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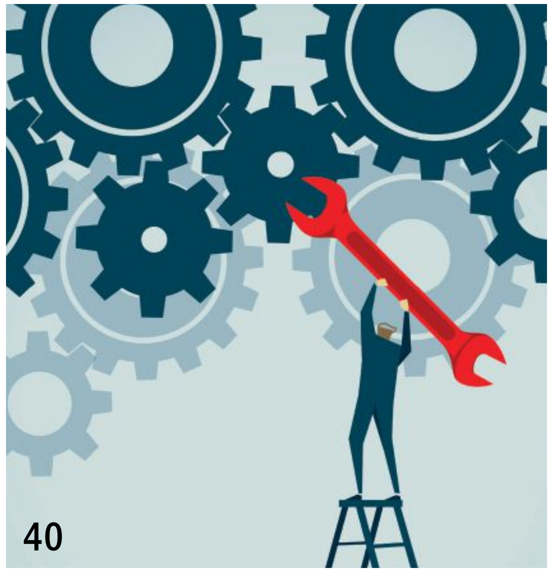
Switching Industries:

What it takes to make the jump


RETIREMENT
AND MORE.
EMPHASIS
ON MORE.

IN THIS ISSUE

October 2018
Volume 34, No. 5



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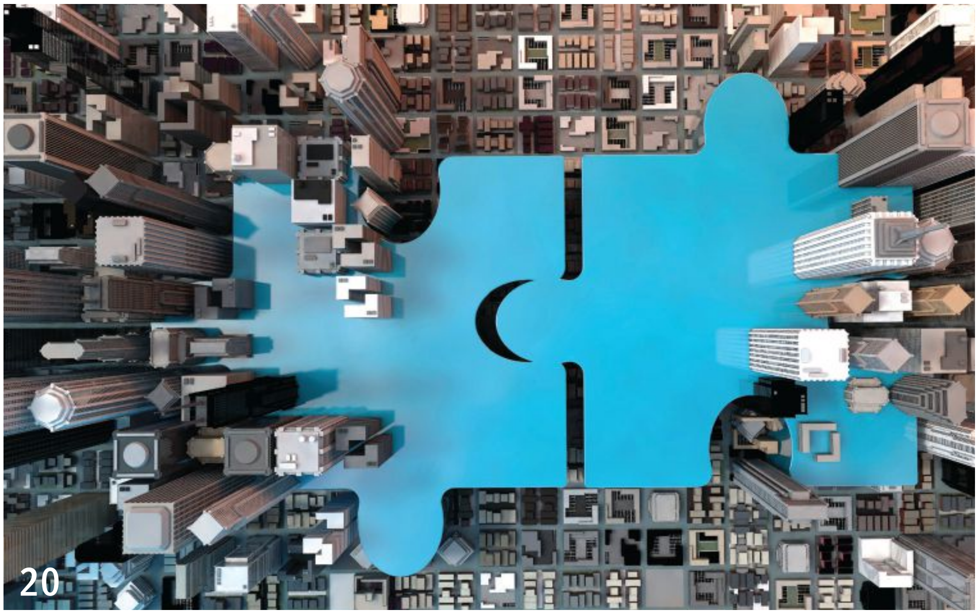

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FROM THE EDITOR

Lack of Accountability

Reading CFO.com, I'm sure it has been hard for our audience to avoid the tales of public accounting missteps that have been detailed in lawsuits and regulatory actions the past two years. ¶ In "defending" themselves, the Big Four usually trot out a familiar excuse: Auditors provide a written report that contains an opinion about whether a company's financial statements are fairly stated and comply with GAAP. The audit's goal under professional standards is "reasonable assurance"—not absolute assurance—that financials are free of material misstatements. Therefore, a properly planned and performed audit may not detect a material misstatement resulting from error or fraud.

Here's the problem with that: not all of the rules and standards violations by auditors are the result of a CFO or a CEO or an audit committee trying to pull the wool over the auditor's eyes. Some of them are purely the result of the audit firm's or partner's laxity or apathy. Is the assigning of engagement personnel with absolutely no technology industry experience to audit a software company's revenue recognition practices the fault of the issuer?

From the seat of an observer, it seems pretty clear that some public accounting firms are, in some engagements, rubber-stamping financials or failing to exercise any professional skepticism. And that may be happening because:

- Auditors are still too chummy with their clients
- The auditing market is highly concentrated in the hands of the Big Four
- A good framework for accountability for auditors, one that would deter bad auditing practices, doesn't exist

Don't misread me; the PCAOB has done a tremendous job the last few years holding auditors to task. But something more is needed. A cap on the number of issuers a firm can audit? More prohibitions on client-auditor relationships? A higher standard of legal and financial accountability for auditors? One of those things, perhaps all three.

No one wants another Enron. Nor would it be constructive to eviscerate the Big Four. But it's time to turn our eyes once again toward the gatekeepers of the public securities markets.

Vincent Ryan
Editor-in-Chief

CFO, Vol. 34, No. 5 (ISSN 8756-7113) is published six times a year and distributed to qualified chief financial officers by CFO Publishing LLC, 50 Broad St., 1st Floor, New York, NY 10004 **(editorial office).** Periodicals postage paid at New York, NY, and additional mailing offices. **POSTMASTER:** Send address changes to **CFO,** 50 Broad Street, 1st Floor, New York, NY 10004. ***CFO*** is a registered trademark of CFO Publishing LLC. **SUBSCRIBER SERVICES:** To subscribe to *CFO* magazine, visit **www.cfo.com/subscribe;** to update your address or cancel a subscription, please email subscription@cfo.com. To order back issues, email subscription@cfo.com. Back issues are $15 per copy, prepaid, and VISA/MasterCard orders only. Mailing list: We make a portion of our mailing list available to reputable firms.

EDITOR'S PICKS

FINANCE
New York is the site of the annual **Chief Financial Officer Leadership Forum** on November 28, hosted by Argyle Executive Forum. The speaker lineup includes finance executives from Diageo, Walt Disney, the NFL, Sony Music, and Bed Bath & Beyond. Register on the Argyle Executive Forum website.

LEADERSHIP
Can you learn effective leadership skills from our 16th president? In **"The Leadership Journey of Abraham Lincoln,"** Harvard professor Nancy Koehn writes how Lincoln's experiences can help executives "craft lives of purpose, dignity, and impact." Read more on the McKinsey Quarterly website.

PROFESSIONAL LIFE
"In a rich nation where technological advances allow companies to create more wealth in less time, it seems that employees should have ample hours to spend according to their own will," writes Livia Gershon. In **"Clocking Out,"** she examines the idea of a U.S. economy "built for free time." Read the article on the Longreads website.

Mark Bennington

In **"How to Cut the Fat Without Cutting Staff,"** contributor David Johnson, founder of boutique advisory firm Abraxis Group, noted that "poorly designed or policed expense-reimbursement policies can result in exploding T&E spend."

One reader said the statement "really stood out" to him. "This applies to numerous other expenditures as well," he wrote. "It often happens that a budget is created and then management and employees fail to use it when making a decision on an expenditure."

Another audience member, however, quibbled with the idea that cost cuts in granular areas like T&E will result in meaningfully enhanced economic value.

"Attacking the usual suspects—the things mentioned in the article—won't impact earnings," he wrote. "Politically, **CFOs are rarely in a position to do anything about cost reduction outside their own organization.** Sure, they can carry the CEO's message, but in the end, CFOs are in no position to force anything to happen."

The commenter also contended that reductions in such areas are rarely sustainable—and took another shot at CFOs' game-changing abilities: "It's noble, but of little value to investors. CFOs are much better at dealing with results after the fact than causing results."

In the online version of our article on Nike's risky move to launch an ad campaign featuring controversial former NFL quarterback Colin Kaepernick, veteran marketing executive Peter Horst deemed the campaign was a well-considered risk and likely to pay off.

Sure enough, **Nike sales spiked 31% in the three days after the first ads aired** during the telecast of this year's first regular-season NFL game, compared with the same dates in 2017. Additionally, the company's stock, after dipping the day following the opening game, reversed course and went on to hit several record highs over the next two weeks.

Before those results were known, some readers suggested Nike would pay dearly for the campaign. One opined that it was a "dumb move by Nike," supporting the contention by saying he would now stop buying the company's products. Another said **Nike's brand "will be forever tarnished in the U.S. marketplace."**

A third audience member called Nike's ad campaign an "interesting hypocrisy." He wrote, "If the company is so concerned about social issues and doing the right thing, why are they making their shoes in Third World sweatshops and paying people very little money?"

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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

80%
Proportion of S&P 500 companies that beat mean Q2 EPS estimates*

20%
Projected average earnings growth for Q3

94.7%
Projected Q3 earnings growth for energy sector

16.7
Forward 12-month P/E ratio, as of Sept. 7

7.5%
Projected year-over-year revenue growth for Q3

* All data is for S&P 500 companies in 2018.
Source: FactSet

TOPLINE

RISK MANAGEMENT

Nike Ads Highlight Brand-Value Risks

How bold should companies be on political and social issues?
By David McCann

"The country is divided, and companies are not getting away unscathed."

So says Peter Horst, a longtime chief marketing officer with several large companies, including Capital One and Hershey.

The value of companies' brands is subject to enormous risk in today's social and political climate, says Horst, author of the new book "Marketing in the #FakeNews Era."

The risks stem from an array of sources—for example, being on the receiving end of a Twitter tantrum, consumers angry that a company didn't take a stand on a political issue, or employees opposing a company's dealings with government agencies or political groups.

Among the boldest recent risk-takers is Nike, owner of one of the world's most recognizable brands. In September the company rolled out its ad campaign starring former NFL quarterback Colin Kaepernick.

There was no shortage of subsequent outrage directed at Nike that Kaepernick, who's become far more famous for kneeling during the national anthem than he ever did for his in-game exploits, because he was given such a platform. But Horst considers the move an educated risk that may well pay off.

That's largely because the company's target audience and actual customers are overall younger, more diverse, and more socially liberal than the anti-Kaepernick crowd, which is, very generally, older and preponderantly Caucasian.

"Research says generations Y and Z want to engage with brands whose values match theirs," notes Horst. "Nike didn't just stumble into this without thinking about it. I'm sure they looked at not only who their customers are, but also what the demographic trends are."

There was already a branding trend toward companies taking positions on socially or politically sensitive issues. But the stature of Nike's brand, together with the high-profile nature of the kneeling controversy (and the charges of police brutality toward African-Americans that triggered it), could accelerate the trend.

"The public is looking to corporate America to help solve social problems," Horst observes. "I think examples of companies like Nike taking strong stances on controversial issues will embolden others to take similar actions."

The brand risks inherent in these polarizing times is clearly not just theoretical. For

Getty Images

Starbucks, a manager's inappropriate treatment last April of two African-American customers at a Philadelphia location ignited a global firestorm of outrage when a video of the incident went viral. That cost Starbucks—another iconic brand—millions.

There are also well-intentioned acts that fail to address the nuances and sensitivities of this era. An infamous Pepsi commercial starring Kendall Jenner, in which she stopped an apparent Black Lives Matter protest by opening a soda can, "was a tin-eared, ham-handed approach to a very sensitive and serious issue," according to Horst.

And don't forget employees. Among other recent incidents, Google associates made it clear they wanted the company to stop selling artificial intelligence to the U.S. government.

According to Horst, every organization should think about and articulate their values, even if there are no plans to say anything publicly. "What would they stand up for if suddenly they were called out by President Trump or CNN, or their employees?"

Conducting such a values assessment provides an internal moral compass to guide in-the-moment decision-making by employees.

Peter Horst

Horst points to the incident in which a doctor was dragged bloody and unconscious off a United Airlines plane. The gate agent faced a stressful situation, needing to get the plane out while finding seats for off-duty flight attendants. But "the script didn't provide a good answer," so the agent called the police.

"It's hard to imagine JetBlue in that situation," Horst says. "It has a culture of customer rights and humanity in air travel. Those values would have told an associate in that situation that anything would be better than calling the cops on a customer." CFO

ACCOUNTING

FASB Tackles Hot Disclosure Issues

Defines "materiality" and describes the proper content of notes to financials.

The Financial Accounting Standards Board announced changes aimed at potentially putting to rest some disclosure issues of long-running debate.

One set of changes involved tweaks and additions to FASB's conceptual framework, which identifies the goals and purposes of financial reporting.

First, FASB aimed to improve the effectiveness of disclosures in the notes to financial statements. A new chapter in the conceptual framework explains the information that should be included in the notes. It describes the purpose of notes, what constitutes appropriate content, and general limitations. It also addresses interim reporting disclosure requirements.

Second, the board updated an existing chapter of the conceptual framework to align FASB's definition of "materiality" with other definitions in the financial reporting system. As a result, FASB's materiality concepts will be consistent with the definition used by the Securities and Exchange Commission, the U.S. judicial system, and the auditing standards of the PCAOB and the AICPA.

The U.S. Supreme Court's definition of materiality "generally states that information is material if there is a substantial likelihood that the omitted or misstated item would have been viewed by a reasonable resource provider as having significantly altered the total mix of information," FASB has stated.

Some investors, lawyers, and accountants had contended that establishing a legal standard for materiality would be a too-high bar, resulting in companies not reporting items that were in fact material.

Both changes are part of an effort to tackle "disclosure overload." According to a 2012 study by Ernst & Young, over the two decades prior, the average number of pages in 10-Ks devoted to footnotes and the Management Discussion and Analysis had quadrupled.

FASB also announced two accounting standards updates (ASUs). One involved Topic 820, the disclosure requirements for fair value measurements. The other concerned disclosure requirements for employers that sponsor defined-benefit or other retirement plans.

Russell Golden, FASB chair, said the ASUs "improve fair value and defined-benefit disclosure requirements by removing disclosures that are not cost beneficial" and clarifying and adding others. | VINCENT RYAN

Top: Courtesy the company; Bottom: Getty Images

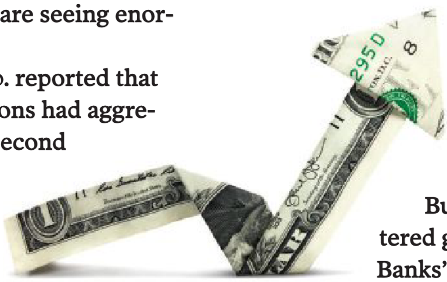
BANKING

Higher Rates Lift Earnings

While U.S. banks continue to complain about being handcuffed by regulations, they are seeing enormous growth in profits.

The Federal Deposit Insurance Corp. reported that commercial banks and savings institutions had aggregate net income of $60.2 billion in the second quarter, up 25% from a year ago.

More than 70% of the 5,542 banks reporting to the FDIC scored year-over-year earnings growth, and the ranks of unprofitable banks shrank to 3.8% from 4.3%.



Higher net interest income and fee income, coupled with a lower effective tax rate, contributed to the increase in the industry's income. The lower federal tax rate gave bank earnings a charge, as the FDIC estimated that at the old effective tax rate net income growth would have been halved.

As the Federal Reserve raises interest rates, the average yield banks are seeing on loans is outpacing the growth in funding costs. The interest income earned on loans rose $134 billion in the second quarter, up about 9% from a year ago. That's the largest annual dollar increase ever reported.

Average net interest margin, which was depressed coming out of the financial crisis, rose again in the quarter, to 3.38% from 3.22% a year ago.

Banks' funding costs are gradually increasing as they are forced to raise deposit rates. The highest rates in the United States on five-year certificates of deposit, for example, cracked 3% this month.

But all major loan categories also registered growth last quarter, up 4.2% from last year. Banks' loan portfolios are also performing relatively well. Noncurrent loans fell by $7.7 billion (6.8%) from the first quarter, led by residential mortgages and commercial and industrial loans.

Net charge-offs, however, rose by $447 million (4%) from 2017. Leading the deterioration were credit cards, which saw a $191 million (13%) increase in charge-offs. | V.R.

TAX

Wanted: Tax Translators

What image of corporate tax officers springs to mind? The erstwhile stereotype of round, rimless glasses peeking out beneath green eyeshades? Or perhaps simply that of an inconspicuous functionary toiling in silence behind the scenes?

The reality is now the opposite, with companies' management teams and boards still trying to grasp the implications of changes to the tax code in 2017's Tax Cuts and Jobs Act, a new white paper contends.

For corporate chief tax officers (CTOs), as has transpired for CFOs over the past decade-plus, the paramount importance of technical skills is starting to fade.

In their stead is the need for strong communication and interpersonal skills that enable CTOs to "translate and distill technical information into business language the C-suite and the board can apply to decision-making," says the paper, from executive recruiting firm Ormsby Park.

Whether some tax officers can adapt to the new demands on their position is debatable. In the words of a CTO anonymously quoted in the paper, "It's a sad statement about tax people, but we like nothing more than complexity. Complexity is opportunity."

In fact, according to the report—which is based on qualitative interviews with 10 large-company chief tax officers and a quantitative survey of 40 others—discomfort with such demands could partly explain a recent increase in retirements among CTOs.

For those who remain and have the mindset and skills required for success, "it promises to be an exhilarating if bumpy ride—a future filled with new challenges," the paper says. It also notes that "it's not easy" to find CTOs with the right skills.

For their part, many CFOs don't want to risk miscommunicating the new tax law to their boards, according to Ormsby Park. | D.M.

Getty Images (2)

CYBERSECURITY

SMBs Carry Greatest Risk

At small businesses, rank-and-file employees may be more aware of the threat from cyber-crime than are company leaders.

It seems so, at least, from a finding in a recent survey of more than 600 full-time employees and 100 C-suite-level leaders at companies with fewer than 500 employees.

In the survey, conducted by Switchfast, an IT consulting and security outsourcer, 35% of the employee group, but a disturbing 51% of the executives, say they are convinced that their business is not a target for cyber-criminals.

Such complacency with respect to cybersecurity is a notable risk, according to Switchfast. In fact, the firm notes in its survey report, small businesses are prime targets for hackers *because* of their size.

Large companies make headlines when cyber-criminals strike. At the same time, they have dedicated IT and security staff to vigilantly do battle with wrongdoers. That makes smaller companies more vulnerable.

"Negligent employees remain the number-one cause of data breaches at small businesses," writes Switchfast. "Seemingly innocent actions, like connecting to a Wi-Fi hotspot in a coffee shop or hotel lobby, can cause [great] damage to a small business."

In fact, hackers notoriously frequent such venues because they know corporate workers are likely to be there and commit such grievous security errors.

In the survey, 66% of the "employees" group, but also 44% of small-business leaders, say they've connected to a public Wi-Fi network to do work.

Poor handling of passwords is another common mistake. For example, writing down email passwords on sticky notes can allow thieves to access otherwise secure accounts.

Also, about 22% of SMB leaders and 19% of employees say they've shared their password with a co-worker. | D.M.

CAREERS

The Bull Market for CFOs

An interesting fact about turnover in the C-suite is that it generally tracks the movements of the S&P 500 Index. That is, when stocks go up, the number of executives leaving or switching jobs does, too. And vice versa.

Accordingly, given this year's bountiful stock returns, the turnover rate among top corporate leaders—CEOs, finance chiefs, and chief operating officers—is on track to reach a 24-year annual high.

The rate is expected to edge past 18% by year-end, against a historical average of 14.4%, according to the latest edition of recruiting firm Crist Kolder's annual Volatility Report. For CFOs, this year's projected turnover rate of 16.6% compares with 15.8% in 2017 and a long-term average of 15.1%.

Overall, it's not a surprising trend. When stock prices climb, executives become likelier to cash in equity awards and then take advantage of the corresponding flexibility to make job or life changes.

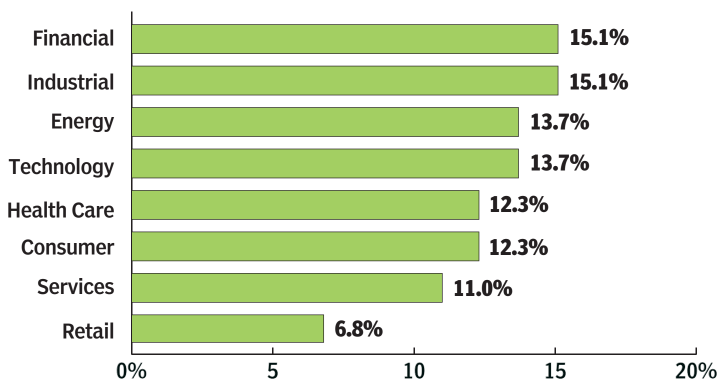
This is Crist Kolder's 15th Volatility Report. It includes data through August 1 on the 673 companies that are in either the Fortune 500 or S&P 500.

Some other tidbits from the report:

- Just 18.5% of sitting CFOs held the title in their immediately previous position.
- The percentage of CEOs who were finance chiefs in their immediately previous position ticked up, to 6.9% from 6.2%.
- The count of female CFOs has reached an all-time high at 12.5%, double the 6.3% recorded in 2004. | D.M.

CFOs on the Move

2018 CFO turnover rate* in Fortune 500 and S&P 500 (673 companies), by industry



*Through Aug. 1
Source: Crist Kolder

TECHNOLOGY

A Cloud Over IT Outsourcing

Information technology departments cut the percentage of their budgets allocated for outsourcing to the lowest level in five years, according to a study by IT management research firm Computer Economics.

The study found that the average outsourcing budget dipped from 11.9% of total IT spending in 2017 to 9.4% in 2018. From 2014 though 2016, the figure had hovered between 10.2% and 10.6%.

Favorable economic conditions are allowing IT leaders to selectively bring outsourced services back in-house, the study's authors wrote. They said the increased use of cloud-based services also pares the need to outsource support of an organization's internal IT infrastructure.

Company size is a big factor in determining outsourcing decisions.

"Large companies are actually increasing their outsourcing this year, while small and midsize companies are cutting back," says David Wagner, vice president of research at Computer Economics.

"Smaller companies are making better use of the cloud and have fewer legacy systems," Wagner adds. "By shedding some of their infrastructure burden, they don't need to reach out to as many specialized service providers. Right now, large companies and smaller companies are on different journeys."

Thirty-five percent of companies outsourced some data-center operations in 2018, down from 41% the year before, the study found. And 37% percent outsourced some IT security, down from 43%. | WILLIAM SPROUSE

Getty Images (2)

REGULATION

SOX Compliance Still Costly

In the early days after the Sarbanes-Oxley Act took effect in 2002, companies expected to struggle for a few years under the added costs and effort required to comply with the law. Then, they believed, the annual exercise would evolve into a relatively stable one.

The first expectation was certainly realized. The second, much less so.

The compliance picture continues to shift year by year, according to management consulting firm Protiviti. Notably, costs continue to rise in response to external changes, such as new laws and regulations, as well as the transitions many companies are undergoing.

"Organizations today are subject to more frequent, significant, and fast-moving changes," Protiviti says in a report on a survey of 1,004 organizations. "These include changes in organizational structures and in processes undergoing digital transformation that, in turn, call for changes in SOX compliance practices."

Another influence on costs is an increase in acquisitions and divestitures. Many associated activities "come with the potential for material changes to a company's SOX compliance work," Protiviti notes.

With respect to internal SOX compliance costs, for large accelerated filers (public float of $700 million or more) the average rose by 17.2% this year compared with 2017, reaching $1.34 million.

But this year's average cost for that group of filers was almost identical to what they experienced in 2016, underscoring the volatile nature of SOX compliance expenses.

The pattern was similar for accelerated filers (public float of at least $75 million and less than $700 million). Their internal costs climbed by 24.3% this year, to an average of $997,000, after having declined by 12.3% last year compared with 2016. | D.M.

HUMAN CAPITAL

Labor Costs to Soar

Organizations worldwide may have to incur more than $2.5 trillion in additional annual labor costs within 12 years as a result of the global shortage of highly skilled workers, according to new research from Korn Ferry.

The United States will face the biggest "wage premium" in 2030, at $531 billion, Korn Ferry says. The term refers to the additional amount employers will need to pay to secure the right talent, above the amount that wages would rise over time due to normal inflation.

But the crisis is not something that's very far off. Even in 2020, the U.S. wage premium is expected to reach $296 billion. By 2025, the gap will total $400 billion, according to the report.

While major economies, including those of Japan and Germany, can expect the highest wage premiums, "smaller markets with limited workforces will feel the most pressure," the report says.

By 2030, Hong Kong and Singapore—small economies with important financial centers—are expected to experience wage premiums equivalent to about 10% of their respective gross domestic products for 2017.

That means highly skilled workers in those two countries will command average wage premiums in 2030 of $40,500 and $29,100, respectively. The corresponding U.S. figure is expected to be only $8,300.

Percentage increases in wage premiums from 2020 to 2030 are forecast to be 169% for technology/media/telecommunications, 161% for financial and business services, and 136% for manufacturing. For the full economy, the figure will be 152%.

But the financial industry may actually face the most dire future.

"Workers already command high salaries, so the additional pressure caused by [labor] shortfalls could push some firms to the brink," says Mark Thomson of Korn Ferry. | D.M.

CYBERSECURITY

Insurance Premiums Increase

Businesses' total cost of risk (TCOR), a measure primarily used by the insurance industry, declined for the fourth year in a row in 2017, according to The Risk Management Society.

Despite record-setting natural catastrophes, the average TCOR was down 3%, RIMS reported.

TCOR—the total cost of insurance premiums, retained (uninsured) losses, and risk-control costs—fell from $10.07 per $1,000 of revenue in 2016 to $9.75 in 2017.

"Market conditions are favorable for insurance buyers," says David Bradford, co-founder and chief strategy officer of insurance data provider Advisen. "A competitive insurance market resulting from a chronic overabundance of risk capital has strongly contributed to TCOR decreasing steadily since 2013."

One area bucking the trend of lower costs, however, is cyber insurance. Over the last six years, the proportion of companies buying such insurance has risen from 35% in 2011 to 65% in 2017.

The average cost of cyber insurance per $1,000 of revenue rose 33% in 2017, to $0.28, up from $0.21 a year earlier. Average insurance premiums per employee increased 9%.

Cyber coverage forms are evolving rapidly, encompassing components such as identity theft as a result of security breaches; costs associated with damage to or breaches of data records; and costs to supply credit-monitoring services for people impacted by a security breach, according to RIMS.

"In the past, common rationalizations for not buying cyber insurance included such things as 'the company does not deal with consumers,' 'the company is too small to be of interest to hackers,' and 'the IT department has everything under control,' " according to RIMS. | V.R

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ACCOUNTING

Keep Quarterly Reporting, Ditch Guidance

The long-term benefits of a switch to semi-annual reporting are doubtful, while its costs would be significant. By Robert J. Pozen and Mark C. Roe

In mid-August, President Donald Trump waded into another complex area by a short tweet. He had apparently asked several top business leaders how to "make business (jobs) even better in the United States." He then directed the Securities and Exchange Commission to study one business leader's reply: "Stop quarterly reporting and go to a six-month system."

Trump's tweet reflected the belief of many executives and commentators that quarterly reporting pushes public companies away from attractive long-term investments. However, the long-term benefits of semi-annual reporting are doubtful, while its costs are significant.

Shifting company reports to every six months does not meet anyone's definition of the long term. An extra three months to announce financial results would not induce U.S. executives to take off the shelf the hypothetical stockpile of long-term, job-creating projects—projects now allegedly stymied by quarterly reporting.

For years, public companies like Amazon achieved large market capitalizations by following long-term strategies, as investors waited patiently. Indeed, most biotechs go public successfully without any history of profits, so investors must be endorsing their plans for completing clinical trials and marketing their drugs.

Company executives who articulate a persuasive, multi-year business plan should not worry much about quarterly reporting. And if they are worried, moving to six-month reports will not help them.

Of course, the SEC could allow each public company to report its financial results with whatever frequency it chooses. However, that would make it very difficult for investors to compare companies in the same industry—a powerful tool for security analysis.

The Evidence

Our position is supported by empirical studies of the United Kingdom and more general studies of capital investment. During the last decade, the United Kingdom twice changed its reporting requirements for public companies. In 2007, the U.K. moved from semi-annual financial reporting to quarterly reporting. Yet, there was no significant fall in capital or R&D expenditures over the next three to six years, according to a CFA Institute Research Foundation study.

Then, in 2013, the U.K. reversed direction. It replaced the quarterly requirement with a semi-annual one. Yet the same study did not find any significant increase in U.K. company spending on capital investment or research after the change.

We recognize that investments in property, plant, and equipment are down throughout the developed world since 1990. But this trend includes those countries that rely more on banks for corporate financing and that have fewer publicly held firms than the United States has. Indeed, America's investment decline is less than that in the rest of the developed world.

"Corporate R&D is not declining, corporate cash is not bleeding out, and the world's developed nations with neither American-style quarterly-oriented stock markets nor aggressive activist investors are investing no more in capital equipment than the U.S.," according to the study. "The economy-wide picture is more one of capital markets moving capital from larger, older firms to smaller, younger ones."

Getty Images

Robert Pozen

Mark Roe

Thus, it's a mistake to blame quarterly stock market reporting for reduced capital spending. Something else is operative—factors such as the movement to capital-light, technology-oriented economies; the rise of Asian manufacturing; and the weakness, until recently, of the economy overall.

While we don't believe that moving to a semi-annual reporting requirement would be beneficial, we do oppose the common practice of quarterly earnings guidance—when companies announce what they expect their earnings will be in the next quarter. Having put their reputations on the line by projecting earnings for the next quarter, some executives then scramble and distort their company's businesses to avoid reporting earning anything less.

But earnings guidance is optional, not required by the SEC, so companies could break this bad habit on their own, without a new or amended SEC rule. Publicly predicting earnings has come under growing criticism, including in an op-ed by Warren Buffett and Jamie Dimon. We note that Buffett and Dimon did not recommend doing away with quarterly reports.

Moving from quarterly to semiannual reporting would also have significant costs. With corporate results disseminated less frequently, stock prices would be less accurate as investors struggled to assess the financial effects of material developments without the company's numbers. Small bits of public information loom larger in stock price valuations when investors are in the dark as to the actual earnings implications of such bits.

Moreover, when the SEC went from a semiannual to quarterly reporting requirement between 1955 and 1970, the cost of equity capital fell for U.S. public companies, according to a definitive empirical study. That result strongly suggests that the investors highly value more frequent reporting because it reduces the risk of buying stocks based on currently available information.

Moreover, if the results of U.S. companies were hidden for longer periods, more people—executives and advisers—would possess nonpublic information. The temptation and potential for insider trading would rise substantially.

A Better Reform

But as any public firm CFO knows, putting together a 10-Q is an arduous task, competing for time and resources that could be better spent elsewhere. While we believe that abolishing quarterly reports is unwise, the SEC should streamline quarterly reports—which now are too dense and long. Companies spend too many hours and dollars putting together what has become a thick tome that repeats too much old information.

For example, the SEC could require full company reports only at the end and middle of the fiscal year. In the other two quarters, company disclosures could be limited to their financial statements plus a concise summary of material developments since the last full report.

In addition, quarterly filings on form 10-Q arrive too late at the SEC—7 to 10 days after a company issues a short press release summarizing its quarterly revenues and earnings. That press release is extensively discussed in an open conference call hosted by management for investors and analysts, who quickly respond to that information.

The SEC should therefore try to integrate those press releases with its quarterly filing requirements. Most investors read these timely summaries and trade on them, rather than the quarterly tomes later filed with the SEC. The appropriate direction is to coordinate the earnings releases with the 10-Qs to cover, in a timely manner, the important information for investors without undue repetition.

"Executives who articulate a persuasive, multi-year business plan should not worry much about quarterly reporting."

Such a reform agenda at the SEC would be more useful than pursuing the pipe dream of increasing long-term investments by shifting from quarterly to semiannual reporting of company results. Six months simply does not constitute the long term. CFO

Robert C. Pozen, the former chairman of MFS Investment Management, is a senior lecturer at the MIT Sloan School of Management. Mark J. Roe is the David Berg professor at Harvard Law School.

Editor's Choice

CHEAPER XBRL

The American Institute of CPAs (AICPA) and XBRL US reported in mid-August that the cost of eXtensible Business Reporting Language (XBRL) formatting for small reporting companies has declined 45% since 2014. Price information given by 1,032 firms showed that 68.6% of them paid $5,500 or less annually for a full-service outsourced solution.

Courtesy the authors

CAPITAL MARKETS

Six Key Steps to a Profitable Spinoff

From higher profits and shareholder returns to tax benefits, a spinoff can generate value on both sides of the transaction. By Tze-Liang Chiam and Lasida Klinsukond

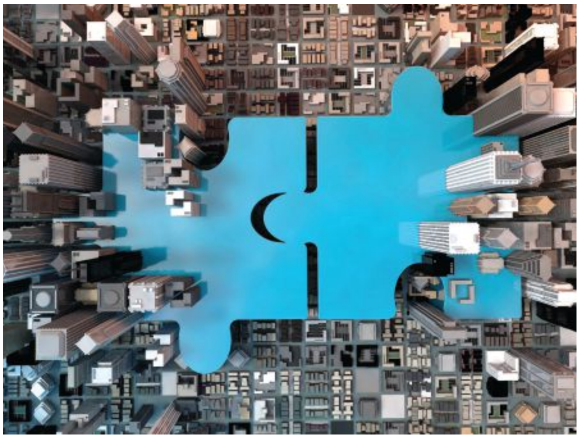
Spinoffs are increasingly used for creating shareholder value as companies more frequently analyze their portfolios and sharpen the focus on their core businesses and assets. ¶ These deals, which involve separating existing businesses through the creation of one or more companies, remain a lesser-used tool for shedding assets than a straight sale. They are also one of the least-understood kinds of M&A transactions.

Still, C-suite leaders are becoming more comfortable with the spinoff as a strategic tool, and with good reason. Companies that were separated through a spinoff generally outperformed the market from 2002 to 2017. That was true of both the spun-off entity (SpinCo) and what remained of the original company (RemainCo).

Additionally, a spinoff can often be accomplished at a reduced tax cost to the existing company and its shareholders when compared with a direct sale of the assets or business. The chart on page 21 shows the total combined shareholder return two years after the transaction for a sample of SpinCos and RemainCos.

However, poor planning ahead of the spinoff and a too-narrow focus on near-term results and market reaction can doom the long-term prospects for separated companies. So, what are the characteristics of successful spins? What steps will help companies succeed in creating long-term value?

Start by creating the right strategic case. The first step is identifying the appropriate assets to spin off and the right time to do it. The rationale for the spinoff needs to be clearly articulated to the markets.



Examples include enhancing focus as businesses reach different stages of maturity; creating a business-appropriate capital structure; or creating a distinct investment profile for both RemainCo and SpinCo. A well-defined strategic case boosts investor confidence when the spinoff is announced. Customers and employees also benefit.

However, a business case goes only so far. An initial-announcement stock "pop" when investors react favorably to the planned spinoff is not correlated with sustainable total shareholder return (TSR). That value comes from having a well-developed long-term plan and executing on it.

Creating Value

Once management and the board are in agreement on the strategic case, there are six key steps companies should take to enhance the probability that the spinoff will be successful.

1. Identify the right leadership mix. In EY's sample of 124 global spinoff transactions from 2002 to 2017, most SpinCos that did well—delivering a total shareholder return one year after the spin that was higher than the parent company's TSR in the same period before the spin—named a candidate from the parent company as either CEO or CFO, or hired internal candidates for both spots.

Those SpinCos that hired both executives from outside were less likely to be successful. It's not unusual to bring in an outsider for one of the positions when looking for new ideas or an executive with a specific skill set, but our research suggests that at least one of the two executives should be very familiar with the company that is being spun off.

2. Get the operating model right. There is a big difference between being a separate public company and being

Getty Images

Tze-Liang Chiam

Lasida Klinsukond

part of a larger entity. SpinCo should be ready to operate as a stand-alone entity before the spin is effective.

But how should the operating model change to support the spin?

Businesses in low-growth industries can work on managing cash and streamlining operations to reduce costs. Businesses in high-growth industries will need more management attention and an operating model to maximize their potential.

Management also needs to question whether the legacy assets are fit for the spinoff's purpose. For example, ERP and other IT systems and applications used by the parent may not be appropriate for SpinCo; more streamlined systems and applications may be required.

Another operations question to ask is if there is a case to be made for redesigning the supply chain or rethinking the go-to-market model. It may not make economic sense to operate in certain countries or markets once the spin becomes effective.

3. Devise a short- and long-term tax strategy. Any spinoff has potential tax implications. As companies develop their operating model, they should also think in terms of (a) the tax implications for the spinoff transaction itself (e.g., will it be taxable or tax-free); and (b) a post-transaction, tax-efficient operating model for both SpinCo and RemainCo.

For example, to make the spinoff tax-free, the tax-structuring team might want to assign different operations to entities in one country. If the operations group decides separately to divest or move those operations to a different country, it could cause the spinoff transaction to be taxable in the initial country or to shareholders.

Further, a move could shift operations from a low-tax jurisdiction to a higher-tax jurisdiction, increasing the cash effective tax rate. Hence, a company needs to understand the tax implications of its operating model design and changes.

4. Prepare people for change. Make sure to have a stakeholder communication plan. It should have clear messages about the rationale for the spinoff, the timeline, and the expected stakeholder value creation for staff, management, customers, and suppliers, as well as investors and the market in general. Communicate objectives clearly, set targets, and delegate and monitor progress.

That means making sure the right people are cleared to make timely decisions for both SpinCo and RemainCo. Also, establish the proper incentives to retain and motivate the management and staff that upper management wants to keep. The needs of the new company may be different from those of the legacy company, so legacy incentives will likely need to be changed.

5. Focus on the new identity. While management tends to focus on short-term operational issues, the long-term success for any spinoff is predicated on the growth case for both SpinCo and RemainCo. This is an opportunity for SpinCo to set its market goals and identity, unfettered by the former parent's go-to-market strategies.

Carefully plan opportunities to grow the business, whether that means new products, increased R&D spending, new markets, new customers, or even acquisitions. The spinoff may also present an opportunity for RemainCo to deploy resources in its own search for growth. After all, part of the reason for the spinoff was to focus management on growing the core business.

6. Act with deliberate speed. EY examined a subset of 54 larger global deals and found correlations between the spin timeline and shareholder returns. Successful spins that generated positive TSRs had a window of 7 to 16 months from announcement to spin. Spins that generated negative TSRs for SpinCo and RemainCo combined tended to take longer, up to 28 months.

Once the decision to spin is announced, companies should develop a timeline to accomplish the various pre-spin tasks, such as defining an operating model, planning the tax structure, preparing carve-out financials, and identifying the market participation model. Then they should stick to that timeline.

The longer the wait, the more time for something internal or external to affect the performance and success of the company to be spun off. Furthermore, investors may run out of patience if companies take too long getting ready to spin.

Executives can efficiently navigate the spinoff process by understanding the operational challenges and planning for the right amount of lead time and the resources needed for the the separation transaction. Planning and preparation will help a company execute a spinoff in a timely manner, achieving the short- and long-term objectives for both SpinCo and RemainCo. CFO

Tze-Liang Chiam is principal, operational transaction services, Ernst & Young. Lasida Klinsukond is manager, operational transaction services, at EY Americas.

Spinoffs Outperform

Well-executed spinoffs can produce robust shareholder returns (for both the spun-off company and the remaining business) within two years.

Total two-year shareholder return (SpinCo + RemainCo)

Bottom quartile	-8.5%
Median	21.7%
Top quartile	45.6%

Source: EY sample of 124 global spinoff transactions from 2002 to 2017.

Courtesy the authors

STRATEGY

Avnet Turns the Page

Financial discipline helps the large semiconductor distributor chart a broad new strategic path after challenging times. By David McCann

Like its longtime rival Arrow Electronics, electronic components distributor Avnet is in the middle of a gritty transformation of its business, driven by fast-changing customer needs. ¶ Making the kind of move that's clearly not for the faint-hearted, in February 2017 Avnet—128th in the most recent Fortune 500 ranking—completed the sale of its technology solutions division. The computer-products distribution business had contributed roughly 40% of the company's revenue.

The sale, together with a handful of acquisitions Avnet has made since 2016, facilitated the company's pursuit of its key new strategies. For one, it has refocused efforts on its traditional core business, the heart of which is distributing semiconductors to manufacturers.

But that's only part of a broader reinvention, similar to one that Arrow (113th in the Fortune ranking) is undertaking as well. The vision, kicked off in Avnet's case by its 2016 acquisitions of U.K.-based Premier Farnell and Hackster.io, is to support customers at every stage of the product lifecycle, from idea creation and prototype design, to manufacturing modeling, product introduction, volume production, and product distribution.

"When Bill Emilio became the CEO about two years ago," says the company's finance chief, Tom Liguori, "he said, 'Listen, there's a big opportunity in this product cycle that we're not taking advantage of—the engineering and new-product introduction side.' So he sold the computer distribution business, and reinvested the proceeds into companies that were specialty distributors to engineers globally."

Financially, Avnet has set a goal of improving its operating margin from 3.5% currently to a range of 4.5% to 5% within three years. "Traditionally Avnet was a high-volume, low-margin business," says Liguori. "Prototype engineering is just the opposite—low volume but very high margin."

How so? For an original equipment manufacturer, time-to-market is crucial. An engineer can go online to Premier Farnell and order one of every item in a bill of materials and receive all of them the next day.

"If I'm the prototype engineer, I'm going to get those items, make the prototype, test it, make revisions, and then tomorrow I'm going to do the same thing," Liguori notes. "And I'm going to keep doing it until I get my design perfected."

Customers similarly interact with Avnet through each stage of the product lifecycle, and the company's transaction-based monetization model is thus designed to drive higher margins. Ultimately, customers may order components for a product in large quantities through Avnet's historical distribution business.

"Traditionally, an OEM's engineer would use one source, and then the company might use another source for product introduction," Liguori notes. "Now we've brought all that together under one house. Once customers—most of ours are in the industrial, automotive, and medical verticals—go into new-product introduction, they're still using Avnet. There's a lot of stickiness."

The future could be bright for semiconductor makers and distributors, given booming demand for wireless internet of things devices and applications. Serving that demand puts Avnet in the business of writing software code and partnering with platform providers like Microsoft and AT&T to deliver connectivity and security.

Avnet's customers—numbering some 2.1 million individual engineers—encompass both large manufacturers and startups. Part of the company's business model is providing online communities that help engineers improve their skills and products.

For example, with the acquisition of Premier Farnell, Avnet gained that company's element14 community, a discussion-based forum where engineers collaborate to solve one another's design challenges. Hackster.io, in another example, offers education on programming and building hardware. Dragon Innovation, a company Avnet acquired last August, allows customers to accelerate their time-to-market by helping them discover fast, simple, and safe ways to manufacture at scale.

Pain Points

It hasn't all been smooth sailing for Avnet, however. Most notably, a botched ERP implementation in 2015 wrought severe consequences.

"It was a big-bang-type implementation—unplug that one, plug in this one," says Liguori, who joined Avnet in January 2018, several months after the former CFO stepped down for health reasons. "Customer-service reps lost a lot of basic things, like the quantities customers ordered and when orders were due."

As a result of subsequent customer defections, Avnet lost about $1 billion in revenue.

There's never a good time to lose a billion dollars of sales. But the problems caused by the ERP mess played out at the same time that new CEO William Amelio, who came aboard in late 2016, was spearheading Avnet's transformation. That included the aforementioned acquisitions and the sale of the computer-distribution business.

The company canceled an investor day scheduled for May 2017 as it continued its efforts to recover from the sales shortfall and refine its messaging about the business transformation.

Making matters worse, when Liguori arrived early in 2018 he discovered that Avnet was not competitive from a working-capital standpoint.

"The first thing we did was a 10-year history of days receivables, days inventory, and payables," the CFO says.

"It will be great to take some money out of our working capital and redeploy it into M&A activities or share buybacks, which offer higher returns."

—Thomas Liguori, CFO, Avnet

"What we saw was that the company used to work with net working capital days in the mid-60s. For many reasons, some valid and some just taking our eye off the ball, we ended up at more than 100 days."

Liguori then set out on a benchmarking effort, working with the company's banks to assess the working capital efficiency of 11 competitors. The finding: the other companies were averaging 52 net working capital days.

In June 2018, at Avnet's first investor day since 2015, the company announced a plan to reach a target of 70 net working capital days within three years. That would free up about $1 billion, according to Liguori. What's the plan to make that happen?

The answer is not forcing customers into shorter payment terms or delaying payments to suppliers. "There are market terms, and we have to assume we're going to do those," Liguori says. "It's more about blocking and tackling. It's about discipline."

For example, improved visibility of inventory in company systems allows procurement to be more efficient.

"Until six months ago, someone in Asia that needed a part for inventory didn't have visibility into whether the Americas or EMEA could provide that part," the CFO says. "We had way too many instances where people were buying parts they didn't have to buy."

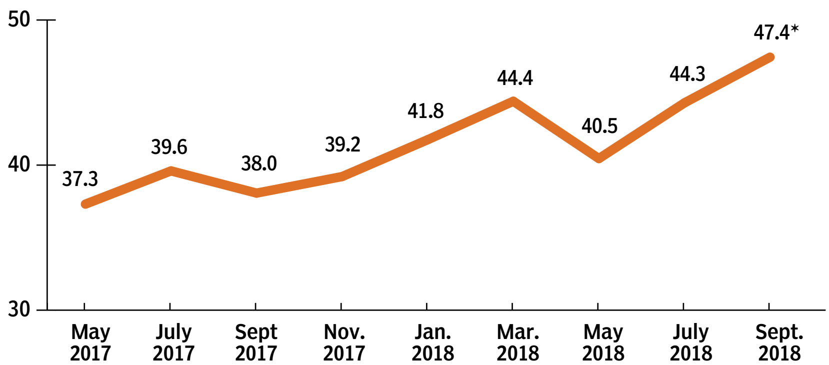
Also, some of the company's messaging around buying protocols was "off," Liguori adds, so procurement people were buying parts the company didn't need at all.

On the receivables side, customers increasingly wanted to pay for purchases using credit cards or PayPal, and Avnet had to do more to accommodate that. "If you can move from giving somebody a 30-day payment term to having them just use their company P-card to pay, you don't have a receivable anymore," Liguori says.

As for payables, Avnet was using many different payment cycles in various regions and countries. In some places vendors were being paid once per month, in others as often as twice

On the Upswing

A new buyback authorization and a 5% dividend increase in August are helping lift Avnet's share price.



* As of September 12, 2018
Source: Nasdaq

Courtesy of the author

a week. Looking at all of the arrangements, the finance team decided that one Avnet unit in Europe had a best practice, which was paying vendors twice per month. That's now become a company-wide standard.

"These are just a few examples," Liguori says. "What I tell investors is that there's no silver bullet that's going to bring our working capital days down where we need them to be. There are going to be many, many examples, and we're going to manage it centrally."

"The good news is that Avnet used to operate with less working capital, and the people we had five years ago are still here today."

Giving Back

Improved working capital was one of three key strategic finance priorities that Avnet outlined at its investor day.

The savings to be generated from the working capital discipline will be useful for capital allocation, which is the focus of another finance priority. "It will be great to take some money out of our working capital and redeploy it into M&A activities or share buybacks, which offer higher returns," Liguori says.

There may be opportunities for some "tuck-in" acquisitions of companies that Avnet partners with, he notes. While there are currently no specific plans,

Vital Signs

Avnet Inc.

HEADQUARTERS: Phoenix, Ariz.
BUSINESS: Distribution of electronic components and embedded solutions
REVENUE: $19 billion
OPERATING INCOME: $545 million
CASH: $621 million
LONG-TERM DEBT: $1.5 billion

Financials as of June 30, 2018

20% of the company's cash flow is to be allocated for that purpose.

Another 20% of cash flow is earmarked for investment in company systems and warehouses.

The rest, 60% of cash flows, is for shareholders. Avnet began issuing a dividend a few years ago and has been increasing it 5% to 7% annually. The dividend will continue to increase at the same rate, "but that's only going to take 10% of our cash flow," Liguori says. "That leaves 50%, and we're going to use it for buybacks."

Given the plan to increase operating income over three years, Avnet considers its stock to be undervalued. "If we can buy back stock today at $47, but we think it's really worth $60 or $70, that will be a very good return for investors," Liguori notes.

Cost-Minus

The third priority for Avnet finance is cost optimization. It aims to cut costs in four areas, a project designed to take out more than $200 million in expenses.

First, some of the company's back-office operations, including its inside sales reps, are located in low-cost labor markets like Guadalajara, Serbia, and India. Migrating more of Avnet's back-office activities to such markets is expected to save $50 million.

Another $50 million gain is expected to come from reviewing and adjusting the number of management levels and spans of control. The company's acquisition binge has resulted in some excess in that area. It also brings a $40 million opportunity to consolidate back-office operations, standardize processes, and integrate all company operations into the SAP ERP system that Avnet runs.

The other $86 million in savings is expected from miscellaneous transformation initiatives. To support them, two years ago the company hired a transformation officer, Pete Bartolotta.

"A lot of times cost reduction is a one-time project and it's done," Liguori says. "But while that can work, you want to get people in a mode of always looking at their processes."

So, Avnet employees are encouraged to submit ideas for process change. With the past year, the company has standardized under a single business travel management firm, reduced external hedging costs, and eliminated most human resources paperwork.

"Our philosophy here is to focus on what we can control," Liguori says. "We can't control our share price or market trends like pricing. We can control our strategic building blocks, working capital, capital allocation, and costs.

"Now," he adds, "we have those strategic blocks in place, and we're trying to put the cost structure and the financial model underneath them to get the returns we think we can get." CFO

The future could be bright for semiconductor makers, and distributors like Avnet, given booming demand for wireless internet-of-things devices and applications.

Courtesy of the company

How Companies Get Culture Wrong

At most organizations, culture is over-hyped, under-managed, and of little tangible value. By Carl Robinson

Given the time, energy, and money most American businesses spend to define their values and a desired culture, one would assume a big payoff. Yet there's very little evidence that these investments yield much impact. ¶ The organizations that can accurately cite culture as a driver of their business strategies are few and far between—think Apple, Facebok, NASA, and Southwest Airlines—and they work at it relentlessly.

For most, company culture is over-hyped, under-managed, and of little tangible value. The reasons are easy to discern: In most places, culture is like a warm fog. It is generally not clearly articulated or highly relevant, and it's almost never consistently demonstrated. Indeed, the internal variance can be dramatic.

This might not matter, except that all employees (top to bottom) love to engage in a game you might call, "Catch the Organization in Contradictions." Culture is a favorite target.

While words matter, actions matter more. When people see a gap between what is promised and what is delivered, they understandably become wary, often defaulting to thinking that leadership doesn't seem to have its act together.

In this way, a deliberate focus on values and desired culture without the managerial will to act will inevitably breed skepticism, distrust, and disengagement.

The Nature of the Beast

To manage company culture as a true business driver, leaders need to understand the complex space they are playing in. Culture is fragile, contextual, and entirely soft.

At its best, culture is the consistent reflection of closely connected and actionable norms, and well-stated and understood operating principles that tie directly to the company's mission. Anything less can present a blurry mess that translates as nonsense. With cynicism on the rise anyway, this isn't a good thing.

Most organizations have a shadow culture, and often that is a function of favoritism, history, and politics at the top. This shadow side can play out as a force for good, but more commonly it's a force for evil. How the desired culture filters through senior leaders determines whether it actually influences behavior in the right direction or is compromised.

Most important, company culture is local. The most direct way culture is experienced, understood, and translated is through the individual behavior of one's boss. He or she captures most of the attention by setting the cultural ground rules, establishing the expectations, and reinforcing what's right and wrong.

Unfortunately, a single bad manager can easily trump a well-crafted values statement.

What to Do

If the company's intent is to create a durable, impactful company culture—one that aligns and galvanizes efforts toward a common purpose—then serious leadership work is required. A little sage wisdom can go a long way:

- **Know what you stand for and start there**. What's actually important to you and the organization? Where will you take a stand? Your cultural expectations can be aspirational—up to a point.
- **Ensure your desired culture is well-reflected at the top**. That means through the behavior of those in charge. This is not conditional; rather, it's a requirement for every ex-

Getty Images

ecutive in the organization.

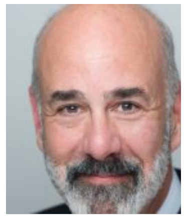
- **Make fewer promises and make sure you keep them**. At the outset, recognize that this is much easier said than done. For instance, creating cultures of respect and helpfulness sounds great, but it requires commitment and dedication.
- **Over time, outlying behavior has to be met with zero tolerance**. An employee either gets with the program or he or she gets shipped to the competition. "He may be a jerk, but he's our star performer" is no longer an excuse for putting up with bad conduct.
- **Understand that culture is reinforced by story**. Leaders must be evangelists. Expect nothing less.

Five Questions

Executive committees should ask themselves the following:

1. Do we at the top have a well-defined and agreed-upon view of our desired culture?
2. Is this cultural picture a clear, seamless reflection of our corporate vision, mission, and values?
3. Do we see this work as integral to our business success, or simply a nice thing to have?
4. How will we mediate inevitable culture clashes?
5. Most importantly, how will we handle individuals when their behavior compromises or violates our expectations?

Establishing a durable, impactful culture that helps attract and retain top-flight employees and actually draws customers and partners to your door is not for the faint of heart. Anything less than a full commitment to it is destined to create more problems than it does value.



"How the desired culture filters through senior leaders determines whether it actually influences behavior in the right direction or is compromised."

—Carl Robinson, founding partner, Vantage Leadership Consulting

If leadership isn't fully prepared to live up to the implications of their compact, no one should expect employees to follow. CFO

Carl Robinson is founding partner of Vantage Leadership Consulting.

Automation Won't Reduce Finance Staffs

Finance execs don't plan to cut heads in response to technology-driven efficiencies.

Will companies decrease their finance and accounting staffs in response to automation-driven productivity gains? Or will they instead assign workers to activities that are more value-additive than the rote ones taken over by machines?

Many observers have suggested the latter is more likely. However, skeptics—accustomed to seeing companies seize almost any opportunity to cut costs—abound.

A study from the Financial Executives Research Foundation (FERF) and staffing firm Robert Half may help silence the skeptics.

In a survey of 1,730 North American finance executives, only 3% and 6% of U.S. and Canadian respondents, respectively, say they expect to pare their finance and accounting teams as a result of digital transformation.

More than half of the survey takers (59%, in the case of U.S. executives) say they will maintain their existing staff levels. What's really eye-opening, though, is that 17% of U.S. executives and 22% of those in Canada say they anticipate actually expanding their finance and accounting staffs because of proliferating technology.

The findings surprised Christopher Westfall, a vice president of Financial Executives International.

"I had the assumption that if you increase efficiency, you decrease staff levels," he tells *CFO*. So, FERF put the question to a number of financial executives in post-survey interviews.

"The answer we consistently got is that they can't cut any more people," says Westfall. "New automation is coming at such a clip that they need their people to oversee the automated tasks."

Exacerbating the situation is the difficulty of finding people with skill sets suitable for such oversight. University finance and accounting programs, rather than helping students develop such skills, continue to "teach the same things they've been teaching for many years," according to Westfall.

At the same time, the most highly skilled finance staffers are needed for other priorities. "As business demands change or rise due to digital transformation," the survey report notes, "many financial executives now have the flexibility to put their best people on those projects." | **DAVID MCCANN**

Courtesy of the author

CAREER CHOICE: THE INDUSTRY SWITCH

Companies are reaching outside their industries for CFOs who have special skills or bring a unique perspective to a market undergoing disruption.

Is it possible to make the leap?

PROFILES BY DAVID MCCANN

PHOTO ILLUSTRATION FROM GETTY IMAGES

As much as anyone else, finance chiefs swap companies when unemployment is extremely low, job-hopping is profitable, and exciting opportunities abound. The CFO turnover rate for 2018 is 1.5 percentage points above its long-run average. But what about moving not just to another employer but to another industry?

Being finance chief of one organization or in one industry for one, two, or even three decades has plenty of pluses. They include the opportunity to become immersed in the business and industry to a degree that enables highly nuanced decision-making. Many of today's CFOs, though, see a downside: forgoing the diversity of perspectives and experience that time spent with multiple employers or industries brings.

In addition, a case can be made that it makes sense to focus on CFO skills rather than industry: activist investors have no qualms about pushing for a CFO to be replaced if his or her experience does not match the company's current situation, even if the CFO has significant industry chops. For example, pre-IPO tech companies almost always hire finance chiefs with public-company experience to steer them through an initial offering.

Can finance chiefs who switch industries be successful, and what would it be like heading finance in a sector totally different from your current one? We spoke with three CFOs: two that have made interesting industry shifts and one that works in an industry few CFOs might consider switching to—until they read her story.

Finally, if entering a whole new sector captures your imagination, now might be the perfect time to explore your options. That goes double if you have held a CFO job for a number of years. In an economy where talent is scarce, the most valuable experience a candidate can have is time in the lead finance role.

Changing Tracks

When switching industries, know what makes a great finance organization and ask a lot of questions, says Change Healthcare's finance chief.

"You have a license to ask dumb questions for an extended period of time. Groupthink is a common enemy for a lot of leaders," says Eliasson.

Count Fredrik Eliasson as one who thinks CFO skills are highly transportable across industries.

Not everyone agrees. Indeed, it's fairly common for finance executives to stay in an industry for their entire careers. For others, the time comes when they just want a change.

Eliasson, 46, is among the latter. After 20 years with railroad company CSX, he switched industries in a big way by signing on in March 2018 to run finance at Change Healthcare. The firm provides software, analytics, network solutions, and other technology-enabled services to health-care payers and providers.

Fredrik Eliasson, *CFO, Change Healthcare*

The company was formed in March 2017 through a merger of Change Healthcare Holdings and a majority of McKesson's technology solutions business unit. Change Healthcare is privately held, owned jointly by McKesson and Blackstone Group, but when the deal was announced in June 2016 the merger partners said they had pro-forma revenue of $3.4 billion.

Eliasson left CSX in late 2017 without knowing what his next move would be. "I felt I wanted to do something different from what I'd done in the past in the industrial transportation space," he says.

When the opportunity at Change Healthcare arose, it certainly checked that box. CSX, aside from being in a much different industry, is a publicly held company that's much larger, with a topline of $11.4 billion for its 2017 fiscal year.

Change Healthcare, in contrast, is a private company that Eliasson could help take public at some point. "The opportunity set itself is different," he says.

In seeking the new job, Eliasson had a broader skill set to work with than some other CFOs. After serving as CSX's finance chief from 2012 to 2015, he spent his last two years with the company as chief sales and marketing officer.

If that sounds like it was a step down, it wasn't. "For a railroad, and some other organizations, the two most important jobs under the CEO are the chief operating officer and the chief sales and marketing officer," Eliasson says. "They have a more direct influence on the business than the CFO does."

He also had a previous sales role at CSX, in between serving in other finance roles. "But I felt my CFO skills were probably the most transferable," he says.

Defining Success

Eliasson understandably had his hands full negotiating the learning curve when he first joined. Still, he stresses that he knows what it takes to run "a great finance organization."

He has a two-fold definition of success for finance. For one, it's about making core processes—processing receivables, closing the books, forecasting results, etc.—better, faster, and cheaper. Two, it's about influencing the finance team to be "positive, challenging partners to the people running the businesses."

"If you approach finance with those sorts of objectives, then CFO skills are very much transferable," Eliasson says.

In fact, a top executive newly brought in from outside can be just the tonic some companies need.

"You have a license to ask dumb questions for an extended period of time," he observes. "Groupthink is a common enemy for a lot of leaders. They've done something for a long time and everybody in the organization believes that's the right way. But coming in with different experiences, I'm already questioning whether several things are still right, now that there's a new organization after the merger."

Meanwhile, what are some of the elements of Change Healthcare's business that differ from Eliasson's past experience?

For one, the company has a multi-tiered revenue model. Software solutions are typically offered as software-as-a-service subscriptions. Other services have a volume-based pricing model. But a key aspect of Change Healthcare's business is its contingency-based pricing model, where the company earns revenue only when customers derive value in the form of, for example, cost savings.

Then there's the product set. The company's Intelligent Healthcare Network processes clinical, administrative, and financial transactions for hundreds of thousands of physicians, hospitals, and other providers, as well as commercial and government payers. The value of claims processed through the network tops $2 trillion annually.

Eliasson isn't wasting time worrying about all the details. "It might be less challenging to get up to speed than you might think. Ultimately, it's about creating value and [applying] common sense."

Courtesy Change Healthcare, Getty Images

Feeling Fintech

A background in private equity prepares Sarah Dickens Spoja to take the CFO position at accounts payable firm Tipalti.

For Tipalti's relatively new finance chief, Sarah Dickens Spoja, successful experiences in consulting and private equity led to her entry into a dynamic industry.

After graduating from Williams College in 2004 with a double major in mathematics and economics, Dickens Spoja went straight into a four-year gig with management consulting firm Bain. There, she was heavily exposed to private equity, working on projects in the areas of buy-side diligence, customer research, and new product potential.

Next came Stanford University Graduate School of Business, where Dickens Spoja earned an MBA in 2010. Newly minted diploma in hand, her first aim was to put her PE experience to work. So, she joined KKR Capstone, an independent firm that provides support for the deal teams and portfolio companies of PE giant KKR.

Sarah Dickens Spoja, *CFO, Tipalti*

She and her colleagues spent a portion of their time "doing diligence for new investments, understanding whether they were good and in particular what types of value improvements KKR could make on them as owners." Another chunk of time was devoted to existing portfolio firms, along a spectrum from project work to "actually having a seat in the company and taking on a role."

Dickens Spoja calls it "probably the best job I could have had." While she had done more traditional strategic consulting during her years at Bain, she "wanted to get more skin in the game," which is what drove her to private equity.

"I wanted to be involved not only as an adviser but also as a shareholder," she says. "With every project I took, I thought about how to align my interests with the management team's interests."

Time is Money

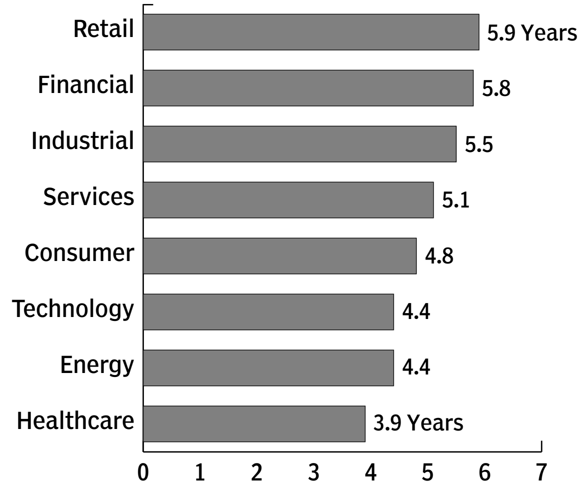
While she rose to become a director at KKR Capstone, Dickens Spoja's next logical career step was to "go to work in a company and have a seat at the table more directly," she says. "I talked to headhunters for a few years about chief operating officer or strategic CFO jobs. I was looking for the right combination of people, product team, and vision of where the company was going."

She was particularly interested in opportunities at financial technology (fintech) companies, the focus of half of her work at KKR Capstone.

Short Stops

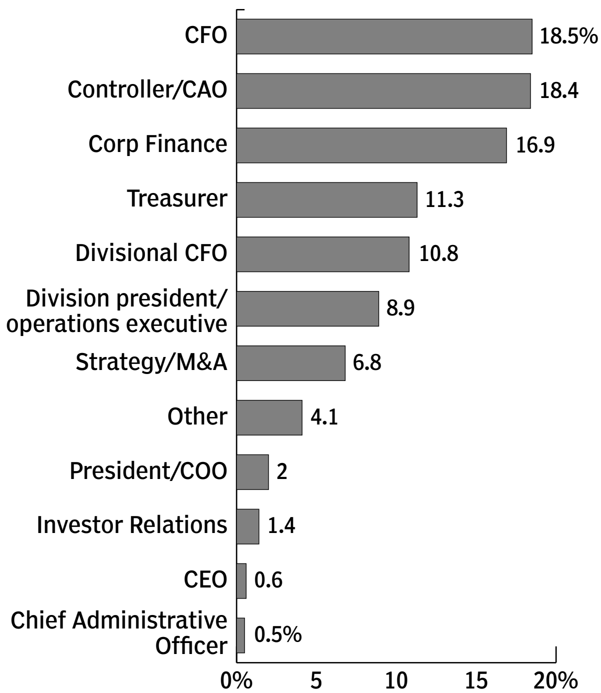
The high turnover rate in CFO positions suggests more finance chiefs are taking advantage of a tight labor market.

Average tenure of CFOs, by industry*



Advantage: Experienced CFOs

Less than 20% of sitting CFOs have prior CFO experience at another company. Here are the immediate previous positions of current CFOs.*



* 2018 Fortune 500 and S&P 500 companies

Source: Crist Kolder Associates Volatility Report 2018 (data as of August 1, 2018); percentages do not add up to 100 due to rounding

Courtesy Tipalti

Going Outside

Why hire a CFO from another industry or sector?

- As a catalyst for change in a sector going through some kind of transformation
- To bring in specific skills at a critical moment in the business
- To maximize the pool of "top-tier" candidates available for targeting
- As part of a broad approach to creating a more diverse leadership team
- As part of a talent strategy that puts leadership ability above purely technical skills

Source: Spencer Stuart

Notably, she had worked on the acquisition of a small fintech firm, Clover Network, by First Data, which KKR bought in 2007 and took public in 2015.

"After we did the deal, I worked for two years alongside the founders of [Clover] in a chief commercial officer-type role," Dickens Spoja says. "I did everything from planning out the teams and the budgeting to doing business development and setting up bank partnerships."

When the Tipalti opportunity arose, Dickens Spoja performed due diligence on the company and its financial models "exactly as if I were a KKR executive [trying to understand] whether I wanted my money in this business—because at this stage of my career, my time is my money."

Dickens Spoja was particularly attracted by Tipalti's customer-retention rate, "which was higher than any I'd seen in the B2B fintech space," she says.

Tipalti is a much more mature company than was pre-acquisition Clover, "but it has a lot of the same qualities," Dickens Spoja says, because it has to figure out how to continue to grow fast, satisfy customers' needs, open up more addressable markets, and fund growth.

Both fintech and the payments space have fast-evolving ecosystems, Dickens Spoja notes. "Understanding the many dimensions in those ecosystems and all the participants—banks, associations, competitive or complementary products—is important, and they're changing all the time."

"I wanted to be involved not only as an adviser but also as a shareholder. With every project I took, I thought about how to align my interests with the management team's interests," says Dickens Spoja.

Water World

Being CFO of a public utility can be as challenging as the private sector, finds Linda Sullivan of American Water Works.

The job of CFO at a public utility might appear on the surface to be rather bland.

After all, strict regulations dictate many of utilities' actions. Utilities don't set their own prices for their services. They are much better able to forecast revenue than are most businesses. Their capital structure is established by state regulatory commissions, which also dictate a return-on-equity ceiling for their capital investments.

Don't try to tell Linda Sullivan that utilities are bland, though.

The finance chief of American Water Works started handling a public utility account almost 30 years ago during her early-career days at a public accounting firm. That led to a 22-year stretch with electric utility Edison International, where Sullivan rose to the CFO role. In 2014 she moved to American Water, the biggest player in the highly fragmented U.S. water-utility industry.

"A lot of people outside the utility industry think it's stodgy, but it's anything but that," she says. "It's very interesting, very exciting, and serves the public. I love it."

The heart of the job is balancing significant ongoing capital investments with the mission of achieving efficiencies that serve to keep customers' rates as low as possible. That balancing act breaks down into four key issues.

Most important among them is the supply of water. There is a finite amount of fresh water in the world, Sullivan notes. It comes from four primary sources: ground water; surface sources such as rivers and lakes; desalination of saltwater; and recycling and re-use. But supply is tight in portions of the United States, especially areas afflicted by near-chronic drought conditions.

"We need to make sure we're taking a long-term view of water supply and understand the risks—relating to water storage and water stress—in each of our locations, so that we can mitigate those risks," says Sullivan, noting that American Water has coverage territories in 16 states.

Such mitigation requires investment. For example, the company is building a desalination plant on California's Monterey Peninsula, "because there's really no other solutions in that area," the CFO says.

The second key issue is aging infrastructure. Like most other U.S. water systems, the pipes and other infrastructure American Water uses were installed well more than 100 years ago and need to be repaired or replaced.

"Every year U.S. water systems lose about 20% of already-treated water, or about 2 trillion gallons," Sullivan

Getty Images

says. "We've gone to the expense of getting that water, treating it, and putting it in the pipes. But we lose 20% of it due to leaks and main breaks. It's very expensive."

Here too, the challenge is making the right investments while keeping an eye on customer affordability. But in general, infrastructure upgrades tend to be good investments.

"The way our rates are designed, if we spend a dollar of operating cost, our customers pay for that, dollar for dollar, every year," she says. "But if we invest in our system, then our customers pay for that over the life of the system, which is generally 40 years or more. So, we know that for every dollar we can save in operating expense, we can invest $8 in capital infrastructure and have the same impact on customers' bills."

Linda Sullivan, *CFO, American Water Works*

The third big issue is water quality, which has been in the spotlight in recent years because of the polluted-water situation in Flint, Mich., and algae blooms in Lake Erie and the Ohio River.

Sullivan's challenge is making the correct investments in smart technologies that allow water quality to be measured at the source and that issue alerts when "something foreign comes into our water," she says.

The fourth key issue, which the company calls customer connectedness, is interesting because the company operates as a monopoly in its coverage territories. However, "the way we look at our customers is that if they were given a choice, we'd want there to be no question in their mind that they would choose us," Sullivan says.

"We need to make sure we're taking a long-term view of water supply and understand the risks—relating to water storage and water stress—in each of our locations, so that we can mitigate those risks," says Sullivan.

Weighing a Transition

Before taking a position in a new industry, CFOs should ask themselves the following questions.

1. Does the company have a clear strategy that I can help support, reform, and deliver?
2. Is the culture compatible with my values and principles?
3. What are the common threads between my current sector and the new one?
4. Am I comfortable with how big a stretch it will be to work in this new sector?
5. Am I willing to learn and be flexible in a new environment?
6. Do I have enough backing from the CEO and am I comfortable with the quality of the board?
7. Do I know who supports this external appointment, who is against it, and why?
8. Exactly what are the expectations of me? Is there a realistic timeline to deliver?
9. Am I completely clear about my goals? How will my success be measured?

Source: Spencer Stuart

The Long Term

In making decisions on all types of capital investments, American Water must take into account that household water usage is declining in the United States, slowly but steadily, at a rate of about 1% to 2% annually. That is the result of the increasing prevalence of low-flow toilets, more-efficient washing machines, and the like, as well as a growing "conservation mindset," Sullivan says.

"We must adapt our systems and rate structures to reduced consumption trends in order to cover fixed costs and maintain reliable service, while a number of fixed costs continue to rise," Sullivan says.

Such fixed costs range from capital needs to operating costs such as plant maintenance, customer service, IT support, and security. "The challenge is to work with regulators to be progressive in establishing rate structures that support appropriate levels of ongoing investment in the pipes and plants that ensure reliable service," Sullivan says.

Regardless of all the challenges, American Water is actually growing and forecasts a compound annual earnings growth rate of 7% to 10% through 2022.

The company also buys, each year, 15 to 20 of the 50,000-plus water systems in the United States, typically ones operated by troubled municipalities. Deciding which ones to acquire involves answering two "sophisticated" questions, Sullivan says.

"One is, where is the 'stupid line'? At what price are we happy to walk away? If someone else is willing to pay that price, we can be happy for them," says Sullivan.

The second question is, "In 5 or 10 years, are people going to look back and believe we made a good decision? Or are they going to say, 'What were they thinking?' I think that's really important for the utility industry, because we're in the business for the long term." CFO

David McCann is Deputy Editor at CFO.

Courtesy American Water Works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The sudden collapse of U.K. construction firm Carillion exposes the limits of public company auditing and sparks discussion of reforms.

FAILURE TO AUDIT

BY RUSS BANHAM

If past is prologue, U.K. accounting regulators may want to take a hard look at the great American business tragedy known as Enron.

In 2002, the scandalous collapse of the energy company caused the demise of one of the Big Five audit firms, Arthur Andersen, resulting in the Sarbanes-Oxley Act's stern reforms. The now Big Four are in the crosshairs of U.K. regulators, following the spectacularly speedy collapse in January 2018 of Carillion, one of Britain's largest construction firms. It was the largest insolvency in U.K. history, jeopardizing some 20,000 jobs and countless pensions. The company went into liquidation with liabilities of $9 billion and only a few million dollars in the bank.

All four auditing giants were connected to Carillion in some capacity, with KPMG its external auditor. A House of Commons report says KPMG failed to challenge management on "highly questionable assumptions" about construction contract revenue and accumulated goodwill from acquisitions. As with Enron, this roiling hurricane has whipped up urgent calls in the U.K. for auditing reform. Some want Parliament to separate the audit work of the Big Four from their prized consulting services; others suggest shattering them into multiple firms. While the first has been done in the United States, some here are still calling for the second.

The United States is ahead of the United Kingdom with respect to regulating auditing, but no one would say America has perfected the approach. An effective framework of accountability for auditors doesn't presently exist. So, could a downfall of Shakespearean proportions like Carillion's happen here? And is there a solution to making sure it doesn't?

Applying Judgment

When considering the accountability of auditors in a sizable corporate meltdown like Carillion's, or MF Global's, or even that of Lehman Brothers, accounting experts underline the imposing task audit firms face. In every engagement, they issue an opinion on the fairness and accuracy of a company's financial statements based on a statistical sampling of its financial data.

The key word here is "sampling." No auditor of a large public company could possibly dig through every single transaction to guarantee its financial integrity. Consequently,

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FAILURE TO AUDIT

there is always the risk of issuing an opinion that may be ambiguous or flat-out wrong. That is why it is called an "opinion," a "judgment not necessarily based on fact or knowledge." And why an "audit" is just another word for a "survey" or "check."

"A lot of what audit firms do is a legitimate judgment call," says Erik Gordon, a professor in the University of Michigan's Ross School of Business. "Here in the United States, judgments are based on [generally accepted accounting principles], but they're still judgments."

The problems occur when the client pushes back, disputing the auditor's judgment. The auditor may decode comments such as "I'm not sure you really understand our business" or "I don't think you appreciate what is special about our industry'" as implying that the company will curtail the high-priced consulting services provided by the firm," says Gordon. "That's when the auditor's objectivity can become strained."

The U.S. Stage

Audit firms in the United Kingdom can still provide consulting services to the same client (unlike in the United States), resulting in a blatant conflict of interest. That and other circumstances of the Carillion case are an old tune in the U.S., which confronted similar issues post-Enron until Congress passed the Sarbanes-Oxley Act of 2002 (SOX). SOX prohibits firms from providing non-audit services to audit clients like internal audit outsourcing and large-scale, large-fee information systems design and implementation. The law also requires publicly held companies to disclose the fees paid to auditors.

By the Numbers

43,000 employees
Number of Carillion employees worldwide before liquidation

450
The number of construction and service contracts Carillion had across the U.K. public sector

$38.1 million
The amount of cash Carillion had when it went into liquidation in January 2018 (against $9.2 billion of liabilities)

$2.63 billion
The amount Carillion owed to its 30,000 suppliers and subcontractors

$1.11 billion
The reduction of value in its contracts Carillion disclosed in July 2017 when it issued a profit warning

Source: Work and Pensions and BEIS Committees Report

Three of the Big Four firms pulled out of consulting after SOX came into effect, eventually returning to the business by committing not to provide audit and consulting services to the same company. For the most part, this accommodation has eased worries over another Enron. But does that make the Carillion calamity a case of "it can't happen here?"

The list of mistakes that the U.K. parliament accuses Carillion's auditor, KPMG, of sound pretty similar to errors that U.S. auditors have made since SOX, especially during and after the 2008 financial crisis: questionable assumptions about revenue recognition and the goodwill value on corporate balance sheets, for example, and a lack of professional skepticism toward aggressive accounting judgments:

"[With SOX], the U.S. took a hard step in adding another layer of regulation. But the result has been greater financial transparency and corporate governance."

Robert Hartwig, *professor of finance, University of South Carolina's Darla Moore School of Business*

• In 2014, the Public Company Accounting Oversight Board (PCAOB) banned a Pricewaterhouse Coopers partner for overlooking improper revenue recognition by a medical device firm. The practices missed included unusual pricing and payment terms, quarter-end sales spikes, and a scheme by which the company funded a distributor's purchases.

• A U.S. district court recently found PwC guilty of giving Colonial BancGroup a clean audit for years before it emerged that huge chunks of Colonial's loans to a mortgage originator were secured against assets that did not exist.

• The PCAOB charged Deloitte with violating PCAOB rules and auditing standards in audits of software firm Jack Henry. The PCAOB said none of the engagement personnel had the knowledge to properly evaluate and audit the firm's accounting for software license revenue.

In addition, criticisms of the U.K.'s accounting watchdog, the Financial Reporting Council, are similar to those leveled at the PCAOB: that the regulating entity is too close to the firms it oversees.

Two of the current five members of the PCAOB, for example, spent significant time at Big Four firms, and an April 2018 academic study found that an increasing number of PCAOB employees leave the regulator for senior-level positions at large audit firms.

Robust Regulation?

The Big Four declined to be interviewed for this story, referring the subject to the Center for Audit Quality (CAQ), which represents the interests of public company auditors. CAQ issued a statement to *CFO* maintaining that "robust independent regulation and oversight" is firmly in place in the United States "to safeguard auditor independence."

"Auditing has become much more rigorous in the past 15

Courtesy University of South Carolina's Darla Moore School of Business years," says Owen Ryan, one-time CEO and managing partner of Deloitte's advisory business and a member of its global executive committee. Financial restatements and large bankruptcies without forewarning by auditors have fallen significantly, he says. "Lawmakers and regulators like the [PCAOB] deserve credit for putting pressure on audit firms to be independent and to continually improve practices."

Like all sweeping business regulations that are passed, SOX was initially greeted by companies as unnecessarily burdensome. But it has changed corporate behaviors for the better, restoring needed investor confidence in the accuracy and completeness of financial statements says Robert Hartwig, a professor of finance at the University of South Carolina's Darla Moore School of Business.

The statement bears repeating, as the White House and Congress are questioning the effectiveness of many capital markets regulations. A current bill in the House of Representatives, for example, would allow small broker-dealers to hire audit firms that are not registered with the PCAOB.

"The U.S. took a hard step in adding another layer of regulation. But the result has been greater financial transparency and corporate governance," says Hartwig

And the PCAOB is still refining its approach. As of June 30, 2019, auditors have to include in their reports a discussion of critical audit matters (CAMs) that have been communicated to the audit committee. CAMs are matters related to disclosures that are material to the financial statements and involve "especially challenging, subjective, or complex auditor judgment."

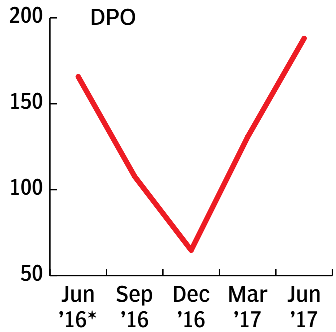
"Audit committee members need to have more of an open mind in appointing second-tier audit firms like BDO, Grant Thornton, and Crowe Horwath."

Jian Zhou, *professor of accounting, University of Hawaii's Shidler College of Business*

Another factor involving the difference in oversight here and in the U.K. is a wide disparity in funding, points out Patrick Villanova, a former lead audit senior manager at PwC. The PCAOB's $250 million annual budget is pretty much double the funding of the FRC and regulators in the Netherlands, Ireland, France, Germany, and South Africa—combined.

Stretching Terms

Carillion's average days payables outstanding (DPO) jumped in 2017 as the company tried to conserve cash.



*Days payables outstanding are as of quarter end.

Source: S&P Capital IQ

Breaking Up

In the United Kingdom, Parliament has remedies in mind in the wake of the Carillion collapse, some of which have also been contemplated here. The two principal ones are (1) fragmenting the Big Four into smaller firms or (2) detaching their audit arms from their consulting services arms, which generally offer strategy, legal, and merger and acquisition advice.

The first solution would encourage competition in the audit market, say U.K. lawmakers, limiting the potential for audit firms and clients to nurture long-term, cozy relationships. The Big Four check the books of nearly all (98%) of the U.K.'s 350 leading public companies. "The veiled threat [by regulators] is that if you don't do it, we'll do it," says Gordon.

More competition would break the Big Four's stranglehold. Other suggestions being proposed in the U.K. would cap these firms' market share of public company auditing or limit the number of audit clients any one firm can have.

But is an oligopoly of four top-tier firms a bad thing, either in the U.S. or the U.K., given that there are tiers of other audit firms right below it? "More competitors usually leads to more competition," says Gordon. "But, I know people at all four firms, and in a sort of semi-genteel way they really do compete for business. Would a 'Big Six' be more competitive, giving a CFO more places to shop? Maybe, but I'm not sure it would result in higher audit quality."

Jian Zhou, a professor of accounting at the University of Hawaii's Shidler College of Business, would rather see a market solution. He notes that the market share of the second tier is growing in the United States. "We may soon have a Big Six, without the need to break up the Big Four to spur competition," Zhou says. "Audit committee members need to have more of an open mind in appointing second-tier audit firms like BDO, Grant Thornton, and Crowe Horwath."

Villanova, now vice president and corporate controller at BlackLine, is doubtful about the prospect of breaking up the Big Four. "The second-tier firms readily admit they currently don't have the national office resources, technical expertise, or the global networks of the Big Four," he says.

He is not alone in that position.

"The Big Four are the 'A-team' for a reason—they've hired the cream of the crop," says Tom Wheelwright, a former tax specialist in Ernst & Young's national office and CEO of WealthAbility, a provider of tax and accounting educational tools. "No one goes to a second-tier firm if they have the opportunity to work for the Big Four ... their resources aren't nearly as good. You'll get better audit prices, but not better audits."

Courtesy University of Hawaii's Shidler College of Business

FAILURE TO AUDIT

Core Conflicts

The provision of both audit and consulting services by a Big Four firm is the other chief complaint of U.K. lawmakers. Their arguments are driven by an enhanced potential for conflicts of interest, since audit firms are both an advocate and a public protector of a company on behalf of shareholders and investors. And the job of advocate, in the form of advisory work, pays more.

The Big Four counter that added services like tax and legal consulting are useful from an expertise standpoint, allowing for higher quality audits. They also say the added revenue stream of consulting services income helps subsidize clients' audits. "If you remove the ability to offer these services, audit prices would be considerably more expensive, as much as double," Wheelwright claims.

Nevertheless, these factors do little to offset the possibility of a serious conflict of interest. "If there are no disputes on the audit side with the client, no issues over asset impairments or how revenue and expenses should be booked, then no problem—the conflict of interest is hypothetical," says Gordon. "But, if the auditor is questioning these things while the firm also provides profitable services to the client" then the auditor may turn a blind eye.

"The Big Four are the 'A-team' for a reason—they've hired the cream of the crop."

Tom Wheelwright, *CEO, WealthAbility*

The conflict of interest argument has also arisen in the United States, where many wonder if it makes sense anymore for the issuer being audited to be the one paying the auditor. After all, why do auditors continue to make big, costly mistakes that result in lawsuits? Could it be the pressure to keep the audit client happy?

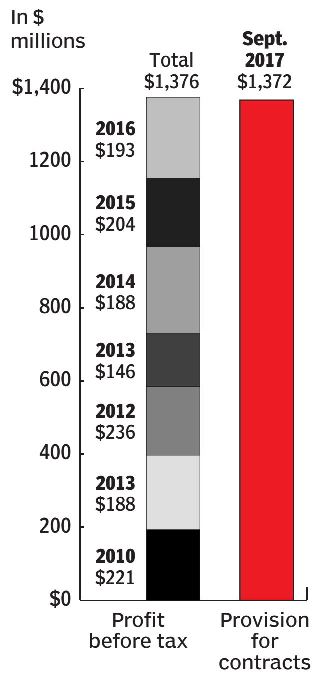
Big Four alumni say the overwhelming majority of auditors are not being negligent. As Villanova explains, an auditor is often trying to figure out some "newfangled, ingenious thing that some banker came up with" while the "clock ticks toward the quarterly earnings report." The company makes a best estimate based on the available information, and the auditor scrutinizes the company's key assumptions to the best of his or her ability.

A potential solution to the problem of long-term auditor-client relationships, says Villanova, is having another firm come in and check the assumptions.

There is no law or accounting rule requiring the use of peer reviews, in the U.K. or the U.S. Not only would a "referee" weaken the conflict-of-interest charge—an auditor would know its work would be evaluated by a competitor—it would spread the wealth among a greater number of firms, addressing the oligopoly assertion.

Disappearing Profits

Carillion's total provisions for problem contracts in July and September of 2017 wiped out 7 years of before-tax profits.



Source: S&P Capital IQ

"It could result in a new practice, whereby a group of firms specializes in scrutinizing the financial data that another firm has already scrutinized," Villanova said. That already happens when a company goes through a major acquisition or divestiture—one Big Four firm gets hired to give the company a valuation report and another audits the assumptions and models used in the valuation.

What Now?

The Big Four would hardly relish having other audit firms peering over their shoulders at their workpapers. In addition, issuers and investors might not put up with longer lead times between when the books are closed and the auditor gives its imprimatur to the financial statements.

One thing auditors can do to head off any new rules is to ensure new auditors are trained to appropriately challenge the client on accounting and disclosure matters. Audit committees on boards of directors can also play a part. They must keep auditor independence intact and identify for auditors the transactions and accounting issues from which misstatements are likely to arise.

Still, audits will miss things, given that auditors need to form an opinion drawn from only a small wedge of the client's financial data. "The public sees an audit as assurance that everything is perfect in a company, which is not what an audit is," said Wheelwright. "It's a testing process to see if what a company is doing is reasonable."

Lawmakers in the U.K. might be off base—"looking for precise answers to improve a science that is inherently gray," as Villanova puts it. But that doesn't mean the quality of audits can't be improved. For certain, if the Big Four firms don't join the discussion about how to make incidents like Carillion less likely, they may not be happy with what regulators impose as a solution. CFO

Russ Banham is a Los Angeles-based financial journalist and author.

Courtesy WealthAbility

Time for An Adjustment?

Keeping the auditor-client relationship free of conflicts of interest is still a struggle. **By Vincent Ryan**

Failure to detect corruption, negligence in approving an accounting treatment, lack of professional skepticism, failure to unmask fraud, and inappropriate familiarity with the client. The Big Four have been accused of all of these transgressions, and more, in the past three years. ¶ Material accounting mistakes resulting in restatements by U.S. public companies rose to 65 in the first six months of 2018, compared with 60 the year prior, found Audit Analytics. And the International Forum of Independent Regulators (IFIR) revealed this year that it had found problems in 40% of the audits of 918 listed public companies that it examined in 2017.

The deficiencies found in the audits of U.S. public companies don't mean that the resulting financial statements can't be trusted. Auditing in the United States has undeniably improved since the crackdown represented by the Sarbanes-Oxley Act of 2002 (SOX). But in the last few years, as lawsuit settlements from the financial crisis reveal what auditors missed and companies wrestle with rule changes like revenue recognition, allegations of auditor malpractice seem to be growing.

Where are the problems in public company auditing, whether real or just perceived? A lot of it boils down to the auditor-client relationship.

Independent Streak

Much work has been done to try to ensure the objectivity and integrity of public accounting firms and their personnel. The Securities and Exchange Commission's rules on audit independence prescribe prohibitions on non-audit services, partner rotations, and conflicts of interest. But some observers think CFOs and their companies' auditors, especially the Big Four, are still too cozy for comfort.

SOX addressed the issue by outlawing the hiring of an accounting firm to perform an audit if a top finance or accounting executive at the client was employed by the audit firm during the preceding year. But a 2018 study of the willingness of Big Four firms to adopt a client's position on a fairly subjective, even speculative accounting matter had an interesting result: 76% were inclined to do so if the client's CFO was a former colleague at the same Big Four audit firm, while only 44% said they would do so otherwise.

"Independence for me is a mindset. For myself and all my fellow partners, independence and integrity are absolutely critical to our profession."
—Michelle Hinchliffe, U.K. head of audit, KPMG

This "alumni effect" occurred even if it had been two years since the CFO left the audit firm. "A one-year or two-year cooling-off period is not enough ... particularly if it requires overcoming social bonds that colleagues often develop," according to the study, "The Alumni Effect and Professional Skepticism: An Experimental Investigation."

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.

But, retired Ernst & Young audit partners Jay Bornstein and Steve Blowers, writing on CFO.com, say that may not be enough. Finance chiefs have an obligation to develop their companies' own independence policies and procedures and test their effectiveness, they write. Company-wide procedures concerning the relation of C-suite executives to the audit firm also need to be in place.

Trusting the Committee

Lately, regulators seem to be hoping that audit committees can iron out any problems with auditor objectivity.

Left: Getty images; Right: Courtesy the company

That makes sense, since, officially, the audit committee oversees the financial reporting process, the audit process, and the systems of internal control.

Audit committees are better-equipped than a few years ago—in the Fortune 100, 66% of audit committee members are financial experts, up from 59% in 2012. More audit committees are also disclosing in public filings the factors that go into their assessments of the auditor's qualifications and its work quality.

Indeed, audit committees have their limits—and their flaws. Audit committees have more tasks on their plates, which may be diluting "an audit committee's ability to focus on its core responsibilities," former SEC chair Mary Jo White declared in 2015. Surveys have found that many audit committee members have difficulty finding time to perform all their responsibilities, especially as they are called on to oversee major risks like cybersecurity and global compliance.

There's no guarantee that an auditor committee is going to handle an audit responsibly, either. In September, WageWorks, a provider of employee benefit plans, opened an investigation into whether its audit committee withheld information from its outside auditor.

Tenure Tensions

Even an expert audit committee of unquestionable integrity may have trouble addressing the issue of overlong client-auditor relationships, and many may not want to.

After the Carillion meltdown in the United Kingdom, members of parliament attacked the fact that KPMG had been Carillion's auditor for the construction firm's entire corporate life of 19 years. Parliament said that "such a long tenure inevitably calls into question whether [KPMG] could provide the independence and objectivity that is crucial to [a] high-quality audit."

In response, Michelle Hinchliffe, KPMG's U.K. head of audit, told Parliament that she did not believe 19 years was "too long to be impartial" and that "independence for me is a mindset. For myself and all my fellow partners, independence and integrity are absolutely critical to our profession."

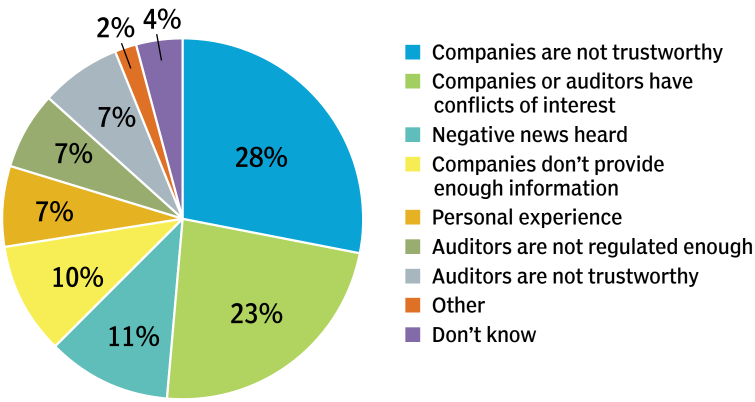
But would rotating a client's external auditor make sense? In the European Union, issuers have to rotate auditors every 10 years (the KPMG-Carillion case was an exception). The only U.S. provision specifically targeting longstanding auditor-client relationships prohibits the lead audit partner, not the firm, from performing audit services for more than five consecutive fiscal years.

The Public Company Accounting Oversight Board (PCAOB) tried to institute mandatory auditor rotation five years ago but the opposition was vehement, from industry and even Congress. ExxonMobil's controller at the time said the idea had been met with "universal rejection" from board audit committees, "as the proposal diminishes the audit committee's role in hiring, assessing, and firing audit firms."

This issue doesn't seem to be going away, however. Earlier this year, proxy adviser Institutional Shareholder Services recommended that General Electric shareholders vote to dump KPMG after a surprise $6 billion-plus write-down. ISS says that for all companies saving time and keeping audit costs down need to be balanced against (1) the risk that a long-tenured auditor can become too close to a client and (2) the potential for a new auditor to uncover problems previously unidentified.

Trust Issues

Main Street investors that have little to no confidence in audited financial information (15%) indicate that conflicts of interest and auditor trustworthiness are among the reasons.



Data may not add up to 100% due to rounding
Source: Center for Audit Quality Main Street Investor Survey of 1,100 investors, August 2018

Accounting Oversight

The one area that should comfort U.S. investors and anyone else interested in the quality of audited financials is the success of the PCAOB. The U.K.'s Financial Reporting Council received a tongue lashing from Parliament after the Carillion collapse and was described as "toothless." But, as EY's Bornstein wrote in 2015, "Through public release of inspection reports, to enforcement actions against firms and individuals, the PCAOB is laser-focused on audit quality and independence." Wesley Bricker, the SEC's former chief accountant, said in February 2018 that "the PCAOB has had a positive impact on [auditing] firms' system[s] of quality controls."

Indeed, a 2018 Protiviti study found that 75% of companies whose external auditors required them to significantly boost their SOX compliance activities attributed the initiative to heightened PCAOB requirements.

Not all is necessarily well at the PCAOB, though. In a Republican administration that is highly skeptical of the wisdom of tight government regulation, the PCAOB, now with a new chairman, may be back on its heels. This spring it kicked off a soul-searching survey project, asking the public's help in figuring out how to enhance the PCAOB's relevance to the capital markets.

"Audit partners need to hear clearly from firm leadership that ... no client is too big to lose and that the partner has the firm's full and unwavering support when he or she is appropriately challenging the client on accounting and disclosure matters."

—Jay Bornstein, retired Ernst & Young partner

Moving Forward

With the success of the PCAOB and SOX, few would call for more regulation around the auditor-client relationship. But if anything akin to Corillian occurs in the United States, it wouldn't be out of the question. One of the suggestions made in the United Kingdom, by none other than Grant Thornton, is to have a public body select the auditors for all U.K.-listed groups and authorize it to review and rotate audit contracts every five years.

For now, there are some things apart from regulation that could improve audit quality, or, at least, the optics on public accounting firms and their clients' financials.

First, technology will be a help: artificial intelligence and advanced analytical tools, when applied in auditing, may allow for a wider sampling of data in audits and catch more fraud.

Second, the Big Four can help themselves by ensuring, if they haven't already, that they have the right tone at the top. Wrote Bornstein: "Audit partners need to hear clearly from firm leadership that quality, including independence, is the most important part of their job; that no client is too big to lose; and that the partner has the firm's full and unwavering support when he or she is appropriately challenging the client on accounting matters."

Third, no matter how good a job auditors see themselves doing in the context of an audit's natural limitations, the failure to catch corporate fraud and the attendant publicity will continue to sour firms' reputations. That's unless, of course, they find a way to address the expectation gap between what the general public wants from an audit and what an audit can really deliver. CFO

Collaborating on the Audit

The finance team has a crucial role in ensuring an effective audit.

Companies often make garden-variety mistakes when it comes to financial audits, says Rahul Sheth, a former director at Accordion Partners and now a corporate controller at DigitalOcean. The first, and perhaps most damaging one, is engaging the "wrong" auditor, or one who doesn't have a nuanced understanding of the business.

With that comes the risk of auditors asking for unnecessary or incorrect information, increasing the number of adjustments and control deficiencies. That can result in a qualified audit report—not exactly a gold star for potential investors or lenders, Sheth says.

The right audit firm not only understands the business and industry, but also has years of experience auditing similar companies.

Equally important, says Sheth, is that the CFO and other executives understand the audit plan. That means ensuring that the auditor focuses on the high-risk areas and the businesses with more complex structures, including various revenue streams, locations, and segments.

Sheth recommends that finance team members meet with the auditor during the planning phase to discuss the engagement personnel's understanding of high-risk areas. Finance should scrutinize the prepared-by-client list to identify items that are not applicable, Sheth recommends.

Sheth also advises that finance be forthcoming, raising potential issues as early as possible, and being available to answer questions throughout the audit.

Finally, Sheth emphasizes, year-end surprises should be avoided. If a company enters into any non-standard or unusual transactions (e.g. purchase or sale of business, change in segment reporting), it's crucial that these transactions be audited when they occur. | V.R.

Courtesy the company

BUSINESS OUTLOOK

Duke University/*CFO* Survey Results

Reform Immigration Policies to Aid Hiring: CFOs

In a tight U.S. labor market, finance executives contemplate changes to H-1B visa policies so they can draw on the worldwide pool of technical talent.

By Matt Heller and Vincent Ryan

Finance chiefs are expressing strong support for easing restrictions on foreign students as they struggle to hire and retain qualified employees, according to September's Duke University/*CFO* Global Business Outlook survey.

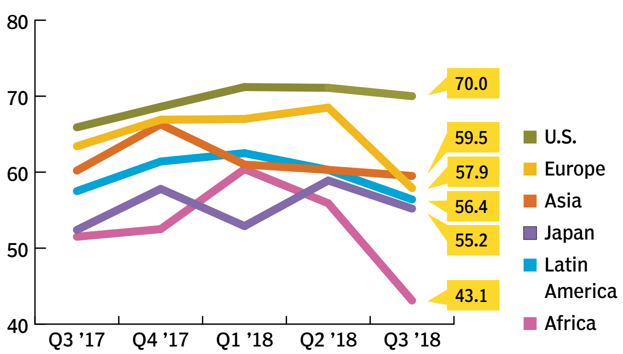
Eighty percent of survey respondents believed the U.S. government should routinely grant H-1B work visas to foreign science and technology undergraduate students studying in the United States. And 77% thought foreign science and technology graduate students should have easy access to green cards.

H-1B visas allow U.S. businesses to employ foreign workers in specialty occupations, defined as those requiring theoretical and practical application of highly specialized knowledge. Caps on H-1B visas have been a controversial issue for years, with business leaders calling for the caps to be increased.

More recently, U.S. CEOs, especially those in the technology industry, have claimed that the Trump administration is trying to discourage H-1B visa applicants by requesting more information from candidates and turning down a greater percentage of applications.

Economic Optimism Steady in U.S. But Falling Elsewhere

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



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

The Duke/*CFO* quarterly survey, which ended September 7 and had more than 800 global respondents, also found that 78% of CFOs believed the United States should drop the lottery system and adopt a merit-based immigration policy.

"The current constraints on hiring immigrants pose considerable risk to the United States being able to sustain three-percent-plus economic growth," said Cam Harvey, a founding director of the survey who teaches a technology innovation course at Duke's Fuqua School of Business.

"Given the tight labor market, firms are most concerned about securing the right talent," he added. "The CFOs are loud and clear that immigration reform will allow them to fill some gaps with skilled immigrant labor."

The scarcity of talent was reflected in the survey results. A majority (53%) of CFOs identified hiring and retaining qualified employees as a top-four concern—a two-decade high and up sharply from the 41% recorded in June.

Over the past 12 months, CFOs reported that they had to replace 14% of their workers, compared with 13% in the year-ago period. Still, they expected to grow full-time employees by 3.9% in the next year.

Among those finance executives listing hiring as a top concern, more than half (56%) said they have raised salaries to improve their chances of filling open positions and retaining workers. Nearly one-third (31%) have increased human resources budgets to better advertise positions, and 29% have increased vacation or flex hours to improve both retention and hiring. In addition, 21% have sweetened employees' health-care benefits packages.

These measures, of course, will eat into company earnings. On average, the executives surveyed projected that wages and salaries would increase 4.8% and health-care costs 7.8% in the next 12 months.

Still Optimistic

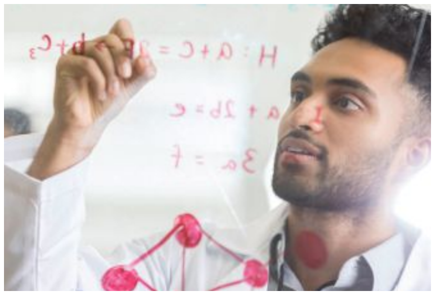
Low unemployment and a plethora of unfilled jobs are, of course, signs of robust economic conditions. It's no surprise, then, that despite the hiring issues, finance executives held fast to their positive economic outlook.

The CFO optimism index fell almost imperceptibly to 70 in the September survey, down from all-time highs of 71.1 in June and 71.2 in March. CFOs' optimism over their own firms' financial prospects, meanwhile, increased to 71.4, the highest level since 2007.

On average, U.S. finance executives projected a 7.5% increase in revenue, a 5.7% boost in capital spending, a 6.3% rise in technology spending, and a 3.6% increase in marketing and advertising spending in the next 12 months.

In addition to worries over hiring, CFOs said government policies, rising wages and salaries, benefits costs, and regulatory requirements were top concerns.

On the policy front, the Trump administration's actions to shrink the U.S. trade deficit through aggressive tariffs is front and center. But most finance executives indicated that the international trade environment will not affect their plans for capital spending or hiring. Those who said they have been negatively affected by the trade wars, however, plan to reduce their capital spending by 6% in the next year.



77%

U.S. finance executives that think science and technology graduate students from foreign countries should have easy access to green cards.

Shorter Horizons

The third-quarter Duke/*CFO* survey asked a special question about whether fast-paced changes in technology, the economic environment, and the geopolitical situation have affected the number of years into the future that companies could reliably plan. The survey also asked if those factors have affected the planned length of a typical investment project.

The results indicated that the fast pace of technological change is hampering the ability of companies to plan for the future. Finance executives said that 5 years ago they could effectively plan 3.5 years into the future, but in the current environment they can plan only 2.3 years out.

Coincident with this shorter planning horizon, CFOs indicated that the projects they adopt now have an expected life of 4.6 years, compared with a 6.2-year life for projects they initiated five years ago.

The accelerated obsolescence is on top of widespread concern that pressure to hit quarterly earnings targets has led to a short-term focus among public companies. The survey found the shortening of planning horizons is even more severe among private firms than public companies.

"If companies hold off on investing because of the fast pace of change, this may damage long-run growth prospects for the overall economy," said John Graham, a finance professor at Fuqua and director of the survey.

Global Unevenness

The direction of finance executives' optimism in economies outside the United States took a significant dip. The survey's optimism index fell among CFOs in Africa, Europe, Latin America, Asia, and Japan.

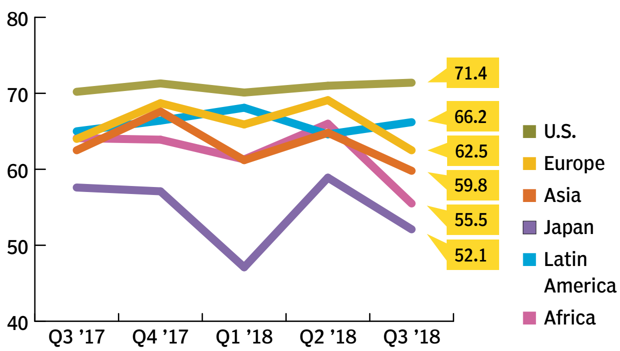
Optimism in Europe plummeted to 57.9 in September, down from 68.5 last quarter. Low optimism in the United Kingdom, Italy, and Spain dragged down the region's score.

Capital spending and employment among these European firms are both expected to grow only about 2% over the next year, with revenue increasing 4%.

Optimism among finance executives in Latin America slipped to 56.4. Economic uncertainty is the top worry in the region, followed by government policies, currency risk, and weak demand. Few Latin American companies said they have taken specific steps to attract and retain workers. CFO

Company Confidence Dips Outside U.S. and Latin America

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 September 7, and generated responses from more 600 CFOs, including 260 from North America, 65 from Asia, 128 from Europe, 352 from Latin America, and 41 from Africa.

iStock

Helping Software Succeed

The process of implementing FP&A software is as critical as the quality of the solution, according to new research. By Chris Schmidt

CFOs understand the importance of financial planning and analysis (FP&A) solutions that allow their finance teams to develop budgets and forecasts quickly and accurately. They need confidence in their numbers and the decisions they drive. But selecting the right FP&A software is only half the battle.

Equally important is how that technology is implemented across the enterprise, from training users and setting their expectations to ensuring that they receive continued support after the software goes live. Absent a successful implementation, a company will never realize the full value from its investment.

A new survey by CFO Research, in collaboration with Vena Solutions, provider of enterprise-class software for budgeting, planning, and forecasting, found that many companies employ a number of best practices when implementing new financial software. At the same time, a significant minority do not—including, in some cases, practices that affect far more than the success of the software implementation. Not following some of these practices can even impact a company's ability to compete in a world where technology laggards operate at an increasingly wide disadvantage to more advanced peers.

Specifically, the online survey of U.S. senior finance executives found that a substantial percentage of firms:

FIGURE 1

Many organizations fail to employ a number of best practices when implementing new financial software.

30%	Do not consider it very important to integrate their FP&A software with financial and nonfinancial data sources
29%	Do not establish and use clear metrics to measure the efficiency and effectiveness of the financial software they adopt
29%	Do not use a phased approach to implementing enterprise financial software
17%	Do not make the end-user experience a critical factor in selecting and implementing new enterprise financial software

Multiple responses allowed.

- Do not establish and use clear metrics to measure the efficiency and effectiveness of the financial software they adopt
- Do not use a phased approach to implementing enterprise financial software, opting instead for a single-step switchover that can dramatically elevate the level of change management involved
- Do not make the end-user experience a critical factor in selecting and implementing new enterprise financial software (ignoring a key variable in the success of the implementation)
- Do not consider it very important to integrate their FP&A software not only with financial but also nonfinancial data sources, foregoing the opportunity to uncover more fully what's driving their financial results.

Legacy Matters

The challenges of conducting financial planning and analysis using legacy systems and processes are well known. Legacy systems typically require that finance personnel manually copy and paste information from disconnected data sources into numerous, disparate spreadsheets. Those spreadsheets are then shared via email with other parties involved in their creation. Several revisions of those spreadsheets occur along the way and also get shared.

While still common practice, that approach to FP&A is highly inefficient and lends itself to human error and version control problems. In some cases, requiring such tedious work can make it difficult to attract and retain skilled finance professionals.

A critical path to addressing these problems is implementing an FP&A solution that can use data from many different sources, both financial and nonfinancial, and unify them in a single database so that everyone is always working with the same set of information. Today's best-in-class FP&A systems do that by automating routine processes, eliminating version control issues, providing robust reporting and analysis tools, and allowing finance professionals to spend more time on higher-value activities, like scenario modeling. The following set of implementation best practices are supported by the findings.

Set and Manage User Expectations. Identifying goals, requirements, and success criteria upfront is critical to a successful implementation. By failing to spell this out early, CFOs risk burdening their organizations with wrong or poorly informed design decisions, gaps in functionality and usability, and longer adoption timelines and payback periods. They also may find they've damaged their own reputations and those of their organizations.

In the survey, 81% of the executives polled said their organizations take the time to set clear expectations, timelines, and success criteria with their vendors, leaving nearly one in five that do not.

Engage End Users Early and Often. All users of new software must know what's in it for them and how their job will become easier once the new software has been implemented. They should understand how the new software and the process changes that accompany it will benefit the entire organization. Employees almost always perform better and adapt more easily to change when they feel they're working toward a common and worthy goal.

In addition, the more structured this process, the better the chances for success. Seventy-five percent of survey respondents said their rollouts of new enterprise financial software were highly structured, and included demos, workshops, help lines, and peer-to-peer mentoring.

Ensure Executive Leaders See Value. To ensure C-suite support, make sure the new system delivers reports that meet executives' expectations. Senior finance managers need to understand the full value of the new software, including how it will help them play a more effective leadership role by providing faster, more accurate budgets, forecasts, and reports and drive company decisions with the right, forward-looking data.

Focus on Quick Wins. Nothing drives support for a new software system, or its accompanying process changes, like demonstrable success, and the sooner it comes the better. The best way to deliver quick wins is to break the implementation into manageable phases, starting with a discrete process, like a departmental forecast.

In addition to phasing in the implementation, finance can build faster support for the project by ensuring continued, controlled engagement with both end users and the software vendor. That can be facilitated by periodic peer reviews, design workshops, and team demonstrations.

29%

Organizations that do not establish and use clear metrics to measure the efficiency and effectiveness of the financial software they adopt

Identify Opportunities for Innovation. CFOs should look at implementations as a chance to improve on existing finance processes for which meaningful gains can be achieved, including: maintaining current processes but with greater efficiency, adoption, and reliability; retooling processes to improve how and when people and other resources are involved; and completely changing or adding processes to optimize efficiency and the overall value provided.

Establish Clear Vendor and Customer Roles. Create a governance structure that keeps stakeholders aware of what's happening, and both involved in and accountable for the process. Participants should include an executive sponsor for each side, and they should meet regularly.

An internal project champion should promote the implementation's progress using well-formatted and compelling internal updates. Even small wins should be celebrated.

Ensure Integration with Systems. Today's best FP&A solutions connect with ERP and other information systems containing operational and company-wide data. Once these ties are made, CFOs and their C-suite colleagues can use the software to more easily connect the dots between operating decisions and financial results, and more accurately forecast how results might play out under different scenarios.

Ongoing Support. Companies will want to agree with their vendor, upfront, on support and maintenance expectations, including how long the vendor will take to respond to and resolve any issues. Companies also should look for a packaged service offering for the application areas they want to automate.

In searching for the right offering, organizations should be mindful that the majority of FP&A implementations involve the same tasks, milestones, processes, training, and documentation—i.e., the same basic implementation stages. That allows for straightforward and consistent comparisons of the implementation timelines and pricing structures proposed by competing software providers. CFO

FIGURE 2

How do finance executives view the implementation of enterprise software?

As a means of automating processes to improve efficiency	36%
As an opportunity to reengineer processes to deliver stronger value	48%
As an opportunity to fundamentally change the processes underpinning their business model	15%

Does not add up to 100% due to rounding.

Getty Images

THE QUIZ

Noteworthy Numbers

There's great variation in the degree to which CFOs factor data about the general economy into decision-making. J.P. Morgan, for its part, published an advisory, "Striking Facts to Guide Your Corporate Finance Decisions in 2018," from which the answers below are drawn. How much do you know about the economy outside your company's walls?

1 What is the shortest time period it took the Dow Jones Industrial Average to climb from one 1,000-point threshold to the next? (Hint: it was achieved in 2017.)

A. 122 days
B. 38 days
C. 375 days
D. 24 days

2 How many physical currencies have more value in circulation than the current total amount of cryptocurrency?

A. 6
B. 15
C. 9
D. 12

3 The OECD recently reported that 100% of the countries it tracks were experiencing economic growth. How many years has it been since that was last the case?

A. 10
B. 7
C. 13
D. 5

4 What percentage of U.S. IPO dollars were raised by special purpose acquisition companies (SPACs) in 2017?

A. 14%
B. 20%
C. 9%
D. 4%

5 Over the last three years, how did the amount of capital invested in nonpublic U.S. firms compare with the capital raised via IPOs?

A. 10% less
B. 20% less
C. 125% more
D. 25% more

6 What was the dollar volume of corporate preferred equity issued by U.S. companies in 2017?

A. $12.7 billion
B. $3.3 billion
C. $7.4 billion
D. $10.6 billion

7 What is the approximate yield spread (basis points) between two-year and 10-year U.S. Treasuries that has prevailed in 2018?

A. 40 bps
B. 30 bps
C. 50 bps
D. 60 bps

Answers: 1-D; 2-A; 3-A; 4-B; 5-D; 6-C; 7-C

Source: J.P. Morgan | Getty Images

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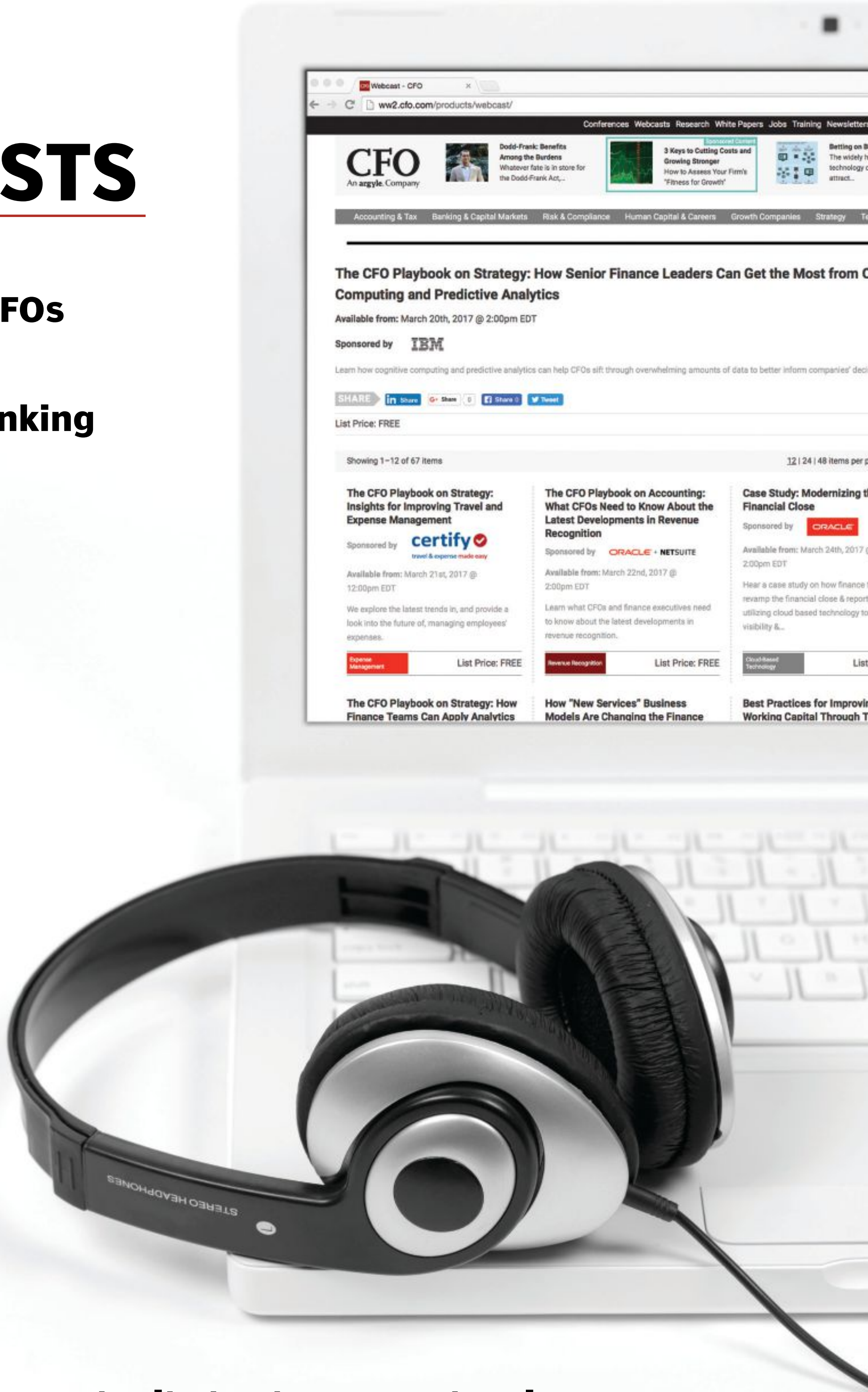

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