Surviving the Fiscal Cliff and Afterwards

POLITICAL AND REGULATORY ISSUES, THE EUROZONE WOES, AND CONSTANT RISK ARE STILL KEEPING CONTROLLERS UP AT NIGHT.

By Ramona Dzinkowski

In 2012, risk management dominated the office of the CFO amid uncertainty around the political and fiscal instability in both the United States and the European Union (EU) and increasing concerns over currency fluctuations/inflationary pressures in emerging economies. At the same time, U.S.-based finance executives were struggling for clarity around the potential adoption of International Financial Reporting Standards (IFRS) in America and a renewed appetite on the part of the Public Company Accounting Oversight Board (PCAOB) for mandatory auditor rotation. Many of their international colleagues in countries such as India faced wholesale changes in their corporate governance environments.

Controllers were also deep in the weeds of technical accounting changes.

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The Financial Accounting Standards Board (FASB) was busy at work with the issuance of a possible 15 new exposure drafts, many of which are still out for comment, as well as seven freshly inked new Accounting Standards Updates (ASUs). Also on the standards agenda, the FASB and, more specifically, the newly formed Private Company Council (PCC) proposed a new framework for how to modify U.S. Generally Accepted Accounting Principles (U.S. GAAP) for private companies with the aim of reducing complexity in reporting for this group. There was much debate surrounding whether what many are calling a two-GAAP system (one for public companies and one for private companies) was ultimately good for corporate America as a whole. This argument continues. The PCC began deliberations on next steps in December 2012, and private-company CFOs will be keeping watch on proceedings throughout the year.

For those companies filing under IFRS, six major projects from the International Accounting Standards Board (IASB) became effective in January 2013. They are IAS 19, "Employee Benefits"; IFRS 9, "Financial Instruments"; IFRS 10, "Consolidated Financial Statements"; IFRS 11, "Joint Arrangements"; IFRS 12, "Disclosure of Interests in Other Entities"; and IFRS 13, "Fair Value Measurement." Also, 2013 will see a host of new exposure drafts amending major IFRS, including financial instrument impairment, hedge accounting, insurance contracts, leases, interim IFRS for rate-regulated activities, and revenue recognition.

Added to the impacts of uncertainty in the regulatory and political environment were the effects of the related market volatility around the world that underscored the importance of risk management. This topped the agenda for most CFOs last year, and it meant much more stress testing of alternative risk scenarios, much more reliance on models, and much more oversight. Ultimately, 2012 saw closer ties between senior finance executives and risk than we've witnessed in recent years, promising a clear expansion of their domains going forward. More specifically, boards are requiring CFOs to expand their risk models in new ways, such as increasing their focus on credit risk and liquidity analysis across the entire supply chain.

What's Ahead for 2013?

For 2013, finally there's some good news (albeit less than normal) about steady global economic growth, a slowly recovering U.S. housing market, and increases in consumer spending, industrial production, and U.S. export growth. U.S. companies are getting back to the basics of running their businesses in (we hope) more stable times. Over the past three years, risk models have been tweaked to incorporate a multitude of scenarios that can be run quickly and frequently under changing assumptions. Again, companies are examining short-term impacts of credit default within their supply chains more often and are adjusting their purchasing agreements, asking for greater payment up front. And CFOs are now more aware of the possible outcomes of the political risks in Europe that were responsible for much of the market volatility in 2012.

As to what's going to keep global controllers up at night in 2013, Eurozone woes will still be the number one source of pessimism for the senior finance folks who continue to watch fiscal and monetary policy in the region very closely. Running a close second is the effect of the fallout over whether President Obama could keep the U.S. from tumbling over the fiscal cliff or at least buy more time to get Congress on board with needed policy to stave off an impending economic catastrophe in 2013.

COSO's New Framework

In November 2011, the Committee of Sponsoring Organizations of the Treadway Commission (COSO), one of the leading contributors to thought leadership in risk and internal control, released its revised *Internal Control—Integrated Framework* (ICIF) for public exposure and comment. A second round of public exposure and comment just ended in December 2012. The newly proposed framework is intended to improve and build on COSO's earlier framework, originally published in 1992, to reflect the changes in the operating and risk environments that have occurred over the past 20 years. More specifically, according to COSO, its intention is to make the "existing framework and related evaluation tools more relevant in the increasingly complex business environment so that organizations worldwide can better design, implement, and assess internal control." Regulatory bodies recommend using the initial framework and subsequent documents and guidance, such as the 2004 *Enterprise Risk Management—Integrated Framework*, in Sarbanes-Oxley Act (SOX) and other compliance activities. It's hoped that the new framework will be in final form and ready for use by finance execs in 2013.

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Even though on January 1, 2013, the House of Representatives voted to approve a Senate bill to avoid the disaster, putting the minds of many at ease for the short term, a number of issues remain. The January 1 legislation averted many of the possible negative impacts by extending some Bush-era tax cuts as well as the soon-to-expire long-term unemployment benefits. But controllers will be revisiting these and other monetary dilemmas as the new Congress proceeds with its work.

Meanwhile, anticipated changes to accounting standards in the U.S. will continue to keep controllers on close watch in 2013, as will the need to reexamine their risk management frameworks to keep pace with changing business models. Also, they're anxiously awaiting the arrival of the final revisions to several big Memorandum of Understanding (MoU) projects to be issued jointly by the FASB and the IASB, namely financial instruments, impairment, hedge accounting, accounting for macro hedging, leases, and revenue recognition.

And there's more. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is planning to rerelease a significant update to its original *Internal Control—Integrated Framework*, which the majority of Sarbanes-Oxley Act (SOX) Section 404 filers have adopted. COSO hopes that the new framework will be ready for CFOs to start implementing this year.

Revenue Recognition Is Top of Mind

Urban Science, a Detroit-based automotive dealer network consulting company with 850 employees in 18 offices around the world, had carefully factored the unresolved fiscal issues in both the U.S. and EU into its 2013 forecasts. According to Dick Widgren, vice president, treasurer, and CFO, "We estimated that if the U.S. fell off the fiscal cliff, the resulting tax increases would not likely support the growth of the business from 2012 levels. As a result, we cautiously looked at that in our risk scenarios as an event that would have a negative impact in our U.S. market in 2013.

"We've also adjusted our models for 2013 on the basis that we *do not* expect Europe to recover," he says. "Economic risk factors have a mixed impact on Urban Science. The demand for Urban Science's services tends to be countercyclical. We're somewhat insulated because we're in the kind of a business where, when the economy recedes or softens, our customers are looking for more strategic answers on how to work their way through the difficulties that are in front of them, so the demand for our services tends to go up."

Also, as a natural hedge, 70% of their business is tied into long-term contracts of at least three years. "So," Widgren adds, "despite the global downturn, we've had dramatic growth over the last three years and anticipate a continuation of that growth, even in this economy. However, the main issue that concerns us relates to the uncertainty around the length of a downturn and the potential longer-run impacts this will have on market demand. The impact beyond our three-year time horizon is the issue."

In terms of reporting in 2013, the anticipated new revenue recognition standard is going to be a key focus for the Urban Science finance function. Widgren explains: "Revenue recognition is an issue that is a constant for us because we're in a service industry that relies on contracts that have a percentage-of-completion issue within them. We're constantly evaluating our recognition of revenues based on the current GAAP requirements. We have to make sure that this is something that we review with our public accounting firm—not only at the year-end but throughout the year—to verify that the kinds of decisions we're making for revenue recognition are in fact going to be correct."

Life Cycles Rank High

For other companies, such as Eli Lilly, a global pharmaceutical company, a slower global economy and fiscal issues in Europe and the U.S. continue to pose a risk in 2013. But as Arnold Hanish, former vice president and

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chief accounting officer, who retired last month, explains, "In our industry, there are other unique factors impacting growth and revenues in all companies. The nature of the pharmaceutical business model is that we go through life cycles related to the loss of patent protection for existing products and uncertainty around new product launches. The patent issues are somewhat predictable; the timing of new products coming out of our pipelines is less certain. The pharma industry in general is currently going through one of those business cycles in certain countries where some companies have lost patent protection on very major products. Other regions are countercyclical due to later product launches. So in terms of what's driving growth, while economic conditions have a negative impact globally, the countercyclical nature of certain products continues to drive revenues. In 2013 we'll continue focusing on expanding in countries like China and Japan, which we consider countercyclical. We'll also focus on expanding in other emerging markets."

Meanwhile, the company continues to evaluate global outsourcing opportunities in order to streamline the business. At the same time, it will have completed a migra-

Nine Fastest-Growing Fronts for the CFO

A recent joint study by the Association of Chartered Certified Accountants (ACCA) and IMA® about the evolving role of the CFO predicts that, for 2013, their domain of responsibility will continue to expand with little end in sight. Below are some of the fastest-growing areas of responsibility for the CFO going forward.

Regulation: CFOs have an increasing stake in and accountability for regulatory adherence and compliance.

Globalization: Global experience on the résumé will be a baseline expectation. Global leadership will be the cornerstone of the future CFO's role.

Technology: A key challenge for CFOs is that data systems and their hierarchies often don't reflect business structures or reporting needs. At the same time, the business continues to change, which means that technology plays catch-up, and finance spends significant time reworking data in spreadsheets. Predictive analytics, forecasting future performance based on past performance, will be a key enabler for CFOs and their finance operations.

Risk: There will be greater scrutiny of the effectiveness of risk management processes and much higher expectations on the adequacy of longer-term financial results.

Transformation: Tomorrow's CFO will need to ensure that finance is a catalyst for change across the business, driving outcomes that affect long-term business performance, not just short-term cost reductions.

Stakeholder management: CFOs will increasingly need to be good at dealing with the media and at brokering the external relationships that matter for the face of the business. In many senses, they will be the face of the corporate brand.

Strategy: Too often the financials and budgeting process remain disconnected or detached from the realities of the business. CFOs will need to drive change programs that integrate and attune the finance processes of the organization to business strategy more effectively.

Sustainability reporting: Reporting on the social and environmental dimensions of performance as part of a broader move toward integrated reporting requires the design and implementation of new reporting systems and more intangible nonfinancial measures.

Talent: Developing talent through a global finance function across geographic, language, and cultural differences will be a key priority for future finance leaders as they seek to develop and retain the capabilities that will be needed in tomorrow's finance function. The rise of virtual teams will make people-development strategies more complex.

Developed from "The Changing Role of the CFO" by ACCA and IMA, October 2012.

tion to a shared-service environment for a number of back-office financial activities. This has meant setting up financial shared-service centers internationally in Kuala Lumpur, Malaysia; Mexico City, Mexico; and Cork, Ireland; as well as in the U.S. Says Hanish, "We've done a lot to create efficiencies in our financial processes. For example, we've transferred a significant amount of back-office accounting activity, transactional processing, and also have outsourced some very basic transactional routine activities to a third-party BPO [business process outsourcer] in Eastern Europe, India, and China. In terms of what's driving our financial process improvement strategy into the next year and the year after that, we continuously reevaluate what's best for the business. We will continue to evaluate how we can lower our costs, create efficiencies, and create better controls, which, to date, has enabled the company to migrate to one SAP platform globally."

In terms of what's in the pipeline from the FASB in 2013, Hanish suggests that controllers in international companies will likely be focusing mainly on the results of three of the big remaining MoU projects. He says, "We're still waiting for a final outcome on financial instruments, revenue recognition, and leases. Those three projects, particularly revenue recognition and lease accounting, are quite problematic for many multinational companies. They could be extremely difficult to implement. For a multinational company, there's going to be a need for a long timeline to adequately adopt those new standards."

Internal Controls Are Foremost

For Steve McNally, finance director and controller at Campbell Soup Company and the IMA® (Institute of Management Accountants) representative on the COSO Internal Control—Integrated Framework Refresh Project Advisory Council, 2013 and beyond will see senior financial executives reexamine the adequacy of their internal control environment. More specifically, McNally says, "Regulatory and stakeholder expectations regarding governance oversight as well as the prevention and detection of fraud will continue to grow. Finance executives will be even more vigilant, revisiting the design and effectiveness of their organization's internal control environment. With the anticipated release of COSO's updated framework, reassessing their approach to risk management will be one of the key themes emerging in 2013 that financial executives will be focusing on." He adds, "There is an expectation that boards will be more proactive in their ability to understand their organization much more than in the past. Clearly, a big part of that is to understand in greater depth the risks and issues that are impacting or could impact the organization and that could prevent the organization from being successful."

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At the same time, companies are in an ever-increasingly competitive environment, he notes, and one of the keys to remaining competitive in the future will be the greater use of third-party partnerships. According to McNally, these changing business models are increasing risk for many organizations going forward, and the updated COSO framework attempts to address these changes, among others.

As he explains, "Many companies currently use COSO's 1992 framework, so, at a minimum in 2013, senior executives need to understand the new framework and how it does or does not impact their internal control environment, making changes or refinements as needed, especially if they leverage COSO for U.S. SOX compliance. The new framework can also support developing controls over reporting from an internal and external financial and nonfinancial perspective in addition to controls supporting operational and compliance objectives."

So for 2013, senior finance executives will be doing much more of the same. Many of them will continue to be buried in compliance and regulatory issues, all the while keeping a close eye on how political events in Europe and the U.S. unfold. It's another wait-and-see year. **SF**

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