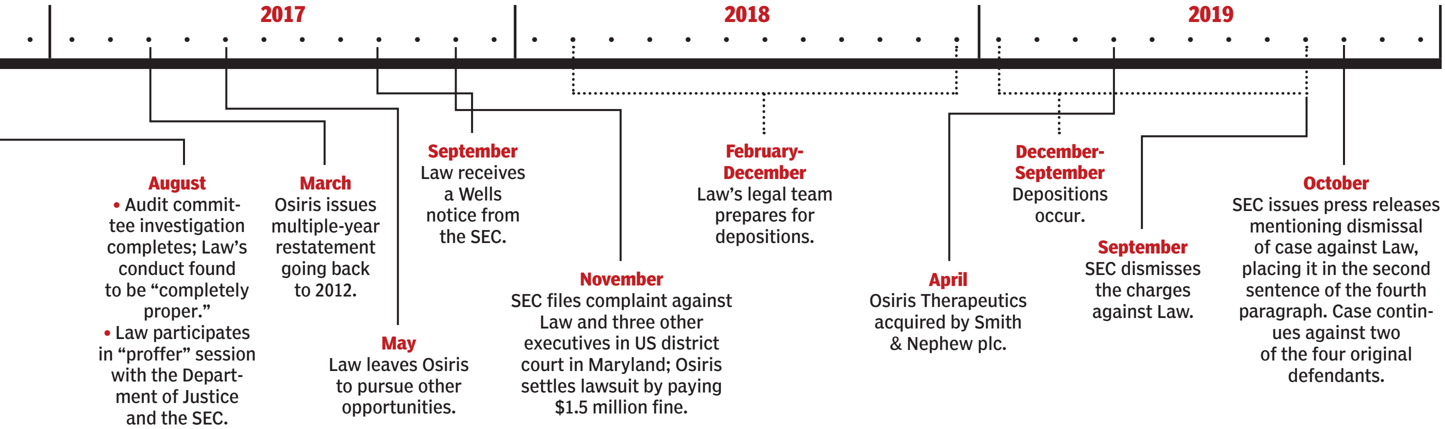
The board's audit committee then retained a law firm and forensic accounting firm to conduct an independent external investigation of the revenue recognition issues. In May, the U.S. Attorney's Office for the Southern District of New York (SDNY) issued its own subpoena. By this time, the audit committee-backed investigation had progressed to the point that the law firm was questioning employees. In June, the recently appointed CEO resigned, and a new interim CEO was appointed.

The audit committee investigation was completed in August 2016. My conduct as CFO was determined to be completely proper before, during, and after the issues that had led the company to announce the restatement.

The accounting organization then shifted from the investigations to completing the restated financials. Based on the forensic audit, it was ultimately decided to do a multiple-year restatement covering 2012 through the previously reported periods of 2014. The restatement was issued on March 27, 2017.

The SEC Closes In

While the audit committee's investigation was in progress, the SEC delayed its own probe pending the results. In August 2016, at the request of my attorney, I voluntarily went to the



SDNY offices in lower Manhattan for a proffer session.

In a proffer session with the DOJ, of which the SDNY is a component, the department, and in this case the SEC, ask you questions. In return for answering truthfully, the DOJ agrees not to use any evidence obtained during the session against you.

In total, I spent about eight hours being questioned by four assistant U.S. attorneys, one SEC attorney, and three SEC accountants, while a U.S. postal inspector (wearing his weapon) took notes. The attorneys were exceptionally professional but asked tough questions. I answered all of them with extensive detail.

The questions the SEC accountants asked were illuminating. They weren't difficult, but they revealed the accountants' limited understanding of the company's business and the specific transactions they were questioning.

For example, the accountants repeatedly confused the company's distributors with its agents. I tried repeatedly throughout the day to explain things, but ultimately, they didn't seem to accept my version of events. By the end of the session, it appeared to me that not only did they misunderstand the business transactions, but that they'd already formed an opinion that I had participated in what they viewed as maleficence by the company's executive team.

After the meeting the investigation picked up in earnest. One evening, postal inspectors simultaneously showed up unannounced at the residences of two company employees. Both were interviewed without lawyers present.

One of the employees was disgruntled over changes made to strengthen internal controls. The other was the one who had created the suspicious sale documents that I had investigated. He was later determined to have participated in a scheme to create false documents to support a fake transaction in a bid to deceive the accounting organization about a sale.

The DOJ and SEC also issued subpoenas and interviewed other employees, distributors, agents, and Wall Street analysts. Some of these people spoke willingly; others exercised their Fifth Amendment rights. The company's former external auditors were also interviewed.

After my initial interview with the DOJ and SEC, I didn't hear back from them for a year. Two months after the restatement was filed in March 2017, I left the company to pursue other opportunities.

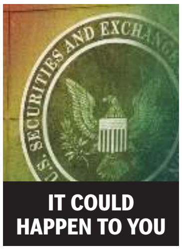
That August the government agencies asked me to return to New York for another interview. This one lasted two days. It was clear that the SEC had become more hostile toward me since the previous year.

"The investigation was completed in August 2016. My conduct as CFO was determined to be completely proper before, during, and after the issues that had led the company to announce the restatement."

The commission seemed to have developed a narrative where everyone at Osiris was involved in a conspiracy to fool the company's external auditors. Questions were around a theory that the auditors had been asking questions about distributors throughout 2014 and 2015 and they were lied to about everything.

The theory with regard to me was absolutely incorrect, because I knew I had been fully transparent with the auditors, and that the same applied to information provided by others with respect to the transactions I was aware of. It was becoming clear to me that the SEC's theory of the case was driven by a narrative from the external auditors.

The auditors were in a tough situation with the SEC and PCAOB at the time the company announced the restatement in November 2015. Two months earlier the SEC had charged the audit firm and five partners with respect to an audit



of another public company. It was in October 2015 that the PCAOB selected the firm's 2014 audit of Osiris for inspection.

This was the inspection I referenced earlier, where the audit performance was determined to have been a failure. In fact, the firm failed 74% of its PCAOB-inspected 2014 audits in 2015.

Given the issues the audit firm was having with the PCAOB and the types of questions the SEC was asking me, I became even more certain that the firm was throwing the company, and me, under the bus.

Wells Notice, SEC Lawsuit, New Law Firm

In early September 2017 my attorney informed me that he'd received a Wells Notice announcing the SEC's intention to charge me with fraud in a federal lawsuit. We had 60 days to file a response.

To say I was shocked would be an understatement. The allegations seemed as if they'd been dictated by the external auditor's engagement partner. I was certain that our response letter would put all of this nonsense to rest, because I knew there were numerous emails, documents, and individuals that could prove each allegation was wrong.

Responding to a Wells Notice is a nightmare for the target. It consists of sitting in a conference room with attorneys for countless hours, dissecting each line of the letter and formulating a response to each allegation.

My attorneys requested access to my Osiris email and documents from the company and the SEC. The company refused to provide anything, severely limiting my ability to defend myself. The SEC agreed to provide a limited set of emails, obtained from the company under its subpoena, that it had determined were relevant to my defense.

"On November 1, 2017, my attorney informed me that the SEC would be filing a lawsuit against me the next day. As you can imagine, I started to wildly consider all of the potential ramifications."

A few attorneys went through every one of those emails and found one after another that refuted the SEC's claims. Specifically, emails documented that information had been provided to the external audit firm that the Wells Notice alleged had not been not provided. We sent our response to the SEC and waited.

On November 1, 2017, my attorney informed me that the SEC would be filing a lawsuit against me the next day. As you can imagine, I started to wildly consider all of the potential ramifications.

The case, called *Securities and Exchange Commission v. Philip R. Jacoby, et al., Civil Action No. 17-cv-03230-CCB*, was filed in U.S. District Court for the District of Maryland. The SEC sent out a press release that described in inflammatory language why it had sued the company and four of its former executives.

It was at this point that I found out the company had already settled and paid a $1.5 million fine to the SEC. It was free to move on. I also found out that the CFO I replaced had been indicted and pled guilty to providing the external auditors with falsified documents.

As a result of the lawsuit, the following week I lost a consulting position. Soon thereafter, an investment firm closed my brokerage account. A couple of months later, another investment firm did the same. The recruiters that had been contacting me weekly about CFO positions stopped calling.

Some people in my professional network became difficult to reach. People in the finance and accounting ecosystem that knew me socially acted measurably different around me even while never mentioning what was all over the newspapers, financial sites, blogs, and message boards.

The most difficult thing for me was having to explain to my wife, children, and parents what had occurred. They all knew me to be an honest, ethical person, and fortunately they all believed me when I told them that all of the allegations were untrue. They stood by me, and my true friends did as well, but my world had suddenly become very small.

In February 2018 I decided to speak with other defense attorneys. Enough of them thought the SEC's case against me was meritless. The most common phases I heard were "complete garbage" and "weak tea." I retained the law firm of Zuckerman Spaeder.

The SEC's Case Blows Up

Any entity filing a federal lawsuit must turn over all of its collected evidence in a process called discovery. That's why most entities that file such cases have a high level of expectation that they'll prevail.

The SEC is unique in this regard because the individuals in the enforcement division that conduct investigations and bring lawsuits do not try the case in court. The case is taken over by SEC trial attorneys.

My lead attorney was Aitan Goelman, a former SDNY Assistant U.S. Attorney and a former director of enforcement at the U.S. Commodities Futures Board. He assembled a team of attorneys to request and review documents from the SEC, Osiris, and Osiris' former external auditors. During the document review, I started hearing from Aitan that his team was finding more and more exculpatory evidence.

The discovery also yielded some troubling evidence about behavior by others at the company, most of which I was seeing for the first time. Some of this evidence indicated that what I had thought were legitimate documents or honest errors may have been intentional acts of fraud.

We also found exculpatory evidence in subpoenaed personal text messages and emails between parties affiliated with the company. There were texts to the effect of, "don't respond to Greg's questioning about this transaction until we talk." There were emails with attached documents that the meta data in the files showed were created weeks after they purportedly were created.

"There were texts to the effect of, 'don't respond to Greg's questioning about this transaction until we talk.'"

My attorneys also found critical inconsistencies in external auditors' emails and workpapers that directly refuted the SEC's allegations that the auditors hadn't been told certain things.

It should have been obvious to the SEC that if there was something nefarious going on, it certainly didn't involve me. In fact, the SEC knew from documents in their possession that I was constantly challenging things I was told or provided with. The fact that we found all of these exculpatory items means that either the SEC never looked at them, or worse, they found them and chose to ignore them.

From February 2018 until December 2018 we focused on reviewing documents to prepare to depose various parties. The depositions occurred from December 2018 through September 2019. Without exception, the deposed parties testified to my ethical behavior and the very black-and-white, conservative view of revenue accounting I practiced. Many of them refuted the SEC allegations about the external auditors being unaware of certain items.

One of the most basic things the SEC got wrong was an allegation that I had told the auditors the company was experiencing receivable collections issues because it had lost its collections employee. In fact, the company had never employed a collections person until I retained a contractor for that purpose in September 2015. The allegation, so easily refuted, nonetheless was featured prominently in the complaint as an example of a lie that I told to the auditors.

In depositions, several parties critical to the SEC's case testified that they either had not met or spoken to me, didn't know I existed, or that I could not have divined that a critical report they had provided was incorrectly used for reporting revenue before I became CFO. My attorneys began to wonder why I wasn't immediately dismissed as a defendant in the lawsuit.

In July 2019, the external audit firm partner was deposed. One of my attorneys, Paula Junghans, a former Acting Attorney General of the DOJ's tax division and an expert in deposing individuals in financial and accounting matters, handled the deposition. The partner was confronted with a number of items over two days of deposition that made it very clear that my version of events was the truth.

Throughout the deposition, the attorneys representing the audit firm and its partner claimed "PCAOB privilege" regarding their conversations and documents with the board. In effect since the board was created by the Sarbanes-Oxley Act in 2002, it ensures that communication between the PCAOB and audit firms during a PCAOB inspection remains confidential. I had never heard of it. I was shocked to learn that a large CPA firm would be allowed to hide behind this.

Based on my defense's contention that the audit firm had potentially exculpatory evidence that was being shielded through the invocation of PCAOB privilege, my attorneys filed a motion to compel the testimony we were seeking. The audit firm's attorneys filed counter motions to block our motion.

One of the next people deposed was the person who had created the false sale documentation. He had been given immunity from criminal prosecution in exchange for testifying against the company executives that were later sued by the SEC.

After testifying with immunity in front of a grand jury in the criminal case, this individual repeatedly invoked the Fifth Amendment when deposed during discovery in the SEC's civil case. Later, two of my co-defendants took the Fifth as well. My predecessor as CFO was the only defendant that gave testimony without taking the Fifth during his deposition.

At this point, the SEC had finally heard enough. A week before I was scheduled to give my deposition, it was canceled. I was the only defendant that wasn't deposed during the discovery process.

Voluntary Dismissal

Immediately after the audit firm partner's deposition, the SEC trial team hinted to my legal team that they had serious concerns about why I was included in the lawsuit. Two months later, they filed the dismissal.

It took 690 days, from November 2, 2017 to September 23, 2019, for the SEC to admit it had mistakenly included me in its lawsuit. It didn't issue a press release announcing the dismissal. The original press release announcing the lawsuit remains on the SEC's website with no notation regarding the dismissal.

To date, there have been no public announcements of any investigations or sanctions against the external audit partner or firm concerning things that came out about them during discovery. The former Osiris senior staff member that was given immunity and later took the Fifth is employed as a vice president of another public company.

One of my co-defendants settled with the SEC and paid a $40,000 fine. As of the time I wrote this article in January 2020, the case against two of the four original defendants continued. The motion concerning the issue of PCAOB privilege

Continued on page 48

Nailing the Number

The stakes are high when forecasting sales revenue. Here's how CFOs are inching closer to producing reliable targets. By Ramona Dzinkowski

Next-level technologies like artificial intelligence and machine learning, coupled with access to big data, have given the chief financial officer superpowers. The problem: many CFOs are not using them.

Real-time data analytics allow finance teams to gain deeper knowledge of operations, risks, sources of efficiencies, and potential new business models, to name a few benefits. But in terms of forecasting sales revenue, perhaps the most important number in financial planning and analysis (FP&A), finance chiefs aren't always leveraging the data and technology they have.

Traditionally, sales revenue forecasting has been a highly manual process. Explains Philip Peck, vice president of advisory services and finance transformation at Peloton, the streaming fitness class provider: "People gather, compile, and manipulate data often within an array of fragmented working Excel spreadsheets and workbooks. Data comes from many disconnected source systems."

With more and more data available, revenue forecasting this way becomes unwieldy and time-consuming. "The power of the analytics platforms, the power of the datasets, and the tools that we now have to crunch that information have the potential to produce a revenue forecast that is dramatically better than not too long ago," says Peck.

Indeed, 74% of companies surveyed by Aberdeen Research in 2018 produced more accurate forecasts as a result of using sales planning analytics. Survey respondents using planning analytics also had a higher percentage of sales reps meeting quota and a higher percentage of opportunities won.

A significant number of organizations have developed unsophisticated forecasting habits. The Duke University/*CFO* Global Business Outlook Survey in the fourth quarter of 2019 found that for almost half (48%) of global respondents, future planning relies heavily on recent historical performance. Only one in five used internal models to forecast sales. And roughly twice as many companies took a bottom-up approach (i.e., a sum of divisional forecasts) rather than a sales outlook that originated from top management.

The problem with relying solely on a bottom-up approach, explains Peck, is that while the CFO has to sign off on the enterprise-wide numbers, he or she doesn't necessarily have good visibility into all of the forecast's underlying assumptions.

"Starting from the lowest level of granularity, the forecast could go through multiple iterations; there could be elements of conservatism or perhaps optimism throughout all the different cycles; and the CFO may have to put a lot of judgment into what may not have been a well-integrated, end-to-end process," Peck says.

A top-down approach can give management a broader picture of revenue potential and help it identify sales patterns. Of course, there are downsides to topdown: a bottom-up approach enlists the participation of employees and managers in the process. That can instill a greater sense of the importance of meeting targets and force wiser spending decisions.

High Impact

Why is sales forecasting so important these days? When sales forecasts miss their mark, the consequences are far-reaching. The December Duke/*CFO* Outlook survey found that when global organizations bungle sales forecasts, about 40% adjust their hiring plans. More than a third of finance executives responding (36%) said they revise spending on inventory and advertising, and 25% said they alter investment plans or production schedules. (See "Hard Target," page 42.)

"We see some significant implications when sales forecasts aren't met," says John Graham, a finance professor at Duke's Fuqua School of Business. "This says to me that as companies continue to adopt advanced analytics and other leading-edge technologies, we're likely to see finance play a bigger role than what the current data suggests."

For the finance chief, it will mean working more closely with the sales organization. Today, says Peloton's

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Peck, companies are elevating the role of the CFO and the finance team in support of revenue forecasting. The era of hype and aspiration for what new technologies and big data can achieve is ending; it's now the era of putting in place legitimate execution plans.

"As these plans pan out," he adds, "we'll see far more collaboration in a constructive and aligned way between the CFO, the finance team, and sales and marketing."

Going Further

In some organizations, sales forecasts are so crucial that the finance chief will take steps to increase ownership of the process.

At Tente Casters North America, a division of a German manufacturing conglomerate, CFO Pierce Kohls took over responsibility for the company's customer relationship management (CRM) system. That meant, among other things, ensuring the CRM was properly populated and overseeing the analysis of the data. The move was prompted by the need to tighten the company's long-run sales forecasts and better capitalize on customer insights.

Tente's one-to-three-month sales forecast was fairly accurate, as is true for most companies that operate on a made-to-order sales process, explains Kohls. However, "once you're looking at the six-month range and further out, that's where the challenges are; that's where sales forecasting becomes even more important; and that's where the true value of understanding the data comes into play."

Kohls' rationale for taking charge of the CRM was, first, his FP&A background, and, second, the changing nature of Tente's business.

"I think finance professionals are more data-driven as a rule, and that was kind of my argument as to why I felt I should take over the CRM," Kohls says. "I recognized the value of data and what

"We really need an early warning system, because 10% or 20% plus-or-minus could have a major impact on the decisions we need to make."

—Mark Schoolcraft, CFO, Midwest Industrial Supply

it brought to the table." By that, Kohls says, he means not just recognizing that the company had large amounts of data but being able to identify key insights and translating those into actions.

For Tente, those insights were critical—like for many other manufacturing companies, forecasting errors have broad implications. "If you overestimate you end up with a lot of inventory sitting around, and that's a big problem. Sitting on inventory means tying up a lot of capital that you could be investing in other areas of the business." If you underestimate sales, on the other hand, "you run out of stock and run the risk of your customers going to your competitors."

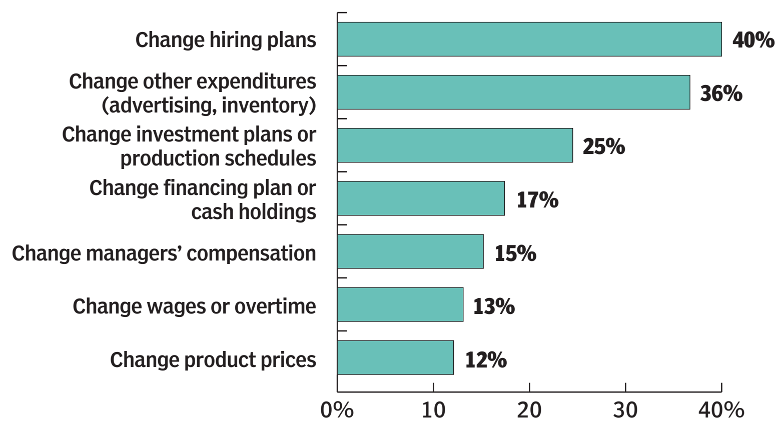
Taking over the CRM also made sense to Kohls because the nature of Tente's business was changing, requiring more involvement from the CFO in the sales process. The company has gone from being just a commodity provider to more of a solution-based seller. That means more questions from sales managers that have to be deferred to the CFO. High-value custom sales opportunities, in addition, mean capital investment Kohls says.

Kohls' heavy involvement meant a shift in the dynamic between the sales team and finance. But the overall result was well received, Kohls says. "The sales team actually liked my increased involvement in the sales process because they could get answers a lot quicker, potentially shortening the sales cycle."

However, Kohls emphasizes, collaboration was crucial. He took the trouble to marry the insights he gained from his business intelligence tool (which is connected to the CRM and Tente's enterprise resource planning system) with those he collected from sales in the field. "It's not just about

Hard Target

What do companies do when sales forecasts miss the mark?



More than one choice allowed

Source: Duke University/*CFO* Global Business Outlook, December 2019, survey of 883 global finance executives.

Photo courtesy of the company

the CFO having access to the data and making forecasting decisions in an ivory tower," he says.

The best approaches to forecasting combine the qualitative and quantitative, he says. "I get information from my salespeople in their territories and combine it with the insights I generate through [Microsoft] Power BI." Kohls is also a big supporter of data democratization, which basically means providing wide access to the data.

"I want us all looking at the same data, the same metrics. I want us all analyzing the same things," he says. "As a CFO, you have to actually show the sales team so they can trust the data."

Beyond Control

Analytics isn't a silver bullet, of course—the right inputs are crucial. Improving the analytics and the data behind the sales forecast has been driving the agenda for Mark Schoolcraft, CFO at Midwest Industrial Supply, a privately held provider of de-icing, erosion, dust control, and soil stabilization services. Its customers include mining, construction, iron and steel, and mass transit providers.

With revenues originating in a number of diverse markets, Midwest Industrial has come to rely on predictive analytics to inform its business decisions. One reason: performance often depends to a large degree on factors beyond the company's control, like weather, commodity prices, raw materials demand, and tariffs, all of which impact industrial production. It's essential that Midwest has the capability to factor those variables into its forecasts.

Midwest Industrial has a fairly robust forecasting platform for all its business units due to the potential downside risk associated with forecasting errors.

"In a company like ours, with high growth and big capital outlays for heavy equipment, it's important to get a good read on where we're growing and what the growth trajectory is," Schoolcraft says. The organization needs to keep a very close watch on whether it has the resources to meet the demand. "We really need an early warning system, because 10% or 20% plus-or-minus could have a major impact on the decisions we need to make," he says.

Midwest Industrial uses different forecasting methods for each business unit, combining historical data and linear regression models with predictive analytics. "The complexity comes in with the impact of independent variables, impacts that perhaps history won't tell us—like how future commodity prices will translate into sales," he says.

Midwest uses Microsoft's Power BI also, which allows it to draw from various databases. The company made the recent decision to weave data from AccuWeather into its sales, dispatch, and ERP systems. It did so because weather events hit Midwest Industrial hard last year. "It never rains in southern California, right? Well, guess what? Last year they had torrential rains," remembers Schoolcraft. "We learned a lot from that and decided to add the weather forecast component into the planning system."

While bad weather doesn't really cancel projects, it moves them around and can have an impact on quarter-to-quarter numbers, Schoolcraft explains. "Before, the company would keep its fingers crossed that it was going to be sunny and bright."

"Fingers crossed" is not the best way to do sales forecasting. While luck may still play a role in business performance, access to better data and tools should give companies a fighting chance of producing sales projections that lead to greater capital efficiency and informed plans for growth. CFO

Transforming Sales Forecasting

A checklist for embracing predictive algorithmic methods and other components to improve sales forecasting *(courtesy of Philip Peck of Peleton).*

- Establish a clear set of overarching goals and objectives.
- Determine what success looks like for you and your organization.
- Embark on a "current state" capabilities assessment that covers the enabling technologies you have or don't have.
- Identify and prioritize the key initiatives enabling the vision.
- Establish a roadmap for the business process, technology, and people changes needed to progress towards the desired end-state.
- Determine if the culture is ready for change.
- Come back to the vision and clearly articulate the importance of the forecasting improvements including the positive impact on operational and financial performance.
- Don't boil the ocean. In other words, don't try to leap-frog into the future too fast. Evolve and enhance capabilities over time.

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Duke University/*CFO* Survey Results

Guardedly Optimistic

CFO are preserving cash in anticipation of turbulent times ahead. But some are also more sanguine than they were in the fall of 2019. By Vincent Ryan

Fifty-six percent of U.S. companies were taking steps to prepare for a recession last quarter, according to the Duke University/*CFO* Global Business Outlook survey, and they expected that recession to coincide with the 2020 presidential election. But they were also more positive about the U.S. economy than they were in the previous quarter.

While those results from December 2019 might seem contradictory, they are actually not. It's typical of CFOs to be highly attuned to worst-case scenarios; indeed, it's prudent. And, lo and behold, the short-term optimism, in hindsight, appears prescient. In late January, talk of an imminent, full-blown recession among economists and market watchers had died down.

However, no one is suggesting that 2020 will see economic activity on par with the leadup to the Great Recession, or the near-3% growth two years ago. The International Monetary Fund projects U.S. gross domestic product will dip to 2.0% in 2020 and fall again to 1.7% in 2021.

That's one reason why CFOs find it hard to put recession out of their minds. Slightly more than half of the more than 400 U.S. CFOs surveyed still expected a recession by the end of 2020. About 75% believed a recession would hit by mid-2021.

"I'd expect uncertainty about the election itself to cause firms to slow expansion in the summer and fall of 2020."

—John Graham, professor, Duke's Fuqua School of Business

"Business leaders continue to expect an economic slowdown in the U.S. before or concurrent with the presidential election," said John Graham, a finance professor at Duke University's Fuqua School of Business and director of the Duke/*CFO* survey. "I'd expect uncertainty about the election itself to cause firms to slow expansion in the summer and fall of 2020."

Indeed, economic uncertainty was second only to "difficulty hiring and retaining qualified employees" as the top worry among U.S. finance chiefs polled in December. (Other top concerns, in order of frequency of mention, were data security, the cost of benefits, and government policies.)

Economic uncertainty was also a major concern among finance chiefs around the globe. Nearly 70% of Latin American CFOs listed uncertainty as a top concern, as did 58% in Asia and 51% in Europe.

Many executives in developing countries were troubled by currency risk and government policies, while executives in Europe fretted about regulation.

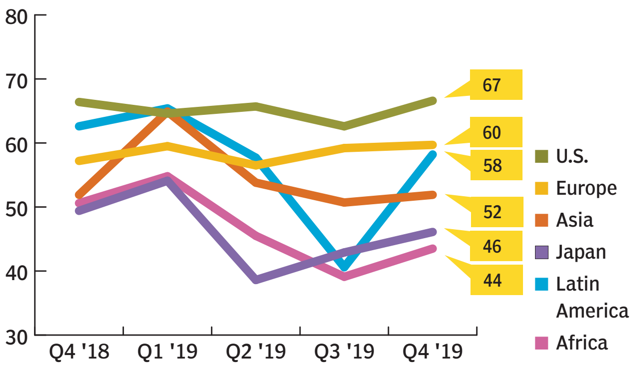
Precautionary Measures

Among the U.S. companies bracing for a recession, 59% said they were fortifying their balance sheets, 58% reducing costs, 49% increasing liquidity, and 31% scaling back or delaying investment.

"During the last recession, CFOs could genuinely say that their lack of planning was a result of a sharp downturn that was a surprise to most," said Campbell Harvey, a

Latin America Sees Biggest Boost in Economic Optimism

Finance executives rate their optimism about their domestic or regional economy*



*On a scale of 0–100, with 0 being least optimistic

founding director of the survey and finance professor at Fuqua.

"However, [in the future] it would be foolhardy to claim that the recession in 2020 or 2021 was a surprise. Although recessions are not controlled by CFOs, the impact on their firms is, to a large degree, managed by the CFO. This time around, CFOs will be judged by their preparations."

One of those preparations, crucial in the last downturn, is preserving liquidity and spending power should a recession actually take hold and tighten borrowing markets. Fifty-four percent of U.S. firms indicated they were unlikely to spend their cash holdings this year. "Hoarding cash and reducing debt are the most obvious tactics to dull the blow of a recession," Harvey said.

52%

of U.S. CFOs believe the United States will be in an economic recession by the end of 2020, and 76% predict a recession by mid-2021.

Other popular anticipatory moves chosen by finance executives in the survey included scaling back or delaying hiring and formulating contingency plans to deal with a recession's onset. Steps taken by individual finance chiefs were "increasing quality of invested assets," "deferring expansion," "minimizing fixed income investment," and "increased conversations with suppliers and customers."

Still Confident

Even with U.S. CFOs mindful of a coming economic contraction, they continued to lead the world in optimism about the general business environment. The U.S. CFO optimism index, historically an accurate predictor of hiring and GDP growth, registered 67 on a scale of 0 to 100 in the fourth quarter. That represented a 4-percentage-point increase over the third quarter and the highest level the optimism index hit all year.

The percentage of U.S. CFOs who said they were more optimistic about the economy than three months prior climbed to 28%, up from 12% in the third quarter. U.S. CFOs were also bullish on their own companies, with the own-company-optimism index reaching 75, a yearlong apex.

Globally, CFO sentiment about the timing and prospects of a recession was mostly in sync. Seventy-nine percent of CFOs in Asia indicated their countries would be in recession by the fourth quarter of 2020, as did the majority of CFOs in Africa (77%), Canada (67%) and Latin America (55%). Forty-nine percent of CFOs in Europe expected a recession, but not until the end of 2020.

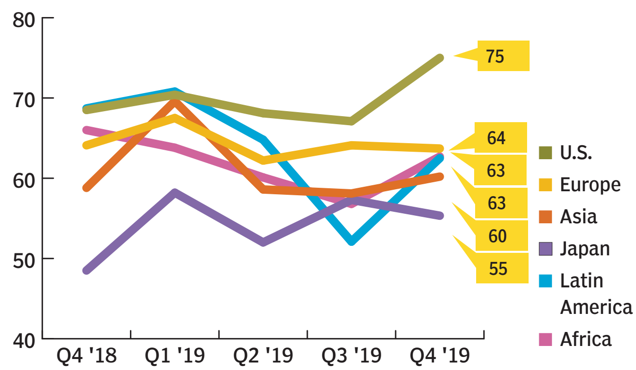
Optimism, however, stayed near level or increased. The CFO optimism index fell in the fourth quarter in Canada (56), but rose slightly in Europe (60), Latin America (58), Asia (52), Japan (46), and Africa (44).

Searching for alternate explanations for the lingering global economic confidence brings to mind a Winston Churchill pearl: "A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty." Perhaps some CFOs are also getting ready to, unlike the last recession, capitalize on others' pullbacks during economic gloom.

The Duke/*CFO* Business Outlook survey has been conducted for 95 consecutive quarters and spans the globe, making it the world's longest-running and most comprehensive research on senior finance executives. The December 2019 survey polled more than 800 finance executives worldwide. CFO

Company Confidence Jumps in U.S.

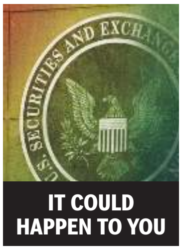
Finance executives rate their optimism about their own companies' financial prospects*



*On a scale of 0–100, with 0 being least optimistic

Source for all charts: Duke University/*CFO* Magazine Global Business Outlook Survey of finance and corporate executives. The survey concluded Dec. 6 and generated responses from more than 800 CFOs, including nearly 500 from North America, 87 from Asia, 87 from Europe, 139 from Latin America, and 40 from Africa.

Getty Images



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still hasn't been decided.

The final tab for my legal fees, paid by Osiris because it had indemnified me, approached $2 million.

How Do I Get My Reputation Back?

The SEC did issue a press release about a month after I was dismissed from the case. It was titled "SEC Obtains Final Judgment Against Former Executive Charged with Lying to Auditors." My dismissal was mentioned in the second sentence of the fourth paragraph, with no context.

It is beyond unconscionable that the SEC would make an error of this magnitude and not issue a release announcing that the case against me had been dismissed and the reason for the dismissal. The commission was very quick to ruin my reputation but did not take responsibility for this life-altering error.

The federal government should be better than this. They could have at least offered an off-the-record apology from the enforcement staff investigators.

My loss of earnings, spent savings, and impact on future earnings this lawsuit cost me have been significant. I cannot sue or otherwise recover any of this from the SEC or the SEC employees that knew or should have known that I shouldn't have been included in the lawsuit. Sadly, the SEC doesn't hold itself to the same exacting standards it holds company executives to.

Since I was dismissed from the lawsuit, I've been able to write and speak publicly about my experience.

I have learned that when defendants settle cases with the SEC, they're routinely required to sign a nondisclosure agreement precluding them from ever discussing the case. Attorneys I have spoken with have told me innocent defendants that settle for the sake of expedience find themselves unable to restore their reputation, with the SEC's version of events being the only public record.

This has become such a contentious issue that in January 2019 the Cato Institute sued the SEC in federal court, challenging the constitutionality of the commission's routine gag orders of defendants in SEC-filed lawsuits.

By comparison to these former defendants, I'm actually somewhat fortunate. I was dismissed from the case in 690 days, while many of these cases go on for five years. I'm doing consulting work while word gets around that the SEC's case against me was completely false. After my experience, I have to wonder how many other cases like mine there have been, as more people reach out to me to share similar stories.

10 Takeaways for CFOs

Here's some advice for staying out of the Securities and Exchange Commission's line of fire and, if you do become ensnared in an investigation, what to watch out for.

1. This should go without saying: always be ethical and talk about ethics to your staff, peers, and company partners. They'll be deposed if there is an SEC investigation or lawsuit. They need to be crystal clear about where you stand on doing the right thing.

2. Use an audit firm that has a reputation of standing behind its audit opinions. Big Four firms generally do that when inspected by the Public Company Accounting Oversight Board. For smaller firms, get references and find out how they've responded to difficult situations. Outside counsel may be a good source of this information.

3. Trust no one, verify everything, and document everything in (near) real-time. Respond to all emails that discuss accounting or internal control matters. Wrongdoers will try to blame their actions on finance and accounting folks. Act accordingly!

4. When joining a company, search the background of all fellow executives and their direct reports. You never know what you may find out about them on the ninth page of search results.

5. Find a great white-collar defense lawyer before you need one and make sure he or she doesn't regularly represent audit firms. If something seems wrong with the attorney representing you, talk to other attorneys.

6. Make sure the company charter indemnifies your legal fees and the company's director and officer liability insurance is sufficient. Legal fees could bankrupt you.

7. The SEC might pursue you even if it knows or should know you didn't do anything wrong. The concept of innocent until proven guilty doesn't exist. You have to prove your innocence.

8. Investment firms may close your accounts. Professional relationships may be tested. LinkedIn contacts may drop you. Recruiters may stop sending potential jobs to consider.

9. There's a perverse incentive for lower-level individuals to color their stories to implicate a "bigger fish" so the SEC can take down a CxO. The SEC seems to relish issuing press releases about top executives and may push people to say an exec pressured them to do something. Your reputation and actions better be unimpeachable.

10. A company's internal investigation is there to protect the board and the company, often at executives' expense. Outside counsel tends to advise companies to settle quickly, leaving executives to fend for themselves. | **G.L.**