# Preserving Control

*In today's still turbulent economy, U.S. controllers are trying to do their best to maintain the upper hand while being surrounded by financial and operational distractions.*

**By Ramona Dzinkowski**

As part of the continuous restructuring activities of U.S. companies, corporate controllers have undertaken critical initiatives to ensure that financial and operational controls remain intact. Impacts of downsizing, new methods and metrics related to risk management, and a general rethink of supply chain strategies and procedures are just some of the issues controllers are dealing with. At the same time, they're keeping a close eye on what the next big operational challenge might be for the finance functions of their companies. Most agree that, after the dust of the U.S. recession clears, it could well be the adoption of International Financial Reporting Standards (IFRS).

At a recent Controllers Roundtable discussion during the Financial Executives International (FEI) Current Financial Reporting Issues Conference, an expert panel of corporate controllers from U.S. companies provided their insights on these and other issues that will be keeping them awake at night in 2010.

## Downsizing

U.S. controllers are concerned with the impacts of downsizing, not only on the productive capabilities of the firm but also on the overall operational and control environment. According to Marsha Hunt, vice president and corporate controller of Cummins Inc., a global company that designs, manufactures, sells, and services diesel engines in 190 countries and territories, one of the critical issues surrounding the control environment during a period of downsizing or restructuring is to make sure that finance is aware of the decisions made for the company as a whole and to make sure a stop-gap strategy exists in advance.

Says Hunt, "One of the considerations as the corporate controller when we were going through [downsizing] decisions was to make sure that there was good awareness of exactly who was being impacted…and I don't mean just within the financial function, but also in other key functions, such as procurement or marketing, the people that make pricing decisions, the people with whom the finance organization may already have very good relationships. There's a lot of work involved to try and make sure that the controller is informed of those decisions and has the opportunity to put in place some alternative procedures in advance of people leaving the company."

At the same time, monetary controls remain a constant focus of the controller's office during periods of significant downsizing, particularly in companies with complex international operations. For example, with the ongoing restructuring at a decentralized company like Tyco, and the accompanying downsizing of the workforce, the emphasis was on a very structured approach to managing financial controls.

John Davidson, Tyco's senior vice president, controller, and chief accounting officer, explains: "We're a decentralized company, so we have lots of different points where accounting transactions or financial transactions are processed. We have ongoing monitoring to make sure that fundamental blocking and tackling is being done, such as your basic account reconciliations. There is a fairly structured process that we have for reporting the status of those, and we make sure there is no significant slippage. As well, we have a structured balance sheet review process that we go through and make sure that our businesses are on top of their various accounts and that we're not slipping in any significant way." With respect to the impacts of loss of people, Davidson says, "We pay very close attention to the positions that have been vacated, and for any key position we make sure that we understand how those roles are being covered."

## The Role of SOX Reporting

New reporting risks may also occur as a result of downsizing that make internal controls over financial reporting even more critical. As Nicholas S. Cyprus, vice president, controller, and chief accounting officer at General Motors Corporation, explains, certain risks emerge when companies lay off a substantial number of the management team. He notes, "When you go through a downsizing, just simple things like certain blocking-and-tackling controls, reconciliations, get put to the side because people don't have enough time to do them, and, of course, depending on how significant the accounting is, it doesn't get reconciled. That sets you up for potentially an end-of-period adjustment and, if it's really bad, a restatement."

***"When you have a major restructuring, what do you do to make sure you haven't broken your control infrastructure?"***

*—Nicholas Cyprus, vice president, controller, and chief accounting officer, General Motors Corporation*

To address these risks, General Motors turned to its highly structured internal control evaluation and reporting architectures. "At GM," says Cyprus, "we took out about a third of our executive headcount and quite a [number] of our salaried employees. We tied that into our SOX [Sarbanes-Oxley Act] team structure. So one of the things I asked the other controllers to do was map out all the jobs that were going away. They didn't necessarily need to be finance jobs because a lot of operations jobs have accounting implications. We actually tied it back to our SOX process and then used that process to see how we were covering those jobs to make sure we didn't have any gaps."

## Key Metrics

Associated with restructuring efforts in a bad economy are the key metrics that are being used to monitor financial risks more closely. At Tyco and many other companies affected by the reduction in global consumer demand, managing working capital has taken on new meaning. As John Davidson explains, "Our focus is on working capital from an operating standpoint, also in terms of just understanding the financial performance of our businesses. This year and over the past year, we actually formed what we called a working capital management team." Each month the CFOs from Tyco's various businesses meet to talk about process performance around things such as accounts receivable. At the same time, Tyco increased its focus on inventories. Because of the downturn, Davidson says, "balance sheets have been tricky, so making sure that the inventories that we do have remain filled is a key thing."

In addition to managing internal financial and operational risks, companies increasingly are monitoring the financial positions of companies they rely on across their entire production and distribution processes. At Cummins, their focus has turned to scrutinizing the strength of the balance sheet of their suppliers as well as their supply policies. In several cases, Cummins was relying on a single source of supply, which, under distressed circumstances, would leave them exposed to risks of disruptions in production. This caused them to look for alternative sources in overseas markets, which then shifted their focus toward measuring inventory turnover related to longer shipping lead times.

As Marsha Hunt says, "We've had a number of areas where we had one source of supply, and in this economy we were concerned. We realize that our suppliers are struggling, so we're looking at alternative sources. In some cases those could be international suppliers." But according to Hunt, the change in the supply chain required a change in Cummins's way of thinking about inventories and how they were measured so that the metrics didn't undermine or mask what was considered a good business decision. "What you can have happening," she explains, "is that you are shifting some of your sourcing to an overseas environment, and you may have a lot of material that's sitting on a boat for 60 days before it gets to you. So now we look at certain measures, such as inventory turnover, for example. You can have a very smart business decision to actually source your material somewhere else, but if you don't take a look at how you measure your inventory turnover you could be actually driving a negative trend or masking the trends you want to measure."

## IFRS or U.S. GAAP? Divergent Views

The Securities & Exchange Commission (SEC) has yet to set a date for the U.S. adoption of IFRS. But with more than 150 countries around the world adopting them and the ongoing momentum by the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) to produce one set of high-quality global standards, U.S. controllers are wondering whether they should turn up the heat on IFRS conversion in their companies in 2010. With the general understanding that converting to IFRS doesn't happen overnight, some international companies are paying closer attention to how the standards are being rolled out in publicly listed subsidiaries around the world, and others are choosing to wait until the SEC is satisfied that IFRS should be the standard for reporting in American firms.

Cummins Inc. owns 51% of a subsidiary in India that's a reporting registrant in that country. Traditionally, the company has been structured so that the corporate control function hasn't been engaged in local statutory reporting; rather, their subsidiaries report to them on a U.S. Generally Accepted Accounting Principles (GAAP) basis. But now that India is adopting IFRS, Cummins's control team will be monitoring what happens there very closely, which will help them make decisions around how to proceed elsewhere. Marsha Hunt says, "Largely it will be accelerating the positions we need to make around certain policies. We don't want to set up our Indian subsidiary in a situation where the parent company comes in, assuming the U.S. were to adopt [IFRS] at some point in the future, and then forces a restatement of the financial statements there. So we're trying to think through those judgment issues now."

To prepare for IFRS conversion now, Cummins has been encouraging training and has identified core team members they want to expose to IFRS, focusing first on the critical conversion areas that are expected to have the largest impact on the company. As Hunt explains, "We've actually taken two of the areas that we think will affect us to the greatest degree, as far as capturing information differently, and [those are] research and development expenses and fixed assets. We've already put together some project teams to try and think through and understand what the differences are between U.S. GAAP and those areas [under IFRS] because we want to be in a position to advise our subsidiaries in India." Cummins has also engaged Ernst & Young to advise the Indian subsidiary to help them move from local GAAP to IFRS and will be learning through the conversion process as it rolls out. "The core team in my group," she adds, "is going to be spending a lot of time on video conferences very early in the morning as we want to participate in those meetings with Ernst & Young and our Indian subsidiary to really understand what's going on."

Similarly, companies like Tyco—with an extensive global network—see the benefit of a unified standard and an early understanding of how IFRS is being adopted in their companies around the world. As John Davidson explains, "We have about 1,200 legal entities across the globe, of which roughly 900 are outside the U.S. For us, one standard, one reporting scheme would be really beneficial. Think about the benefits that would improve the company—to be able to move people from one country or one business to the next and think they'll be talking about the same set of standards. I think it would be a great benefit. We're not there yet, and it's certainly going to be a lot of work, but we are working with the [business] units that are getting ready to adopt."

But as the economic downturn in the U.S. has limited discretionary spending across the board, it has also potentially impeded the progress toward understanding the likely impacts of IFRS in many companies. From a practical perspective, controllers are concerned that the budgetary aspects of adoption aren't being adequately considered at this time, and, without a hard adoption date, the argument for IFRS conversion resources remains weak.

As Marsha Hunt explains, "…we have people at Cummins who are engaged in other groups in other parts of the organization that don't understand necessarily that IFRS could advantage us. So one of the things that [has] happened is that…°the spending has been turned off on anything but the compliance function at this time. I'm sure we're not alone with other controllers that are a little concerned, or at least I'm concerned, about the budgetary aspects of this not being properly considered by some of those senior folks in the company. It's difficult, frankly, without any rules to put in front of someone to try and argue why we should be spending those resources and even doing the work to figure out what that cost is going to be. So, I think we've lost a little bit of time in being ready compared to where we might have been a couple years ago."

Others are taking a wait-and-see approach, looking to the FASB and the IASB to move further along the path to convergence of IFRS and U.S. GAAP. Says Nicholas Cyprus of GM, "I'm not moving GM forward in IFRS other than just a monitoring process of understanding what the rules are….I think we've got to get a heck of a lot closer to having one converged set of GAAP before we all go crazy trying to reconcile between the two." At the same time, given the business and legal environment in the U.S., he questions whether or not a less rules-based system makes sense. "I am still very sceptical in the way we do business in the United States," he says, "and the kind of litigation rules that we have, whether a principle-based philosophy's going to work….You know, you get into a judgment-based thing and debates are going to reign…and we have enough even with the rules-based environment today, and all the complexities of the rules….So I think if the regulators want the preparer community to step up and get this done, they need to look at themselves and get convergence on the way, really on the way, before you're going to see General Motors step up and spend money. I don't want to spend it multiple times, and I'm worried about that."

## Shifting Focus

From the three experts providing their views on what's keeping them up at night, we clearly see that controllers now have to do things differently in order to ensure that their control environments remain intact. A shift in effort toward monitoring the impacts of layoffs on control procedures, increasing the focus on accounts receivable, and scrutinizing the financial health of suppliers with greater rigor isn't likely to be unique to American controllers but is expected to characterize their jobs for many months to come. At the same time, some U.S. controllers are turning their attention toward adopting global accounting standards in 2010 in anticipation of eventual acceptance from the SEC. Others, like General Motors, continue to wait with caution for a level of comfort that the FASB and IASB are getting closer to finalizing their conversion projects. **SF**

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