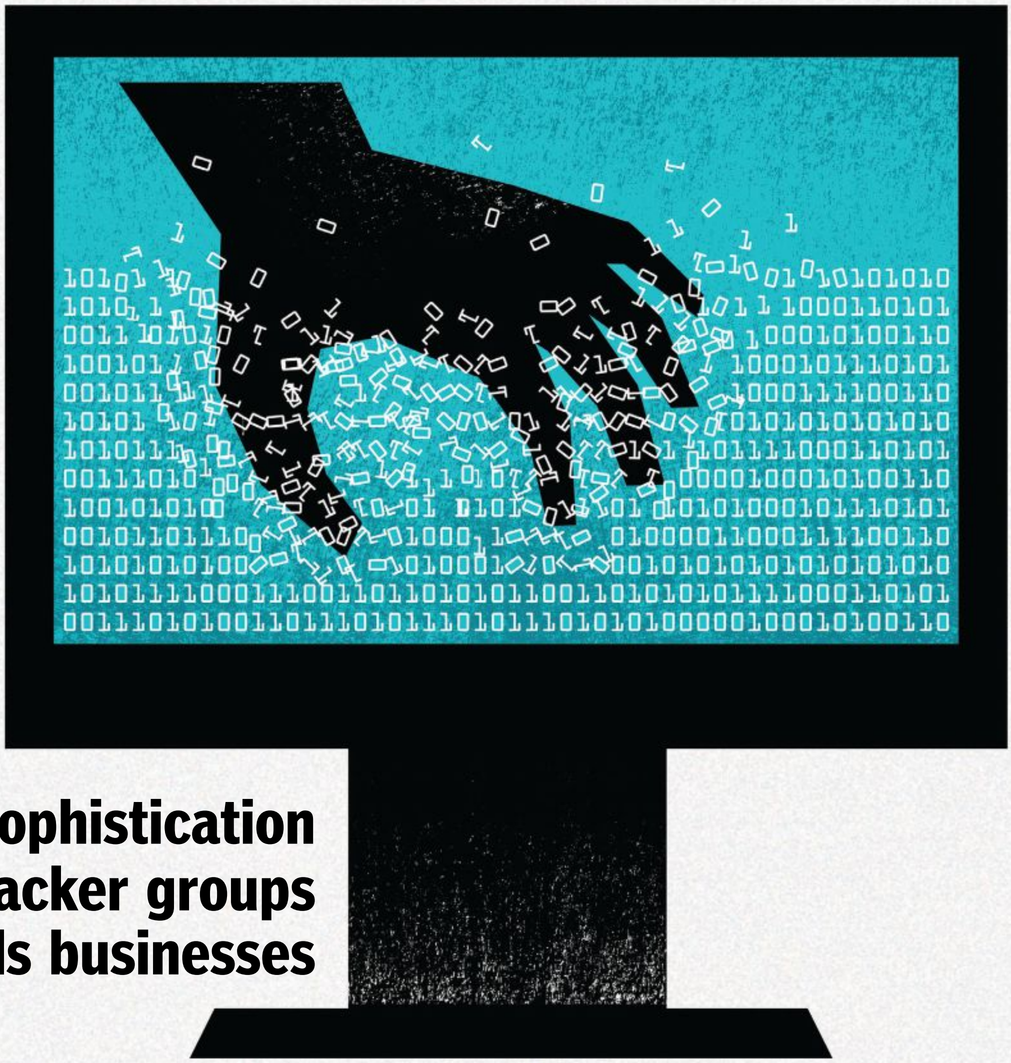
CFO

JANUARY/FEBRUARY 2017
WWW.CFO.COM

WHAT'S WRONG WITH CROWDFUNDING?

HOW TO BE A METRICS MASTER

The Corporatization Of Cyber Crime



The growing sophistication of hacker groups imperils businesses


04:00:13:17
1,260,366,175
Partners
In Health


CFO RISING EAST SUMMIT
LEAD THE PATH TO FINANCIAL GROWTH
March 22 & 23
Boston
SAVE 20% WITH CODE CFO20
Speakers include:
YAHOO!
DREAMWORKS
KraftHeinz
Unilever
ebay
Audi
Disney | abc Television Group
LEGEND
Brought to you by
CFO

FEATURES

January/February 2017
Volume 33, No. 1

Cover: Getty Images; clockwise from top left: Thinkstock (2)

January/February 2017
Volume 33, No. 1

Up Front

By the Numbers

Clockwise from top right: Thinkstock (5)

FROM THE EDITOR

Crowdfunding: Help Wanted

››If President Donald Trump really hopes to return the nation to 4% gross domestic product growth and add 25 million jobs to the economy, he should focus on small business capital formation, not Twitter-shaming *Fortune* 500 manufacturers. Capital-raising is a constant pressure for small businesses, especially for those located outside the venture-capital hubs of Silicon Valley, Boston, and New York; however, they are the biggest source of jobs and innovation.

The work has already been started: Five years ago this April, Congress passed the Jumpstart Our Business Startups Act, and, after much deliberation, the SEC last year finally finished all the rule-setting needed to help smaller companies raise capital in the digital age. Among other things, the JOBS Act sanctioned "crowdfunding," a means for startup companies to raise debt and equity through hundreds of bite-size investments online.

Since May 2016, about 80 companies have amassed $19.6 million through crowdfunding, according to Crowdfund Capital Advisors. The average funded campaign attracted $227,000, with the average investor pool numbering more than 300. Each investor kicked in about $830. How many jobs will that translate into? As of late January, CCA estimated that 2016's funded companies could potentially create about 174 jobs in the next three months. Meager results for sure, but it's early. Despite the 19 funding portals that have been set up in the U.S., the world of crowdfunding still feels like a tiny, undiscovered club.

The new presidential administration could promote awareness of crowdfunding and other parts of the JOBS Act, like Regulation A+ offerings. Additionally, Congress could get to work on amending the law, as explained in our feature, "What's Wrong with Crowdfunding?" More small businesses mean more jobs, and that's what President Trump says he's about. It's hard to imagine a more suitable agenda item for the new resident of Pennsylvania Avenue.

Vincent Ryan
Editor-in-Chief

Mark Bennington

EDITOR'S PICKS

FINANCE

Just around the corner is the CFO Rising East Summit, taking place in Boston on March 8-9, 2017. Some of the latest speakers to be added are the North American finance chief of Unilever, the CFO of Audi, and the VP of finance at DreamWorks Animation. For more information, go to: https://the-innovationenterprise.com/summits/cfo-rising-east-summit-boston-2017.

POLICY

In "The Right Way to Build America's Infrastructure," Harvard University senior lecturer in finance John Macomber explains why political leaders "should be thinking about infrastructure as a long-term investment in competitiveness and quality of life, not as a spending program." Read the article at https://hbr.org/2016/12/the-right-way-to-rebuild-americas-infrastructure.

CFO, Vol. 33, No. 1 (ISSN 8756-7113) is published 10 times a year and distributed to qualified chief financial officers by CFO Publishing LLC, 295 Devonshire St., Suite 310, Boston, MA 02110 **(editorial office).** Requests for reprints and permissions should be directed to FosteReprints, (866) 879-9144; E-mail: rhondab@fosterprinting.com; website: www.fostereprints.com. Periodicals postage paid at Boston, MA, and additional mailing offices. **POSTMASTER:** Send address changes to **CFO,** 45 West 45th Street, 12th Floor, New York, NY 10036. ***CFO*** is a registered trademark of CFO Publishing LLC. **SUBSCRIBER SERVICES:** To order a subscription or change your address, write to CFO, 45 West 45th Street, 12th Floor, New York, NY 10036, or call (212) 459-3004; or visit our website at **www.cfo.com/subscribe.** For questions regarding your subscription, please contact subscription@cfo.com. To order back issues, call (212) 459-3004. 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.

THE BUZZ ON CFO.COM

A former CFO, Jack Healey, responded to **"How CFOs Can Budget to Boost Cybersecurity"** (Jan. 19) with some suggestions of his own. Healey, who now helps companies prepare for cyber-incident response, proposed that companies compile a comprehensive database of notification requirements.

"Most contracts today contain requirements associated with data breaches," Healey wrote. "These requirements include contractual abstracts with suppliers, customers, NDAs, and regulatory agencies. **Compiling these notification details during a cyber incident is a daunting task** and a huge cost driver."

Healey also recommended that companies have a cybersecurity-response plan and team, which would include the CISO, brand presidents, and participants from the finance, legal, internal audit, risk, and communications functions, among others. "This is a business issue, not an IT issue," he wrote.

A Dec. 27, 2016 article, **"When Cost Cutting Gets Expensive,"** touched some nerves in our audience. The authors argued that serious efforts to shed costs require substantial investments, but that often these investments fail to deliver the intended result. Restructuring charges are commonly 125% of the savings realized, "which makes cost cutting a losing proposition," they claimed.

Agreed one reader, mincing no words, **"The top three layers of management have no grasp of what costs are in SG&A,** why the costs are there, how long the costs have been there, and what benefit is generated by each. So, since SG&A is so confusing they think restructuring is the answer. That way it looks like the executives are doing something sustainable."

Wrote another audience member, taking issue with the article, **"Big initiatives tend to be slow, risky, expensive, and disappointing.** All these things lower margins and revenue per employee. Better to install a good management team, align the organization structure with key value streams, continually improve business processes, and turn cost savings into market share."

Correction:

A sidebar in the December 2016 cover story on non-GAAP reporting ("Misleading Metrics?") transposed the name of an employee benefits software firm, Hodges-Mace, referring to the company as Mace-Hodges.

CFO

An argyle. Company

argyle.

CFO Publishing LLC is a wholly owned subsidiary of Argyle Executive Forum LLC, 122 W 26th Street 2nd Floor, New York, NY 10001
www.argyleforum.com

PRESIDENT & CEO Danny Phillips

VP & MANAGING DIRECTOR, CFO Scott Pierce

CFO Magazine/cfo.com

EDITOR-IN-CHIEF
Vincent Ryan (vinceryan@cfo.com)

MANAGING EDITOR Deana Colucci

DEPUTY EDITORS:
David M. Katz (davidkatz@cfo.com)
David McCann (davidmccann@cfo.com)

WEB EDITOR Sean Allocca (seanallocca@cfo.com)

CFO Marketing Services

DIRECTOR, MARKETING SERVICES
Chris Schmidt

EDITORIAL DIRECTOR, CUSTOM CONTENT & RESEARCH
Joe Fleischer

CONTENT MANAGER
Kim Zimmermann

Advertising Sales

NORTHEAST
Haley Moore, (646) 277-6478; fax: (212) 459-3007
Brian Kleve, (646) 556-7653; fax: (212) 459-3007

MIDATLANTIC/SOUTHEAST
Matt Moore, (212) 488-4702; fax: (212) 459-3007
Brian Kleve, (646) 556-7653; fax: (212) 459-3007

CENTRAL/CENTRAL MIDATLANTIC
Brian Kleve, (646) 556-7653; fax: (212) 459-3007

MIDWEST, PACIFIC NW
Brian Kleve, (646) 556-7653; fax: (212) 459-3007

WEST COAST
Judy Hayes, (925) 736-7617
Brian Kleve, (646) 556-7653; fax: (212) 459-3007

Editorial Offices

295 Devonshire St., Suite 310
Boston, MA 02110
(617) 345-9700

45 West 45th St., 12th Floor
New York, NY 10036
(212) 459-3004

Subscriber Services

www.cfo.com/subscribe

CFO WELCOMES YOUR LETTERS

Send to: The Editor, *CFO,* 295 Devonshire St., Suite 310, Boston, MA 02110, or e-mail us at: letters@cfo.com. Please include your full name, title, company name, address, and telephone number. Letters are subject to editing for clarity and length.

STATS OF THE MONTH

FUND FLOWS

6.4%
Increase in U.S. nonfinancial corporate borrowing, Q3 2016*

$8.4 trillion
Value of nonfinancial entities' debt outstanding, up 5.2% from Q2 2016

$687 billion
Share buybacks by U.S. nonfinancial entities, up 4.9%

$1.9 trillion
Value of capital spending by U.S. companies, down 0.6%

* All data is for Q3 2016. Rates are annualized and seasonally adjusted. Source: Standard & Poor's

Topline

BENEFITS

ACA Replacement: Hurry Up and Wait

No matter what Congress does about repealing and replacing Obamacare this year, the near-term impact on employers will be minimal.

At press time on Jan. 20, the day before President Donald Trump was inaugurated, Republicans in Congress were readying a budget reconciliation bill that would repeal much of the Affordable Care Act, although details of the proposal were under wraps.

Trump himself was saying he had a plan that would provide "insurance for everyone." It was unclear how similar that plan was to one that's been floated by Rep. Tom Price, a Republican from Georgia and the nominee to head Health and Human Services.

Amid the chaos, companies' advisers on health-benefits matters were telling them to keep cool—and not just because of uncertainty over what repeal-and-replace legislation might look like.

Julie Stone, a national health-care practice leader for Willis Towers Watson, said she'd been getting numerous inquiries from corporate clients about "what to do in 2017." The answer came easily: "Nobody should do anything differently, from a compliance

perspective," she said.

While Stone said that companies would be unwise to make such changes while the ACA was still on the books, she was also skeptical that changes material to companies would take effect anytime soon. "The regulations that underlie the ACA are so complex that it would take years to unwind," she said. "All of the pieces were framed to fit together."

Geoff Manville, principal for government relations with Mercer, said he doubted that legislation would undo popular insurance reforms provided for under the ACA. Those include the ban on lifetime and annual dollar limits on coverage; plan eligibility for children of employees to age 26; and the ban on pre-existing condition exclusions.

Also expected to be untouched, at least in a budget reconciliation bill: reporting requirements around the ACA's employer mandate to provide essential health benefits. "A lot of people assume those duties would go away if they zero out the employer mandate in a reconciliation bill, but that's not true," Manville said. "Those provisions are in a separate part of the tax code, and the penalties for failure to report would still apply."

Notably, budget reconciliations are not subject to filibuster, so Senate Democrats would not be able to derail the bill unless they lure some Republicans to their side.

Still, despite Trump's demand that Congress simultaneously repeal and replace the ACA, Manville said it's "becoming increasingly clear that repeal and replace will not be done in one fell swoop. It's much more likely to be done in a series of steps." Further, he noted, it's not yet a "done deal" that all Senate Republicans will back a repeal effort.

Many Republicans, including Price, advocate that replacement legislation include a cap on the tax exclusion for employer-provided coverage. Under Price's proposal, employees would have to pay income taxes on the value of health benefits that exceed $8,000 for individuals and $12,000 for families.

The ACA also calls for limiting employee-sponsored health benefits, but through the so-called "Cadillac tax," a 40% excise tax on the value of policies above a certain threshold. The tax, which would be paid by employers, is slated to take effect in 2020.

There has been bipartisan support for a repeal of the excise tax. But many Republicans feel there should be some cap on the tax exclusion of employer-provided coverage in order to raise money for the proposals they're going to put forth for an ACA replacement. And many economists, both left- and right-leaning, have long felt that exempting employer-provided health benefits from taxation is unsound economic policy.

Meanwhile, Stone suggested a possible ramification for employers, should repeal-and-replace legislation do away with the public exchanges, that hasn't gained much attention.

Some clients, she said, have told her that the prospect of employing more contingent workers in the fast-developing "gig economy" has been considered doable in part because such people could find health-care coverage through the public exchanges.

"If the public exchanges go away, the willingness of a large number of people to work on a contingent basis, versus having that more-permanent relationship with an employer, could be impacted," Stone said. **DAVID McCANN**

CAPITAL MARKETS

IPOs: Look Out Below

The sluggish U.S. IPO market recovered from a dismal first half in 2016, but still fell well below 2015 levels in both activity and proceeds raised, according to Renaissance Capital, an IPO investment adviser.

Last year's 105 pricings raised $18.8 billion, down from $30 billion raised in 170 deals in 2015. Annual IPO proceeds thus dropped 37% year over year, to their lowest level since 2003.

"While there is every indication that the market will improve, we're still missing the larger IPOs that drive activity and volume," says Alex Castelli, a partner at consulting firm CohnReznick.

Renaissance Capital suggests that a two-year drought in tech offerings—the market's bread and butter—led to the 2016 decline. A disconnect between private and public valuations caused many tech companies to delay their offerings or withdraw them altogether.

The situation "can only be remedied by [venture capitalists] caving in to their growing urgency to sell ... or by time as companies grow enough to justify their lofty private valuations," the Renaissance Capital report says.

Mergers and acquisitions provided alternate paths for tech companies looking for quick cash. The payment processor TransFirst and security software vendors BlueCoat and Optiv all filed for IPOs but then withdrew after a merger or acquisition.

Such companies "create liquidity for their shareholders and employees and raise capital to expand," Castelli said. "They enjoy the benefits of an IPO without taking on the risk or expense of going public."

The silver lining in 2016 was the aftermarket. IPOs had their best-performing year since 2013. The average IPO was up 23% from its offering price.

While experts are optimistic for a recovery in 2017, the IPO pipeline is running a bit dry. Only 64 names were on file looking to raise $18.3 billion, as of the second week of December, representing declines of 46% and 32%, respectively, compared with 2015 year-end totals. **SEAN ALLOCCA**

Key U.S. IPO Statistics

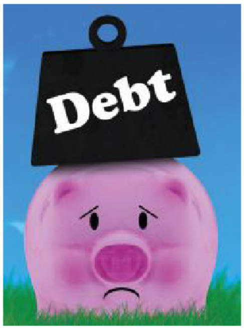
IPO Volume	2015	2016
Median deal ($M)	$94	$95
Number of deals	170	105
PE-backed deals	39	30
PE-backed proceeds ($bil)	$11.3	$8.8
Proceeds raised ($bil)	$30	$18.8
VC-backed deals	85	42
VC-backed proceeds ($bil)	$8.9	$3.5

Source: Renaissance Capital

Thinkstock

BANKING

Bailout Buffer



The U.S. Federal Reserve added a rule to its bailout-prevention regulatory package that requires the eight largest banks to maintain a minimum amount of long-term debt. The Fed board voted 5-0 in December to adopt the final version of the total-loss absorbing capacity rule, known as TLAC. The rule will increase the funding costs of globally and systemically important banks by a total of between $680 million and $2 billion annually.

According to the Federal Reserve, four of the banks will have to issue new debt or equity totaling an estimated $70 billion to comply with the rule, which would be down from about $120 billion a year ago.

The rule is "one of the last critical safeguards that make up the core of our post-financial crisis reform efforts," said Fed Chair Janet Yellen. The TLAC requirements "build on, and serve as a complement to" regulatory requirements that are intended to ensure that a bank has sufficient capital to remain a going concern, according to the Fed. The objective of TLAC is "to reduce the financial stability impact of a failure by requiring companies to have sufficient loss-absorbing capital on both a going concern and a gone-concern basis."

The minimum level of total loss-absorbing capacity can be met with both regulatory capital and long-term debt. In the event of a bank's insolvency, Fed Governor Daniel K. Tarullo noted, equity capital "will either be totally lost, or at least below the level markets have historically required for a financial intermediary to be credible. The long-term debt required by this proposal would survive the disappearance of a bank's equity and resultant failure, and would be available for conversion into new equity."

The banks will have until January 1, 2019, to comply with the final rule. According to Moody's Investors Service, the four banks that will have to issue new debt or equity are Bank of America, JPMorgan Chase, State Street, and Wells Fargo. **MATTHEW HELLER**

M&A

Buyers Are Wary

Which risk factors are acquirers worried about most before closing their next deal? Sixty percent of financial professionals say overpaying for deals was the biggest risk buyers faced in 2016, according to a survey conducted by the Financial Executives Research Foundation and the consulting firm Crowe Horwath. Forty percent say high valuations made completing M&A transactions risky business.

With the U.S. stock market indices near all-time highs in mid-January, the high level of M&A risk won't be going away. "M&A is just too competitive and the pricing too expensive to rely on financial arbitrage, inflated cross-selling models, or wishful thinking that you will find a diamond in the rough," says Chris Nemeth, a managing director at Crowe Horwath.

Companies have learned to operate on leaner budgets since the financial crisis and have been reluctant to spend capital on transactions that don't provide near-term value, the survey suggests. The net result: an overabundance of cash on balance sheets. Combined with the still-low cost of debt and a limited availability of targets, that factor makes M&A a seller's market.

Top 10 M&A Risk Factors

Executives rated the top risk factors facing buyers during and after mergers and acquisitions.

1. **Overpaying for deals**
2. **Insufficient operational diligence**
3. **Maintaining strategic clarity and focus**
4. **Current valuations**
5. **Culture assimilation challenges**
6. **Fuzzy growth strategy or specific deal rationale**
7. **Employee anxiety, morale, and/or engagement issues**
8. **Limited access to target company**
9. **Underestimation of time and resources required for synergy**
10. **Insufficient rigor in financial due diligence**

Source: Survey of 180 financial professionals from private, public, and not-for-profit organizations; Financial Executives Research Foundation and Crowe Horwath

Maintaining strategic clarity and focus is also among the top three risk factors survey respondents mentioned. A lack of clarity often leads to a more reactive approach to unforeseen problems, overpaying on the acquisition itself, or simply chasing too many targets.

"The single most common mistake that more inexperienced poker players make is simply playing too many hands," says Marc Shaffer, partner with Crowe Horwath. "It's indeed hard—and takes real discipline—to wait on the sidelines, at the ready, until precisely the right opportunity comes along." **S.A.**

Thinkstock (2)

FINANCIAL REPORTING

Sustainability Disclosures "Flawed"

Unless compelled, companies appear reluctant to disclose material information on their sustainability risks and opportunities. That's the finding of the inaugural State of Disclosure report published by the Sustainability Accounting Standards Board.

The report analyzed 713 annual SEC filings, mostly from fiscal year 2015, representing about 12% of the companies listed on the NYSE and Nasdaq. Eighty-one percent of the companies analyzed by SASB divulged some kind of information about sustainability. The board identified a handful of sustainability topics included in the SASB provisional standards for each industry. Sixty-nine percent of the companies reported on at least three-quarters of those topics, which included concerns like overall operational footprints and end-of-life product management for telecommunications companies, and customer privacy and data security for commercial banks. Almost 4 in 10 (38%) companies reported on every topic in their industry standards list.

While the quantity of disclosures increased, though, the majority of reporting was seriously "flawed," said SASB. The board categorized the quality of the disclosures into four groups from the least to the most informative: no disclosure, boilerplate, company-tailored narrative, and metrics.

Fifty-three percent of company disclosures used nonspecific language to describe sustainability topics, such as, "We believe our energy consumption is the lowest in the industry." SASB says such "boilerplate" language pays only lip service to sustainability reporting and is inadequate for responsible decision making. Only 24% of the reports included metrics.

Without metrics, sustainability disclosures may not allow investors to compare and contrast a company with its industry peers. S.A.

ACCOUNTING

Goodwill Impairments Double

While 2015 was filled with merger and acquisition activity in the U.S., it was, unfortunately, also filled with goodwill impairments—the charges companies record when goodwill's carrying value on financial statements exceeds its fair value.

After increasing 18% in 2014, goodwill impairments doubled to $57 billion in 2015, a record since the height of the global financial crisis. The number of impairment events increased only slightly, to 350, but the average impairment per event jumped, to $163 million.

Duff & Phelps, author of the annual U.S. Goodwill Impairment Study, attributed the impairment increases to ongoing weakness in energy prices and "a few significant impairment events in the tech sector."

Goodwill, of course, is an intangible asset that arises as a result of one company acquiring another at a premium value.

Fifty-six percent of energy companies that carried goodwill on their balance sheets recorded an impairment in 2015, said Duff & Phelps, resulting in total impairments of $18.2 billion. That was up from $5.8 billion in 2014. "Not surprisingly, the collapse in oil prices since mid-2014 through early 2016 had a broad and material impact in the energy industry," according to the report.

The largest impairments were recorded by National Oilwell Varco, Hess, and Crestwood Equity Partners, all of which had impairments exceeding $1.4 billion.

In the technology industry, goodwill impairments more than tripled in 2015, to $12.9 billion. The technology industry saw two of the three largest impairment charges—Microsoft's $5.1 billion writedown of its Nokia handset division and Yahoo's $4.5 billion charge on its Tumblr business.

With M&A activity robust in 2015, companies of all stripes added goodwill to their balance sheets, $458 billion in total (tech added the most, $122 billion). According to Duff & Phelps, aggregate goodwill as a percentage of total assets for U.S. companies has grown steadily since 2012. In 2015 it exceeded 7%. **VINCENT RYAN**

COMPENSATION

Incentive Pay Adjusts

The criteria for earning short-term incentive (STI) compensation appear to have entered a state of flux, judging by research from the CFO Alliance.

In particular, some companies are putting nonfinancial metrics, like customer or employee satisfaction, into the mix. But far more companies should be doing so, according to Ernie Humphrey, a former CFO who is director of content for the CFO Alliance.

Among 188 executives who responded to the group's poll—82% of whom were either CFOs or controllers—46% say their company either added new performance metrics to the STI pay calculation or expect to do so in 2017.

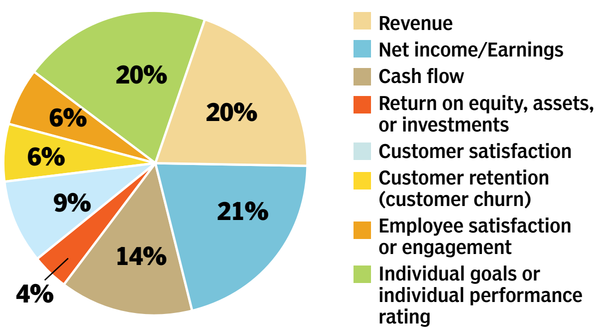
That much change in the behaviors companies are looking to motivate with their STI programs "represents a strong indicator that companies realize there is a misalignment between incentives and key drivers of company performance," the study report says.

Finance and management professionals increasingly recognize that customer satisfaction, quality of business processes, customer relationships, quality of people, and brand reputation are what drive value.

In the CFO Alliance study, among the participants who say changes have been or will be made to STI criteria this year or next, 9% say some changes relate to customer satisfaction metrics; 6% say the same for customer retention and employee satisfaction.

Those numbers probably represent an uptick in the proportion of companies prioritizing those areas for STI purposes. But Humphrey still finds the change-in-criteria results disappointing. "I was looking to see more of that, because those areas are becoming a driving force in what companies are tying to accomplish," he says. "In general, the incentives in place do not inspire behaviors that impact company value." **D. M.**

Short-term Incentive Metrics



*added in 2016 or to be added in 2017
Source: 2016/2017 CFO Mid-market Executive Compensation Survey, The CFO Alliance

Thinkstock

Ready for Lease Accounting?

They don't take effect until 2019, but new lease accounting rules will have an immediate bottom-line impact. By Sean Moynihan

» The new lease accounting rules will have far-reaching implications for both public and private companies, but many organizations have procrastinated on preparing for them. ¶ The Financial Accounting Standards Board's leases standard will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other organizations, the update on leases will take effect for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020. The International Accounting Standards Board's rule will become effective on January 1, 2019.

The new standards, approved separately, require that leases with a maximum term longer than one year be capitalized on company balance sheets. With the exception of leases with maximum terms of less than 12 months, no leases will be grandfathered in. That means the impact will be immediate and, in many cases, material to financial statements.

Finance vs. Operating

Under the IASB standard, all leases will be classified as finance leases. Under the FASB standard, there will be both operating and finance leases.

Operating leases are recorded on the income statement with straight-line rent expense—similar to today's operating-lease model, but nonetheless capitalized on the balance sheet. Finance leases are similar to the current capital lease model. Factors that would trigger a finance classification under the FASB rules include the following:

- The lessor transfers ownership of the underlying asset to the lessee by the end of the lease term.
- The lease grants the lessee an option to purchase the underlying asset, and the lessee is likely to exercise that option.
- The present value of the sum of the lease payments and any lessee residual value guarantee not reflected in the lease payments is equal to or exceeds "substantially all" of the underlying asset's fair value.
- The underlying asset is expected to have no alternative use to the lessor at the end of the lease term.

These classifications will have a real impact on financial statements, influencing everything from cash-flow presentation and balance-sheet metrics to net income and earnings before interest, tax, depreciation and amortization (EBITDA). Below are examples that demonstrate how the new rules will affect financial statements.

- A finance lease will be categorized as a financing activity on the statement of cash flows.
- The liability for a finance lease will be classified as debt, which will have a detrimental impact on a company's debt-to-equity ratio and will threaten loan covenants.
- Shareholders' equity will take more of a hit from a finance classification versus an operating classification.
- Expense reported on the income statement for finance leases will include a combination of amortization of the "right of use asset" and front-loaded interest expense assessed against the outstanding lease liability.

Late Changes

Before the rules were finalized, FASB and IASB made a few last-minute changes.

For one, a "gross lease"—a kind of commercial lease in which the land-

Long Runway

How the new lease accounting standards evolved

August 2010
FASB and IASB issue first exposure draft on lease accounting.

May 2013
Exposure draft by FASB and IASB calls for companies to separate leases according to the kind of asset leased: Type A (equipment) or Type B (real estate).

March 2014
A rift between FASB and IASB opens up, as FASB holds that differences in the economic underpinnings of leases must be reflected on balance sheets.

Sources: *CFO*, FASB

lord pays for the building's property taxes, insurance, and maintenance—will now trigger the inclusion of taxes and insurance on the balance sheet. Because of this, companies that are focused on EBITDA may find gross leases classified as finance leases to be more advantageous. That's because finance leases allow taxes and insurance to flow through the income statement as interest and amortization, instead of selling, general, and administrative (SG&A) expenses.

Other late changes to the rules relate to subleases. When FASB and IASB were close to finalizing the rules, they were reminded that existing subleases—at least those where the sublessor recognized a loss on the sublease—were already impacting the balance sheet of the sublessor. As a result, bringing the underlying lease onto the balance sheet would effectively result in two liabilities for the same obligation.

FASB and IASB revised the proposed standards late in the process to account for new and existing subleases. The result of that change is that leases that have previously been subleased will reappear on the balance sheet and income statement of the sublessor.

Caught Napping?

The new lease accounting rules were debated publicly and within FASB and IASB for more than six years, and the lengthy process lulled many companies into a false sense of security.

Many CFOs took an "I'll believe it when I see it" approach to the standards, which was understandable since the rules seemed stuck in limbo for so long. Then, when the rules were finally approved, companies were in the throes of dealing with the new revenue-recognition standards slated to take effect in 2018. So, for many companies, preparing for the new lease accounting changes has not been a priority.

Yet the deadlines remain set. Public companies that have yet to turn their attention toward this issue should consider that they will have comparative reporting in their 2019 financial statements that will reflect 2017 and 2018, and the window is quickly closing for them to invest the time and resources required to understand and mitigate the rules' impact.

Also, companies subject to SEC reporting requirements would be wise to remember that the commission requires them to disclose the impact of new accounting standards that have been issued, but not yet adopted, in advance of those rules going into effect.

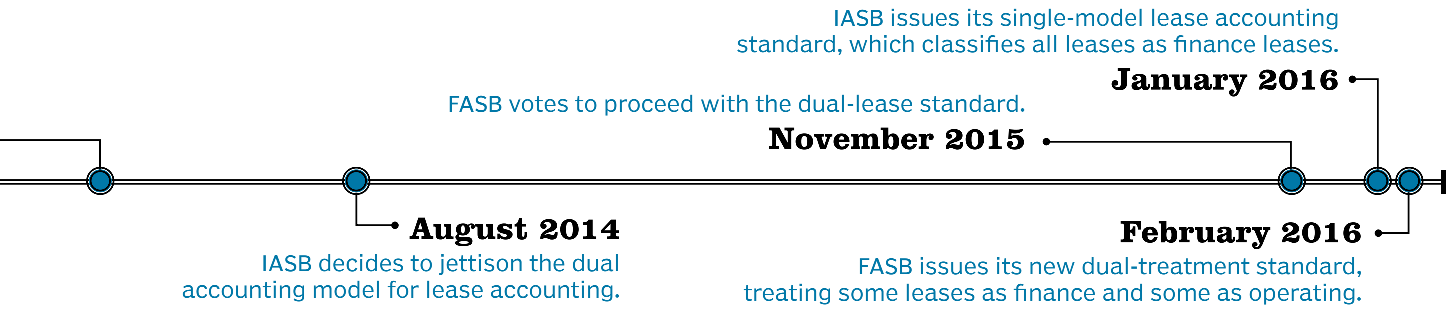
One of the biggest obstacles to readiness is the availability of information about existing leases. Many components of rent payments are not tracked under existing accounting standards. Operating costs are often included in rent payments, but under the new rules they will need to be segregated from gross rental costs for purposes of calculating the asset and liability associated with any lease.

Also, under the new rules, property tax and insurance costs in a gross lease—which may be part of an aggregate "operating expense" value—will have to be capitalized. Failing to bifurcate service components from "rent," or entering into gross leases as opposed to net leases, will result in the balance sheet being materially and unnecessarily overstated.

Adding complexity to the already-time-consuming process of reviewing lease structures, many companies with legacy lease administration software are finding they cannot use these applications to run lease accounting analysis under the new standards. Consequently, in order to move forward firms are either re-abstracting lease data or finding ways to blend that data with other reporting data.

The longer companies wait to get started, the more difficult compliance will become. Wishful thinkers may be hoping that FASB and IASB will delay the compliance deadline, but there is no indication that will happen. CFO

Sean Moynihan is a principal in the office properties group at Avison Young, a commercial real estate services firm.



How to Make Hay Out Of Trump's Policies

Taking advantage of a lower corporate tax rate and incentives for offshore cash repatriation will not be straightforward. By Tom Liguori

We've all read the headlines: a trillion dollars in infrastructure spending, a repatriation holiday, and corporate tax reform. Sounds great for the country. What will be the affect on your company? Will there be winners and losers? Which will your company be? ¶We are likely entering a period of stimulative spending and higher gross domestic product growth, though it will be accompanied by higher government deficits and interest rates. Stock markets are reaching all-time highs. Debt markets are pricing in interest-rate increases. It's time for management teams to answer a few questions:

1. How do we maximize the opportunities from these proposals?
2. How do we minimize the risks?
3. What is our action plan?

At press time we don't know what the proposals from President Trump and the House of Representatives will look like in their final form; they ultimately may have profound affects on businesses. Let's take a look at a few of the proposals, as of mid-January.

Higher infrastructure spending. Current proposals range from close to $1 trillion to more than $2 trillion in new spending. Spending on bridges, roads, tunnels, and airports creates demand for steel, raw materials, industrial products, and more. We may have larger industrial opportunities than previously thought. It's time to assess the impact on existing strategic plans for revenues, spending, and investment needs.

Higher interest rates. The period of historically low interest rates may be over. Higher interest rates affect interest expenses, profitability, and cash flows. Tax reform proposals include the possible elimination of interest as a tax-deductible expense. That has significant long-term implications.

What can a company do? Explore refinancing current variable-rate debt with fixed rates. With equity markets strong, an equity or convertible debt placement should be part of the capital structure discussion. Higher interest rates and eliminating interest expense deductibility would affect cost of capital. Companies need to reassess their capital structure, weighted average cost of capital, and investment hurdle rates. Each requires careful thought and planning.

Repatriation holiday. Headlines imply a low tax rate of 10% to repatriate offshore cash. Bringing the cash back to the United States presents significant opportunities for U.S. investment, acquisitions, and shareholder distributions.

The fine print of this proposal reveals more details, however. The "holiday" may be more of a mandatory tax than an optional holiday. Plus, the 10% tax will most likely be on previously untaxed foreign profits, not just offshore cash.

That's a huge difference. Many, if not most, companies have far higher offshore profits than offshore cash. The reason, presumably, is that offshore profits have been reinvested in the business, as they should be, leaving a smaller cash balance.

A company with $300 million in untaxed foreign profits, though with only $100 million in offshore cash, would have a tax due of $30 million, equal to 30% of its cash balance.

Understanding the potential tax expense and cash flows is important. They may be

TABLE 1

"Border Adjusted" Tax for Importers

	TODAY	BORDER ADJUSTED	
	Income Statement	Income Statement	Tax Return
Revenue	$100	$100	$100
Cost of sales	$65	$65	$0
Gross margin	$35	$35	$100
Operating expenses	$15	$15	$15
Profit before tax	$20	$20	$85
Tax rate	34%		15%
Tax expense	**$7**	**$13**	**$13**
Net income	$13	$7	

Source: Tom Liguori

different than initially thought. Still, having cash available in the United States will have enormous benefits. Domestic acquisition opportunities are easier to fund, and with the tax handcuffs off, shareholder distribution policies will need careful review.

Tax reform. This is an even more complicated subject, with potentially far-reaching positive and negative implications.

While the headline benefit of a corporate tax rate of 15% (or 20%, depending on which plan you are looking at) is extremely appealing and should provide many benefits, again it is necessary to read the fine print.

On the plus side, the proposals are a blueprint for a booming U.S. economy:

- 15% corporate tax rate
- 0% tax rate on profits from goods manufactured in the U.S.
- Low tax rate on intellectual property (IP) royalties
- Full expensing in year one of capital expenditures made in the U.S.
- Possibly a territorial system (no tax of offshore profits)

If a company were starting anew, it would be a no-brainer to say: Let's develop our IP in the U.S., license it offshore, manufacture in the U.S., and pay 0% tax!

For importers and companies that manufacture in low-cost offshore locations, however, there can be significant drawbacks and economic costs. For example, current tax proposals include a concept called "border adjusted."

"Border adjusted" means there is no tax on profits from goods manufactured in the U.S., and the cost of imported goods is not a tax-deductible expense. That's right, the cost of imports is not a tax-deductible expense. Theoretically, as a result, a business that solely imports could be paying close to a 15% tax on its revenues.

The question is: Does the benefit of a 0% income tax in the U.S. outweigh the higher cost of manufacturing here?

Table 1 shows the affect of a "border adjusted" 15% tax rate on a firm that has outsourced its manufacturing to a low-cost Asian supplier. Since the firm must import its product, the cost of sales is not tax deductible and the amount of tax expense actually increases.

If the same firm moves its manufacturing back to the U.S., it will enjoy the proposed 0% tax rate on U.S.-manufactured goods though will likely pay higher U.S. labor costs.

The challenge for management is, therefore, how to change the company's operations and cost structure to be able to cost-effectively manufacture in the U.S. and take advantage of a 0% tax rate. A company can do this by automating processes, reducing direct labor content, redesigning products, and streamlining overhead. Succeeding in those areas provides an opportunity to benefit from tax reform as illustrated in Table 2.

TABLE 2

Move from Offshore to U.S. Manufacturing

		Offshore mfg.	Mfg. in U.S. with higher labor rates	Mfg. in U.S. cost effectively
Revenue		$100	$100	$100
Cost of sales:	Material	$35	$37	$35
	Labor	$10	$20	$8
	Overhead	$20	$25	$27
	Total COS	$65	$82	$70
Gross margin		$35	$18	$30
Operating expenses		$15	$15	$15
Profit before tax		$20	$3	$15
Tax rate		34%	0%	0%
Tax expense		$7	$0	$0
Net income		**$13**	**$3**	**$15**

Source: Tom Liguori

There are many other implications. Companies will need to assess the impact of border adjustability on their suppliers and customers. Add proposed tariffs to this, and the topic is even more complex. The entire way of thinking about supply chains may change.

How to Win

A winning strategy could start with repatriating offshore cash. That cash could be used to repurchase shares and invest heavily in strategic M&A. Operationally, a company could open a development center in the U.S., license IP to offshore subsidiaries, manufacture in the U.S., and take advantage of the proposed 0% U.S. tax rate. The result: higher earnings and a higher share price.

The new Trump administration has far-reaching proposals. Regardless, strategic thinking at the board and executive management level is required now to capitalize on the benefits and minimize the risks. Asking the right questions today will facilitate having plans in place once proposals are finalized.

How much time do companies have? Let's assume final details are available in the first quarter of 2017, the House and Senate vote in the summer, and implementation is effective in 2018. Companies have just about one year to think through their options and have a strategy in place. CFO

Tom Liguori is CFO of Advanced Energy. He has been a public company finance chief for the past 15 years.

Fighting Falling Food Prices

The CFO of warehouse club-style retailer Smart & Final finds a way to keep profits level while industry-wide deflation persists. By David McCann

Richard Phegley is keeping his head above water, even if pricing for his company's products has been underwater for months. While the retail grocery industry has been plagued by deflation all year, Smart & Final Stores, where Phegley is CFO, is on track for flat profits for 2016 and forecasting solid growth for 2017. ¶ To be sure, keeping profits level has been enabled by growing the company, which currently operates 305 stores in seven Western states. Ranked at No. 595 in the *Fortune* 1000 after taking in about $4 billion in revenue in 2015, Smart & Final opened 33 new stores in 2016 and relocated six others to larger facilities.

Same-store sales have been off—by 1.2% in the third quarter of 2016, for example—because of deflation as well as cannibalization of business from older stores by the new ones. The Consumer Price Index "food at home" segment, in which Smart & Final plays, was down 2.2% for the 12 months ending November 30, 2016.

"I sleep well at night," says Phegley, "but deflation is something I think about before I go to sleep and when I wake up in the morning."

The publicly held company, which offers both retail and wholesale products and serves both household customers and businesses through warehouse-style club stores, expects to see double-digit EBITDA growth in 2017. "We think the deflation is transitory," Phegley says, although he admits that so far "we've not been very good at predicting the end" of the trend.

The company operates Smart & Final stores and larger Smart & Final Extra! stores, both of which sell food, food-service supplies, and janitorial products. It also operates Cash & Carry Smart Foodservice stores, which are strictly business-to-business, focused mainly on small food-service operators like hot trucks, caterers, restaurants, bars, and clubs.

Phegley spoke with *CFO* in December 2016.

What impact is Smart & Final Stores experiencing from the deflationary environment?
There have been three deflationary periods [for retail grocers] since 1960, but this is the first one that hasn't coincided with a recession. It's a nationwide phenomenon. Typically food and food-related products show average annual inflation of about 2% over time.

It makes managing a company very difficult because the top line is shrinking while the economy in general is growing. So the prices of a lot of products that we purchase—not purchase for resale, but things like supplies for stores, products for our offices, and labor—are increasing while the prices of what we sell are deflating.

What's causing the deflation?
It's obviously an imbalance of supply and demand. There's too much product. But there's a lot of head scratching about exactly why.

Look at eggs, for example, which have been very deflationary. Just a year ago they were inflationary, coming out of a period of avian flu and the culling of flocks of producing chickens. Egg exports from U.S. markets to non-U.S. markets used to be very strong, but now eggs are being overproduced at a time when exports are low because of the strong dollar.

More products are currently deflationary than is historically typical. It seems to be mostly in high-volume categories. Beef is another example. It's been very deflationary for almost two years, although it's starting to level out.

But why are so many food products deflationary at the same time? It seems like each should have its own supply-and-demand dynamics.
Yes, and that's the head scratcher among economists. Is this just a random event, or is it something that's not random but not yet fully understood?

Is making pricing decisions part of your role?
I have input into it; I'm not directly setting the prices. But we are very responsive to prices in the market. As

a value retailer, we want to be priced right for consumers.

We are typically 8% to 12% cheaper than Kroger or Albertsons. We have a more edited set of products, and we sell what we sell in great volume at real value. We're competitively priced, perhaps at a very slight premium, to Costco and Walmart. That price position [reflects] our unique assortment of products and convenient, smaller-format stores that are close to customers.

As lower acquisition costs flow through into all retailers, the typical behavior in the market is to pass the reduction through to consumers. We're surveying prices in the market every week, and we'll lower our prices to stay at a competitive gap to the competition.

What is all this doing to your performance?

We measure our economic performance primarily at the EBITDA line, which is flat this year even though our store count is up. Some other retailers have seen year-over-year decreases.

At the retail level, if I'm selling the same number of cases of goods, the price of the case is lower but all of my handling costs are the same. I still have to deliver the cases to the stores, put the product on the shelf, and staff the registers. I'm just paid less for doing that.

We've tried to be very judicious about cost, but the flatness is based on having a greater number of stores. Our average store is down a bit in terms of income generation.

Is there an end in sight for the deflation?

We really believe that there are supply-and-demand checks and balances that should presage an end to price deflation, especially in agricultural products. When there's more of a normal inflationary environment, we should do much better from a financial standpoint.

Have you delayed your schedule for new store openings until the pricing environment improves?

We believe very strongly in store development. In fact, this year we've actually opened more stores than in any prior year. We had an opportunity to acquire a group of stores from the bankruptcy of a competitor in the California market: In early 2015, Albertsons and Safeway group merged, and the Federal Trade Commission required the divestiture of 100 stores in the Pacific Southwest. They went to a buyer that operated them for about six months, and when they failed, we were able to buy 33 of the stores out of the bankruptcy. It was a unique opportunity and one we would do again, although the industry environment was not ideal.

Does Smart & Final anticipate expanding beyond its current markets (Arizona, California, Idaho, Nevada, Oregon, Utah, and Washington)?

Our long-term plan is to grow outside of our seven Western states. The near-term plan, which will cover the next few years, is to continue to saturate the geography that we have.

We like that region a lot. It's one of the fastest-growing areas in the country. Our seven states have over 60 million people—more than the Northeast or Midwest. Its growth characteristics are much like the Southeast.

In food retailing, the economics of the business depend a lot on distance to distribution centers. So it's most efficient to have our growth in that seven-state region. Anywhere else we'd have to set up a different supply chain.

Then, is your long-term plan to grow incrementally farther eastward?

As you grow east from California and Arizona and Nevada, you run into low-density population areas. We'd need to jump geographies to get to a more dense area like the Midwest, with Chicago, St. Louis, and Kansas City, or Texas, with Dallas, Houston, and Austin.

We still have relatively low market penetration, even with 305 stores. Compared with Safeway or Albertsons or Kroger, we have a much lower density of stores to population than they do.

You've been converting many of your Smart & Final stores into larger versions called Smart & Final Extra! What's the strategy behind that?

The "Extra!" stores fulfill more household shopping needs. They have all 10,000 products that are in the legacy Smart & Final stores plus about 5,000 more, with a strong focus on natural, organic, and perishable items, like produce and fresh meat.

At the end of 2016, about 70% of our Smart & Final banner stores will be Extra! stores. We're trying to [convert] as many of the legacy stores as possible. We can do that in three ways.

First, if there's enough space in the store, we can just stock the extra products. We've already done that with most of the stores that are big enough. Second, if there's an available adjacent space, we can expand. We've actually had pretty good success doing that. And third, we may need to relocate a store. All of those [options] are very productive places to make capital investments.

But there will always be some legacy stores because the real estate is irreplaceable, and we just can't economically let them go. CFO

SEC Targets Internal Controls

A decline in accounting fraud has freed up time for SEC staff to take aim at weaknesses in internal controls over financial reporting. By Howard Scheck

A developing trend in the SEC's approach to accounting enforcement is the increasing risk for public companies in the area of internal controls over financial reporting (ICFR). ¶ Specifically, SEC enforcers have been investigating and prosecuting a broader range of ICFR violations than ever before, raising the stakes for officers certifying SEC filings and others involved in financial reporting. Due to the heightened risk, it is helpful to understand why the SEC has expanded its focus and to consider strategies to minimize exposure and potential consequences.

SEC enforcers have always been interested in investigating allegations of accounting fraud and prosecuting those responsible for "cooking the books." On the other hand, enforcers often viewed ICFR violations as ancillary—either as "add-ons" in fraud cases or as fallbacks in nonfraud settlements.

Recently, however, the SEC has viewed ICFR issues as primary considerations during investigations, potentially prosecuting conduct that would not have been pursued in the past, even in the absence of a restatement of previous filings.

For instance, the SEC's staff has been focused on whether companies have properly identified material weaknesses and have done so in a timely manner. While prosecutions solely along these lines have been limited so far, the risks of getting caught-up in a controls-focused inquiry have been increasing. That is especially true for companies that have restated financials or have otherwise popped up on the SEC's radar.

Specific issues that investigators have been addressing include whether a material weakness: (1) existed in a reporting period before a restatement; (2) was adequately described as to scope; (3) existed, even if there was no material error; and (4) existed in connection with controls and procedures for disclosure, or in connection with 302 certification processes.

Relating to independent auditors, the SEC's staff has been focusing on the adequacy of a firm's processes in connection with illegal acts under Section 10A of the Securities Exchange Act.

The SEC's expanded focus is surprising, given that past and present chairmen have long stressed financial-statement integrity and transparent disclosures as bedrocks of fair and efficient securities markets. However, the lower incident rates of accounting fraud and less-significant restatements in recent times have caused prosecutors to shine their lights more closely on ICFR.

Fraud Dwindles

Pre–Sarbanes-Oxley, and for a time thereafter, accounting prosecutions—including fraud and nonfraud cases—averaged about 25% of all SEC enforcement actions. However, after peaking at 31% in 2007, accounting actions dropped to just 10% in 2013.

While that rate increased to about 17% in the past four years, whether it will go much higher remains unclear. Large accounting scandals such as Enron and WorldCom have just not been as prevalent, nor have there been pervasive trends in accounting abuse, such as Chinese-reverse-merger frauds or stock-options backdating.

Fewer incidents of accounting fraud are, of course, good for investors. But less fraud gives enforcers more time, and perhaps incentive, to focus on potential ICFR violations.

Nowadays, the SEC is likely to target potential ICFR violations at the outset of investigations and to continue pursuing them even when there are no fraud or indications of bad faith found. Thus, errors that appear to have arisen from honest mistakes and restatements with few fraud risk factors may be pursued.

Additionally, the SEC does not need to prove fraudulent intent to establish ICFR violations, making potential enforcement hurdles easier to overcome.

Risks of Material Misstatement

For example, the SEC has been pursuing cases in which material weaknesses should have been reported sooner or internal controls were designed, or operated in a manner, that created an unidentified risk of material misstatement.

In such circumstances, a clean audit opinion and Sarbanes-Oxley Section 404 report may not insulate CEOs, CFOs, and others who sign or certify SEC filings. They may have to respond to an SEC inquiry questioning whether they exercised reasonable judgment or had adequate support for accounting, disclosure, and ICFR-related decisions.

While the SEC could decline to investigate or prosecute actual or suspected ICFR violations, considering them to be minor infractions best dealt with by enhancing systems and taking some remedial actions, convincing SEC staff to do so is becoming harder.

Certain strategies to minimize consequences, should SEC staff start "second guessing" accounting-related conclusions, include:

• Maintaining contemporaneous documentation for critical accounting, disclosure, and ICFR-related judgments, including those made by auditors concerning Section 10A

• Performing and regularly updating risk assessments, including those relating to fraud and corruption

• Taking a fresh look at how potentially material information is gathered and reviewed for disclosure consideration in connection with quarterly 302 certification processes

• Reviewing how the severity of identified control deficiencies is evaluated

• Ensuring that qualitative materiality factors are considered and documented when assessing accounting and disclosure issues, especially when there are financial reporting red flags

• Using appropriate legal and forensic accounting experts to investigate anomalies, including early notification to independent auditors about potential illegal acts

• Ceasing any problematic conduct and working promptly to enhance controls

• Self-reporting to, and cooperating with, the government in appropriate circumstances

While engaging in these practices cannot shield companies and individuals from an SEC inquiry, enforcers like to see a tone that is focused on investor protection. Therefore, demonstrating a commitment to financial reporting integrity—before an incident occurs and during the handling of an incident—positions subjects to be viewed in the most favorable light by SEC staff, increasing the odds of a favorable outcome. CFO

Howard Scheck, a former chief accountant with the SEC's Division of Enforcement, is a partner with forensic accounting firm StoneTurn in Washington, D.C.

Audit Fees Rise Again

Audit fees increased by a median of 3.2% in 2015, to $522,205.

Audit fees swelled for the majority of publicly and privately held companies last year, but some of the largest SEC filers are combating rising costs by improving internal controls before auditors come knocking.

A new survey by the Financial Executives Research Foundation found audit fees increased by a median of 3.2% in 2015. The foundation reviewed SEC filings from more than 6,490 unique filers and found companies paid an average of $1.8 million and a median of $522,205 for their 2015 audits.

"Increasing the efficiency and decreasing the cost of audit fees is integral to controlling overall administrative costs," said FERF president and CEO Andrej Suskavcevic.

FERF also surveyed 245 financial executives at a mix of public companies, private companies, and nonprofit organizations.

The survey found that mergers and acquisitions, inflation, and reviews of internal controls continued to be the driving factors behind rising fees. Almost one-third of respondents from public companies cited acquisitions as the most common cause for the hikes, and more than one-fifth cited a "review of manual controls from [Public Company Accounting Oversight Board] inspections."

Companies that cited ineffective internal controls as adding to audit fees experienced a 5.1% median increase, almost two percentage points higher than the median increase for all other filers.

However, not all companies experienced fee hikes. More than 1,100 of the 6,490 filers reported a decrease in audit fees for fiscal year 2015.

Moreover, large accelerated filers (public float of $700 million or more) have seen year-over-year declines in auditing cost increases, from a median of 5.5% in 2012 to 3.8% in 2015. The largest filers have the means—and the incentive—to tackle auditing costs head on and in house.

"This likely suggests larger companies have had greater success with increasing audit preparedness, negotiating with auditors, improving internal controls, and other initiatives," according to the survey.

On the other end of the scale, nonaccelerated filers (companies with public floats of less than $75 million) experienced the largest median increase in audit fees (4.8%).

SEAN ALLOCCA

Opposite page, Thinkstock; above, courtesy the author

The Gender Pay Gap Persists

Compensation for women doesn't reflect their performance levels or their impact on business results. By David McCann

Despite significant evidence that companies with more women leaders experience greater profitability and stock returns, men continue to enjoy more advancement opportunities at every stage of career development. ¶ Discussions about that disparity are frequently framed in terms of pay inequity. Indeed, the size and causes of the compensation gap between genders is a matter of unending debate.

Most experts put little credence in the oft-cited U.S. Census Bureau statistics comparing earnings by gender. The bureau's most recent report on the topic shows women earning 83 cents on the dollar paid to men. That's up from 79 cents a year ago, but it's still a raw figure that doesn't compare men and women doing similar work or take into account factors like the time women spend out of the workforce focused on raising families.

That's not to say the pay gap is fictional. "There's no question there's an income disparity, and probably in no case does more than half of that [79-cents-on-the-dollar] gap go away when you control for other factors," says Barry Gerhart, a professor at the University of Wisconsin School of Business. "The question is, what causes that? That's harder to answer."

Cockeyed Data

A host of studies have shown a link between gender diversity and corporate performance. For example, a 2015 report by McKinsey, based on data from 366 companies, found that those companies in the top quartile of gender-diversity metrics were 15% more likely to have financial returns that were above their industry's national median.

A study of 3,000 companies across 40 countries by Credit Suisse Research Institute found that, from 2009 through 2014, those with an approximate three-to-one male-female management mix had average annualized stock returns of nearly 23%. Where the ratio was two to one, average returns increased to more than 25%. And when the numbers were balanced (although that sample size was small), returns exceeded 28%.

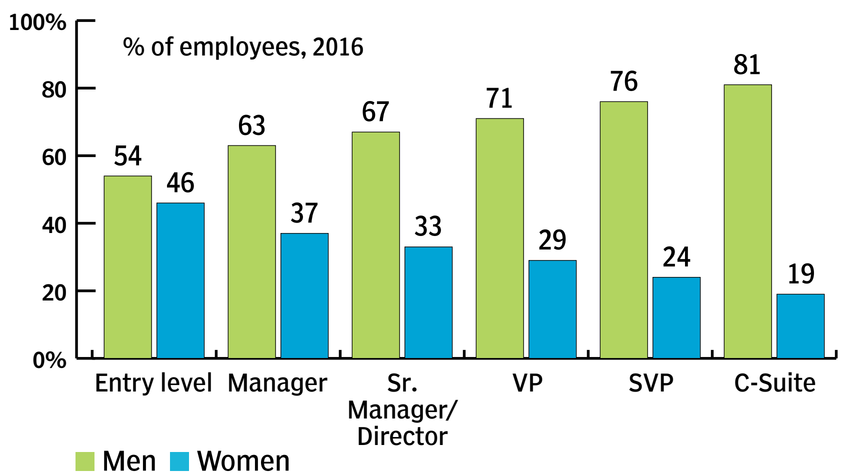
Much research has also shown that women tend to outperform men in other corporate roles—including CFO—yet are paid less. For example, among the 870-plus customers of Xactly, which provides sales-performance and employee-performance software, in 2016 the average female salesperson outperformed the average male by 2% in sales-quota achievement, the company says. Yet the women's total compensation—base pay plus variable pay—registered a rather shocking 21% less than the men's.

"We find almost routinely that women on average have higher performance ratings, but their compensation doesn't reflect that," says Christine Hendrickson, an employment attorney with Seyfarth Shaw.

Nor do women fare well in the promotion department. According to 2016 research by McKinsey, which surveyed 132 companies employing

Leadership Inequity

The proportion of women in corporate America decreases at each higher level of leadership.



Source: *Women in the Workplace 2016*, McKinsey & Co.

4.6 million people and separately surveyed 34,000 employees, women are under-represented at every level within corporate leadership pipelines—and more prominently so at each succeeding, higher level. (See "Leadership Inequity.")

For every 100 women promoted, 130 men are promoted, McKinsey notes.

As for CFO representation, women make up just 14.1% of finance chiefs globally, though they're heavily skewed toward Asia, and in particular China, where they account for 22% of finance chiefs, according to a September 2016 report by Credit Suisse Research Institute. In the United States, among the 1,000 largest companies by revenue, as of July 2016 only 12% had a female CFO, according to Korn Ferry.

The higher up in the corporate hierarchy you look, the fewer women there are. But why is *that?*

Subtleties Abound

Hendrickson suggests that women are, on average, more reticent to apply for jobs or promotions unless they meet all of the stated requirements. Applicants who seek promotions when they have 70% or 80% of the qualifications needed are less likely to get them. But "if you put yourself in the hat more often, you're more likely to be selected for a promotion," she says.

Also, women are 20% less likely than men to say that their manager often gives them difficult feedback that helps improve their performance, according to McKinsey's research.

"Men may be more comfortable giving feedback to men," says Janice Ellig, an executive recruiter and past president of the Women's Forum of New York. "Sometimes they're afraid of legal ramifications." For its part, McKinsey reports that managers who hesitate to give feedback are more likely to fear they will trigger "an emotional response" from women.

"Direct feedback is [crucial], because improved performance leads to getting choice assignments, which impacts pay," Ellig points out.

Indeed, fear is the root cause of not having more gender balance in leadership ranks, according to Melissa Greenwell, chief operating officer for The Finish Line, a specialty shoe retailer.


Melissa Greenwell

"Women fear taking risks and having so much responsibility that they'll be over-extended," Greenwell writes. "They fear not being completely prepared. They fear being wrong.... Many aren't willing to take the next step to find out whether they'll be successful."

Men, meanwhile, "fear changing the rules," according to Greenwell. "The new idea of work-life integration is perceived to be fraught with sticky policy issues and precedents that many leaders do not want to handle."

But qualities that women innately possess are ones that companies may overlook until it's too late, Greenwell charges: "When things go wrong, what excuses do boards ... typically cite? 'They didn't communicate. They didn't listen to others. They didn't ask enough questions. They didn't collaborate. They took too many risks.' These are traits more likely to be missing if women aren't involved."

Meanwhile, the McKinsey research also indicates that fewer women than men feel they are able to participate meaningfully in meetings (67% vs. 74%), have recently gotten a challenging assignment (62% vs. 68%), believe their contributions are appropriately valued (49% vs. 54%), and say they are turned to for input on important decisions (56% vs. 63%).

Further, more men lobby for a promotion or new assignment (39% to 36%), ask for an increase in compensation (29% to 27%), have a substantive interaction with a senior leader at least once a week (62% vs. 51% among senior managers, and 46% vs. 40% among middle managers), and say they believe they'll one day be a top executive (32% vs. 24%).

Pushing Accountability

There are increasing efforts to make companies more accountable for gender-based pay inequity.

It has long been illegal to pay men and women differently for doing the same work, under two federal statutes: the Equal Pay Act of 1963 and the Civil Rights Act of 1964. In 2009, President Obama signed the Lilly Ledbetter Fair Pay Act, restoring the protection that had been stripped away by a Supreme Court decision. This year new laws with more-specific requirements took effect in California, Maryland, Massachusetts, and New York.

Massachusetts, for example, made it illegal to ask a job candidate about his or her prior compensation. In California, companies can still ask about that, but cannot use the information in setting compensation. "Over time that's a significant factor in perpetuating pay inequity," says Margaret Keane, an employment attorney with law firm DLA Piper.

Also, a series of shareholder proposals were filed in advance of the 2016 proxy season, asking nine technology companies—Adobe, Amazon, Apple, eBay, Expedia, Facebook, Google, Intel, and Microsoft—to study their compensation practices and commit to closing the gender pay gap. Several of them publicly made such commitments. Amazon, Apple, and Intel found they were at near 100% pay parity.

However, Keane notes, "This was a limited group of technology companies. I would not say that most employers are going to come out evenly the way those did." CFO

Courtesy Melissa Greenwell


CRIME SCENE
SCENE CRIME SCENE

The Corporatization Of Cyber Crime

Cyber crime groups are increasingly operating like traditional businesses. Will this new professionalism lead to more attacks on companies?

BY DAVID M. KATZ

"It's beautiful, it's elegant, it's convincing," Markus Jakobsson gushes, describing the fake email used to hack into the personal Gmail account of Hillary Clinton's presidential campaign chairman.

Sent on March 19, 2016, to the chairman, John Podesta, the email landed in the spam folder of his account. That should have signaled "heightened danger" to the recipient, says Jakobsson, chief scientist at Agari, a Silicon Valley computer security firm that works with Google on email authentication. Spam implies a clear message, he adds: "Don't touch!"

But members of the Clinton campaign succumbed to what was probably a powerful temptation to open an email that was both addressed to Podesta and that carried a warning about his password. Once the email was opened, the message, still visible in January as a screenshot on WikiLeaks, so much resembled a normal Gmail warning notice that it almost begged to be clicked. »

Getty Images

The expertly crafted message was clearly not the shoddy work of "Nigerian" email scammers, according to Jakobsson. Aimed at a specific target rather than a vast population of email users, it lacked the inept spelling, factual errors, and incoherence of those messages that ask individuals to send money to bogus business officials in Nigeria. Other signs that it was the work of highly focused hackers: the domain name was subtly altered, and the email was customized to make it seem as if it were meant precisely for Podesta (see "Anatomy of a Spoof," facing page).

No, "you don't have to be insane to fall for [scams like the Podesta spoof]," says Jakobsson.

And fall for it the Clinton campaign did, resulting in "a decade of emails that Podesta maintained in his Gmail account—a total of about 60,000"—being unlocked by Russian hackers, according to a December 14, 2016 *New York Times* investigation. A December 29 report by the Department of Homeland Security and the FBI all but confirmed that the email to Podesta was part of a spear phishing campaign by Russian civilian and military intelligence services. The report provides technical details about the tools and infrastructure used to trick email recipients into changing their passwords, leading to "the exfiltration of information" from multiple senior members of an unnamed political party tied to the U.S. election.

While the cyber attack on the Clinton campaign might seem worlds apart from the private sector, the expertise, focus, and sophistication it represents are closing in fast on corporate America, cybersecurity experts and former FBI officials say.

No, "you don't have to be insane to fall for [scams like the Podesta spoof]."

MARKUS JAKOBSSON, chief scientist at Agari

Very soon the tactics mentioned above could be used to ensnarl a large number of finance chiefs and other senior executives in scams against their companies. And evidence is mounting to support the theory that behind these increasingly targeted attacks on both companies and governments is a formidable underground economy with its own corporate structures, white-collar employees, regular hours, and even its own version of the Internet: a reverse image of the world these criminals aim to exploit.

THE SURGE BEGINS

Email attacks against businesses of all sizes, with many of them exhibiting characteristics similar to the Podesta attack, have surged over the last two years, according to the FBI. Since January 2015, there has been a 1,300% increase in losses incurred by companies in so-called business email compromise (BEC) scams, according to a June 2016 statistical update issued by the bureau. Overall, 22,000 domestic and international companies have been exposed to $3.1 billion in losses from actual and attempted BEC attacks. Businesses in all 50 states and in 100 countries have reported email-related attacks.

BEC is "a sophisticated scam targeting businesses working with foreign suppliers or businesses that regularly perform wire transfer payments," the FBI notes. Such crimes are "carried out by compromising legitimate business e-mail accounts through social engineering or computer intrusion techniques to conduct unauthorized transfers of funds."

Like the Clinton campaign hackers, BEC attackers know their victims and often engage in "spoofing," a means of making it seem as if phony emails are sent from a legitimate sender. By studying company posts on social media before launching a scam, the fraudsters "are able to accurately identify the individuals and protocols necessary to perform wire transfers within a specific business environment," according to the FBI.

Targeted executives may first get phishing emails, in which the scammers, posing as legitimate businesspeople, ask for details like the names of other company executives

On March 19, 2016, cyber criminals alleged to be Russian hackers sent John Podesta (right), the chariman of Hillary Clinton's presidential campaign, a phony email pretending to be from Gmail technicians.

Twitter, Getty Images

and the dates they will be out of the office on business travel.

In one common scenario, the email accounts of CFOs, chief technology officers, or other high-level executives are spoofed or hacked. The scammers then send an email from the compromised account requesting a wire transfer from a company employee who normally processes such requests.

"In some instances, a request for a wire transfer from the compromised account is sent directly to the financial institution with instructions to urgently send funds to bank 'X' for reason 'Y,'" according to the FBI.

Jakobsson predicts that an added surge of BEC and similar scams will be fueled by a "trickle down effect" caused by the prominent success of targeted attacks like the ones on the Clinton campaign and the Democratic National Committee.

"Similar attacks will be a big thing in a year or so, as more and more criminals latch onto this and say, 'this worked really well' and do it to their intended victims," he says.

NOTES FROM THE UNDERWORLD

Indeed, there are signs that the pace of innovation, if you can call it that, has been quickening in the cyber underworld. Buttressed by increasingly hierarchical and stable crime organizations, highly efficient and secretive means of communication, and digital currency, a variety of online criminals are able to move quickly when new opportunities arise.

Because of its secretive nature, a comprehensive view of the economy and structure of cyber crime against corporations has been hard to come by. But researchers like Steve Meckl, director of Americas Incident Response for cybersecurity firm Symantec, have traced the outlines of this shadow world by studying data on criminal patterns and making inferences based on the information.

"We see that a lot of these groups are coming from areas of the world that have a high degree of technical education and poor job markets. [People there] find that working for organizations that conduct cyber crime pays more," says Meckl, a former technical operations unit chief in the cyber division of the FBI. The groups hail largely from Eastern Europe and increasingly from Internet-supported areas of Africa and Asia.

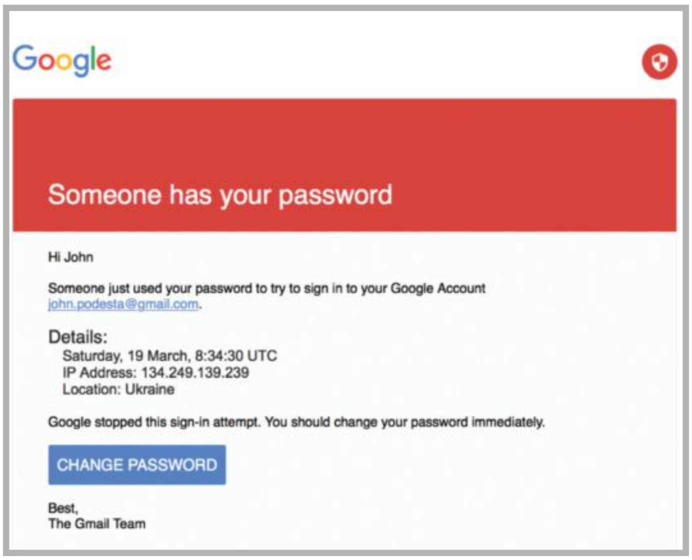
Jakobsson, for example, says he found IP addresses and other technical information confirming that the spoofed email sent to Podesta's Gmail account last year was part of a batch sent from servers in Russia.

Anatomy Of A Spoof

Featuring the familiar colors of the Google logo, the phony email that appeared in John Podesta's spam folder announced in white letters on a bright red banner that "Someone has your password."

After greeting the recipient with "Hi John," the message's sender went on to warn that "Someone just used your password to try to sign in to your Google Account," which it identified correctly as "john.podesta@gmail.com." At the bottom, on a blue banner, it provided a link with the words "CHANGE PASSWORD."

Sara Latham, Podesta's chief of staff, had access to her boss's Gmail account and forwarded the email to Charles Delavan, a Clinton IT aide who was manning the campaign's help desk. According to press reports, Delavan said he recognized the email as phony. But he reportedly added that he erred in his reply to Latham, typing out "This is a legitimate email" when he really meant to write that it wasn't legitimate.



To be fair, after advising Latham that Podesta "needs to change his password immediately," Delavan directed the chairman to do that through Google's legitimate page for changing one's password and included a link to that page. Unfortunately, someone—Podesta himself, according to a Motherboard.vice.com report—clicked on the phony change-password link, rather than the legitimate one, and apparently followed the instructions.

Markus Jakobsson, chief scientist at computer-security firm Agari, found other "digital fingerprints" testifying to the sophistication of the scam. For example, the hackers used a fake webmail domain that was very similar to the one used by Google. The researcher also notes that the hackers customized the email so that it was addressed only to Podesta, "not sent to a million other recipients with exactly the same name." D.M.K.

Some of those criminal groups look like regular companies, with their own organizational charts, call centers, and white-collar employees working the equivalent of 9 to 5 jobs, with holidays included, Meckl deduces from data patterns unearthed by Symantec in its research on the "Dridex Gang." The gang is run by criminals from Moldova and elsewhere and operates a "sophisticated malware package designed to steal banking and other credentials from infected computers," according to a U.S. Department of Justice press release.

Says Symantec's report on the gang: "Dridex's operators are quite professional in their approach, usually following a Monday-to-Friday work week and even taking time off for Christmas. The malware is continually refined and some degree of effort is applied to its spam campaigns to make them appear as authentic as possible."

➵ Officials from the UK's National Crime Agency lead away Dridex and Dyre Malware Gang members in the UK.

Such regular hours and time off are "not normal for your lone-wolf attackers. This looks more like a business," observes Meckl. "In tracking other groups in the past, we've seen similar patterns." For example, you can sometimes tell which time zone a group is located in because the attack activity is occurring during the business hours of that part of the world.

Another indication of the professionalization of these groups is an accelerating pace of innovation that suggests they are supported by significant effort and financing. Meckl sees proof of this activity in the rapid increase in hackers' exploitation of "zero-day" vulnerabilities.

Competing against other criminal "software developers," highly skilled cyber criminals race to find software vulnerabilities that are unknown to vendors, who thus have zero days to patch holes in their software. Then, the criminals develop customized malware to mount "zero-day attacks" themselves, or they sell the malware on the black market. Such activities are comparable to legitimate corporate research and development operations.

"In the hacker community, [zero-day exploits] are prized possessions," Meckl adds. "Attackers will only use these when they're going after a target [they deem] worth it. It takes a lot of effort to find and hold onto a zero day, so they don't get used very much."

From about 2006 to 2012, cyber professionals noted that attackers were exploiting only a handful of zero-day defects a year, according to Meckl. "Yet in 2015 alone, we saw 54 zero days in the market, which is over four times more than we saw a couple of years prior," he says.

Yet another sign of the professionalism of these groups is attention to detail. For example, Dridex uses real company names in the body text, subject lines, and sender addresses of most of their spamming campaigns, according to the Symantec report on the gang. "The attackers behind Dridex have gone to some lengths to make their spam emails appear more authentic," it says.

The Great Compromise

Business email compromise (BEC) scams attack legitimate business email accounts through social engineering or computer intrusion techniques with the aim of getting victims to transfer funds to the attackers. The following statistics reflect victim complaints to the FBI's Internet Crime Complaint Center between October 2013 and May 2016.

15,668	14,032	$961M	$93M
Domestic and international victims of business email compromise	Total U.S. victims	Total U.S. exposed dollar loss*	Total non-U.S. exposed dollar loss*

*Includes actual losses and those targeted in failed hacks.
Note: Loss numbers are rounded. Source: FBI

AN INTERNET OF THEIR OWN

Two other signs of the emerging sophistication of the cyber crime economy: it has its own communication system and its own currency. When a hacker group wants to transact business—sell a zero-day application, say, or hire an illicit web designer—it's likely to do so on what's known as the "dark web." And if the group wants to collect a ransom from a company that it has hobbled via malware, it's likely to demand payment in the digital currency bitcoin to avoid detection.

Purposefully hidden outside the realm of conventional browsers like Google, Safari, and Internet Explorer, the dark web resides on the Tor Network. On its aboveground website, Tor describes itself as "free software and an open network that helps you defend against traffic analysis, a form of network surveillance that threatens personal freedom and privacy, confidential business activities and relationships, and state security."

As Austin Berglas, a former assistant special agent in charge of the FBI's cyber branch in New York, sees it, the dark web descends into deeper and deeper areas of anonymity. At its least private level, "it is various marketplaces, forums, and chat rooms where people can gather and talk about the selling of guns or drugs or stolen credit cards or child pornography, as well as various other illegal activities like hacking services and murder for hire," he says.

The next layer down consists of password-protected forums. "You need to have some sort of street cred to get into these forums. Often, you are vetted by an admin," says Berglas, who is now head of cyber defense at K2 Intelligence, an investigative firm.

Finally, there are the user-created sites "where the real deep-down dirty work takes place," says the investigator, who during his tenure at the FBI managed the seizures of a number of illegal Tor-based sites, including Silk Road. On the dark web's user-protected sites, he says, small groups can gather to trade zero-day exploits and plan attacks, protected from law enforcement officers and cybersecurity vendors looking to do research in the underworld.

If payment is to be arranged within the confines of the dark web, it most likely will be made in bitcoin, the virtual, encrypted currency that passes from user to user without the intrusion of an intermediary. The development of bitcoin has helped modernize the underground cyber economy by enabling hackers to seize company networks and demand ransoms in ways "that were very difficult to do before," says Symantec's Steve Meckl.

Before bitcoin, scammers could demand payment only via cash, credit cards, or wire transfer, ways that made it "much easier for law enforcement to follow the money," he notes. Picking up the trail is much tougher with the virtual currency, "which drastically reduces risk for the criminals who are conducting this activity," says Meckl.

Seeing the advantages of bitcoin, some of the more established cybercrime groups have begun providing technical support to their victims to make it easier for them to pay up. In one instance, scammers set up a ransomware pop-up page for companies under attack that provides step-by-step instructions on how to obtain bitcoin and make payments, says Meckl.

But if users still can't figure out how to pay, "they can click on a link to get tech support, which takes them to a message center, where they can ask questions and get help," he adds.

The development of such efficient service is a hallmark of what has become an increasingly corporate cybercrime economy. Ever more prepared to probe the online vulnerabilities of legitimate businesses, emerging hacking organizations warrant significant attention from senior corporate management. If CFOs and their peers fail to appreciate the centralized power of their enemies, they could find themselves on the wrong side of an ever more asymmetrical struggle in the years to come. CFO

DAVID M. KATZ IS A DEPUTY EDITOR AT *CFO*.

An Ounce Of Prevention

The following strategies can prevent 85% of targeted cyber attacks, according to the Department of Homeland Security.

1 **Patch applications and operating systems.** Vulnerable applications and operating systems are the targets of most attacks. Ensuring they are patched with the latest updates greatly reduces the number of exploitable entry points available to an attacker. Only updates from authenticated vendor sites should be used.

2 **"Whitelist" applications.** Whitelisting allows only specified programs to run while blocking all others, including malicious software.

3 **Restrict administrative privileges.** Hackers increasingly focus on gaining control of legitimate credentials, especially those associated with highly privileged accounts. Reduce privileges to only those needed for a user's duties. Separate administrators into privilege tiers with limited access to other tiers.

4 **Segment and segregate networks.** Segment networks into logical enclaves and restrict host-to-host communications paths. That helps protect sensitive information and critical services and limits damage from network perimeter breaches.

5 **Validate inputs.** Input validation is a method of sanitizing untrusted user input provided by users of a web application and may prevent many types of web application security flaws.

6 **Tune file reputation systems.** Keep antivirus file reputation systems at the most aggressive setting possible. Some products can limit execution to only the highest reputation files, stopping a wide range of untrustworthy code from gaining control.

7 **Maintain firewalls.** Firewalls can be configured to block data from certain locations (IP whitelisting) or applications while allowing relevant and necessary data through.

Source: Joint Analysis Report 16-20296, Dept. of Homeland Security and the FBI

Opposite, courtesy National Crime Agency; above, Thinkstock


Some Stupid Chart
Good
Bad
Ugly
Happy Co
Unhappy Co
Morning
Afternoon
Evening
Firefox 60
MSIE 10
Opera 20
Safari 10
Assessed probab
Data
Results definition
Chart
Weights
Style file
Line Chart

Master Of All Metrics

BY RUSS BANHAM

Getty Images

How CFOs can take charge of nonfinancial performance measures without alienating the rest of the organization.

In the quaint days of old, managing a business entailed studying last quarter's revenues and expenses, taking the pulse of market demand, and conjecturing a forecast with fingers crossed. Do this today and you'd be laughed out of the boardroom.

Companies now plot their future on more than just financial metrics. To steer the organization forward, they rely on an assortment of nonfinancial performance indicators like customer satisfaction, employee engagement, brand loyalty, market share, and pipeline throughput.

Master Of All Metrics

The thinking is that such measurements provide a more accurate, comprehensive, and especially forward-looking sense of actual business conditions. Unlike traditional financial metrics that tell leaders how well the business *did,* nonfinancial metrics indicate how well the business *is doing*. Fortified with this knowledge, company leaders can make more-assured and productive decisions.

Sounds all well and good. The problem is that discrete business units, departments, and functions are developing nonfinancial metrics with little centralized oversight. One can argue that different business leaders know enough about their respective fiefdoms to craft appropriate and useful key performance indicators (KPIs). Since each leader is held accountable for the performance of his group, he should own the metrics without meddling from above.

But what if one group's KPI unknowingly affects the performance of another group's KPI, as is inevitable? A low days-in-inventory ratio is good news for the chief supply chain officer, but it may cause product stock-outs that result in customer dissatisfaction, bad news for the chief customer officer.

Obviously, the achievement of desired scores in one part of the organization must be balanced against different goals in other parts. That's not an easy task without some form of governance structure in place to collect, prioritize, monitor, and assess the enterprise-wide use of nonfinancial metrics.

Meanwhile, the sheer number of nonfinancial metrics grows wild. The Hackett Group tallies close to 100 KPIs across diverse industries.

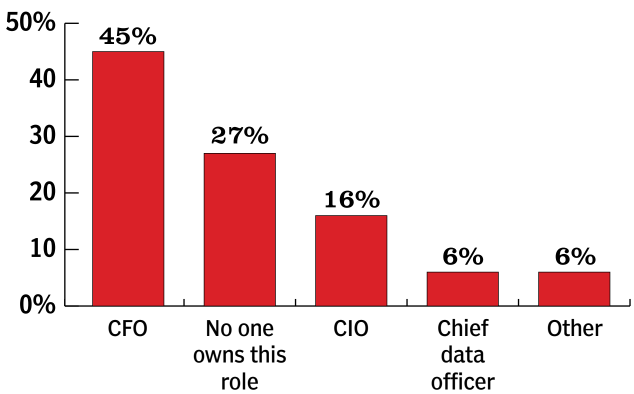
"Businesses are developing all sorts of innovative KPIs, not surprising given the advancements in data analytics," says Jason Balogh, principal in Hackett's enterprise performance management transformation practice. "The issue with the KPIs is that there are too many 'PI's' and not enough 'K's.'"

Greater rigor is required to ensure that senior executives are aware of both the upsides and the downsides of nonfinancial measurements, and, most importantly, their interrelationship.

"Each metric is designed to align with the business goals of a certain function, but they always cross over to affect the business goals of other functions," says Sean Monahan, a partner at A.T. Kearney. "No one metric is perfect. They all come with tradeoffs."

LEADING THE CHARGE

In most companies, who is the acting chief data officer? Nearly half of CFOs surveyed said they are.



Source: Adaptive Insights November 2016 survey of 300 global CFOs

Maverick Metrics

These tradeoffs—like the aforementioned potential impact of low inventory on customer satisfaction—must be comprehended. The challenge is oversight. But, traditionally, no one executive has been entrusted with supervising the development and use of KPIs across the organization.

"The goal is not for the CFO to micromanage or own the metrics, but to analyze their interrelationship."

JASON BALOGH,
The Hackett Group

Resolving the issue is a delicate matter. The idea of someone else owning their data irks business leaders. "The heads of sales, marketing, supply chain management, product development, and HR don't want another executive with little understanding of their sphere of operation looking over their shoulders and telling them what they should and shouldn't be doing," says Balogh. "They're closest to the activities associated with that data and feel they should own it, rightly so."

What's the solution? The answer is not for a single executive to police other executives' use of KPIs, but for the executive to be a fulcrum for sharing the data. "One of the best ways for an organization to improve its performance management environment is to have the CFO partner with the rest of the business in the development of more-balanced metrics," says Balogh. "The goal is not for the CFO to micromanage or own the metrics, but to analyze their interrelationship."

In other words, the CFO's accountability for traditional financial metrics should extend to nonfinancial measurements, as well. "The CFO's job is to synthesize all kinds of information—financial and nonfinancial—flowing into the business to determine their correlations and noncorrelations," says Michael Blake, president of Arpeggio Advisors.

Why must the CFO and not the chief operating officer, for instance, take on the task? "Most CFOs have basic skills in statistics to determine if the metrics connect to actual company performance and are aligned with strategic goals," Blake says.

Sharing this perspective is John Mulhall, U.S. leader of the financial management consulting practice at KPMG. "Many CFOs have a clear understanding of the company's strategy, operating model, customer channels, and competitive challenges to ensure that the right financial and nonfinancial metrics are used to drive performance," he says. "They also have the ability to translate the numbers for the CEO, board of directors, and shareholders."

Chief Performance Tracker

More finance chiefs are assuming this broader responsibility. About three-quarters (76%) of finance teams currently track some nonfinancial metrics, according to a November 2016 survey of about 300 global CFOs by Adaptive Insights. Nearly half (45%) of the respondents say they now act as their companies' de facto chief data officer—reporting on a range of KPIs, including nonfinancial metrics.

That storehouse of nonfinancial information represents 20% of all the KPIs tracked today. Looking ahead a mere two years, however, 48% of the CFOs project that nonfinancial metrics will comprise 30% of the total volume of KPIs they track.

That's a lot of data flowing into finance, but someone has to be accountable for business performance, says Tom Bogan, CEO of Adaptive Insights. "The CFO's job is to blend, balance, and evaluate all the KPIs coming in from across the organization to cultivate what really matters; otherwise there's the risk of too much information cluttering decision-making," he explains. "The CFO also is in the ideal position to drive consensus around the KPIs, helping business leaders spot trends early to mitigate risks and seize new opportunities."

Nevertheless, Bogan acknowledges, the challenge of rapidly assimilating operational and financial data into a single source of truth is a "daunting task" for finance teams. A CFO must extract wide-ranging metrics from across the enterprise, ensure the metrics are accurate and as real time as possible, and then analyze the interplay of the measurements to discern interesting or alarming correlations.

CFOs also need operational skills to detect if departments and functions are tracking the right metrics. They must be able to prioritize which KPIs are more important than others in achieving the company's overall strategy. And in doing all of this, they must not step on the toes of other department and function heads, much less the chief operating officer.

"The CFO's goal is to balance the tensions across families of measures and their probabilistic outcomes, ensuring data transparency and a consistent visibility of overall performance," Balogh says.

Expert Jugglers

This heightened accountability for CFOs raises the obvious question: Is the finance department up to the task? If not, then today's ideal performance management model may be little more than tomorrow's pie-in-the-sky waste of time.

One CFO putting stock in the concept is Neil Williams of Intuit. The company developed what it calls the "True North Framework" to monitor, manage, and report on the nonfinancial KPIs in use across its organization.

The framework is composed of four categories representing employees, customers, partners, and shareholders. Each features a list of the nonfinancial metrics of key import to its constituency. For example, the metrics for "employees" include engagement scores, which are determined by quarterly surveys; turnover rates; and what Williams refers to as "regrettable employee losses," a tally of exceptional employees who have left the company.

For "customers," the primary metric is NPS (net promoter score), which gauges how willing a customer is to recommend the company's products and services.

Each Intuit product has an NPS that encompasses its

"The finance team is less biased and less invested in the business units … making it more likely that we can consistently and efficiently collect, calculate, and report the metrics with an objective view of how they affect overall strategy." NEIL WILLIAMS, CFO, Intuit

specific value proposition to the customer. "With our TurboTax product, for example, we draw the NPS from three measurements—how quickly our customers are able to finish their taxes, their ease of use in doing that, and how quickly they receive their largest allowable refund," says Williams. Intuit captures this information via customer surveys and online monitoring of the customer's use of a product, he notes.

All of Intuit's nonfinancial metrics flow into a data repository, where they are sliced and diced by QlikView business intelligence software and served up on a customized dashboard. "Once a month, I meet with the top 400 leaders here in a videoconference to go over the dashboard," says

Opposite page, courtesy The Hackett Group; above, courtesy Intuit

Master Of All Metrics

Williams. "We discuss the findings, deciding the things we need to improve upon. They see me as their partner in the process."

Mark Partin of BlackLine is another finance chief who has effectively assumed the role of chief data officer. Among the key nonfinancial metrics he gathers from across the business for tracking is NPS.

"Traditional accountants often think that DSO [days sales outstanding] is the truest measure of customer success, but frankly the information comes in too late to do much about it," he says. "NPS really gets to whether or not your customers are satisfied and enables a company to take mitigating actions now."

Partin also finds value in scoring "time to implementation," a measure of the time between a customer sale and when the buyer begins to get value from the product. That is different from the typical "time-to-revenue" metric calculating the time between a purchase and the actual use of a product, at which point a software company begins recording revenue.

BEHAVIORAL RESET

At Ricoh Americas, nonfinancial metrics steer sales in a new direction.

→ **FOR DECADES,** Ricoh Americas mainly sold hardware—printers, copiers, and multifunction office products—along with repair services. But with the commoditization of such equipment, it needed to transform its identity to that of a provider of valuable enterprise services.

To change the company's culture, "we needed to look more deeply at what we measured—our key performance indicators (KPIs)—and determine whether any were driving 'old' behaviors," explains Gary Crowe, Ricoh Americas senior vice president and CFO. "You get what you measure, and it turned out that many KPIs were focused on and incenting the behavior of a hardware company."

For example, during the transition, although Ricoh Americas' business units were hitting their goals for revenue and services sales, management discovered that the number of salespeople who were actually selling a services-led offering was quite small. As a result, the company added KPIs to measure the percentage of representatives who were successfully selling services.

In addition, for much of its history, Ricoh Americas had relied on cycle time (the time between responding to a proposal from a business customer or the dealership

"My role includes making sure the data is correct and comprehensive, and determining if there might be better ways to do what [employees are] doing."

GARY CROWE, SVP and CFO, Ricoh Americas

network and delivering the product) to gauge customer satisfaction. The metric worked just fine—until Ricoh altered its value proposition.

"We decided to focus more on customer needs, developing additional software solutions and services," says Crowe. "These different services required customer interactions with different groups at the company. We needed to take this one metric we had relied on for so many years and make it much more granular, measuring multiple customer-related processes across the enterprise to minimize cycle time. One cycle time metric became many."

Crowe says the proliferation of data analytics has made it easy for employees to access a lot more data and do their own analytics to understand customer behaviors. But as CFO he needs to be sure what they're doing "is pulled up to a higher level. My role includes making sure the data is correct and comprehensive, and determining if there might be better ways to do what [employees are] doing." ◗ **R.B.**

"It's just a much more insightful metric," says Partin. "Just because the revenue flows in doesn't mean much of anything in terms of customer satisfaction. There's always a learning period that occurs once the product is used." By continually measuring this time period, BlackLine can take actions to reduce it, Partin says.

BlackLine's finance team also is entrusted with measuring the engagement of both customers and employees. User engagement is gauged by tracking how many of the company's software licenses are used by each customer. "If a customer buys 1,000 user licenses and only 900 are being used, then 100 licenses are going to waste," says Partin. "As a software-as-a-service provider, if you want customers to buy your licenses every year, they need to regularly, routinely engage with the product."

Employee engagement is tabulated by annual surveys of the workforce. Says Partin, "Why wait for the retention metrics when you can gauge employee satisfaction, motivation, and productivity well ahead of the curve?"

Both Williams and Partin insist that finance is the right department to entrust with oversight of nonfinancial KPIs. "I have a strong point of view that the finance team is less biased and less invested in the business units and functional groups, making it more likely that we can consistently and efficiently collect, calculate, and report the metrics with an objective view of how they affect overall strategy," Williams says.

Adds Partin: "The CFO tends to be the person in a business who best recognizes the value of metrics and is in a prime position to drive accountability throughout the organization. We know which KPIs will drive the financial outcomes we want, and the initiatives that tie back into them."

"Time to implementation" has real value. "It's just a much more insightful metric."

MARK PARTIN, CFO, BlackLine

Demand for Data Diviners

To perform the task of overseeing nonfinancial KPIs, finance needs staff members with data science skill sets. So, many CFOs are starting to recruit data analysts from outside the traditional finance and accounting professions and installing them in their departments. At Intuit, Williams is beefing up the analytical capabilities of the financial planning and analysis group.

"Twenty percent of the finance workforce [at Intuit] is now focused on reporting, forecasting, and budgeting," Williams says. "We're constantly looking for ways to automate more of the accounting role so that the staff spends less time on manual data collection and working on spreadsheets and PowerPoint presentations, and more time answering the important questions posed by the numbers."

Still, he acknowledges that finance "is not all the way to bright on this. We've made great strides in getting the data available and out quickly, with high integrity. We're now beginning to understand what it all means and the actions required."

Partin's company, BlackLine, is in the business of developing automated tools to liberate accountants from routine tasks so they can provide value-added analyses of nonfinancial metrics. Nevertheless, he maintains that technology is only part of the solution.

"You also have to create structure and accountability around what you're doing to ensure the metrics are accurate, timely, and actionable," he says. "It's up to the CFO to integrate the nonfinancial metrics and the financial metrics in creating the long-term strategic plan."

Partin provides the example of a sales department projection for a significant increase in the number of new global customers over the next three years. That growth will subsequently require the legal department to contract additional attorneys and the accounting department to hire more staff in billing and collections.

"Knowing this, finance is now in front of what will be a future capital allocation, giving the CFO time to be more balanced and flexible in the budgeting," says Partin. "That's why we have to lead this. We're in the perfect position to complete the puzzle." CFO

LITMUS TEST FOR KEY PERFORMANCE INDICATORS

Characteristic	Key Question
Linked to objectives	Can the measure be aligned with an objective?
Actionable	Can action be taken to improve the metric's performance?
Simple	Can the measure be easily and clearly explained?
Credible	Is the measure resistant to manipulation?
Integrated	Can the measure be linked both down and across the organization?
Measurable	Can the measure be quantified?

Source: The Hackett Group

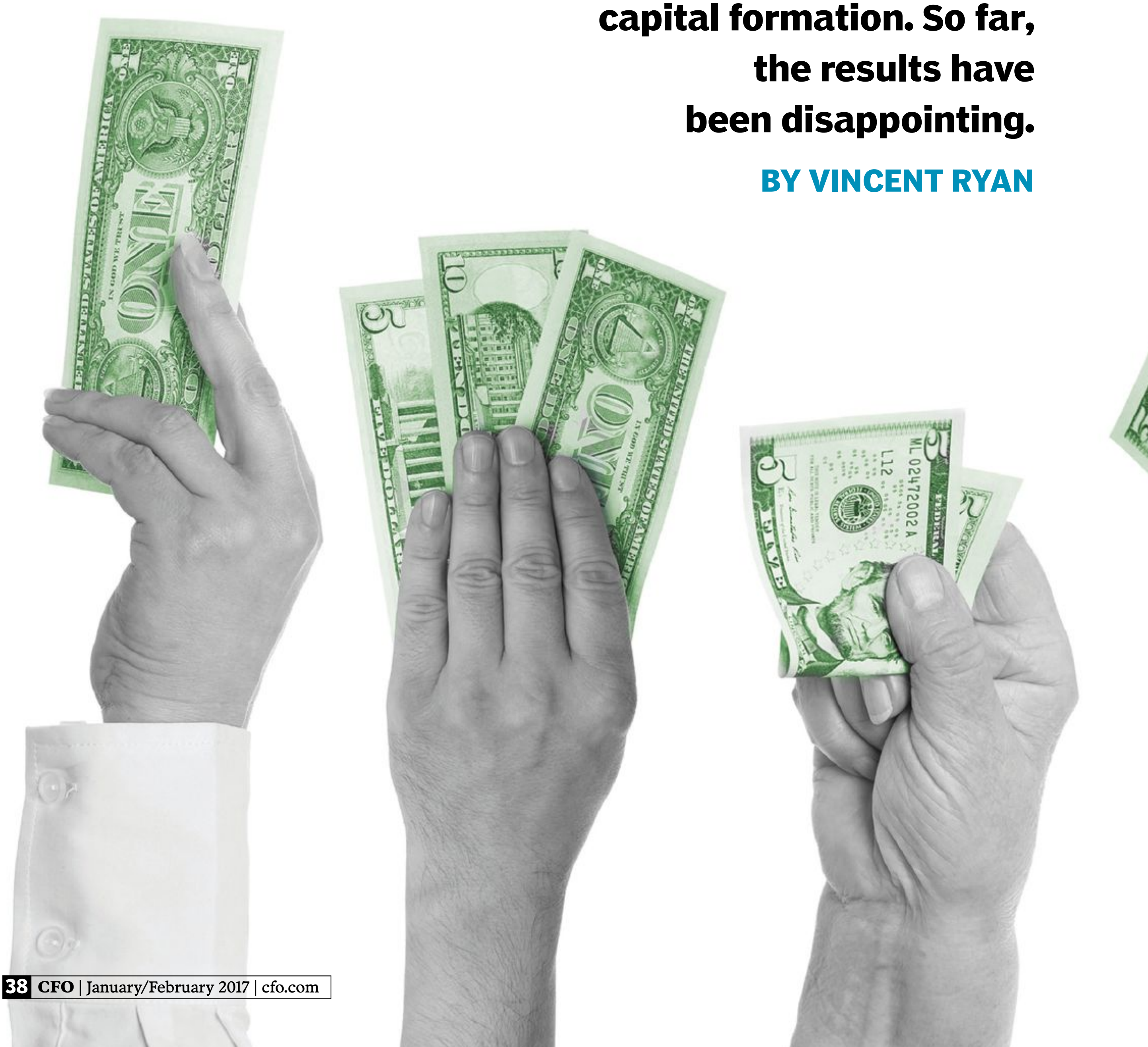
RUSS BANHAM IS THE AUTHOR OF 24 BOOKS AND A LONGTIME CONTRIBUTOR TO *CFO*.

Opposite page, courtesy Ricoh; above, courtesy BlackLine

What's Wrong With Crowdfunding?

The JOBS Act was designed to help online capital formation. So far, the results have been disappointing.

BY VINCENT RYAN



Raising $5 million, $10 million, even $50 million online seems irresistibly easy. An attractive video and PowerPoint, a credit card number, a few mouse clicks, and the transaction is done. Joe Six-Pack gets in on the ground floor of a business just like a venture capitalist would, before the real returns are made. And the early stage company funds its brilliant idea for very little money. In some ways the Jumpstart Our Business Startups (JOBS) Act may have been a precursor of the new

Thinkstock

economic populism, giving privately held, small and midsize companies the opportunity to raise capital from ordinary people instead of Wall Street's coastal elites.

It was a beautiful idea. The JOBS Act sped through Congress within a month and was signed into law in April 2012. But five years later, the experiment that the JOBS Act represents has produced uninspiring results.

After a lengthy delay over implementing rules, the law has only incrementally increased the amount of capital distributed to entrepreneurs. Why isn't capital raising through web portals on fire? Some say it's just a matter of time and awareness. But when examined closely, some of the JOBS Act's capital-raising techniques appear destined to be used sparingly. In their current form, experts say, they come with too many regulatory burdens, cost too much, or expose a startup to too much risk.

HARDLY A CROWD

With private capital abundant and companies trying to stay private longer, many parts of the JOBS Act should be very appealing to issuers. The smallest capital raises created by the JOBS Act come under Title III, the "crowdfunding" provisions. Startups can raise up to $1 million every 12 months from non-accredited investors. The process must take place through a funding portal that qualifies as a broker-dealer.

Whether Title III capital raising will ultimately succeed is a tough call, given its short lifespan. Title III crowdfunding only became legal in May 2016, and there's no entity collecting data from all the funding portals. The best estimate is that Title III offerings, in which the investor gets an actual share in the company or a promissory note, have raised between $5 million and $20 million as of January 2017. According to the Securities and Exchange Commission, as of September 2016, more than 100 companies had filed a Regulation Crowdfunding (RefCF) offering statement, and 19 entities had registered with the SEC as funding portals.

Wefunder, one of these portals, says it is handling about 70% of RegCF activity. Wefunder founder and CEO Nick Tommarello says the portal funded 43 businesses in the 6 months ending December 2016, raising about $12 million for organizations as diverse as a biotech company manufacturing an artificial pancreas, an Austin, Texas-based brewery, and a startup Hollywood studio. Thirty-one percent of the time individual Wefunder investors kick in exactly $100, and 76% of all investments are under $500.

"Back in March, before anyone heard about RegCF, we took a train trip from San Francisco to Boston to find new companies; now companies are much more likely to come to us," says Tommarello. "It's like a snowball rolling down a hill—it works in practice and is affordable."

But some critics say Title III capital raising would be much more affordable—and used more—if it didn't create so many headaches for entrepreneurs. Having to track hundreds or even thousands of investors in a company's capitalization table, for example, is frequently mentioned as a turnoff. But the real thorn in the side of founders is the disclosure requirements. Title III requires third-party audited financial statements for offerings of more than $500,000 and CPA-reviewed financial statements for offerings of more than $100,000. That's on top of having to convert financials to generally accepted accounting principles (GAAP).

"The detailed level of disclosure and the third-party reviews of financial statements cause sticker shock," says Samuel Guzik, a corporate attorney at Guzik & Associates. "[Portals] will tell you it's simple and easy, but [many startups] don't get that far. They hear about [RegCF] second- and third-hand, take a look at it, and say, 'this seems too complicated for me.'"

Ken Nguyen, co-founder of Republic, another crowdfunding portal, says entrepreneurs get deterred when they realize they will have to disclose information on revenue and profits to the world—both at the launch of a crowdfunding campaign and every year afterward. "If you're in a competitive industry, you don't want your competitors knowing your revenue, cash on hand, and profit," says Nguyen. And "public disclosure makes sense at launch, but after a campaign has closed the requirement seems unusually onerous."

"IF YOU'RE IN A COMPETITIVE INDUSTRY, YOU DON'T WANT YOUR COMPETITORS KNOWING YOUR REVENUE, CASH ON HAND, AND PROFIT."

—KEN NGUYEN, Co-founder, Republic

Realizing high-quality founders are busy, Tommarello says Wefunder handles regulatory disclosures and accounting tasks, and tries to keep costs low by doing so. "There was definitely a fear that it would cost [$50,000] to do one of these, which is absurd—it's more like $3,000; generally the only costs that companies need to pay are accounting costs." However, Wefunder, like almost all portals, also takes a 4% cut of the funds raised. And if a company needs audited financial statements, they can expect to incur an additional $10,000 or more, says Wayne R. Pinnell, a managing partner of accounting firm Haskell & White.

How much dollar volume Title III offerings will capture on a regular basis is unclear. But already, legislators are working on tweaking the requirements (see "Under Repair," below).

Before the JOBS Act was passed, "I was thinking it would be nice to have very little disclosure, a very light regulatory touch, and to grease the skids for small local fundraising or early seed capital, to encourage real small businesses," says Joan MacLeod Heminway, a law professor at the University of Tennessee. "But at $1 million there were nerves [among legislators and regulators] about the potential for fraud. The regulatory weight has stifled the ability for Title III to work for those really small capital raises."

SOLICITING THE WEALTHY

The JOBS Act also allows companies to raise large private placements through social media and other digital means. Title II of the law removes the prohibition against general solicitation and general advertising of offerings under Rule 506 of Regulation D. These offerings are the largest part of the private market. The new rule, called the 506(c) exemption, also preempts state securities laws. However, compa-

Under Repair

Capital markets participants, lawyers, and legislators have been recommending changes to the JOBS Act since nearly day one of its passage. Here are a few of the most-debated amendments, some of which are contained in the Fix Crowdfunding Act passed by the House of Representatives in July 2016.

Raise the Title III annual offering limit to $5 million. At seed stage, venture-financed companies typically raise about $2 million. A $5 million cap for crowdfunding campaigns, as opposed to a $1 million cap, would increase the utility of Title III crowdfunding and help offset some of the accounting, audit, and legal costs. This amendment was removed from the Fix Crowdfunding Act but could be put back in by the Senate or included in a reintroduced version of the House bill.

Allow special-purpose vehicles in Title III deals. Special-purpose vehicles (SPVs) for Title III deals were "accidentally outlawed" in the JOBS Act, says Nick Tommarello, CEO of Wefunder. With an SPV, all of a company's small investors would be pooled into a single entity, giving management one point of contact and adding only one shareholder to the capitalization table. With the SPV model, "one fund manager can aggregate all the voting power of [the thousands of investors who put in $100] and advocate on their behalf with the company," says Tommarello. The SPV amendment is included in the Fix Crowdfunding Act.

Change the definition of accredited investor. Under current Regulation D rules (related to Title II offerings), sophisticated investors without high incomes or net worths are unable to invest in private, high-growth companies. Altering the accredited investor definition to include investors that meet bright-line tests for experience in financial and business matters would expand the universe of investors able to participate in 506(c) offerings.

Let companies stay private longer. The JOBS Act actually made it easier for companies to remain closely held, increasing the number of shareholders of record that a company can have (to 2,000, up from 500) before being obliged to register with the SEC. But companies must also have less than $25 million in assets. One proposed amendment to the JOBS Act is to switch the maximum asset requirement to a maximum $100 million revenue requirement. That would also enable investors in some crowdfunding rounds to keep their shares longer and experience more of the investment's upside. Currently, companies bumping up against the ceilings have to repurchase crowdfunded shares to stay under the limit.

Let existing public companies use Regulation A+. OTC Markets has petitioned the SEC to allow public companies to use Reg A+ offerings. "If the point was to create growth in the microcap space, it doesn't make much sense to not allow companies that are already reporting to the SEC to raise $50 million on the Internet," says Jason Paltrowitz, OTC Markets' executive vice president of corporate services. "There are thousands of microcap issuers, early-stage growth companies that find it hard to raise capital, and Reg A+ would be a perfect fit for them," Paltrowitz adds. **V.R.**

Thinkstock

nies must sell only to "accredited" investors who can meet certain tests for net worth and income.

"The reason for 506(c) is that there were many more accredited investors out in the marketplace than there were participating in private placements," says Heminway. The theory was that getting those people to invest was just a matter of reaching out to them en masse with the right deal.

By some accounts, 506(c) offerings have gained traction, in part because the Title II rules were the first to take effect. In August 2014, musician Neil Young's PonoMusic startup raised $6 million in equity from accredited investors in a 506(c) offering on Crowdfunder. The average investment was $12,000. In the entire market, according to Crowdnetic, there have been more than 6,000 Title II offerings on 16 different online platforms in the 3 years since the SEC adopted Title II. Those offerings generated nearly $1.5 billion in commitments. (See "Title II: Offerings and Success Rates," next page.)

While it was not the intent of the JOBS Act to spur investing in real estate, that industry has made frequent use of Title II. Guzik cites two reasons: First, real estate syndications couldn't be widely exposed before the JOBS Act. "If the investor didn't know the right people he wouldn't know of the opportunity, even if he were an accredited investor," he says. Second, the due diligence on real estate that can be done online increases those transactions' transparency.

"IF THE INVESTOR DIDN'T KNOW THE RIGHT PEOPLE HE WOULDN'T KNOW OF THE OPPORTUNITY, EVEN IF HE WERE AN ACCREDITED INVESTOR."
—SAMUEL GUZIK, attorney, Guzik & Associates

The perception overall, however, is that 506(c) private placements haven't been as widely tapped as expected. That might be just a function of the amount of capital awash in markets the last few years. For example, a traditional venture capitalist who raises money among her existing network has no need or appetite to go out to the general public with an investment opportunity.

On the other hand, Title II has introduced some friction into private placements: while it gives with one hand it takes away with the other. Title II enables companies to broadcast an investment opportunity across the Internet, but it requires them to proactively confirm that an investor is accredited. The companies must review potential investors' tax forms and obtain their bank and brokerage statements. "When [investors] realize they have to submit to an investor verification process instead of simply filling out a confidential questionnaire, they get a little skittish and move on to another deal that doesn't require that," says Guzik.

A LITE VERSION

Title IV of the JOBS Act creates a new exemption for companies that want to raise significant amounts of money from Main Street investors online—and allow current investors to get some liquidity—without going public. In these Regulation A+ offerings, also called, "IPO-lite," companies can obtain up to $50 million in a 12-month period. Of course, the exemption comes with some heavy disclosure requirements, including qualifying with state-level securities regulators. But some of the disclosures have been streamlined. Issuers are also not subject to the Sarbanes-Oxley Act or SEC proxy rules.

Elio Motors is building a three-wheeled vehicle that will have a base price of less than $10,000. The company raised $16 million in a Regulation A+ deal.

As of December 2016, 165 companies had filed with the SEC to do a Regulation A+ offering. A little less than half of those are seeking to raise $20 million (Tier 1) and more than half, $50 million (Tier 2). Sixteen of those filings have been withdrawn, and 94 qualified (or approved) by the SEC. But case studies of completed Regulation A+ deals are scarce. One frequently mentioned is Elio Motors, a vehicle maker that raised $16 million in early 2016 and eventually migrated its shares to an over-the-counter market.

IPO-lite deals have proven difficult to execute. "Because you can raise up to $50 million [with a Reg A+ deal], some founders think that it's just a question of putting a lot of money into marketing and that you don't need a broker-dealer," says Guzik. Elio Motors, for example, didn't use a broker-dealer. But the company could have raised double the $16 million it did, because initial indications of interest online were nearly twice that.

"If you look at the people who actually invested in the Elio Motors deal, a large majority were already highly engaged with the company prior to the offering—they had put down deposits on Elio's vehicles and were actively following it," says Guzik.

PonoMusic, with its triangular music player, was an early success story for 506(c) offerings.

To attract a broader audience to a deal (especially if trying to raise $50 million), the typical issuer will really need the help of a broker-dealer and its retail distribution network. However, there are few brokerage firms that conduct such small offerings or leap at the prospect of doing them. That's because IPO-lite transactions can require nearly as much work as a traditional IPO.

Without professional advisers, it's easy for companies to over-estimate the number of Twitter followers or Facebook friends willing to pony up actual money. Reg A+'s "test the waters" at least allows companies to gauge interest in an offering before it spends money on auditors and lawyers. But companies have also found that spending a few months collecting names and commitments for a $50 million offering can doom it, because investor interest wanes as time goes by, says Jason Paltrowiz, executive vice president of corporate services at OTC Markets.

On the other hand, even companies that think they are positioned well for a Reg A+ offering have to be careful about what happens afterward, says Paltrowiz. Such offerings create securities that are freely tradable. "When you issue freely tradable shares it's relatively simple for you to wake up one day and essentially be a public company," says Paltrowitz. "If I'm an investor with 100 shares and want to sell them, all I need to do is take my shares to my broker-dealer. The broker-dealer would go to FINRA and be granted a ticker symbol."

As a result, the issuer would then have a ticker symbol, a public quote, and would be trading on the Pink Sheets, Paltrowitz says. To avoid that, Elio Motors arranged to list its shares on OTC Markets' OTCQX. But that kind of risk from a Reg A+ offering could definitely limit the technique's appeal.

BUILD IT AND THEY'LL COME?

In some ways, the JOBS Act was bound to disappoint capital markets players and entrepreneurs. Online capital raising is just not as easy as it looks: "Just because you expose a transaction to the public doesn't mean investors are going to come flocking," says Guzik. "That's just not the reality of financing."

The truth is that raising capital online is going to be successful only for certain kinds of companies, says Guzik: businesses "that have a simple and compelling story that the general public can understand and engage with," like those building three-wheeled high-mileage cars or recording industry stars looking to disrupt the world of digital music. On the other hand, if a business is fairly complex and selling to other businesses instead of consumers, it will generally do poorly, Guzik assesses.

That is partly because a decision to invest in a crowdfunding round is often more emotional than financial. Not many investors will make a return on their $100, $500, or even $1,000 investment. Indeed, most will take a 100% loss. Title III, in particular, "is more about sharing in the story of entrepreneurship of a company you believe in," says Republic's Nguyen.

For entrepreneurial, privately held companies that could make use of online capital raising, the trick will be to avoid falling in love with the idea of selling equity on a flashy website. The smartest CFOs and founders will still "use the capital-raising techniques that provide the most flexibility, impose the least regulatory burdens, result in lower costs to the company and shareholders, and generally provide the most freedom to secure capital," as one *CFO* columnist wrote in 2016.

When online capital raising doesn't satisfy most of those conditions, it's best to find money elsewhere. CFO

Title II: Offerings And Success Rates

As Title II gains a foothold, it is "attracting larger, more successful, or slightly later stage issuers," says Crowdnetic. In the early years, in contrast, more numerous small companies "might have been testing out the new capital formation tool."

	New offerings*	Annual capital commitments	Success rate
Year 1†	4,4,712	$385M	20.2%
Year 2†	1,351	$484M	26.3%
Year 3†	550	$603M	30.5%

*as of October 2016

† Year 1 – September 23, 2013–September 30, 2014; Year 2 – October 1, 2014–September 23, 2015; Year 3 – September 24, 2015–September 23, 2016

Source: Crowdnetic

Opposite, courtesy Elio Motors; above, CNET

‘Trump Bump’ Buoys CFO Optimism

The fourth-quarter Duke/*CFO* Business Outlook Survey finds optimism among U.S. finance chiefs lifted by the election of Donald Trump and his pro-business rhetoric.

By Josh Hyatt

With the U.S. presidential election fading in the rearview mirror, the country’s CFOs are feeling upbeat about the economic road ahead.

The latest Duke University/*CFO* Global Business Outlook survey, which drew responses from nearly 1,000 senior finance executives, found U.S. finance chiefs harboring high expectations for the regulatory and tax reform touted by President Donald Trump during his campaign. At the same time, many CFOs say that their companies will not take specific actions until the new administration’s plans come into sharper focus.

In the fourth quarter of 2016 (the survey ended on December 2), the Duke University/*CFO* Global Business Outlook optimism index for the U.S. soared above 66, its highest level in more than a decade. For the preceding five quarters—characterized by a consistently chaotic presidential campaign—the index measuring economic optimism had lingered near the long-term average of 60 (out of 100).

U.S. CFOs were slightly more optimistic about their own companies’ financial prospects in the year ahead. That optimism index rose to 67.4, registering a slight uptick from 65.3 in the previous quarter. Will the corporate tax rate really be reduced to 15%, as Trump has proposed? Which provisions of the Dodd-Frank Act will be repealed? As enthusiastic as CFOs may be about the installation of a pro-business commander-in-chief, in the absence of new policy few companies are tangibly changing their plans: Among survey-takers, 20% say that their hiring and spending plans have increased in anticipation of regulatory reform, and a lower proportion, 16%, say spending plans have increased to accommodate coming tax reform.

Interest rates are expected to continue rising throughout the coming year, with the Federal Reserve guiding toward three increases in 2017. While that might be expected to dampen optimism, senior finance executives have already factored those rate hikes into their expectations. In the survey, CFOs supporting the increases outnumber those opposed by a 2-to-1 margin. Given that the Fed has kept rates artificially low for a prolonged period—with nary a sign of inflation—CFOs don’t expect the incremental raises to have a material impact on borrowing costs. Overall, U.S. CFOs say they anticipate their interest expense to increase by fewer than 50 basis points in 2017.

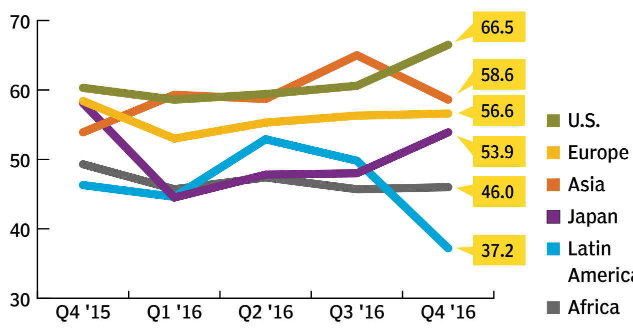
While largely unconcerned about interest rates, though, some CFOs are saddled by burdensome debt loads and won’t have sufficient flexibility to increase spending. An economy that has exited the doldrums over the last five years, combined with a strong dollar and cheap

20%

Percentage of U.S. finance chiefs who says their hiring and spending plans have increased in anticipation of regulatory reform

Economic Optimism Rises in Japan and the U.S.

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



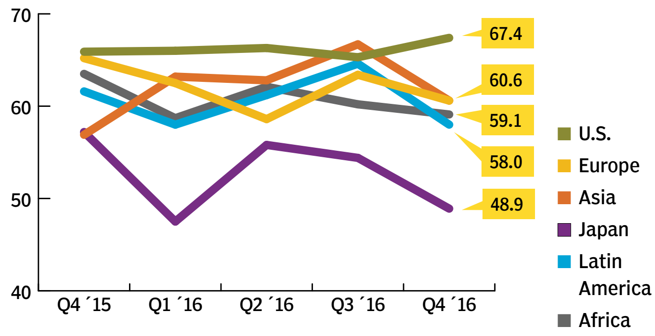
*On a scale of 0–100, with 0 being least optimistic

Source for all charts: Duke University/*CFO* Magazine Global Business Outlook Survey of finance and corporate executives. Responses for the current quarter include 367 from the U.S., 160 from Asia (outside of Japan), 32 from Japan, 169 from Europe, 126 from Latin America (including Mexico), and 99 from Africa.

oil, are among the reasons that U.S. manufacturing firms increased their borrowing as a percentage of assets by one-third—and two-thirds in the case of energy firms. More than 60% of companies in those industries say that high debt loads will now limit their future corporate investment.

Company Confidence Stronger in the U.S.

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



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

OTHER PERSPECTIVES

The wave of optimism that washed over U.S. CFOs as a result of Donald Trump's ascendance to leader of the free world was not universally felt, the Duke/*CFO* survey found. Predictably, Mexico's optimism index dropped a sizable 16 points from the previous quarter, landing at 47.2. Canadian optimism fell one point, to 63.1.

In the wake of Europe's tumultuous year, that region's optimism index edged slightly upward, reaching 56.6. European CFOs' expectations for the coming year are subdued, with wages expected to grow by 1.2% (compared with 2% in the U.S.) and full-time employment by a lean 0.4% (2.2% in the U.S.). The top concerns of Europe's CFOs include economic uncertainty, government policies, and recruiting qualified employees. More than half of European CFOs say that business spending will be constrained by high corporate debt loads.

In Asia (except Japan), two-thirds of CFOs say that capital spending will be dampened by corporate debt, although spending will still rise by an average of about 3.2%. In Japan's contracting economy, where the index measuring own-company confidence toppled from 57.2 in the fourth quarter of 2015 to 48.9 last quarter, CFOs still expect capital spending to decrease.

Overall, Asian economic optimism dropped to 58.6 during 2016's fourth quarter, down from 65 in the third quarter. The index ranged from 30 in Malaysia to 70 in China with other countries in between, such as India (52) and Singapore (45).

Wages are expected to rise nearly 6% across all of Asia, including 3% growth in Japan and 7.6% growth in China. With full-time employment expected to increase by 6%, it's perhaps not surprising that the top concerns among finance executives include difficulty attracting and retaining qualified employees. Among other top issues they cite are economic uncertainty, weak demand, government policies, and currency risk.

CAUSES FOR CONCERN

Many of those same issues resonated with CFOs in Africa—along with the volatility of political situations. That was especially true among finance executives in South Africa, where full-time employment is expected to fall over the next year. Optimism among African CFOs essentially held steady at 46, with capital spending slated to rise, on average, about 4.2% over the next 12 months, during which time wages are projected to increase 7% (less than 2% when accounting for core inflation).

Nearly 70% of African CFOs say that corporate indebtedness is leading to greater-than-normal financing risk in the corporate sector, with about three-fourths saying their companies will limit spending.

In Latin America, economic optimism crashed. The index fell to 37.2, toppling from 49.8 in the previous quarter. Within the region, some countries showed resilience (Brazil, at 57) while others held firm to their optimistic outlook (Peru, 71). Elsewhere in the region, the index remained below 50, including Ecuador (21), Chile (41), Colombia (47), and Mexico (also 47).

Economists forecast gross domestic product in Latin America to grow in 2017 after contracting in 2016, but they think the recovery from last year's economic performance (the worst since 2009) will be modest.

The investment outlook is decidedly mixed. Capital spending plans are up, on average, 3.3% across Latin America, with positive growth expected in all responding countries except Ecuador and Mexico. CFOs in Columbia and Peru project full-time employment will rise during 2017, while those in Brazil, Chile, Ecuador, and Mexico anticipate the numbers will move in the opposite direction.

And unfavorable macroeconomic forces aren't the only things that will limit growth in investment in Latin America in 2017. A majority—nearly 60%—of Latin American CFOs share the belief that a recent increase in borrowing has led to more financial risk than normal in the corporate sector and will stifle future business spending. CFO

flickr

Better Data, Better Decisions

Risk-based analytics enables CFOs to improve efficiency and keep exposures acceptable. **By Kim Ann Zimmermann**

12%

Percentage of executives who believe their company has an "excellent" risk management program

Finance chiefs are responsible for minimizing the risks that their organizations face in all facets of business—from supply chain operations and fixed-asset investment to payment processing and cybersecurity.

While analytics has played a greater role in risk reduction over the past decade, many organizations acknowledge that they still need to step up their efforts to leverage data within their risk management programs. That was one of the insights culled from a recent survey on the evolving role of data and analytics in mitigating risk, conducted by CFO Research in collaboration with PwC.

Most of the 154 senior finance executives surveyed say that their companies should spend more on risk management, including supplying managers with such tools as risk dashboards and data visualizations, as well as training them to use risk analytics. Barely 1 in 10 respondents (12%) believes that his or her company has an "excellent" risk management program—41% rated their company's efforts as good, 31% as fair, and 11% as poor.

Currently, half of the C-suite and other senior managers at the companies surveyed do not use risk analytics in their decision making.

IDENTIFYING DATA GAPS

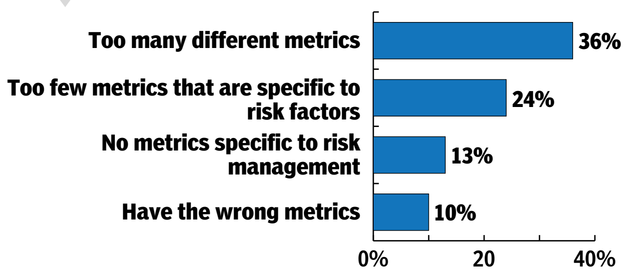
How can finance executives become more adept at managing risk? The answer, according to most of the surveyed executives, is that the finance team should do more to improve the quality of risk data and analytics at their company. Survey respondents point to four areas for improvement: reliability, relevance, timeliness, and the cost of providing the data.

Just 18% of respondents are confident in the reliability of their company's risk data. While data relevance and timeliness were also barriers to making effective use of data and analytics, if there's a lack of confidence in the data, its significance and prompt delivery become moot points.

Fifty-seven percent of survey respondents report that their companies have developed risk-specific metrics. But 36% say that their biggest challenge is dealing with too many metrics (see Figure 1). That reflects an opinion voiced in comments from survey re-

FIGURE 1

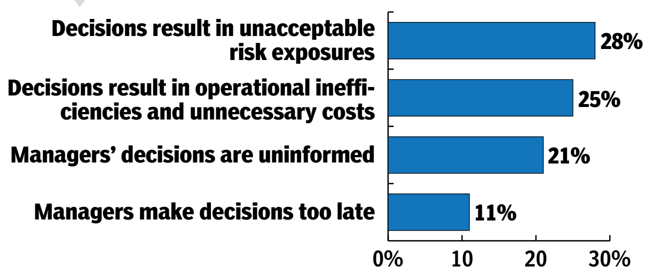
What is the most serious challenge your company is facing in terms of the effective use of risk-specific metrics?



Note: Does not include "None" and "Don't know" responses.

FIGURE 2

What is the most serious consequence of management's failure to make effective use of risk analytics?



Note: Does not include "None/Don't know" and "Something else" responses.

Thinkstock

spondents and executives interviewed for the study: It's important to not simply throw money at a risk management issue and to not use data just because it's available.

While organizations often collect large amounts of data, that doesn't necessarily help improve operational efficiency or productivity. If not carefully orchestrated, much of the data and analysis effort can add unnecessary costs without yielding sufficient results.

CONSEQUENCES OF INACTION

As finance chiefs make the case to their CEOs and boards for greater investment in data and analytics to bolster decision making, they can highlight the negative impact of poor data management on performance and operational efficiencies. By partnering more effectively with other departments on risk data and analytics, survey respondents note, they would be able to substantially improve their decision making.

Twenty-eight percent of respondents say the most serious consequence of not effectively using risk analytics is that decisions result in unacceptable risk exposures (see Figure 2). Not far behind, 25% cite decisions that result in operational inefficiencies and higher costs as the most serious consequence. Managers are also at risk for making uninformed decisions (21%) and making decisions too late (11%). In the age of real-time access and cross-functional visibility, companies that do not master data management and analytics are destined to fall behind.

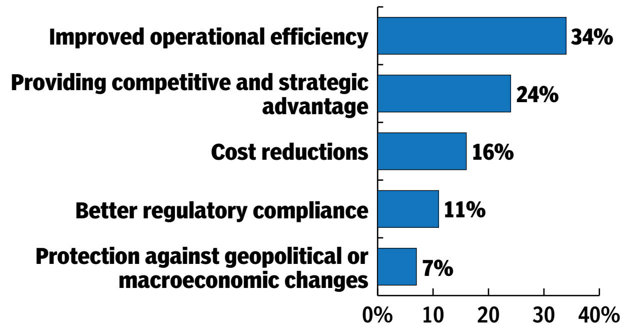
THE ROLE OF FINANCE

Finance chiefs are at the forefront when it comes to the use of data and analytics to manage risk in their organizations. They are looking to apply better quantitative risk management techniques and more advanced analytics than they currently do, across all types of risk.

Partnering with business function leaders to understand how to measure risk is an important step in improving overall risk management practices. Seventy-five percent of respondents acknowledge that decision making could be improved if finance partnered more effectively with other functional areas when it comes to using risk-specific metrics. The wider adoption of cloud-based accounting and finance systems is expected to make it easier to share and view data going forward, giving all departments greater access to risk analysis.

FIGURE 3

Where do you believe risk analytics could provide the greatest value to your company?



Note: Does not include "Don't know/Something else" responses.

Finance executives see themselves as potential agents of change when it comes to influencing how other business functions view risk analytics. Two-thirds say decision making could be substantially improved if finance took the lead role in helping other managers use risk-specific metrics and understand risk analytics. They also note that their own teams could do a better job of gathering and sharing risk-based data. Nearly two-thirds agree that providing better risk analytics and metrics for others to use could result in substantially better decision making.

FUTURE VALUE

For senior finance executives seeking improved risk management systems, positive changes can come from investing in more and better risk analytics and data. According to 34% of respondents, the top benefit of risk analytics will be improved operational efficiency (see Figure 3). When a company has a clear view of where things could go wrong and how to avoid or minimize problems, the result is typically higher productivity and lower costs. In addition, high-performing business functions can share best practices with others in the organization, further mitigating risk.

As risk management evolves with more proactive approaches, and analytics becomes an integral part of strategic decision making (i.e., not just raising red flags), senior finance executives have to take more responsibility for improving the quality of risk data and analytics.

Finance chiefs play a unique role in positioning their companies to extract the maximum value from risk analytics. With this knowledge in hand, progressive CFOs can partner with C-level executives, IT, and business unit leaders to make smart investments in technology and provide access to risk analytics on a company-wide basis.

While progress may be slow and may involve a great deal of collaboration, organizations risk losing their competitive advantage if they do not implement tools to enhance their decision-making capabilities. CFO

THE QUIZ

On the House

Executive compensation packages often include perquisites, or perks, so companies can attract top executive talent. From flights in private jets to sporting-event tickets, executive privileges—which can go unnoticed by investors—really add up. Take our quiz to find out how much executive perks are actually worth.

1 In 2015, what were the most common perks offered to named executives from Fortune 100 companies?

A. Insurance premiums
B. Corporate cars
C. Plan-based contributions (post-retirement or equity ownership)
D. Professional services

2 What percentage of CEOs received corporate aircraft perks in fiscal year 2015?

A. 38.5%
B. 22.3%
C. 51.7%
D. 12.2%

3 Dropping to its lowest level in three years, what was the median value of a CEO aircraft perk in 2015?

A. $80,323
B. $105,709
C. $72,449
D. $95,127

4 Executive perks cover a variety of benefits, from health-care premiums to severance packages. Which of these was offered as compensation to executives in 2015?

A. Personal and home security perks
B. Flexible cash perks
C. Perks covering charitable donations
D. All of the above

5 Including the use of a private car, optional driver, parking costs, and mileage reimbursement, what was the median value of automotive perks for CEOs in 2015?

A. $20,981
B. $13,764
C. $17,809
D. $25,902

6 The median value of automotive perks for CEOs increased year-over-year in 2015, but the number of executives receiving them declined. What percentage of CEOs earned such perks in 2015?

A. 44.3%
B. 34.6%
C. 59.2%
D. 21.6%

7 Thirty-seven percent of CEOs received professional services perks in 2015, including financial counseling, tax planning and preparation, and legal aid. What was the median value of such services?

A. $11,443
B. $17,040
C. $9,589
D. $14,400

Note: CEO statistics are from S&P 500 companies
Source: Equilar

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

Thinkstock