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LEADERSHIP STRATEGIES FOR ACCOUNTANTS
AND FINANCIAL PROFESSIONALS

Rich Brady: Focused on the Mission

A Balanced Approach to Optimize Working Capital

Carl Menconi Case Writing Competition

JULY 2023

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THE CASE FOR STRONG FIRST-LINE RISK GOVERNANCE

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Navigating Change

IMA's new Global Board Chair shares his priorities for the coming year, including helping the organization navigate a leadership transition.

By Richard T. Brady, CMA, CGFM, CDFM

Leadership transitions and new beginnings are critical aspects of any organization's growth and success. One of the main benefits of these transitions is the opportunity to explore fresh ideas and perspectives. As I begin my term as IMA Chair for 2023-2024—a change in itself—IMA® is undertaking a key leadership transition this year with the appointment of Mike DePrisco as president and CEO. Mike has the opportunity to build on the solid foundation of his predecessors while charting a new path forward for IMA. Together with the IMA Global Board of Directors, staff, and all of the IMA members around the world, Mike will be supported and equipped to manage challenges and create opportunities.

Broadly speaking, a new leader brings experiences, values, and beliefs that can help an organization evolve and adapt to changing circumstances. IMA is buzzing with possibility, as our teams are mindful that such transitions can spark innovation and creativity, helping the organization to stay relevant and competitive in an ever-changing environment.

IMA leadership is conscientious too about the reality that organizational transitions can also be a time of uncertainty and anxiety, particularly for stakeholders who may be unsure of what changes are to come. With that in mind, Mike and the entire IMA team are carefully planning and managing the transition to ensure that everyone is informed and prepared for the changes on the horizon.

For IMA, that vision and strategy for the future remain unchanged: to be the premier organization and leading resource for developing, certifying, connecting, and supporting the world's best accountants and financial professionals in business. Supporting this vision will be many of the IMA programs you already know and value, such as the CMA® (Certified Management Accountant) certification—but it will also involve developing new initiatives, building relationships with key stakeholders, and implementing changes to the organizational structure or processes.

During my time as your Chair and with the support of the entire organization, IMA will continue its work toward this strategic vision by providing a forum for research, practice development, education, knowledge sharing, and advocacy of the highest ethical and best business practices in management accounting and finance. Articles like this month's "SVB and Credit Suisse: The Case for Strong First-Line Risk Governance" by Parveen Gupta and Tim Leech or "Strategic Marketing in a Digital World" by Mark L. Frigo with Steven Mark Kahan are just two examples of this kind of thought leadership in the profession.

I'm honored to be part of this leadership and organizational transition. As your Chair, I'm committed to supporting Mike in assuming his role, increasing IMA member value, and growing the IMA membership base. With effective communication, a clear vision, and a focus on innovation and collaboration, we'll successfully navigate this change, chart a sustainable course for IMA, and take our organization to new heights while ensuring its continued success in the years to come.

I invite your comments, questions, and thoughts on this or any other topic. I look forward to our future together.

Richard T. Brady, CMA, CGFM, CDFM, is the CEO of the American Society of Military Comptrollers (ASMC) and Chair of the IMA Global Board of Directors. He's a member of IMA's Nation's Capital Chapter. You can reach Rich at rich.brady@imanet.org or via LinkedIn.

Welcome, New CMAs: May 2023

1,185 IMA members became CMAs between May 1 and May 31, 2023.

By Dennis Whitney, CMA, CFM, CAE

For more information on CMA certification, visit www.imanet.org/cma-certification.

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Yixuan Zhu
Haihua Zhuang
Ya Zou
Rong Zu
Lei Zuo

Customer-Centric Strategic Decision Making

Finance leaders who integrate data on customer preferences and behavior into projections formulate more effective strategic plans.

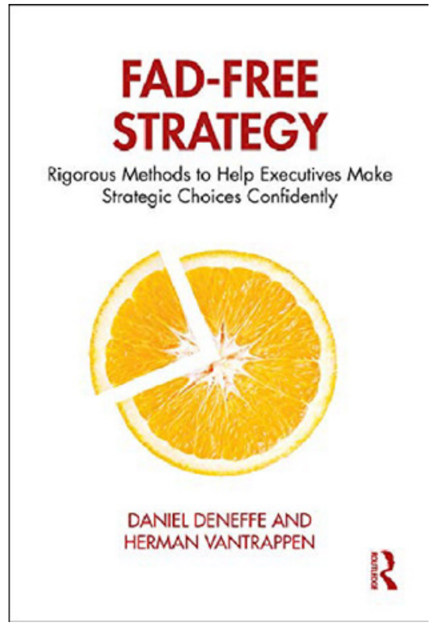
By Marianne Dahmen, CMA, CSCA

Many corporate executives, including management accounting and finance professionals, can relate to doubts and questions such as: Did we choose the right go-to-market strategy? Did we launch the right solution at the right price? Are our revenue and margin forecasts sufficiently validated? Often, we have to admit that we've missed something or, even worse, bet on the wrong horse altogether. It can be difficult to forecast how setting objectives and strategic and tactical planning to achieve them will be executed and impact operations and the organization's bottom line.

In *Fad-Free Strategy: Rigorous Methods to Help Executives Make Strategic Choices Confidently*, coauthors Daniel Deneffe and Herman Vantrappen guide readers through a simple yet game-changing thought process that they call "operational strategy" that aims to validate, adapt, or possibly reject leadership's "grand strategy" decisions (e.g., which markets to create, enter, defend, or exit).

Operational strategy is based on the authors' premise that customers and their choices, rather than internal ambitions or the application of any other faddish strategic framework, determine the success of a chosen strategy.

Ultimately, a company's strategy can only be successful in maximizing profit when revenues are sufficiently large relative to costs. Hence, to understand these revenues and influence their growth, CFOs and finance managers need to be able to forecast customer choices for whatever product, service, platform, or solution the company could launch or reposition at different prices. Too often, top-line forecasts are generated with little customer input. As a result, the foundations of a strategic business plan are shaky and difficult for the CFO and other leaders to evaluate.



Fad-Free Strategy describes tools to extract and contextualize data on customer preferences and spending behavior, predict customer choices, and therefore generate more reliable forecasts. Deneffe and Vantrappen explain how to apply these tools, which are designed to result in tailored solutions to most strategic problems, no matter what industry vertical your company is in.

The tools they discuss have been developed using the latest academic insights in decision analysis and utility theory from Deneffe's academic network—he teaches at Harvard University and Hult International Business School—while being applied and validated by both authors in various consulting projects with real-world clients.

In their book, Deneffe and Vantrappen combine microeconomic behavioral assumptions with hands-on practical examples and explain complex mechanisms in a direct, easy-to-read way. Their book is refreshing and inspiring and provides an end-to-end how-to guide to building more customer-centric revenue predictions that are more likely to hit closer to the mark and avoid costly miscalculations.

If applied properly, the authors' operational strategy could unleash short-term benefits at the intersection of finance, strategy, and marketing by helping CFOs and other leaders to challenge fundamental commercial assumptions used in business plan proposals and learn from plans that didn't materialize as expected. Whether you're a C-level executive, controller, finance or operations manager, professor, or student interested in pragmatic strategy best practices, *Fad-Free Strategy* is a must-read.

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New Publishing Schedule for *SF*

Check out the SF website every week to keep up with the latest stories and news.

By Lori Parks

Strategic Finance is moving from a monthly publishing cycle to publishing new content weekly. Readers are encouraged to visit sfmagazine.com regularly to view any newly released content. With this change, *Strategic Finance* will no longer publish its digital turn-the-page edition.

To ensure you don't miss any new stories, readers are encouraged to sign up for weekly SF Alerts to get updates about the latest articles delivered straight to your inbox. For those who like to read the issue all at once, we'll also be making a searchable (and printable) PDF available for download at the end of each month that will contain everything published that month.

These changes follow the refresh to the sfmagazine.com website earlier this year, which provides an improved reader experience and streamlined organization. The new publishing schedule will enable the magazine to embed supplemental content and bonus materials directly into the magazine, something that wasn't possible with the print format.

Strategic Finance will continue to develop special themed issues as well. August 2023, for example, will be Accounting Education month. Look for articles each week covering a range of education topics, including teaching management accounting competencies, adding data analytics to cost accounting curricula, and embracing ChatGPT and AI to enhance accounting education.

For questions about these changes, please contact IMA Member Services at info@imanet.org.

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What to Know about Anti-Money Laundering

Accountants help to ensure an ethical culture by checking that their organization maintains anti-money laundering best practices.

By Daniel Butcher

One of the most common forms of unethical conduct is money laundering, and multinational companies with offices in various countries can be especially susceptible to getting their reputation stained by enabling or associating with such illicit transactions. Management accountants can work to ensure an ethical culture by checking that their organization has implemented and is maintaining best practices for compliance with anti-money laundering (AML) regulations in particular and fraud prevention in general. These include regular due diligence checks, from know your customer or client (KYC) and AML policies to identity verification (IDV); secure internal control and information systems that raise alarms at suspicious transactions; and background screenings to ensure that the organization isn't hiring individuals or working with customers involved with money-laundering schemes or facilitating high-risk entities that are in financial crime databases or on fraud watch lists.

Financial regulators worldwide are developing new regulations to identify and fill in loopholes in financial systems that enable money launderers. Another regulatory priority is combating the financing of terrorism (CFT), financial measures used to disrupt the flow of money and other resources to terrorist groups through a set of laws, regulations, and government agency practices. This increased legal and regulatory scrutiny puts companies at risk of civil, criminal, or reputational damage if their internal control systems fail to detect and deter criminal activity. For example, in 2022, Deutsche Bank settled an AML lawsuit for €7.1 million ($7.6 million), and Credit Suisse was fined 2 million Swiss francs ($2.2 million) for failing to prevent money laundering.

"Recently we have seen prosecutors across the globe successfully bring cases against and fine financial institutions for their noncompliance with AML regulations," says Patrick Kelly, head of sales, the Americas, at ShuftiPro, a digital IDV service provider. "It doesn't seem like prosecutors will stop here; they've made their position clear—banks [must] comply with AML regulations or face the ramifications."

Implications for Professional Ethics

The implications of this type of lawsuit for finance professionals vary depending on where they work. If you work at a regulated financial institution that must remain compliant with the U.S. Bank Security Act (BSA), then your organization must remain compliant or risk legal action, Kelly notes. Compliance with BSA includes filing suspicious activity reports (SAR) within 30 days for cash purchases of negotiable instruments, cash transactions totaling $10,000 per day, and suspicious transactions that may be linked to criminal activity. Further, banks must perform IDV to remain compliant.

Notably, accountants working in-house at nonfinancial institutions and accounting firms aren't regulated under BSA. But this doesn't mean they should disregard AML best practices since they're an important element that contributes to an ethical organizational culture. While regulated financial institutions are required to file SARs, accounting professionals can file them as well. Virtually any person can file a SAR regardless of occupation or job function. Transaction monitoring into accounts can help your company detect suspicious activity and take steps to file a SAR for transactions it feels may be linked to money laundering or terrorist financing.

"Interactions that once happened in person now frequently occur wholly over the phone or by email," Kelly says. "Implementing robust IDV measures and subsequent AML checks during the client onboarding process can ensure you're working with reputable clients."

Engaging in business with unethical individuals or companies can lead to widespread ramifications—all negative—for an organization, Kelly stresses. Depending on whether you work in-house at a financial services organization or a company in another industry vertical, the required response and potential repercussions will be different. Finance professionals working at a bank must report suspicious financial activity per federal law. Most large, regulated institutions have established best practices to ensure compliance with domestic and international laws and regulations, while small to medium enterprises likely won't have the same robust compliance efforts. Software is a viable option for finance professionals at organizations of all sizes to deter criminal activity.

"Working with known criminals or engaging in suspicious activity or business deals can harm your firm and be detrimental to its reputation," Kelly says. "As a trusted business partner, reputation is everything—firms can use automated KYC and AML [software] to mitigate the risk associated with known criminals."

In addition, transaction monitoring is critical, whether that's the responsibility of the information technology team or accountants, Kelly says. Finance professionals have complete visibility into corporate transactions to facilitate transaction monitoring, which allows finance professionals to flag suspicious transactions such as unusually large deposits into an account or irregular funding activities.

The Finance Function's Role

Finance professionals, even those without a direct role in compliance, risk management, or internal controls, need to take AML and CFT procedures such as KYC and IDV seriously, Kelly says. This can be one aspect of multifaceted efforts to instill an ethical organizational culture.

"With the rise of hybrid working, this need has never been greater," he says. "Implementing KYC and IDV and then performing screenings against known criminal and sanction lists can ensure that customers aren't linked to known illegal activity."

AML technologies powered by AI and machine learning have improved the ability of businesses to prevent money laundering, Kelly says. AML systems can intelligently extract risk-related facts from large volumes of data, resulting in a quick and secure process. AI AML algorithms have the ability to screen customers against adverse media checks, 1,700-plus watch lists, and politically exposed person lists in less than a second, according to Kelly.

"With adequate preventative measures, you can avoid working with known criminals," he says.

While compliance with regulations is important, it doesn't ensure an ethical culture. Cultivating ethics across the organization starts from the top down, and leaders should educate their teams on AML and CFT risks and fraud prevention best practices as an element of employee training initiatives.

"This shouldn't be a one-hour webinar once a year," Kelly says. "Instead, an ongoing and engaging discussion among team members on AML and CFT can ensure the team knows what to look out for and how to act when they detect suspicious activity."

Daniel Butcher is the finance editor at IMA and staff liaison to IMA's Committee on Ethics. You can reach him at daniel.butcher@imanet.org.

Reporting Ownership Information under the Corporate Transparency Act

Beginning on January 1, 2024, many small U.S. businesses will be required to report information about the individuals who own or control the business.

By Shirley Dennis-Escoffier, Ph.D., CPA, and Anthony P. Curatola, Ph.D.

In the past, most small businesses weren't required to disclose information about the individuals who actually own or control the business (beneficial owners). This lack of transparency allegedly allows criminals to use businesses as shell or front companies to hide their true identities while they launder their illegally obtained funds through the financial system. At least 30 countries have implemented centralized reporting of beneficial ownership to address this lack of transparency, and 100 more countries have committed to implementing systems similar to that contained in the Corporate Transparency Act (CTA) in the United States.

The U.S. Congress passed the CTA in 2021 to expand the government's ability to prevent money laundering, terrorist financing, tax fraud, and other financial crimes. The CTA requires that beneficial ownership information (BOI) be reported to the Treasury Department's Financial Crimes Enforcement Network (FinCEN) beginning January 1, 2024, by U.S. entities and foreign entities registered to do business in the U.S. Some large companies and financial institutions that are already required to report similar information to a governmental authority are exempt. This new BOI reporting, however, will apply to many small businesses, including limited liability companies (LLCs) that have never previously interacted with FinCEN, and is expected to require reporting by more than 30 million companies in 2024.

Who's Required to Report?

Businesses required to report BOI include corporations, LLCs, and any similar entity created by filing a document with a secretary of state or similar office. This includes many limited partnerships and business trusts that filed formation or registration documents in addition to foreign entities that are registered to do business in the U.S. Sole proprietorships and other entities that weren't required to file registration documents aren't subject to these new rules.

The regulations (31 Code of Federal Regulations (CFR) §1010.380(c)(2)) list 23 categories of businesses exempt from this new BOI reporting, such as large operating companies (businesses with gross revenue exceeding $5 million on their prior year's U.S. tax return that employ more than 20 full-time employees in the U.S. and have a physical office in the U.S.), publicly traded companies, banks, registered money transmitting businesses, insurance companies, pooled investment vehicles, brokers or dealers registered with the U.S. Securities & Exchange Commission, public accounting firms registered in accordance with the Sarbanes-Oxley Act of 2002, and certain tax-exempt entities. Businesses should review the list of exemptions and prepare a separate entity-by-entity analysis for any subsidiaries or affiliates to determine if an exemption applies.

What Must Be Reported?

Companies that don't qualify for an exemption should begin preparing the required BOI and company information. Each company must report its full legal name (and any trade or doing-business-as name), street address, jurisdiction of formation (state, tribal, or foreign jurisdiction of registration), and taxpayer identification number. The company must report information for each beneficial owner, including (1) full legal name, (2) date of birth, (3) current street address, and (4) a unique identifying number from the individual's passport, driver's license, or other acceptable document (and include an image of that document).

A beneficial owner is any individual who owns (directly or indirectly) at least 25% of the company or exercises substantial control over the company. The regulations use an expansive definition of ownership interests including any equity interest, capital or profits interest, and options as well as more complex instruments. Individuals will be considered to exercise substantial control if they're a senior officer or if they direct, determine, or exercise substantial influence over important decisions the company makes or have any other form of substantial control. For example, if a corporation is owned by four individuals who each own 25% of the stock and three other individuals serve as CEO, CFO, and general counsel (none of whom own any stock), there are seven beneficial owners for whom information must be reported.

Companies created after December 31, 2023, must also report information on their company applicants. An applicant is the individual who creates a domestic business by filing the document that created the entity (or registers a foreign entity to do business in the U.S.). If another individual was responsible for directing or controlling the filing of that document, that second individual is also considered an applicant. For example, if a legal professional prepares the formation documents and then has an assistant file the documents with the state, both the legal professional and the assistant are considered applicants. A company can have up to two applicants. Companies that existed before January 1, 2024, don't have to report information on their company applicants.

Once all of the beneficial owners are identified, their BOI must be collected for reporting and maintained in a secure manner that complies with privacy laws. Reporting will be done electronically through the Beneficial Ownership Secure System that will be available through

FinCEN's website. If an individual voluntarily provides their four required pieces of information directly to FinCEN, that individual may obtain a FinCEN identifier that can then be provided on the BOI report instead of the required information for that person.

New entities created or registered after December 31, 2023, must file within 30 days of their creation. Existing entities (created before January 1, 2024) must file by January 1, 2025. Changes to previously reported information (or if errors are discovered) must be filed within 30 days of the change (or discovery of the error).

Taxpayer penalties for noncompliance of these reporting obligations include civil penalties of up to $500 per day that a violation continues. Criminal penalties include a $10,000 fine and/or imprisonment for up to two years. To avoid possible penalties, entities with a complex ownership structure may need to spend a significant amount of time and resources in establishing ownership percentages and in identifying the individuals who have authority to substantially control the company.

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The Benefits of Career Cushioning

With many employees worried about their future, helping them plan their career and develop skills can be a win-win.

By Paul McDonald

You never want to think that your best employees are contemplating career options outside of your company. But in an uncertain economy that has seen layoffs and hiring slowdowns in recent months, it's a strong bet that many of your workers are doing exactly that. Even if the pace of business at your company is robust, employees may still be wondering, "What if things suddenly change? What would I do?"

Even though Bureau of Labor Statistics data shows that national unemployment is low—and rates are trending even lower for many roles in fields like accounting and finance—worrying about job security is natural in the current climate. Over the past few years, businesses and their workers have been hit with some major surprises. Still feeling that sting, or wary of experiencing it, many professionals are now trying to preemptively soften the blow of what might come next through "career cushioning."

Career cushioning is the process of taking practical steps while you're still employed to prepare for a job search should the need arise quickly. To put a finer point on it, employees make full use of the resources available to them—including from their company—to help them increase both their current value and future marketability as a professional.

To an employer, career cushioning might seem a bit self-centered. But it shouldn't. Job security is never guaranteed, and serious professionals should be doing what it takes to invest in themselves in any economy. And workers engaging in career cushioning can actually benefit your business. Employers should acknowledge this trend and try the following strategies to make the most of it.

1. Understand where your employees are now—and where they want to be. Consider setting up one-on-one meetings with your team members, including remote staff, to discuss their career paths. Don't ask outright if they're actively creating a career contingency plan, though, as it will put them on the defensive. It will also make them worry that their job might be at risk.

Instead, tell them you want to know how they're feeling about their current career situation and how (and if) they visualize their future unfolding with your organization. Some questions to raise during these conversations could include:

- What are your career objectives for the next two to three years?
- Do you want to stay in your current role or take a new direction?
- Are you interested in taking on a leadership position someday?
- Are there any personal skills or professional certifications you would like to acquire?

Even if an employee has shared their career aspirations with you before, confirm that they're still working toward the same goals now. It'll demonstrate that you want to stay attuned to their needs and expectations. Importantly, it gives you the opportunity to help the employee chart a course toward achieving those objectives at your organization and outline what the company is prepared to do to help support them.

2. Take stock of skills and experience needs across your team. One major objective of the career cushioning process is learning new skills that are in demand in the marketplace. Research suggests that the inability to learn new skills could prompt an employee to leave: In a recent Gallup poll of U.S. workers, nearly half (48%) of the respondents said they would switch to a new job if it meant they could access skills training.

So, why not take advantage of your employees' increased desire to engage in training and professional development opportunities? It's a win-win. Your workers will feel invested in and that they're future-proofing their careers, while your business grows the skills it needs to compete today—and tomorrow.

Conduct an assessment to determine where skills gaps exist on your team. Should you increase capabilities in areas such as financial reporting, tax, or auditing? What about digital skills? Do you need to expand your team's ability to work with cloud-based accounting software or train them on data analytics or visualization tools? What about certifications? Could your company offer financial support to employees who want to earn in-demand credentials?

Next, think about which people on your team are logical candidates for targeted training, either because of their current role or what they may have shared with you about their career goals. And don't just focus on building up technical skills in your team. Present opportunities such as stretch assignments or innovation challenges, for enhancing soft skills and developing leadership abilities.

3. Step up succession planning. As your employees lay the groundwork for their career continuity, make sure you're thinking about your company's continuity too. If valued employees suddenly leave—or have to be let go for business reasons, do you have a viable succession plan to put into action fast?

It's well worth the effort to think ahead: An orderly succession ensures that the departure of one or more critical employees remains a manageable event rather than an organizational crisis. It also helps to create a culture of professional development, enhances knowledge-sharing between existing leadership, and helps identify and retain future leaders.

While it's important to create succession plans for major roles in your organization, avoid focusing only on top positions at the company. Creating succession plans for key employees at all levels helps to deepen your overall bench strength. It's also an effective way to identify your rising stars. Plus, it will help surface skills gaps in your team, so you can provide appropriate training and development.

As you step up succession planning, think about what additional resources you could tap for vital skills in a crunch—or to handle noncore capabilities so your team can stay focused in a crisis. Contract professionals and managed solutions are two options to consider. Many leading organizations rely on these resources to keep work moving forward as they upskill and reskill team members and transition them into new roles.

Strengthen Your Company's Future

Many professionals today are worried about the future. The COVID-19 pandemic certainly underscored how things beyond our control can create tremendous disruption. Career cushioning can help employees feel at least a little more confident that if their employment situation did change suddenly, they have a strong chance of landing on their feet or pivoting in a new direction quickly.

Accept that career cushioning is happening among your employees. Use this time when your employees are thinking a lot about their futures to engage with them and learn how they're feeling and what they want. Use that insight—along with what you glean from a skills assessment—to align employees with training and development that can benefit them and benefit your company. Through these efforts, you can identify those employees who want to stay with your organization for the long term and perhaps even take the reins one day.

Paul McDonald is a senior executive director at talent solutions and recruiting firm Robert Half and a member of IMA. You can follow him on LinkedIn.

For more on providing employees with personal and professional development opportunities, listen to the episode of IMA's *Count Me In* podcast featuring Sarah Rubenstein.

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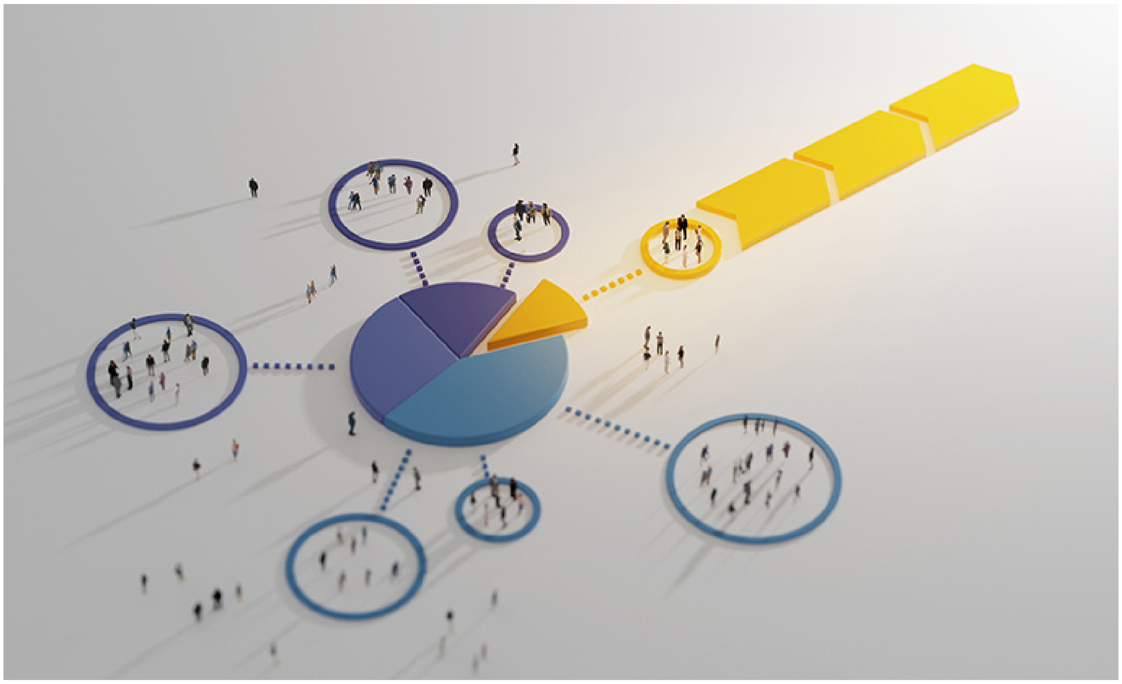

Leading with Data Analytics

A strong understanding of data analytics' applications to the finance function is integral for accounting leaders.

By Elhadi E. Elimam, CMA

Whether you're a manager, controller, treasury director, financial planning and analysis director, CFO, CEO, board member, committee chair, or chapter leader, you direct and coordinate groups of people in order to achieve certain goals. Leaders influence others to achieve organizational objectives—and one way they can exercise their leadership effectively is by explaining clearly how data analysis informs their decision making. In the current business landscape, management accounting and finance leaders need to have a familiarity with how to leverage data analytics to inform strategic planning and decision making.

Types of Data Analytics

Data analytics is defined as the process of gathering and analyzing data in a way that produces meaningful information to aid in decision making. For a leader's decisions to be sound, they must be based on sufficient, reliable, relevant, and useful information. This makes data analytics important for leaders to embrace.

Data analytics is classified into four types: descriptive, diagnostic, predictive, and prescriptive. Descriptive analytics answers the question "What happened?" It describes past performance or how a situation transpired. For example, descriptive analytics is used to quantify a decrease in a company's profits.

Diagnostic analytics is used together with descriptive analytics to answer the question "Why did it happen?" It provides reasons for, and causes of, past performance or a situation. Analysts look at historical data to learn and understand past performance and look for the reasons behind success or failure. Diagnostic analytics can be used to find possible reasons for a profit decline by analyzing a profit-and-loss statement and figuring out what factors led to a decrease in sales or an increase in expenses.

Predictive analytics looks to the future and answers the question "What is likely to happen?" Historical data is combined with newer data and analyzed to identify patterns and relationships between known variables or among data sets, which are used to make predictions about what's likely to occur in the future. A net income forecast using past profit-and-loss trends is a form of predictive analytics. Predictive analytics can be used to determine whether a profit decline is likely to continue.

Prescriptive analytics answers the question "What needs to happen?" by offering the best course of action among potential solutions and adding value based on an objective interpretation of the data. Prescriptive analytics might generate a projected income statement and then use that to determine what's needed to address the anticipated situation. Prescriptive analytics could help leadership develop plans to reverse a decline in profits. Prescriptive analytics can utilize what-if scenarios and incorporate new data variables to predict various likely effects until company leadership reaches an optimal solution or course of action.

Leaders should be able to recognize the elements that contributed to a particular past situation and analyze how these elements led to a positive or negative performance. In short, leaders should describe what happened, explain why it happened, and identify the reasons for the failure or success. Leaders also should be able to use data analytics to predict what's likely to happen in the future and determine what needs to be done by prescribing solutions to problems and a course of action to achieve strategic objectives.

How to Lead with Data Analytics

To be an effective leader, you need to be knowledgeable and skilled—preferably an expert—in data analytics and data visualization. In fact, the IMA Management Accounting Competency Framework includes data analytics and data visualization under the Technology & Analytics domain as competencies that management accountants and finance professionals need to learn to be strong business leaders.

A leader needs to have at least basic knowledge of data analytics and data visualization such as spreadsheet and data manipulation (sorting and filtering data, as well as knowing functions and formulas), descriptive statistics and basic calculation (including ratios and indicators), and data mining to be able to use data to make decisions and further business intelligence. It's important to be able to create and present digestible charts and graphs using visualization tools such as Excel and Tableau to communicate results and findings.

A leader also needs to have applied knowledge of data analytics and data visualization so that they can provide explanations of data by using query language, evaluate the efficiency and effectiveness of initiatives and proposals by using descriptive analysis, and extract and transform large volumes of data and make queries. It's also important to be able to predict outcomes and explain results by using linear regression analysis, diagnose and determine the causes and impacts of data trends, and utilize table and graph design to communicate complex information as simply as possible.

Additional data analytics and data visualization skills that leaders need include:

- Using data mining tools to identify patterns and provide insights about the data.
- Designing standard templates.
- Organizing and cleaning raw and unstructured data and transforming it into an appropriate form that's suitable for analysis.
- Utilizing specialized reporting tools for cataloging, interpreting, and presenting results of complex data analyses in an understandable manner.
- Using multiple regression tools for predicting events, providing solutions, and recommending the best course of action.
- Using business and statistical software to draw conclusions from large data sets.
- Demonstrating an understanding of communicating results with advanced visualizations such as bubble charts and network diagrams.
- Facilitating rapid decision making by using visualization tools to create multimedia dashboards combining relevant charts, graphs, tables, and images.
- Using predictive and correlative analytics techniques to provide solutions.

A leader can add value to the organization by reaching an expert level in using data analytics and data visualization to build financial and operational prescriptive models that help to optimize performance and make progress toward strategic objectives. Other key skills include using specialized query or interpreted language such as Structured Query Language (SQL) and Python to provide solutions, using tools such as JavaScript for creating customized visualizations, and using advanced statistical programs for data analysis to identify patterns and provide insights to achieve goals.

Demonstrating expertise in data visualization and an ability to interpret and communicate complex data to a lay audience increases leaders' persuasiveness. Leaders can utilize data analytics to extract, transform, and analyze data to gain insights, improve predictions, and support decision making. They can also utilize data visualization to present data clearly to better explain key patterns, trends, correlations, decisions, and strategic initiatives.

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Strategic Marketing in a Digital World

High-velocity digital marketing can transform the long-term sustainable value of your organization.

By Mark L. Frigo, Ph.D., CMA, CPA, with Steven Mark Kahan

In today's digital world, businesses need to embrace a new way of thinking about marketing. Ongoing research in the Return Driven Strategy Initiative at the DePaul University Strategic Risk Management Lab has recently focused on how companies can increase the effectiveness and efficiency of marketing in today's digital world and develop new key metrics for the return on investment (ROI) of marketing.

In this article, I am joined by Steven Mark Kahan, author of *The Wall Street Journal* best seller *High-Velocity Digital Marketing*. He shares his insights on how companies can transform the way marketing is done in a digital world based on his experience as a chief marketing officer (CMO).

Part 1: Shifts in Technology

CFOs need to understand and evaluate the forces of technological change that drive the need for a new way of thinking about marketing strategy, marketing investments, and the ROI of marketing, which leads to High-Velocity Digital Marketing (HVDM).

Mark L. Frigo: In your book, you discuss three seismic shifts that impact marketing: (1) knowledge parity, the leveling of the playing field between buyer and seller; (2) digital dominance, the centrality of technology; and (3) metric availability, the rise of data and measurement. Could you describe how these changes impacted marketing in today's digital world?

Steven Mark Kahan: In the beginning of the 21st Century, those three seismic shifts occurred, all inextricably tied to technology that changed everything about marketing. Yet few marketing professionals understand these shifts, so they rely on outdated techniques and strategies that ultimately don't efficiently contribute to the attainment of revenue objectives. As much as these shifts have caused challenges, they also present huge opportunities. If you as CFO understand the shifts and how to market in the digital world, you can help your company deliver more revenue growth at a lower cost.

Shift 1, Knowledge Parity. Until the early 1980s, there was a wide knowledge gap between buyers and sellers. For the most part, buyers relied on their gut and what the seller told them to make decisions. The best marketers exploited this imbalance. They focused on finding creative ways to play to buyers' emotions to drive sales, while only highlighting the best parts of their products or services. This was the age of catchy slogans, taglines, and funny campaigns.

The ubiquity of the internet changed all that. Now buyers can access almost all the knowledge in the world in an instant. And, perhaps more importantly, they can read reviews. In the business-to-business (B2B) world, marketers can't hide aspects of their products or rely on emotional messages to persuade customers to purchase them. Of today's B2B buyers, 67% no longer prefer to interact with a sales representative as their primary source of information. Instead, they gather information online through digital content. This means that to be successful, modern marketers must focus on creating thorough content that quickly connects with buyers and gets them to act. While this requires a pivot in strategy and tactics, it gives modern marketers a real chance to set the tone for the entire sales process.

Shift 2, Digital Dominance. Digital is the core of everything in marketing. It has gone from one of the things marketing does to the thing that marketing does. A Forrester research survey found that 62% of B2B buyers say they develop selection criteria for finalizing a vendor list based *solely* on digital content. This shift is great news in many ways, but only if you understand how to exploit it. Digital technology makes it possible to reach much larger audiences and target them with far more precision than traditional media does. You can do this by leveraging marketing technology. But it's often difficult to know what marketing technologies you must have. Even if you get the right ones, those technologies also can be difficult to master, which means that today's marketing leaders need to understand (and make sure their teams understand) how to use it to maximize return on investment of marketing.

Shift 3, Metric Availability. Several of the most successful companies, including Amazon, Apple, and Google, achieved their heights by selling, managing, and leveraging data in the new data economy. Few fields have felt the impact of data more than marketing. Marketers now can use the huge amount of personal information that exists on the web to create incredibly personalized and far more effective campaigns than ever before. And they can track the performance of specific ad buys and campaigns with an unprecedented degree of detail.

Part 2: Measuring the Effectiveness, Efficiency, and ROI of Marketing

In this section, we discuss how HVDM can help CFOs to measure the effectiveness, efficiency, and ROI of marketing; and to help them support HVDM in a company. In the Return Driven Strategy Initiative, we focus on disciplined performance measurement and valuation as a bedrock foundation of the framework that can be used to position HVDM as part of the overall strategy of an organization.

MLF: Based on your experience, how do the three shifts in technology impact strategic marketing and the way CFOs can better measure the effectiveness and ROI of marketing?

SMK: Far too many of the companies I've initially met (from small start-ups to the biggest Fortune 500 companies) claimed to be all about data and metrics. Most have invested large sums in data-processing technologies, and some have teams dedicated to statistical analyses and reporting. Yet, somehow, they struggle to find the answers to the most basic questions required to run effective marketing strategies, such as:

- Where did my leads come from?
- How much did I pay (in either time and/or money) to generate those leads?
- How much pipeline and revenue did those leads produce?

You would be shocked to know how many of the world's biggest companies can't answer these three simple questions. According to HubSpot, only about 50% of marketers measure customer acquisition costs (CAC). To me, this is inconceivable. As a marketing leader, if you can't demonstrate marketing ROI, someone higher than you will reduce your budget, which ultimately shrinks marketing's impact and revenue growth. It becomes a vicious cycle. If you can master marketing data and measurement, you will score a huge advantage over your competition and create a virtuous cycle of value creation.

Part 3: The Killer Value Proposition

What is a company value proposition and how do you link it to cash flow, revenue growth, profitability, and ROI, as would be done in a balanced scorecard strategy map?

MLF: In your book, you describe how developing a "killer value proposition" is key to successful marketing. Based on your experience, can you describe an example of a value proposition?

SMK: A value proposition promises value to a customer. It tells customers exactly why they should buy from you, as opposed to a competitor. If I could give you only one piece of advice to improve conversions on your website, it would be to make sure your value propositions quickly resonate with target buyers.

Keep in mind that your value proposition is written for the people you're targeting to do business with. It's crucial that your value propositions focus on what the buyer needs, not on what you, the seller, care about. In the tech industry, I call this "bits and bytes value" propositions.

Weak value propositions emphasize features and functionality rather than the benefits and value that buyers are seeking. Benefits are the advantages the product offers. The value is how those benefits support the buyer's underlying goals.

The best value propositions zero in on your niche and the buyer's must-solve problem. To do that, value propositions must be loaded with specifics. At minimum, a value proposition contains these three things:

- Who benefits from your products
- How you help customers overcome challenges and meet their goals
- Why your product or approach is different and better than anyone else's

Let's examine a great value proposition so you can compare it to your own: "We empower K-12 teachers to help students become active learners. Our easy-to-use, video-based learning tools boost student engagement fivefold. We're the only video solution that adapts to a student's specific learning challenges." This is a great value proposition because the buyer knows the following:

- Who the customers are: K-12 schools
- What the company provides: video-based learning
- What the competitive differentiator is: The company tells us why it's better than the competition: It's easy to use, and it adapts to the needs of different students.
- What benefits to expect: Students become active learners.
- How we can measure this: Engagement increases fivefold.

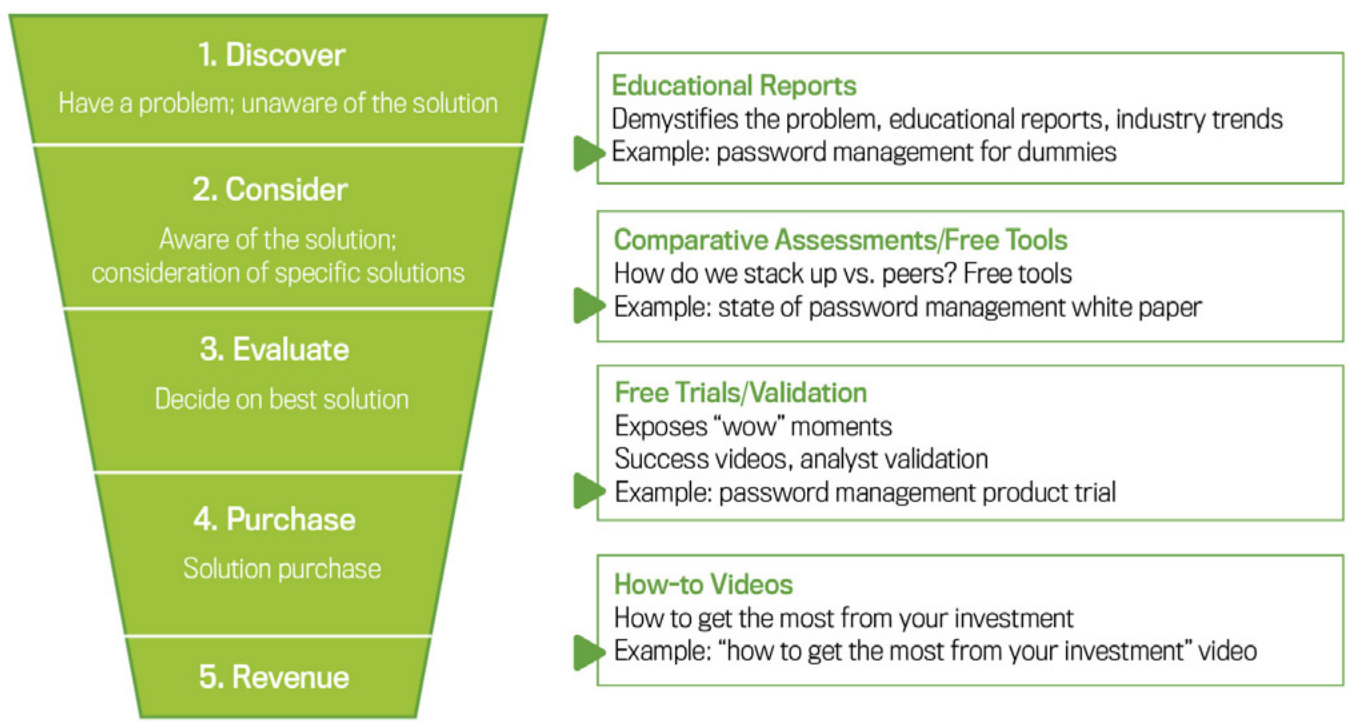
Part 4: The Buyer's Journey

The buyer's journey, sometimes called the purchase journey, can also be used to great effect in driving key performance indicators (KPIs). There are four phases of the buyer's journey, and we'll explore a bit about how it works.

SMK: Figure 1 shows the four phases of the buyer's journey: (1) discover, (2) consider, (3) evaluate, and (4) purchase. The discover phase is really all about education. The consider phase is when the customer is starting to think about solutions. The evaluate phase is when the customer is evaluating specific solutions and working their way to purchase. If you've got a gap in content at any one of these stages, you're going to be zapping the velocity out of any high-velocity sales and marketing model because the content needs to be where the buyers are (not where you hope them to be).

When you can slice and dice data around this buyer's journey with proprietary information, this often results in great reports and insights. Your organization is communicating information that

FIGURE 1: HVDM BUYER'S JOURNEY



Source: *High-Velocity Digital Marketing* by Steven Mark Kahan, p. 146. Used with permission.

nobody in the world has, which feeds lead generation. And it also feeds webinars, blogs, and social media. Further, it gives a storyline to sales reps, and that can then be formulated into models that enable sales reps to communicate based on where that individual buyer is in their journey.

At the highest level, organizations use the purchase phase to focus on how the customer can get the most out of their investment. This enables an upsell to create greater value for the customer and reveals how well the company understands customer needs. Taking a close look at marketing content, CMOs should be able to answer the following questions: How well does our content within the buyer's journey lead buyers to move from one phase to the other and ultimately to the purchase phase? Does our content help us tell a convincing content story, which in many organizations is what they would call campaigns?

Part 5: Strategic Marketing KPIs

KPIs can be used to monitor and manage the performance of HVDM initiatives.

MLF: In your book, you describe strategic marketing KPIs that can help companies to manage and monitor the performance and results from HVDM. Based on your experience, can you describe an example?

SMK: Many companies struggle with measuring their digital demand generation performance, which means they're completely lost when it comes to optimizing and accelerating revenue. In my experience, this happens because they either focus on too few metrics or the wrong ones. They might keep track of the events they've been running, how many people attend their webinars, how many press releases they send out, and how many articles they placed. All of this fails to provide a clear picture of marketing's performance. Instead, you need to hold your chief marketing officer accountable for focusing on the right data and metrics as well as connecting the dots to business performance. While the KPIs you choose to track might vary from campaign to campaign, there are several essential KPIs to track at each part of the buyer's journey, from discovery through to purchase. Here are a few of the key metrics to track in the discover/educate; consider; evaluate; purchase funnel described in my book and in Figure 1.

Discover/Educate

1. Number of net new inquiries: This is the net number of people who respond to digital marketing content for the first time. I like to divide these by source. Remember, the sales team needs qualified leads, not inquiries.

2. Digital ad click-through rates: Digital ad click-through rate is the number of clicks an ad receives divided by the number of times it's shown. This measures how well ads (and their placement) perform.

3. Website traffic: Website traffic is the number of new and total visitors. To make HVDM successful, try to make sure traffic increases every quarter.

4. Website bounce rate: Bounce rate tracks the percentage of visitors who leave after viewing only one page. Visitors who bounce rarely become leads, so this number should be as low as possible.

Consider

1. Visitor-to-lead conversion rate (CVR): Visitor-to-lead CVR indicates the proportion of website visitors who convert to leads. This metric is one of the strongest indicators of how well a website generates demand.

2. Total leads by source: The following are examples of lead sources.

- Search
  - Organic
  - AdWords
- Social
  - LinkedIn
  - Facebook
- Advertising (paid media)
  - Specific display ad campaigns

Once you have all this data, you can identify exactly which channels produce the most and the highest-quality leads and invest more in the highest-producing channels.

Evaluate

1. Lead to sales-accepted lead and opportunity CVR: This is the percentage of leads that convert to sales-accepted leads as well as opportunities. It's one of the best ways to determine lead quality and whether the lead scoring is accurate.

2. Total number and dollar value of opportunities: This metric focuses on how many sales-qualified leads become an opportunity or how many prospects are likely to buy. Keep track of how much money you would make if you closed every opportunity.

3. Pipeline coverage vs. revenue goal: This measures the ratio of the dollar value of opportunities in the pipeline to an upcoming revenue target. It's a great way to see if you're on track to meet your goals. Since you won't close every opportunity, I've found that the only way to consistently hit revenue targets is if your open pipeline is at three or four times higher than the current goal.

4. Lead-to-opportunity velocity: The time (expressed in days) it takes a lead to convert to an opportunity.

Purchase

1. Actual revenue vs. revenue goal: This is the most important metric. It will show if your efforts have been successful.

2. New customers added: This shows whether you're increasing your customer base or relying on upsells and renewals to drive revenue.

3. Opportunity-to-deal CVR: This indicates the closing rate of the sales team. A low number could mean sales isn't doing enough to close deals, or it could indicate that marketing hasn't generated good enough leads. Or both.

4. Opportunity-to-deal velocity: The amount of time (expressed in days) it takes for an opportunity to convert into a deal.

5. End-to-end CVR and velocity: Often referred to as win rate, this is calculated by determining the total number of leads that convert into customers. Velocity measures the amount of time (expressed in days) it takes for a lead to convert into a deal.

6. CAC: CAC is calculated by dividing all the costs spent on acquiring customers (marketing and sales expenses) by the number of customers acquired in a given period. The lower the CAC, the higher the profit.

I recommend that CFOs have access to a

KPI Ownership

Marketing owns these results:

1. Leads generated: the number of new leads that marketing generated.
2. Cost per lead: total marketing spending divided by number of new leads.
3. Lead-to-opportunity and customer ratios: the rate at which leads are being converted into opportunities and customers.
4. Marketing-sourced pipeline: the amount of pipeline marketing has sourced.
5. Marketing-sourced revenue: the amount of money marketing has sourced.
6. Customer acquisition cost: the amount of money it costs to acquire a new customer, which includes both marketing and sales spending.
7. Marketing ROI: the overall return on investment from marketing activities.

Sales owns these results:

1. Total revenue: total revenue (new, upsell, and cross-sell).
2. Sales- and channel-sourced pipeline: the amount of pipeline sales or channel sources.
3. Sales- and channel-sourced revenue: the amount of revenue sales or channel sources.
4. Sales growth: the increase or decrease in revenue from two different time periods.
5. Sales closing ratio: the rate at which sales converts leads to customers.
6. Average sales cycle: the number of days it takes on average to convert a lead into a customer.
7. Average revenue per account: the average dollar amount per closed deal, which is often compared against CAC to determine whether the average customer can generate enough revenue to cover the cost of acquiring them.

Both sales and marketing own this result:

- Customer lifetime value: the potential value that a customer provides your business, which is often compared against CAC.

KPI dashboard (often in Tableau) that enables them to view the key metrics at a glance.

Part 6: Summary and Action Plan for CFOs

Here are three takeaways for CFOs and finance organizations based on the discussion in this article:

1. Evaluate whether you have the right content to attract buyers. Buyers use online content to make purchase decisions. Have your CMO map your company's content (i.e., white papers, free tools, etc.) to each stage in the buyer's journey and discuss effectiveness such as downloads and contribution to lead generation. If you're missing content, suggest sending examples of great content that you see online and engage your best and brightest across several functions by challenging each of them to come up with their best idea for content that they believe your buyers would covet.

2. Compare and evaluate your value proposition to the example in this article. Does your value proposition clearly and concisely articulate: who your idea buyer is, what your company provides, how it helps buyers overcome challenges and meet their goals, how your company is differentiated, and the primary benefits/value to expect?

3. Get crystal clear about quarterly goals and KPIs with your CMO and chief revenue officer (CRO), including which teams own what KPI (see KPI Ownership).

CFOs have a great opportunity to use the HVDM framework to measure the effectiveness, efficiency, and ROI of marketing; to position HVDM as part of the overall strategy of an organization and engage with CMOs; and to develop KPIs that will help the organization to create long-term sustainable value.

This article is part of the Creating Greater Long-Term Sustainable Value series in *Strategic Finance* launched by the October 2018 article "Creating Greater Long-Term Sustainable Value," by Mark L. Frigo, with Dominic Barton.

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STRATEGICFINANCE

SVB and Credit Suisse: The Case for Strong First-Line Risk Governance

The failure of Silicon Valley Bank, and tens of thousands of other cases like it, is symptomatic of flawed, weak first-line risk governance.

By Parveen Gupta, Ph.D., and Tim Leech, FCPA

The recent wave of bank failures including Silicon Valley Bank (SVB), Signature Bank, First Republic, and Credit Suisse is a symptom of the continued use of weak first-line risk governance. Regulatory attempts to plug holes won't prevent more risk governance disasters if regulators and the audit and risk professions refuse to address the harsh reality that the core assumptions in corporate risk governance today are fatally flawed and continue to fail key stakeholders in colossal ways.

Weak first-line risk governance is an approach where those responsible for key mission-critical objectives—like liquidity in banking, safety in companies like Boeing, compliance with the laws at Wells Fargo, or reliable financial disclosures required of all public companies—aren't trained and required to assess and report on the status of residual risk to the CEO and the company's board of directors. Second-line risk groups and third-line internal audit functions try to compensate for this gap by using ineffective legacy risk and internal audit methods. In some cases, CEOs even prevent boards of directors from seeing the flow of risk status information that risk groups and auditors are aware of within the company (Wells Fargo and WorldCom are two such examples). While this goes on, external auditors who are often aware of major problems, including widespread illegality and regulatory infractions, sometimes stand by and certify financial reports that present a materially misleading position to stakeholders (e.g., SVB).

Weak first-line risk governance—the dominant risk governance approach in use today—continues to fail repeatedly. Why can't or won't regulators, as well as risk and audit professionals, see the real root cause and address it? We suspect a mix of paradigm paralysis, herd mentality, and cognitive biases is at work.

History Repeats Itself

Almost 40 years before the demise of SVB and Credit Suisse, Justice Willard Estey chaired a Canadian royal commission investigation looking into the failure of two of Canada's eight major banks at the time. According to Alix Granger in *The Canadian Encyclopedia*, the August 1986 report of the commission's findings discovered that "...management, directors, auditors and regulators were all seriously lacking in the performance of their duties. It criticized the banks' management for improvident lending policies and bizarre banking procedures, overstated income and loan values and misleading financial statements. The external auditors, the report stated, accepted financial statements that did not follow accepted banking practices nor reflect the true financial position of the banks. The commission claimed that the directors had relied heavily on management and had not performed their customary function of setting policy and directing management. The regulators, in turn, had made no independent assessment of the loan portfolio and did not support the auditors when they challenged management, relying instead on the banks' own reports and on discussions with management in what the commission termed 'a wink and nod system.' Furthermore, it claimed that the Inspector General of Banks had full knowledge of the situation but refused to act and therefore bore much of the blame."

Sadly, given the most recent wave of risk governance debacles highlighted by SVB, it appears little has changed. The failures of SVB and Credit Suisse show that the current paradigm of weak first-line governance needs to be replaced with strong first-line, objective-centric, demand-driven risk governance.

The challenge is how best to accomplish the goal of establishing a culture of personal responsibility and accountability where management, the first line, is willing to effectively identify and escalate concerns to the board. When a board is fully apprised of management's risk taking linked to key objectives, then the job of risk functions and internal audit is done unless they believe the board's decision making is so egregious that they need to take the career-risking step of blowing the whistle to regulators or law enforcement.

Once boards are apprised of the true state of risk linked to key objectives, it's up to board members to decide whether they're okay with management's risk acceptance decisions or if the board needs to intervene. Overseeing management's risk management process and risk taking in pursuit of key objectives is, or should be, seen as a core part of the board's oversight responsibilities and purpose.

Weak First-Line Risk Governance

The roots of weak first-line risk governance date back to early command-and-control beliefs of how a company should be "controlled." Driven by the views of the audit and accounting professions at the time, early "internal control" thinking focused on having companies create policies and rules, then setting them out in corporate policies. Regulators wanted to see evidence of plenty of rules spelling out what employees were expected to do as well as evidence there were people assigned to check whether the policies and rules were being followed.

This thinking guided the founding principles of The Institute of Internal Auditors (IIA) as well as what is considered the "internal audit Bible": *Sawyer's Internal Auditing: Enhancing and Protecting Organizational Value*, seventh edition. The book described internal audit primarily as compliance-centric—checking that rules and policies are being obeyed. Internal audit's primary job is to ferret out management's "internal control weaknesses and deficiencies" and report them to senior management and the board.

This concept still lives today. The modern vision of internal audit's role since 2020 has been IIA's Three Lines Model. Originally known as the Three Lines of Defense, the central premise in the model is that management, as the first line of defense, isn't trained or required to formally assess and report on the state of risk linked to key organizational objectives. The job of second-line functions, including risk groups, is to monitor and report on risk-related matters. The role of internal audit, which comprises the third line, is vaguely described as providing independent and objective assurance and advice on all matters related to achieving objectives.

Most of the world's regulatory regimes, including those in the banking and financial sector key to global financial stability, operate on the premise that management isn't the primary risk assessor and reporter. With weak first-line risk governance, management isn't expected to formally assess and report upward on the state of risk linked to the achievement of objectives for which it's responsible. Neither is management expected to undergo training on how to formally assess and report on the degree of certainty that key objectives will be achieved with a level of risk acceptable to the CEO and the board. The job of formal risk assessment and reporting is left to second-line functions and third-line internal audit.

Misdiagnosing Failures

We've been studying regulatory response to risk governance failures for more than four decades. Tim Leech's 2011 joint paper, "Preventing the next wave of unreliable financial reporting: Why US Congress should amend Section 404 of the Sarbanes-Oxley Act" in the *International Journal of Disclosure and Governance*, chronicled multiple waves of risk governance failures and regulatory response dating back to the '70s. His 2012 paper, "The High Cost of Herd Mentality" for the London School of Economics Center for Risk and Regulation, described guiding principles that regulators around the world continue to apply, regardless of their low effectiveness and success rate. Parveen Gupta's "COSO 1992 Control Framework and Management Reporting on Internal Control: Survey and Analysis of Implementation Practices" for IMA® (Institute of Management Accountants) pointed to serious problems in regulators' and standard setters' practices for how to best assess, and report on, the state of risk.

In virtually all the cases we have studied, the primary responsibility to assess and report to the board on the state of risk linked to key objectives wasn't assigned to management. Risk functions and internal audit were expected to fill that role. This is counterintuitive since management, not these functions, is responsible for achieving the company's objectives that flow from its strategic plan.

This weak first-line risk governance is the core assurance paradigm today, despite its incredibly high failure rate. Why can't regulators around the globe see the root cause of the problem? We suspect it's because regulators like the U.S. Securities & Exchange Commission (SEC) and its counterparts in countries around the globe take their advice from organizations that have built their training and certifications around the premise that auditors should be primary risk assessors and reporters, not management. We label the strong attachment to weak first-line risk governance as "paradigm paralysis" and believe it requires serious reconsideration.

The most visible manifestation of this cognitive bias was seen in 2003. The SEC had generated a discussion paper describing how it intended to implement Section 404 of the Sarbanes-Oxley Act of 2002 (SOX). That exposure draft proposed the following wording for Section 404(b) related to management's internal control attestations:

"With respect to the internal control assessment required by subsection (a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. The external auditor must provide an opinion on the reliability of the assessment developed by management in section 404(a)(2)."

This exposure draft called for management to prepare a risk and control assessment related to the objective of reliable financial disclosures. The external auditor was to audit that assessment and opine on it. This is one of the few instances in risk governance history we have found where a regulator called for a strong first-line risk governance model, i.e., one where the first line would be the primary assessor and reporter.

In the end, the SEC changed the wording in its final guidance so external auditors would form their own independent opinion on internal control effectiveness. This is a distinct difference from having them audit and report on the reliability of management's assessment of internal control and the reliability of information the board is receiving about the risks being accepted linked to the objective of reliable financial statements.

In a large percentage of the major risk governance disasters, however, the boards of directors involved have asserted and continue to assert that they didn't know. The recent Wells Fargo debacle is a classic example. The Office of the Comptroller of the Currency, which regulates Wells Fargo, is fining the company's chief risk officer and two chief internal audit executives tens of millions of dollars (which the individuals are appealing). The board's role in the Wells Fargo scandal appears to have received little attention.

The lack of responsibility and accountability of management to assess and report on the residual risk status to the board is not only problematic, it's also tantamount to breaching its fiduciary duties to the shareholders. This is the flaw that then-chairman at Credit Suisse António Horta-Osório identified when he said in 2021:

"We are committed to developing a culture of personal responsibility and accountability, where employees are, at heart, risk managers; know exactly what they must do; escalate any concerns; and are responsible for their actions. Such a culture is of critical importance and, by working relentlessly on this goal, we can create lasting change and value for both clients and shareholders."

What's missing in his diagnosis is the need for management to be trained, to be required to periodically identify and assess risks that threaten achievement of key objectives for which it's responsible, and to report the results for mission-critical objectives to the boards of directors.

We believe this is the primary failing of weak first-line risk governance. The focus should be on ensuring there's agreement about the acceptability of risk linked to mission-critical objectives, up to and including the board. This includes ensuring reliable financial statements, safety, liquidity in banks, and other mission-critical objectives specific to different sectors. To accomplish that, there must be a reliable system in place to ensure management has a robust understanding of the true state of risk and certainty that key objectives will be achieved, and that the CEO and board are receiving reliable risk and certainty status reports linked to those mission-critical objectives to support their decisions.

Yet the dominant approach to enterprise risk management (ERM) has been risk functions creating and maintaining lists of risks in "risk registers" that purport to be the entity's "top risks." Even though the International Organization for Standardization (ISO) definition of "risk" is "effect of uncertainty on objectives," most CEOs and boards don't receive risk assessments of the composite effect of uncertainty or risk on achievement of key objectives. Similarly, they also don't get regular updates on the residual risk status affecting their company's mission-critical objectives.

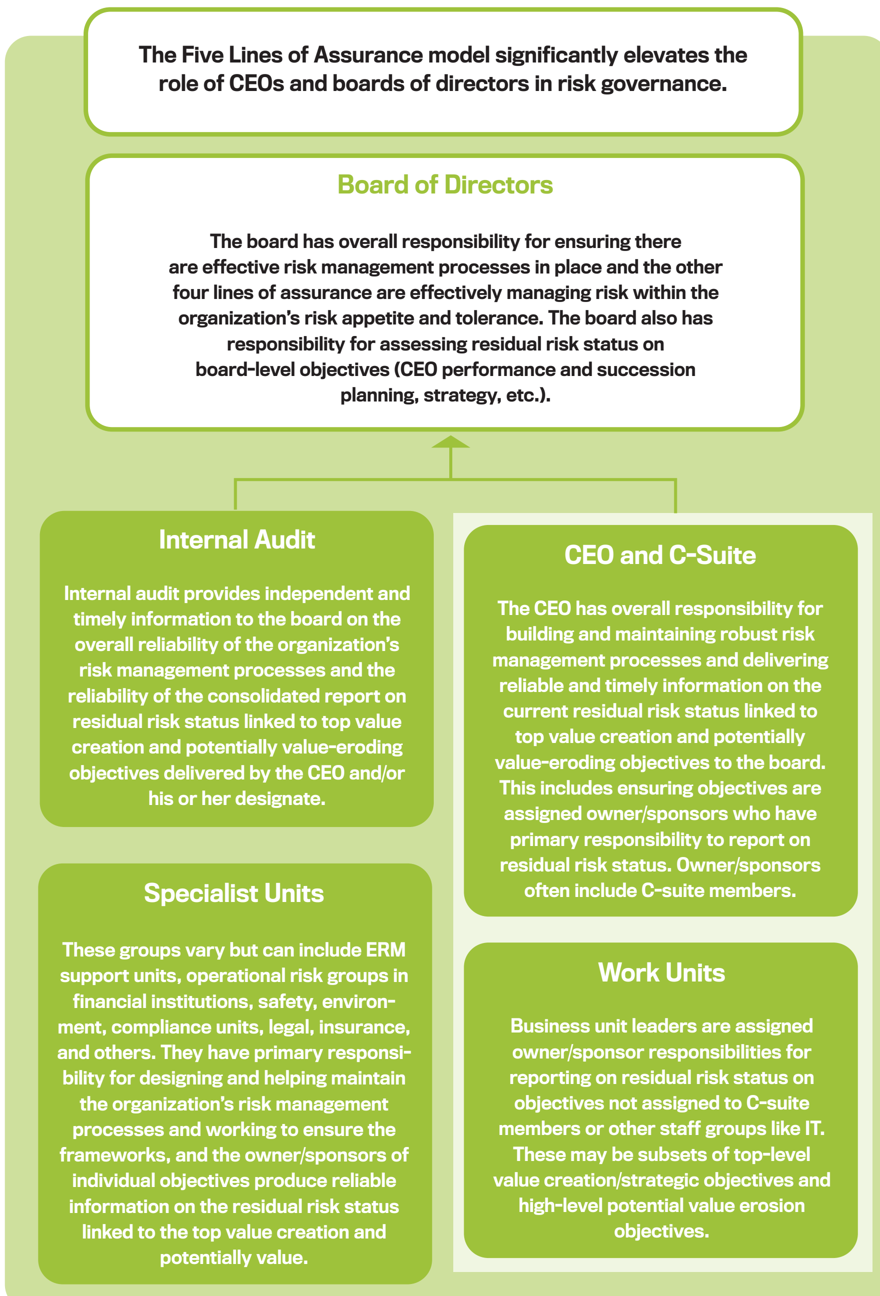
On the internal audit front, internal auditors develop annual audit plans and provide their view of management's significant deficiencies and material weaknesses in order to comply with legislation like SOX and their sense of what else the CEO and board want. The methods they use usually include a mix of first-generation compliance-centric approaches dating back to the 1940s, second-generation process-centric approaches from the late 1970s and early 1980s, and third-generation risk-centric assessment methods like risk registers. Huge problems are frequently missed. Few internal auditors provide boards with concise reports on the likelihood or risk that key objectives will be achieved while operating with a level of risk and certainty acceptable to the board.

The Way Forward

The Five Lines of Assurance (see Figure 1) takes a different view on roles than the Three Lines Model. The focus of the Five Lines of Assurance is on assessing, managing, and reporting to the CEO and board on the likelihood and risk that top strategic, value-creation, and value-preservation objectives will be achieved within the risk limits and tolerances acceptable to the board.

In this approach, management (the first line) is the primary risk assessor and reporter. Second-line functions, including risk groups, help management assess and report on risk and certainty status. Third-line internal audit assesses and reports on the effectiveness of the risk

FIGURE 1: FIVE LINES OF ASSURANCE

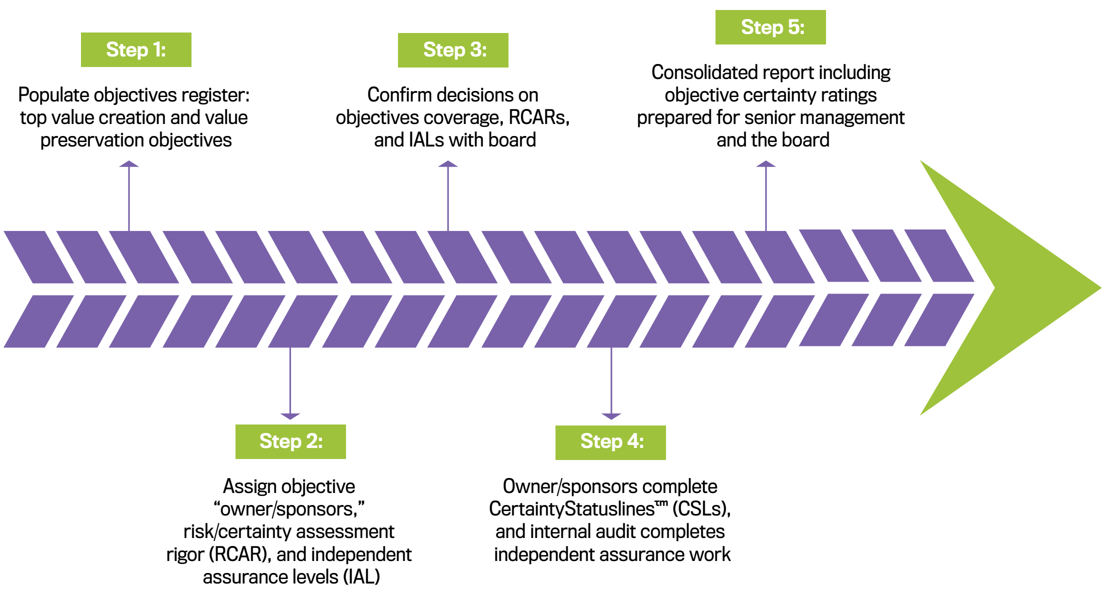


assessment/reporting process and reliability of risk status information linked to key objectives going to the board.

Implementation of this strong first-line, objective-centric, demand-driven risk governance is relatively simple (see Figure 2). It starts with management and the board agreeing on the objectives key to the entity's long-term success (objective-centric risk management) and assigning management "owner/sponsors," the people responsible for assessing and reporting upward on risk and certainty status (strong first line).

Objectives in an entity's "objectives register" may include environmental, social, and governance (ESG) objectives in cases where the company considers ESG to be part of its top strategic and value-creation and/or value-preservation objectives. Decisions are also made on

FIGURE 2: FIVE-STEP OVERVIEW OF OBJECTIVE-CENTRIC RISK AND CERTAINTY MANAGEMENT



Core Objectives

	Owner	Certainty
Achieve 8% return on private equity investments in excess of the sector benchmark.	Mary Brown	
Increase customer retention by 15% year over year.	Chuck Smith	
Increase customer satisfaction ratings from 3.2/5.0 to 4.0/5.0 by year-end 201X.	Elaine Ford	
Reduce lost time due to accidents by 30% year over year.	Paul Stevens	

Fully acceptable level of certainty of achievement. Any significant concerns have been identified and shared upward.
Some management effort is required to increase certainty of achievement to an acceptable level.
Considerable management action is required to increase certainty of achievement to an acceptable level.
Significant analysis and corrective action by senior management and the board is urgently required to increase certainty of achievement to an acceptable level.
Massive corrective action by senior management and the board is required now to increase certainty of achievement to an acceptable level.

the target level of risk assessment rigor (the amount and sophistication of methods used to assess the state of risk linked to key objectives) as well as the target level of independent assurance from internal audit and other assurance providers that the CEO and/or board want on risk status reports they receive on key objectives (the demand-driven element).

The Paradigm Shift

We recognize moving to strong first-line risk governance represents a paradigm shift for most organizations today. So, what is the business case for change?

Driver #1: Reduce the number of repeated and colossal risk governance disasters. Most companies that have had colossal risk governance failures over the past five decades had traditional internal audit functions. Few internal audit functions today provide concise information to boards on the composite effect of risks linked to achievement of mission-critical objectives to help boards decide whether they're aligned on and agree with management's risk-acceptance decisions.

More recently, companies—particularly banks like SVB—have been forced by regulators to have risk functions and chief risk officers. Most of these risk functions produce lists of top risks to boards with little linkage to key mission-critical objectives or performance. Few risk functions today provide boards with information on the composite effect of risk on achievement of key mission-critical objectives.

Strong first-line risk governance places the accountability for assessing and reporting on risk status directly on management, the people best positioned to assess and monitor risk status linked to key objectives. Second-line risk functions help the first line assess and report on risk status to the CEO and board. Third-line internal audit provides objective assessments of the risk management process and reports on risk status linked to key objectives going to the board. Moving the responsibility to assess and report to the first line is particularly important in high-change environments.

Driver #2: Provide boards with reliable risk status reports on mission-critical objectives to help discharge escalating risk oversight expectations. Courts, particularly in the U.S., are increasingly holding that boards and, more recently, "officers" of listed public companies (see the Caremark and Blue Bell Dairy decisions) have a fiduciary duty of care to oversee mission-critical objectives and risks. Financial sector regulators are increasingly codifying expectations that boards have a legal duty to oversee management's risk taking in pursuit of strategic and value-creation objectives and top value-preservation objectives.

Driver #3: Evolve the role of risk and internal audit from that of "risk police" to a more productive and effective peer-to-peer interaction. For systems to work effectively, they need to have the type of aspirational attributes and "risk culture" described by Horta-Osório. Companies that want management at all levels to see themselves as risk managers and reporters need to take tangibles steps to assign the responsibility to assess and report on risk status linked to key objectives to those who are responsible for achieving those objectives.

Because assessing and reporting on the risk linked to key objectives is a new responsibility for many first-line executives, management needs training, facilitation, and support. Managers in companies around the world need to develop better, more structured ways to identify and assess threats and opportunities linked to key objectives.

Second-line risk can play the primary role helping first-line management assume these new responsibilities. Third-line internal audit can play the role of the second line in companies with no risk function and can provide independent assurance and advice on how objective-centric risk management processes are working.

Driver #4: Improve performance. When risk and opportunities are managed well, there's greater certainty that key objectives will be achieved at a level of risk acceptable to the CEO and board. When risk assessments are objective-centric, they detail the objective being assessed; internal and external contexts; the threats and risks, including likelihood and consequences;

risk treatments in place linked to those risks; and "residual risk status" information, including performance history and impact of not achieving the objective in whole or in part. The goal is to increase the likelihood that key objectives are achieved while operating with a level of risk and certainty acceptable to the CEO and board.

Driver #5: Reduce the cost of inspection. Build quality in, not on. Manufacturing sector and safety specialists learned a long time ago that positioning process analysis and improvement directly with work teams is key. At the same time, companies around the world have been steadily increasing spending on second-line risk, compliance, internal audit functions, and, most recently, ESG groups.

In companies where management demonstrates integrity and competence in assessing and reporting on the risk status of key objectives, the spend on third-line internal audit can be reduced or redeployed to instances where management consciously misstates the true risk status.

Stronger First-Line Risk Governance

The recent bank failures have reminded us yet again that the current dominant approach to risk governance isn't adequately fulfilling its purpose. Weak first-line risk governance, coupled with excessive reliance on second- and third-line functions like risk groups and internal audit to identify, assess, and report on risk, creates a potential disconnect that can prevent a company's board of directors from receiving the information it needs to fully understand and monitor the risks linked to key objectives and to provide appropriate oversight to ensure whether management is taking the proper courses of actions.

Changing the paradigm to a strong first-line risk governance approach—where management must identify, assess, and report to the board any risk decisions or concerns—not only creates a clearer, more direct line of communication but also places accountability where it should be. The ultimate result would be better-informed decision making and fewer company failures—a result that all stakeholders would appreciate and value.

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Rich Brady: Focused on the Mission

U.S. military veteran Rich Brady, IMA's new Global Board Chair, brings a resourceful approach to problem solving and a mission-focused attitude to his new role.

By Lori Parks

Richard T. Brady, IMA® (Institute of Management Accountants) Global Board Chair for fiscal 2023-2024, has spent his entire career focused on serving something greater than himself. He's currently the CEO of the American Society of Military Comptrollers (ASMC), which he joined in 2021 following his retirement as a colonel in the U.S. Marine Corps after a 32-year career. Rich's broad range of experience in the military—leading teams, serving in combat, and making decisions that impacted the lives of thousands of men and women—gives him a disciplined, resourceful approach to solving problems and achieving goals. "It's important to take responsibility for your actions and be decisive about what you want to achieve," he says.

Rich will bring this can-do attitude to his role as IMA's volunteer leader, both in helping to ensure a smooth transition for IMA's new president and CEO, Mike DePrisco, and redefining what it means to be a global leader in the accounting and finance profession.

Illustrious Military Career

Rich was born in Atchison, Kan., a small town on the Missouri River in the state's northeast corner. It's about 20 miles north of Leavenworth—site of a U.S. Army installation at Fort Leavenworth—and renowned as the childhood home of Amelia Earhart. These two influences exemplify Rich's sense of service and adventure.

Growing up, Rich wanted to see the world, "to move beyond the banks of the Missouri," he says. Rich had always considered joining the military, largely due to the influence of his parents. His father had served in the Army during the Vietnam War era, and his mom worked at Fort Leavenworth for the U.S. Air Force. He was also attracted to the discipline and leadership training of the military.

In the summer between his junior and senior years of high school, he walked into a U.S. Marine Corps recruiter's office. "They told me that once I graduated, I could go off to basic training." And that's what he did: Seven days after earning his high school diploma, Rich shipped off for basic training at the Marine Corps Recruit Depot in San Diego, Calif.

Those 12 weeks—May 30 through August 17, 1989—are etched in Rich's memory. He recalls, "The goal of basic training is to break you down and then build you back up." The drill instructors shaped Rich's military career, teaching him valuable lessons such as how far he could push his body, mind, and spirit—in ways that he hadn't thought were possible. They also instilled in him a way of thinking that's laser-focused on the mission and what's needed to accomplish it. "And while the objectives may get more complex and consequential as you advance in your career, the process remains the same: focus on achieving the mission," Rich says.

Following basic training, Rich was part of the Marine Corps Reserve and enrolled in college at Saint Louis University (SLU), where he also attended Officer Candidate School in the summers. He selected SLU for two reasons: It was less than a five-hour drive from his home in Kansas, and it offered international business, a popular major as the Berlin Wall was falling and businesses were opening up to globalization. Rich also had his first opportunity to travel outside of the United States, spending a summer abroad at the London School of Economics.

Rich graduated with a bachelor of science and as a commissioned second lieutenant in the Marine Corps. He spent the next nine months at what's known as The Basic School, in Quantico, Va., where all Marine Corps officers get their initial military training. This experience helped Rich define his professional future: "You don't have a job when you finish. Instead, you're asked

Leadership Lessons from the Military

During his more than 30 years of service in the U.S. Marine Corps, Rich gained valuable insights about management, fiscal responsibility, acting ethically, and more. The following lessons can be applied to a variety of organizations and situations:

1. Be technically proficient. Whether you're an executive or an early careerist, you must know the basics of your job to be successful.

2. Know yourself. If you want to lead others, you first have to know how to lead yourself.

3. Develop a sense of teamwork in your organization. Culture eats strategy for breakfast, and your plans won't survive if you lack a strong sense of teamwork behind them.

4. Show up early, work hard, and solve problems. The best advice that can be given to people who want to progress in their jobs or profession: No one ever rose to the top by being late, being lazy, and creating problems.

5. Make decisions. There's an element of uncertainty and risk in every decision, but this is what leaders are paid to do. Not making a decision can be as bad as making the wrong decision.

to complete a questionnaire that includes about 15 job possibilities, which you must rank. My top three were tanks, intelligence, and financial management, in that order. I ended up with financial management. I sometimes wonder how my career might have been different if I'd gotten my first choice—I may not be working in finance and accounting today!" The experience also taught Rich a valuable lesson: You don't aways get your first choice and must "bloom where you're planted."

That first commissioned assignment brought Rich to Camp Pendleton in San Diego, where he served as a fiscal officer for four and a half years. Rich ran the command's financial operations and served as a platoon and company commander. At the end of that assignment, Rich decided to continue his education. After considering top-tier but costly MBA programs, Rich discussed his plans with his commander, who mentioned the Naval Postgraduate School in Monterey, Calif., which is open to all branches of the U.S. military.

"I'd just gotten married, and the idea of staying in California appealed to me," Rich recalls. "I applied to the school and figured that if I got in, I would go. Not only was it in beautiful Monterey, but you also stay on active duty, which means you still collect a salary, and they also pay for your degree program."

After earning his master of science in finance in December 1999, Rich reached another crossroads where fate, luck, and circumstance helped decide his future. There were four Marines graduating at the time, and there were five jobs available: one as an instructor, two at the Pentagon, one at Quantico, and one in Albany, Ga. Rich didn't get his first choice, as there were two other Marines who had more seniority. "I wanted to be an instructor, but they got to pick before I did. So, I ended up at the Pentagon, something I definitely have no regrets about."

Rich's Pentagon assignment set the trajectory for his entire career. His first role there was as an investment programs development officer at Marine Corps headquarters. After two years, he was promoted to major and selected as the aide-de-camp to the assistant commandant of the Marine Corps. Next came an assignment to serve outside of the U.S. as assistant chief of staff/controller of the 3rd Marine Division in Okinawa, Japan. In this role, he also did a tour of duty in Iraq, deployed in support of tsunami relief operations in Indonesia and mudslide relief operations in

Get to Know Rich

- He's run five marathons.
- He started collecting coins when he was eight years old and remains an avid collector. His personal favorite is his collection of 1976 U.S. Bicentennial coins.
- In addition to being a CMA, he's also a Certified Government Financial Manager (CGFM) and a Certified Defense Financial Manager (CDFM).
- For three years, he served as the Department of Defense representative to the Federal Accounting Standards Advisory Board (FASAB) Entity Task Force, which considered new standards for federal financial reports.
- His daughter, Katherine, will be a freshman at Georgetown University in the fall.
- His wife, Jeanne, who passed away in 2022, held a doctorate in occupational therapy and wrote her doctoral dissertation on traumatic brain injuries in wounded warriors.
- He still maintains close connections with friends from his time in Tbilisi.

the Philippines, and participated in military exercises throughout Southeast Asia.

After serving in Japan from 2004 to 2007, Rich returned to the Pentagon as a defense resource analyst for the Joint Staff J8, Program and Budget Analysis Division. Named the Joint Staff J8 Action Officer of the Year for 2009, Rich advised on strategy to support the chairman of the Joint Chiefs of Staff and the Secretary of Defense on resource matters, among other high-level responsibilities.

The next years of Rich's career took him outside of the Pentagon and to new opportunities: first, as commanding officer and director for the Marine Corps Financial Management School at Camp Johnson, N.C. In this role, he led an organization of 45 military and civilian staff and instructors in the development, implementation, scheduling, and delivery of financial management training and education courses for the Marine Corps' financial management workforce of 1,500 personnel. "I finally got my wish to be an instructor," says Rich. He also took the opportunity to earn another master's degree, this one in strategic resource management from the National Defense University at Fort McNair in Washington, D.C.

That was followed by a year of language training and two life-changing years in Tbilisi, Georgia, where he served as the naval/marine defense attaché and an accredited diplomat assigned to the U.S. Embassy in Georgia. In this high-profile role, Rich advised on political, military, and economic affairs in the Russia/Eurasia region. He also planned, coordinated, and managed all military intelligence and maritime training of more than 1,100 Georgia soldiers, special operations forces, border police, and coast guardsmen.

After Georgia, Rich returned to the Pentagon to serve nearly two years as assistant chief of staff and CFO of the Marines Corps Installations Command, where he managed the accounting, budgeting, auditing, capital planning, and expenditures of a $3.5 billion annual budget supporting 24 military installations worldwide. He completed the last leg in his military career in North Chicago, Ill., at the U.S. Military Entrance Processing Command, first as a regional commander of the western U.S. sector and, two years later, as commander. Here, he led nearly 4,000 employees in the Department of Defense organization responsible for screening and processing the approximately 250,000 applicants enlisting into the U.S. armed forces each year.

Finding the Best Fit

Rich's ability to execute the daily duties of these demanding roles was aided by his decision, in 1999, to earn the CMA® (Certified Management Accountant). He first learned about the certification while pursuing his first master's degree.

"During my last semester, a professor said to me, 'Hey, you may want to consider this. It's very good preparation for the kind of work you're going to be doing.'" After looking into what the exam covered (at that time, it was a four-part test), Rich joined IMA and enrolled in the CMA program. He started studying while on his first assignment at the Pentagon in the early 2000s.

He passed two exam parts, but external events prevented him from finishing. "9/11 happened, and everything changed," Rich recalls. "The priorities at the Pentagon shifted from austere, peacetime footing to full-alert, wartime engagement." Responsible for procurement of Marine Corps ammunition at the time, Rich's budget had typically been about $75 million per year. Within a week after 9/11, it had skyrocketed to $375 million.

Given the drastic shift in his job responsibilities, Rich had to put off his CMA studies for about six years. When he was finally able to resume his preparation, he studied on his own, using flash cards, and passed and earned his CMA in 2008.

Rich's volunteer involvement in IMA began in 2013 when he was asked to join IMA's Editorial Advisory Board (EAB), where he still serves as a member. The EAB reviews articles submitted for publication in *Strategic Finance* and *Management Accounting Quarterly*. Rich found it a great way to connect with members and stay in touch with the profession.

His connection to IMA grew in 2017 when Rich responded to a call for Global Board nominations. He had experience on other nonprofit boards, including spending five years on the board of the Fairfax (Va.) County Library Foundation, and thought he'd have expertise to offer. "I thought I may as well apply—even if I don't get it this time, at least I've given it a shot."

It's a good thing he did apply, as he was appointed to the Board. Soon afterward, Christian Cuzick, IMA Global Board Chair-Elect at that time, asked him to join the Nominating Committee.

"The committee does such a great deal of work in a very short time: You're reviewing nominations starting in October, and all the decisions are made by January." Rich found the experience incredibly rewarding because it gave him the opportunity to talk to members and hear their stories. "I think every Board member should serve on the Nominating Committee at some point. It's a great chance to shape the future Board and the leadership pipeline."

During his other work on the Board, including the Strategic Planning Committee and its Governance Task Force, Rich was deeply involved in the discussion about changing the structure of the Board. The committee reduced the Board size from 53 to 36 members in 2021 and established a Global Markets Committee and Regional Advisory Committees in China, India, and the Middle East; it also changed the term limits for Board members.

"Some of the changes were drastic, but they were all aimed at helping the Board better serve members. We need to make sure we continue to evolve and ensure that the Board's structure is fit for the work it must do." Rich firmly believes that the Board should be reflective of IMA's increasingly non-U.S. membership, as a large and diverse board gives IMA "lots of eyes and ears to appropriately assess risks."

Given his experience serving on several influential Board committees—he was also chair of the Performance Oversight and Audit Committee and the CEO/Executive Compensation Committee—Rich was a natural fit for Board Chair. He welcomed the opportunity: "I have a strong desire to lead a world-class organization, and I'm happy to serve in any capacity that's a good fit and where I can make a meaningful impact."

From the Pages of Rich's Library

- *The Art of War*, by Sun Tzu: This is the classic in developing and executing tactical, operational, and grand strategy in a competitive environment

- *War and Peace*, by Leo Tolstoy: Certainly not "light" reading at 1,000+ pages, War and Peace is set during the Napoleonic Wars and captures sociological themes that are as common today as they were in the early 1800s

- *History of the Peloponnesian War*, by Thucydides: Known as the "father of history," Thucydides records the conflict between Athens and Sparta—the two dynasties of the age—and in doing so sheds light on the enduring nature of human motivation and the influence of power, persuasion, and truth on world events.

- *Good to Great*, by James C. Collins: A must-read for anyone wanting to elevate their business to greater levels of performance, Collins's simple approach (which has been criticized as "too simple") lays out the framework and systematic approach that great companies must go through that's both easy to understand yet deceptively hard to implement.

- *The Innovator's Dilemma*, by Clayton M. Christensen: Change is hard and uncertain, and it causes fear and anxiety. Yet organizations must change, not only to survive but to thrive. Christensen points out that companies will get pushed aside unless managers know how and when to abandon traditional business models and pivot to a new strategy based on emerging technology.

A Shared Focus

Rich hopes to bring that mission-focused mindset to the priorities he has set forth for the coming year. Chief among these priorities is to help with the transition of Mike DePrisco as IMA's new president and CEO. This will establish the foundation for not only Mike's success, but also IMA's long-term success.

"We're at a critical moment with this leadership change," Rich says. "We want to ensure a seamless transition, and that's going to take the effort of a lot of people. Typically, transitions like this can take two to three years, so I see it as part of my role to help IMA focus on our top priorities and to support Mike's vision for the organization's future."

Part of that vision includes a shared focus on global growth and putting members first. Regarding global growth, Rich acknowledges that it shouldn't be at the expense of IMA's long-standing focus on the U.S. market. "It has to be a balance. We must remember that part of the appeal of the organization, and especially the CMA, is because we are U.S.-based and have a long history in the U.S." That's why explaining the IMA value proposition is also important.

Coupled with this belief is the recognition that member value isn't static. "We have to acknowledge changes in demographics and regional differences," Rich says. "What's valuable to a member in Kansas may not be valuable to someone in Shanghai. We must think globally but act locally, customizing some of our offerings—our continuing education products, translated exams, and more—to meet the needs of the regional markets."

He points to the example of the CMA Scholarship program. One of the requirements when applying is that students meet a certain minimum grade point average (GPA). But many colleges and universities outside the U.S. don't use GPA as a measure of academic performance. "We have to adapt our offerings to address these important regional nuances," Rich explains.

Of course, Rich acknowledges that there are common global themes where IMA will always stand firm: on the subject of ethics, for example. And there are very real risks that IMA—like many other organizations around the world—is contending with. "There are macroeconomic risks, like living in a VUCA [volatile, uncertain, complex, ambiguous] world, and there are global risks that are impacting all markets."

Among Rich's priorities is to continue to place emphasis on engaging with educational institutions and early-career professionals. As someone who learned about IMA and the CMA through a professor, Rich acknowledges the valuable role that academics play in spreading awareness about IMA, the CMA, and much more. He also wants to continue to build IMA's thought leadership role in areas like sustainable business practices and diversity, equity, and inclusion. And he's pragmatic about the forces that are creating seismic shifts in the profession, especially AI tools like ChatGPT and others. "In the Digital Age, with its rate of change, we must constantly be learning and reskilling," he notes.

On the list of things that Rich most looks forward to in his role as Chair is meeting with members and getting to talk to them about IMA. Serving outside of the U.S. and thus working alongside both internal and coalition partners have been among the most impactful experiences of his life.

"I'm ready to get started in doing my part to help IMA deliver on its mission as the association for accounting and finance professions in business around the world."

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STRATEGIC FINANCE

A Balanced Approach to Optimize Working Capital

Optimizing working capital can foster an organization's growth path and bring otherwise unattainable goals within reach.

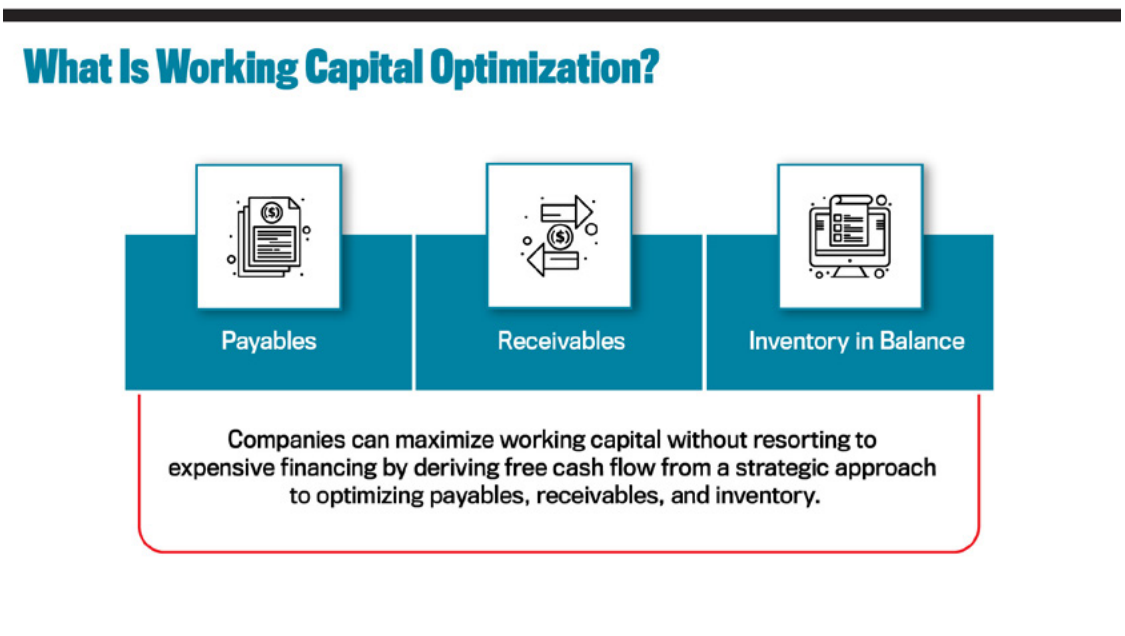
By Don Freitas, CPA

When cash is abundant, interest rates are low, and borrowing is easy, optimization of working capital is often seen as a low priority. But raising free cash flow is now a top priority for the CFO's office, as companies find their cash locked up in inventory, payables, and receivables. We're still reeling from the effects of a global pandemic and all the inventory and supply chain challenges that entailed, shifting consumer spending patterns, an economy teetering on the brink of recession, and high interest rates that have dramatically changed corporations' attitude toward borrowing. The balance has shifted, and growth is more dependent on having sufficient free cash flow than the availability of low-cost financing.

The optimization, maximization, or overall improvement of available working capital would seem to be mere table stakes in any management strategy. Unusual circumstances call for a more holistic approach that goes beyond the traditional linear methods often applied to capital management, and the CFO is particularly well-placed to see the entire end-to-end working capital picture and take decisive steps to improve it. Long-term success and continued growth require a balance of three pillars: release cash, reduce cost, and improve service.

Why Is Optimization Important?

Total working capital, reflected in the combination of payables, receivables, and inventories, does more than just reflect availability of cash. Optimization of that working capital will also reduce costs and improve services. It can also meet multiple strategic goals, including increasing shareholder value; enabling mergers and acquisitions funding, debt reduction, and share buybacks; improving profitability; funding internal projects; and facilitating growth and investment.



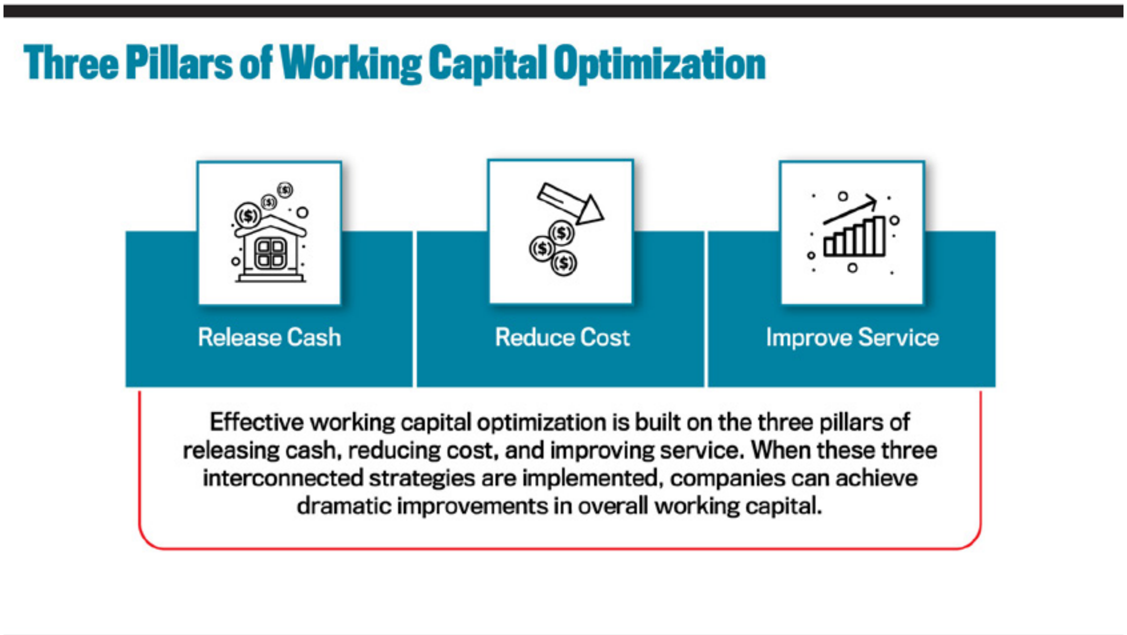
During 2023, we continue to see the impact of COVID-19, permanent changes in supply chain strategies, higher interest rates with an unpredictable federal policy, and a real possibility of recession. A company may be otherwise performing well, but other factors are minimizing the amount of available cash that could be used for dividends, growth, and expansion.

Without a new approach, current events could well lead to a crisis. Regardless of the merit of any organization's product line, it can't survive without liquidity. It's incumbent on the CFO to ensure that the right processes are in place and that cash is readily available—if not through financing then through other methods of working capital optimization. Fortunately, with the right strategies and tools, that optimization can be easily achieved, and cash can be made available when it's needed.

Three Pillars of Working Capital Optimization

Those tools begin with a set of three pillars: release cash, reduce cost, and improve service. A company's successful cash mentality is never a one-size-fits-all approach, and those who limit their cash strategy to one area alone, such as maximizing receivables or cutting costs, will never be able to achieve their full cash potential.

Going beyond the mainstream linear approach to capital optimization, Total Value Optimization (TVO)—a management methodology that takes into account the entire end-to-end supply chain and is endorsed by the University of Tennessee's Global Supply Chain Institute—incorporates all three of those pillars. By doing so, these changes can yield a measurable benefit over a short period of time that will allow companies to have improved free cash flow and to better position themselves for growth.



The results of employing the TVO approach can be positive across several areas of the organization, with optimization of inventory like stock keeping unit (SKU) product range management, inventory management, forecasting and planning, sales order processing, materials scheduling, manufacturing execution, and warehousing and distribution.

Using the TVO methodology, a large manufacturer of solar control and safety window film implemented a high-velocity demand-pull process and sales and operations planning process that yielded an $11 million improvement in EBITDA (earnings before interest, taxes, depreciation, and amortization) and an $18 million decrease in working capital requirement. In another example, implementation of a sales, inventory, operations, and planning (SIOP) process reduced a company's inventory position by $15 million, which allowed the company to reinvest in technology and maintain its share of a very competitive market.

On Poor Working Capital Performance

Some macroeconomic issues such as interest rates, pandemic-induced supply chain stresses, and the possibility of recession may be beyond the finance office's control. By focusing on what can be controlled, it's possible to achieve a positive outcome and gain control of working capital even in the face of these issues.

Several inventory-related factors can contribute to poor working capital performance, potentially leading to a competitive disadvantage, lower profitability, reduced cash flow, and poor supplier relationships. With a strategic approach and the correct tools, all these issues can be remedied in any economic climate. When these inventory issues are addressed, working capital improvements can be quickly achieved.

Some of these inventory-related issues include:

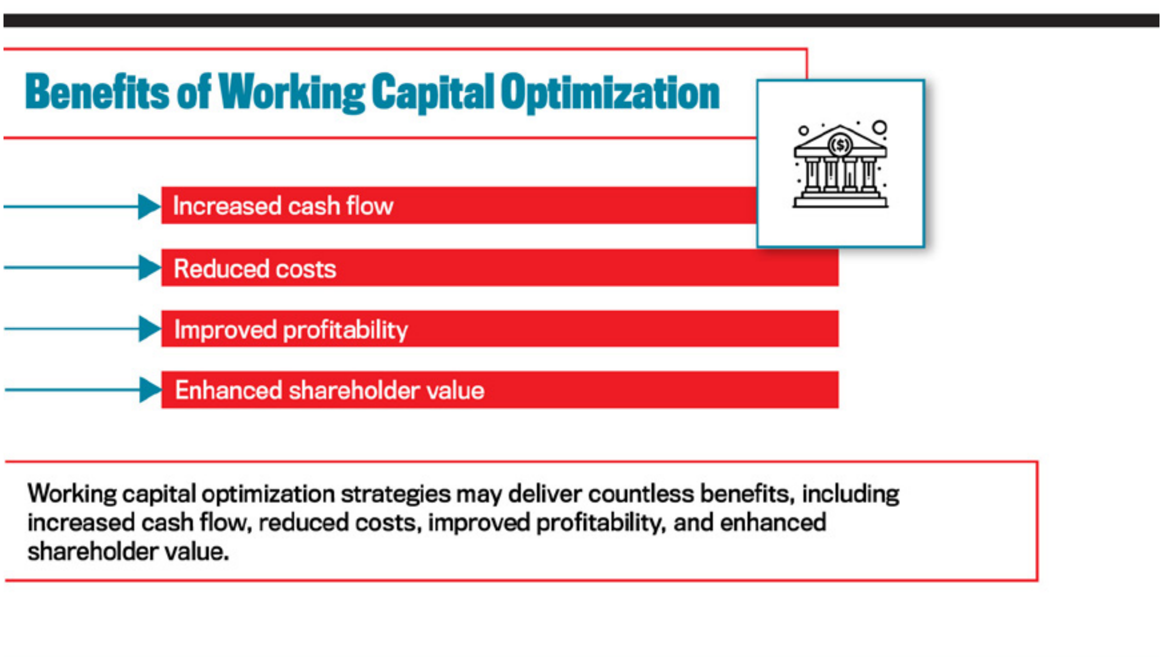
- Distribution: Addressing issues such as a high level of stock crossovers, poor picking accuracy, and a high level of damaged or returned product will quickly return locked capital to the organization.
- Supply chain strategy: Improving oversights such as a lack of strategy, not considering the impact of working capital on supply chain, and not considering customer/supplier constraints will help to

improve visibility and more easily address those working capital challenges.

- Product management: Product issues impacting working capital include an unknown product profitability level, a proliferation of product range, and product cannibalization.
- Forecasting: Working capital may be negatively impacted through inaccurate sales forecasting, poor accountability for accuracy of the forecast, and a forecast that isn't granular enough to impact inventory management.
- Sales order processing: Working capital may be negatively impacted through lost sales not being recorded, agreeing to unrealistic delivery parameters, and frequent changes in customer requirements.
- Production scheduling: Other issues to consider may include poor data integrity in product scheduling, including bills of material, lead times, inventory levels, and poor visibility.
- Raw material planning: Poor vendor reliability may also negatively impact cash flow, along with short notice of material requirements or inefficient raw materials receiving processes.
- Production planning: Issues in production planning may include a mismatch between capacity and product mix, a mismatch between order and minimum batch quantity, and poor communication with purchasing.
- Production: Production bottlenecks and poor order prioritization may be major factors in working capital performance, along with frequent or long changeovers, ineffective replanning for delays, and excessive or nonscientific buffers.
- Warehousing and inventory management: A high level of slow-moving or obsolete stock can be a significant issue in working capital, along with duplication of safety stocks and poor correlation between stock levels and customer service.

Solution and Benefits

Management must go beyond traditional linear tactics to balance optimization across three areas: payables, receivables, and inventory. Traditional drivers of payables and receivables would include tried-and-true tactics of renegotiating payment terms and offering favorable terms for clients to pay earlier. Receivables optimization may also include tactics such as reducing the quantity of potential disputes and monitoring the dispute cycle. On the payables front, taking advantage of price discount captures may also lead to some freeing of cash and lowering of potential debt interest.



Beyond payables and receivables, inventory issues are often at the root of the working capital crisis, and many companies are now seeing a whiplash effect. Companies found themselves with excess inventory, shifting sales trends, and cash being tied up in that inventory. This also led to degraded service quality, as products that customers want may no longer be available, prices will have to increase for those that are, and cutting one area too sharply could negatively impact service levels.

Reducing SKUs and product range may be seen as a short-term solution, but it also may negatively impact service. Early pay discounting may have an apparent negative impact on working capital, but doing so may also have a positive impact in other areas and drive a shorter-term boost to the profit and loss statement. Other short-term receivables tactics like factoring may also bring in working capital more quickly but could also bring higher costs later on.

Aligning sales with inventory will deliver a more accurate and predictable picture and better cash management—along with improvements in service to the customer. Using SIOP accomplishes that alignment using tactics like automation and analytics to better align the silos of sales, production, manufacturing, assembly, and logistics. The result is delivering the product as fast as possible and at the highest value, with better service to the customer.

An end-to-end solution extends from initiatives addressing raw materials, work in progress, semi-finished goods, and finished goods, with enhanced visibility in inventory at every stage of the product life cycle. Opportunities for improving cash flow and optimizing working capital are present at every step. In the raw materials phase, improving working capital may begin with segmentation by value and usage, rescheduling of suppliers, and more on-time delivery. Once work is in progress, further improvements can be gained through lead-time reduction, by outsourcing production overloads, and in the semi-finished goods arena. Improvements can also be made with order quantity reduction and better planning synchronization. Finally, regarding finished goods, a root-cause analysis should look at the reasons for nonshipments, along with a weekly follow-up that identifies actions being taken to resolve all current and future delivery problems.

Other key initiatives include inventory management solutions that set targets, review and update policies on a regular basis, and define inventory strategy for each material type and at each location. In addition, linking sales order processing with production planning may also deliver improvements, as will improved materials scheduling that defines guidelines for replenishing materials based on a coherent inventory strategy. Finally, in the critical warehousing and distribution area, improvements can be made in defining where and how much material to hold while setting up an improved warehouse flow.

How Can the CFO Optimize Working Capital?

Getting started doesn't have to be difficult, and the next steps on the optimization road map and improving the organization's financial well-being begin with analyzing the current working capital position, identifying weaknesses and opportunities for improvement, and setting some clear objectives. The CFO's office never works in isolation, and bringing in other departments that are affected by working capital will help in creating these objectives and identifying a clear set of policies and procedures—which may relate to issues around inventory, payables and receivables, and contract management. With new strategies and policies firmly in place, the cash forecast can be continuously revisited, with an eye toward gaming out multiple scenarios to identify the best possible solution as well as optionality and alternative plans.

Working capital optimization is a continuously improved process, never a one-and-done. Regular monitoring of key performance indicators (KPIs) and results will help keep optimization on track and help the organization make adjustments along the way should external circumstances change and demand a shift in approach.

Automation, Digitalization, and Analytics

Optimization will be built on a tool set that includes automation, digitalization, and predictive analytics, which may necessitate that the CFO's office expand beyond traditional tactics and strategies to set the stage for a successful transformation of the digital supply chain. By implementing automation throughout the process, from analysis to execution, the company can reduce the cost and increase the accuracy of repetitive tasks. This automation may even be projected into the next level of actual management practices. For example, in inventory management, automation can be successfully applied in some areas of decision making, such as classification of inventory or where it should be located.

In the analysis phase, automation can be applied, for example, to deliver a continuous refresh of segmentation analysis to show inventory positions on a regular basis, taking key decisions by segment and embedding that into the system on an automated basis. Automation can also include a trigger that requires human intervention for things like exceptions.

Also, the staff shortages that have plagued warehouses over the past few years can be mitigated with technologies like barcode scanning and robotics along with software automation for decision making and repetitive tasks.

Who Needs Working Capital Optimization?

A call for optimizing working capital doesn't necessarily mean that a company is failing or even at risk of failing. There are two distinct and separate needs—to be sure, some companies are ill-prepared, didn't consider the future during the times of plenty, and are facing dire circumstances now. Even those companies can still benefit from optimization practices, implementing the three levers, and deploying a TVO strategy.

Companies not facing immediate risk will still benefit by better positioning their operations and cash flow to better meet current and future challenges. Companies may remain successful but may begin to realize that their cash isn't moving as fast as it used to and may not be able to accomplish some of the more aggressive strategies that they would've considered when interest rates were at near-zero. Optimizing working capital will allow those companies to continue succeeding, stay on their growth path, and meet their goals more effectively while continuing to enjoy access to the cash they need to meet those goals. And, more importantly, the path to optimization of working capital isn't, and shouldn't be, a one-time cash release but a systematic, ongoing improvement of cash flow.

This approach of balancing the triple impact of releasing cash, reducing cost, and improving service levels, as compared to the traditional, linear approach more often undertaken to manage working capital, unlocks cash that would otherwise be tied up in inventory, payables, and receivables. The resulting cash culture enables a company to better withstand periods of slow growth or unexpected challenges while also providing much better visibility and control over inventory, receivables, and payables.

Don Freitas, CPA, is executive vice president of finance at SGS Maine Pointe. He can be reached at dfreitas@mainepointe.com.

FEATURE

STRATEGIC FINANCE

When Change Isn't So Good: New Management Brings Ethical Dilemmas

The 2023 winner of the Carl Menconi Case Writing Competition centers on the dilemma faced by an employee working under new management.

By Dawn Schwartz, DBA, CMA, CPA, CFE

The IMA® Committee on Ethics is proud to announce that Dawn Schwartz, DBA, CMA, CPA, CFE, has won the Best Case Award in the 17th annual Carl Menconi Case Writing Competition for her case, "When Change Isn't So Good: New Management Brings Ethical Dilemmas."

The competition is named in memory of Carl Menconi, who held leadership positions in IMA for many years and served as chair of the IMA Committee on Ethics. The objective of the competition is to develop and distribute business ethics cases with specific application to management accounting and finance issues and that use the *IMA Statement of Ethical Professional Practice* as a reference or guidance tool.

The winning case and teaching notes will be available later this year for use in a classroom or business setting. IMA academic members will be able to access and download the teaching notes from the Academic Teaching Notes library via the *IMA Educational Case Journal* section of IMA's website.

A tear rolls down Liz Kane's cheek as she thinks about the last 20 years. She has devoted most of her career to Break Free Renewal, Inc. (BFR) and loves the company, its customers, and its employees. Liz has always been the shining star in the office, everyone's biggest fan and strongest supporter. If someone has a question, Liz is the one to go to. Everyone trusts her to get the job done, be fair, and, above all, protect the company. She has been dedicated to her work and the company. It's her life's mission.

Now it appears Liz has hit a fork in the road, and she isn't quite sure how to move forward. She has become increasingly worried about the credibility and reliability of the financial information being distributed to BFR's board of directors by BFR's CEO, Sam Phillips. Initial efforts to raise the issues internally were brushed aside, and Liz now faces a decision regarding what actions to take next.

The question is a difficult one. Liz can't imagine life without BFR. It's all she has known for two decades. But her integrity means everything, and she's trusted to make tough choices. Not one to jump ship when it's sinking, Liz would rather repair the ship and keep it steering in the right direction. Yet she feels that's impossible. Several people had tried and were terminated. If Liz stands up for what she thinks is right, she could lose her job—and with it, her health insurance coverage, which is very important to Liz.

Company Background

A 501(c)(3) organization located in Charleston, W.Va., BFR was founded in 1995 to provide support for addiction recovery, including inpatient and outpatient support, housing, and family support services. Its main sources of revenue are individual and corporate donations, grants, and the sales of some products and services.

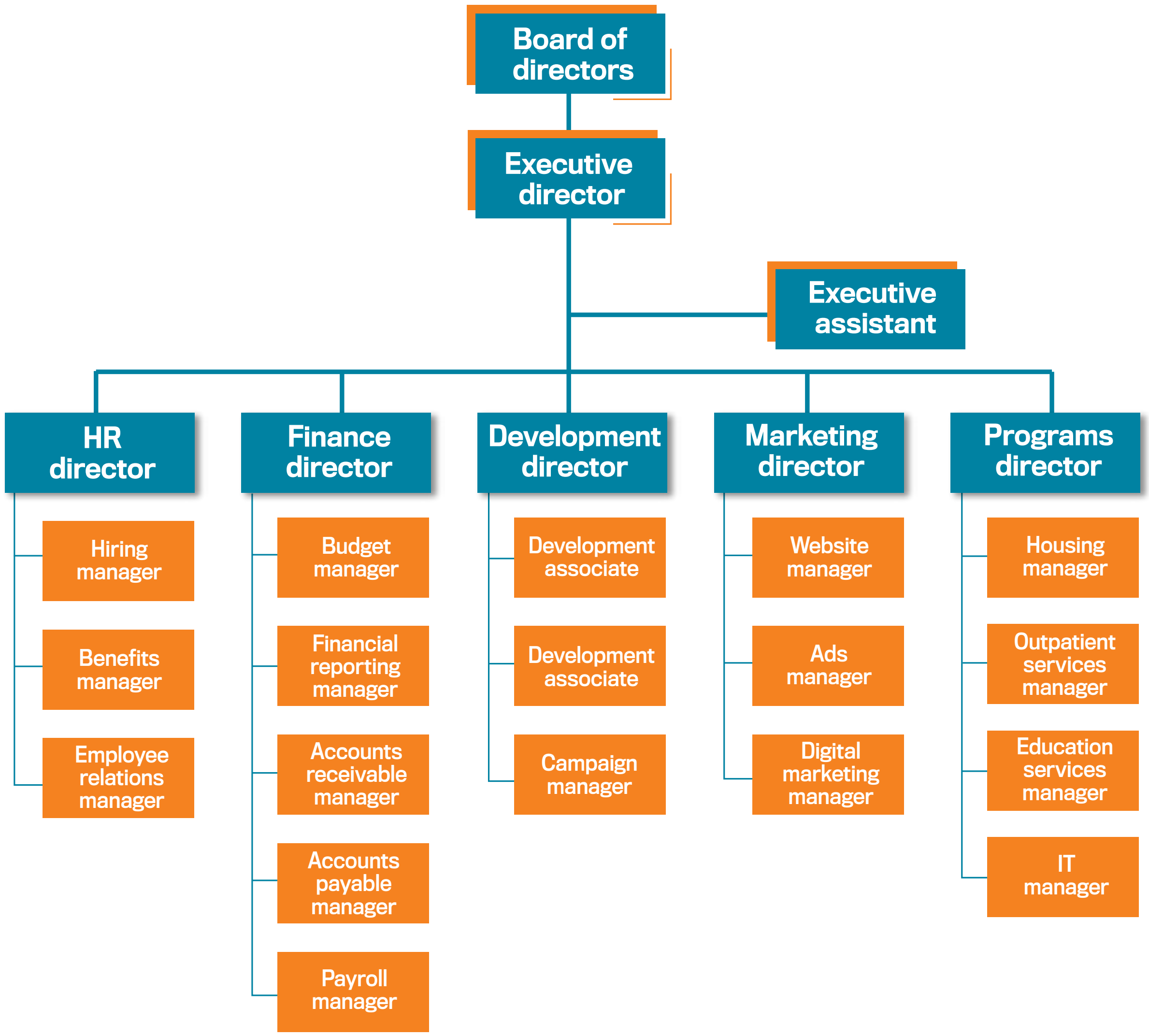
The company also developed an addiction-support training certification program that it charges participants to complete. BFR also offers continuing professional education courses and partners with a local college to teach some of the courses in the school's psychology and nursing programs.

As of 2023, BFR has 38 full-time administrative employees, 87 full-time counselors, and another 75 part-time employees. In the early to mid-2010s, BFR experienced a five-year period of growing revenues that resulted in the accumulation of a large, unrestricted cash balance of $36 million. At the time, the money had been earmarked to save for future growth and potential economic downturns. Then, in 2018, BFR began to use the cash reserves to upgrade and expand its facilities and program offerings, which also involved hiring additional employees and revamping its marketing. Now the company is facing the impact of the economic downturn from the pandemic and doesn't have the large cash reserves to help mitigate the impact. The company was managed by James Sims from 2003 to 2018 (see Figure 1). He had a laissez-faire leadership style and was very friendly, energetic, and transparent. James felt BFR was his legacy. He thought of the employees as family and walked through the office halls every morning to say hello to them. He held quarterly meetings with employees to discuss the current state of BFR and future projections, brainstorm ideas, and address any issues or concerns they might have.

James was economical with an accounting background. Having been through tough times with the company, he believed in saving money and knew the value of having savings on hand. James was always very transparent about plans and finances with the board of directors, donors, and other stakeholders.

James retired in early 2018 and was replaced by Sam Phillips as executive director. Sam came from the private sector. He had a management background but limited finance and accounting experience. Sam restructured the company and created the positions of chief information officer (CIO) and CFO. He brought in two of his previous employees, Miguel Teague and Amrita Gupta, to be CIO and CFO, respectively. The executive director position title was changed to CEO. The organizational structure was further changed to combine the administrative and finance functions under the CFO (see Figure 2).

FIGURE 1: BFR ORGANIZATIONAL CHART, JANUARY 1, 2018



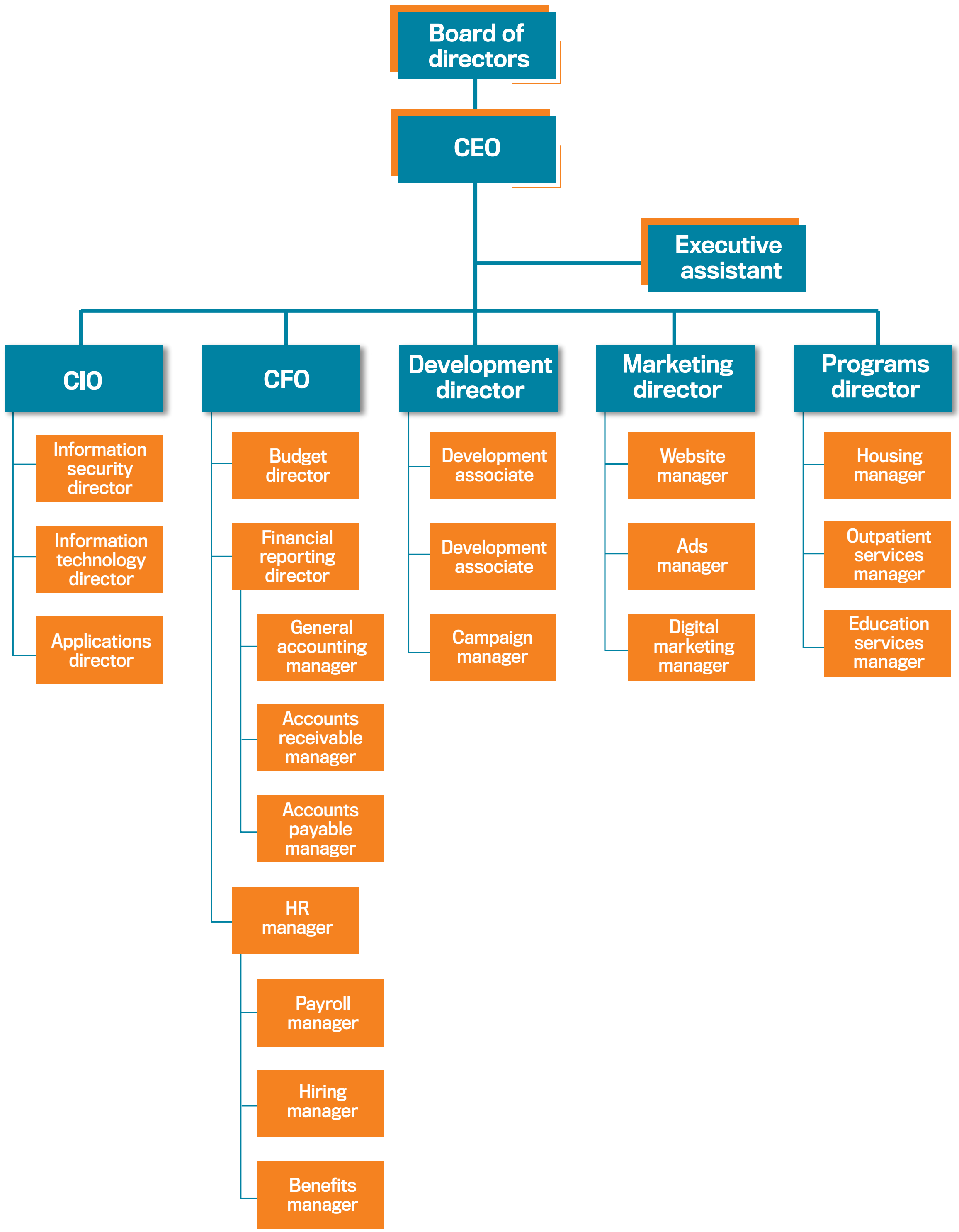
Sam has a very different leadership style than James did. Sam leads with more of an authoritative style; he's the primary decision maker and only communicates directly with the CIO, CFO, development director, marketing director, and programs director. Sam isn't in the office much because he's also helping to run a family business. As a result, the culture at BFR has shifted from the upbeat, comfortable, friendly, and family-like atmosphere to a more reserved, secretive, and disconnected atmosphere.

Many employees have left because of clashes with the new CEO; some left on their own, while others were fired. The employees who left no longer keep in contact with the others still at the company, even though they had been like a family for years. In fact, when current employees see them out in public, they make it seem like they're no longer allowed to talk to them. Rumors of nondisclosure agreements have been circling, and people are nervous.

New Management, Changes, Uncomfortable Adjustment

As the budget director for BFR, Liz is responsible for creating and managing the company's budget, including projections, monthly reviews, and compliance reports. Liz works with other departments and considers market and economic trends to determine revenue and expense projections. She compiles and reviews the monthly reports and addresses any issues.

FIGURE 2: BFR ORGANIZATIONAL CHART, MARCH 31, 2018



Liz has held the position for 20 years. She was skeptical when Sam came in, but her optimistic personality and extreme dedication to the company drove her to fiercely defend him and try her best to be supportive. She reinforced her support to her employees, letting them know that new management and leadership styles can be difficult to adjust to, but that they all shared the same goals, would find middle ground, and learn to work well together. Liz knew BFR needed a united front and believed employees must support management, or the company and everything they had worked so hard to create could be destroyed.

But it was becoming more difficult each day. Things changed gradually over the past three-and-a-half years. Liz and the other directors previously attended all board meetings and presented information from their departments. Board members often asked questions directly to the directors. Now the directors aren't allowed in the board meetings at all. At first, Liz thought maybe they forgot to invite her and the other directors to the board meetings, so she went to the first one after Sam took over. After the meeting, Sam informed her that she was no longer needed at the board meetings. Only the CEO, CIO, and CFO were to attend the board meetings going forward.

Liz was a bit taken aback by that change and wondered if she had done something to offend Sam. She enjoyed seeing the board members and always answered questions about the budget and the projections. Liz was frustrated and disappointed, but she knew that new management meant new perspectives, new visions, and new goals. She knew she needed to be supportive and work hard toward the new goals. Liz was determined to support Sam even if their personalities clashed and their perspectives were very different. She knew from discussions with her executive coach that sometimes she could be resistant to change. So Liz made it her personal mission to work hard toward acceptance of the new management style and other changes.

Liz had always prepared reports for the board of directors for each quarterly meeting. Starting in 2020, however, she has been asked to make several alterations to them. Many were gradually changed so substantially since then that Liz feels they no longer represent what they're supposed to—and she fears they're misleading board members. When James was executive director, Liz had prepared board materials with the operating budget to date, comparison to actual, detailed analysis of the cash balance, and comparative year information (see Table 1 and Table 2). But the detailed analysis of the cash balance report has been removed. Instead, board members are given a total cash balance at the bottom of the statements that includes restricted and unrestricted cash combined. The board members don't know how much of the cash is unrestricted and available for use.

TABLE 1: CASH BALANCE ANALYSIS REPORT AS OF FEBRUARY 28, 2018

	February 2018	February 2017	February 2016	February 2015	February 2014
Unrestricted	$29,884,686	$36,259,423	$31,264,855	$27,569,542	$23,542,684
Restricted					
Permanent	31,500,421	28,654,921	26,512,985	23,412,595	19,562,854
Temporary	29,185,533	25,695,214	22,051,643	19,458,741	18,951,322
Total	$90,570,640	$90,609,558	$79,829,483	$70,440,878	$62,056,860
Projected revenues over/ (under expenses)	12,790,122				
Projected year-end balance	$103,360,762				

TABLE 2: FISCAL YEAR 2018 BUDGET AS OF FEBRUARY 28, 2018

	Original Budget	Year-to-Date Adjustments	Revised Budget	Actual-to-Date	Remaining Budget	Percent of Budget to Date
Revenue and support						
Contributions of cash	$ 7,500,000	$1,700,000	$ 9,200,000	$ 1,615,520	$ 7,584,480	17.56%
In-kind contributions	2,350,000		2,350,000	383,520	1,966,480	16.32%
Program service revenue	16,000,000	275,000	16,275,000	2,379,893	13,895,107	14.62%
Interest and dividends	450,000		450,000	26,000	424,000	5.78%
Other revenue	165,000	(3,150)	161,850	12,500	149,350	7.72%
Total revenues	26,465,000	1,971,850	28,436,850	4,417,433	24,019,417	15.53%
Expenses						
Program expenses						
Total program expenses	9,500,000		9,500,000	1,572,060	7,927,940	16.55%
Supporting expenses						
Management and general	2,100,000	350,000	2,450,000	323,645	2,126,355	13.21%
Fundraising	1,250,000		1,250,000	75,000	1,175,000	6.00%
Total supporting expenses	3,350,000	350,000	3,700,000	398,645	3,301,355	10.77%
Total expenses	12,850,000	350,000	13,200,000	1,970,705	11,229,295	14.93%
Change in net assets	13,615,000	1,621,850	15,236,850	2,446,728	12,790,122	29.85%
Net assets, beginning of year	256,845,210		256,845,210			
Net assets, end of year	**$270,460,210**		**$272,082,060**			

Altered Report

The first signs of trouble with the reports began a few days before the March 2020 board of directors meeting. Amrita, the CFO, emailed Liz new projections for Liz to use in her report. The projections were materially different than hers were: The projected revenues were $2.2 million higher than hers. Liz asked Amrita for the supporting documentation so she could make the changes. Amrita said she didn't have any documentation and that Sam had sent the projections to them and requested that Liz make the changes.

TABLE 3: CASH BALANCE ANALYSIS REPORT AS OF FEBRUARY 29, 2020 (ORIGINAL AS PREPARED BY LIZ)

	February 2020	February 2019	February 2018	February 2017	February 2016
Unrestricted	$ 3,793,591	$ 6,229,854	$ 29,884,686	$ 36,259,423	$ 31,264,855
Restricted					
Permanent	32,165,421	31,917,171	31,500,421	28,654,921	26,512,985
Temporary	28,985,632	27,025,681	29,185,533	25,695,214	22,051,643
Total	$64,944,644	$65,172,706	$90,570,640	$90,609,558	$79,829,483
Projected revenues over/ (under expenses)	2,576,386				
Projected year-end balance	$ 67,521,030				

TABLE 4: FISCAL YEAR 2020 BUDGET AS OF FEBRUARY 29, 2020 (ORIGINAL AS PREPARED BY LIZ)

	Original Budget	Year-to-Date Adjustments	Revised Budget	Actual-to-Date	Remaining Budget	Percent of Budget to Date
Revenue and support						
Contributions of cash	$ 7,110,725		$ 7,110,725	$ 1,411,906	$ 5,698,819	19.86%
In-kind contributions	1,833,000		1,833,000	219,960	1,613,040	12.00%
Program service revenue	16,960,000	(20,000)	16,940,000	2,307,228	14,632,772	13.62%
Interest and dividends	81,250		81,250	5,780	75,470	7.11%
Other revenue	98,000	2,500	100,500	9,250	91,250	9.20%
Total revenues	26,082,975	(17,500)	26,065,475	3,954,124	22,111,351	15.17%
Expenses						
Program expenses						
Total program expenses	16,910,000		16,910,000	2,991,210	13,918,790	17.69%
Supporting expenses						
Management and general	4,683,000	12,500	4,695,500	704,325	3,991,175	15.00%
Fundraising	1,750,000		1,750,000	125,000	1,625,000	7.14%
Total supporting expenses	6,433,000	12,500	6,445,500	829,325	5,616,175	12.87%
Total expenses	23,343,000	12,500	23,355,500	3,820,535	19,534,965	16.36%
Change in net assets	2,739,975	(30,000)	2,709,975	133,589	2,576,386	4.93%
Net assets, beginning of year	178,282,910		178,282,910			
Net assets, end of year	**$181,022,885**		**$180,992,885**			

Liz told Amrita that she didn't feel comfortable changing her numbers without sufficient support and rationale. She explained the projections were lower than originally expected due to a downturn in economic conditions and the COVID-19 pandemic. Revenues were lower, and expenses were increasing. There was a lot of uncertainty due to the pandemic.

Liz also explained her position as a CMA® (Certified Management Accountant) and her duty to maintain the credibility of her reports. Amrita said she understood and asked Liz to send the reports without the changes for the board meeting (see Table 3 and Table 4). Liz was perplexed by the request to change the projections and was hopeful that the rationale and support would be sent to her soon.

A few days after the board of directors' meeting, Liz reviewed the board meeting materials. This was standard procedure for her, as she always downloaded and saved the materials, then added her notes with her reports. When Liz reviewed the report, she was shocked. Her numbers had been changed (see Table 5). The projected revenues were $2.2 million higher than her original report. Liz immediately contacted Amrita, who sternly said Liz should have reported what she was told to report. She then told Liz that the CEO wasn't required to share with her his rationale or his supporting documentation.

They had a heated discussion, with Liz explaining her responsibilities under the *IMA Statement of Ethical Professional Practice*. She told Amrita that she wasn't trying to be difficult, but she was scared she would lose her certification if she made changes without any understanding of the basis for them. At the end of the conversation, Amrita said she understood and agreed that if they changed her numbers again, they would put the caveat at the bottom that the numbers were prepared by management. This was supposed to imply that Liz, the budget director, didn't prepare them.

TABLE 5: FISCAL YEAR 2020 BUDGET AS OF FEBRUARY 29, 2020 (REPORT PROVIDED TO BOARD OF DIRECTORS)

	Original Budget	Year-to-Date Adjustments	Revised Budget	Actual-to-Date	Remaining Budget	Percent of Budget to Date
Revenue and support						
Contributions of cash	$ 8,310,725		$ 8,310,725	$ 1,650,178	$ 6,660,547	19.86%
In-kind contributions	1,833,000		1,833,000	219,960	1,613,040	12.00%
Program service revenue	17,960,000	(20,000)	17,940,000	2,443,428	15,496,572	13.62%
Interest and dividends	81,250		81,250	5,780	75,470	7.11%
Other revenue	98,000	2,500	100,500	9,250	91,250	9.20%
Total revenues	28,282,975	(17,500)	28,265,475	4,328,596	23,936,879	15.31%
Expenses						
Program expenses						
Total program expenses	16,910,000		16,910,000	2,991,210	13,918,790	17.69%
Supporting expenses						
Management and general	4,683,000	12,500	4,695,500	704,325	3,991,175	15.00%
Fundraising	1,750,000		1,750,000	125,000	1,625,000	7.14%
Total supporting expenses	6,433,000	12,500	6,445,500	829,325	5,616,175	12.87%
Total expenses	23,343,000	12,500	23,355,500	3,820,535	19,534,965	16.36%
Change in net assets	4,939,975	(30,000)	4,909,975	508,061	4,401,914	10.35%
Net assets, beginning of year	178,282,910		178,282,910			
Net assets, end of year	**$183,222,885**		**$183,192,885**			
Total cash balance as of 2/29/2020:	*$64,944,644*					

Growing Dissent

That was three years ago. In the time since, Liz's dissatisfaction grew, and she continued to worry about the credibility of financial information distributed to the board of directors. She's again faced with a report going to the board of directors that was altered to show projected revenues $3.2 million higher and projected expenses $1.5 million lower than her original report (see Table 6, Table 7, and Table 8). Amrita continues to withhold explanations and supporting documentation for the changes. Liz has given up hope that she will ever understand the rationale for the changes.

TABLE 6: CASH BALANCE ANALYSIS REPORT AS OF FEBRUARY 28, 2023 (ORIGINAL AS PREPARED BY LIZ)

	February 2023	February 2022	February 2021	February 2020	February 2019
Unrestricted	$ 1,557,615	$ 2,859,631	$ 3,816,319	$ 3,793,591	$6,229,854
Restricted					
Permanent	33,604,443	33,181,313	32,531,313	32,165,421	31,917,171
Temporary	27,820,255	30,186,240	29,645,455	28,985,632	27,025,681
Total	$62,982,313	$66,227,184	$65,993,087	$64,944,644	$65,172,706
Projected revenues over/ (under expenses)	(3,218,634)				
Projected year-end balance	$59,763,679				

TABLE 7: FISCAL YEAR 2023 BUDGET AS OF FEBRUARY 28, 2023 (ORIGINAL AS PREPARED BY LIZ)

	Original Budget	Year-to-Date Adjustments	Revised Budget	Actual-to-Date	Remaining Budget	Percent of Budget to Date
Revenue and support						
Contributions of cash	$ 6,584,136		$ 6,584,136	$ 1,235,158	$ 5,348,978	18.76%
In-kind contributions	1,583,000		1,583,000	284,940	1,298,060	18.00%
Program service revenue	14,936,674	85,000	15,021,674	2,471,516	12,550,158	16.45%
Interest and dividends	81,250		81,250	8,350	72,900	10.28%
Other revenue	98,000	(3,650)	94,350	12,396	81,954	13.14%
Total revenues	23,283,060	81,350	23,364,410	4,012,360	19,352,050	17.17%
Expenses						
Program expenses						
Total program expenses	18,526,610		18,526,610	2,846,614	15,679,996	15.37%
Supporting expenses						
Management and general	5,823,250	12,500	5,835,750	854,937	4,980,813	14.65%
Fundraising	2,109,875		2,109,875	200,000	1,909,875	9.48%
Total supporting expenses	7,933,125	12,500	7,945,625	1,054,937	6,890,688	13.28%
Total expenses	26,459,735	12,500	26,472,235	3,901,551	22,570,684	14.74%
Change in net assets	(3,176,675)	68,850	(3,107,825)	110,809	(3,218,634)	
Net assets, beginning of year	178,282,910		178,282,910			
Net assets, end of year	**$175,106,235**		**$175,175,085**			

Spending in the past few years has reduced the unrestricted cash to $1.5 million. Sam approved a major renovation of all the buildings, built two new housing developments, built a new executive suite, and hired a major marketing firm. While these were all good improvements, the pandemic caused major increases to expenses while revenues declined. The company was unable to fill the rooms in the new housing developments due to the market.

Liz's budget for 2023 shows that the expenses this year would exceed revenues by more than $3 million. In the past, BFR could have covered this budget deficit with the unrestricted cash saved. Now it didn't have enough saved to cover the shortfall. Worried about cash flow, Liz voiced her concerns to Amrita, who told her it was under control. In fact, the report that was distributed to the board of directors showed revenues exceeding expenses by more than $1 million. But it didn't offer any further explanation or the basis for those changes.

Liz wonders why the board of directors wasn't asking more questions and if the directors have enough information to know that there are issues. The board was only given the CEO's revised budget, with no comparative year-over-year information or cash balance details. The total cash figures given included unrestricted and restricted cash. The restricted cash couldn't be used for operating expenses. Yet the board wouldn't know the breakdown and may assume that the cash is all unrestricted. Board members also didn't have comparative information to see the fluctuations over time. Unless the board members were pulling prior years' reports themselves, they may not know there's an issue.

Turning Point

Jim Gallagher, a BFR board member, stopped by Liz's office this morning with his most recent board meeting materials. He had a question about the budget and wanted to know how the performance was when the market had been hit hard by the pandemic. He also wanted to know why he and the other board members weren't being given the budget-to-actual figures and the breakout of cash balances anymore.

Jim also wanted clarification about the caveat disclosing that the report was created by

TABLE 8: FISCAL YEAR 2023 BUDGET AS OF FEBRUARY 28, 2023 (REPORT PROVIDED TO BOARD OF DIRECTORS)

	Original Budget	Year-to-Date Adjustments	Revised Budget	Actual-to-Date	Remaining Budget	Percent of Budget to Date
Revenue and support						
Contributions of cash	$ 7,584,136		$ 7,584,136	$ 1,422,754	$ 6,161,382	18.76%
In-kind contributions	1,583,000		1,583,000	284,940	1,298,060	18.00%
Program service revenue	17,136,674	85,000	17,221,674	2,833,482	14,388,192	16.45%
Interest and dividends	81,250		81,250	8,350	72,900	10.28%
Other revenue	98,000	(3,650)	94,350	12,396	81,954	13.14%
Total revenues	26,483,060	81,350	26,564,410	4,561,922	22,002,488	17.17%
Expenses						
Program expenses						
Total program expenses	17,776,610		17,776,610	2,731,376	15,045,234	15.37%
Supporting expenses						
Management and general	5,323,250	12,500	5,335,750	781,687	4,554,063	14.65%
Fundraising	1,859,875		1,859,875	200,000	1,659,875	10.75%
Total supporting expenses	7,183,125	12,500	7,195,625	981,687	6,213,938	13.64%
Total expenses	24,959,735	12,500	24,972,235	3,713,064	21,259,171	14.87%
Change in net assets	1,523,325	68,850	1,592,175	848,858	743,317	
Net assets, beginning of year	178,282,910		178,282,910			
Net assets, end of year	**$179,806,235**		**$179,875,085**			
Total cash balance as of 2/28/2023:	*$62,982,313*					

Estimates prepared by management

management, as he didn't recall seeing it in the past. He asked Liz, "Wasn't the report always prepared by management?" Jim explained he hadn't been able to dedicate a lot of time for review of the information the past couple of years due to the struggle of the pandemic on his own company. But he was there now, at Liz's desk, demanding explanations.

Liz explained to Jim that she had an appointment in a few minutes. She asked if they could discuss it another time. Jim told her he would be back tomorrow morning at 10 a.m. Now Liz is panicking. She's fearful that the reports were altered due to the failure to meet projections and that the budget-to-actual comparison, cash details, and prior-year information were removed so the board couldn't make the connection. But she had no proof.

It's possible that Sam and Amrita know something she doesn't. Sam is in charge of the company, and, surely, he's coming up with a solution. Liz is scared to voice her concerns to Jim because it could mean losing her job if she's wrong. She also isn't sure if the changes are considered fraud or even illegal because they're internal reports going to the board of directors, not published financial statements.

But if Sam doesn't have something else in the works and Liz doesn't voice her concern, the company could be at risk of failing. If BFR runs out of cash, it won't be able to pay expenses, no one will have a job, and BFR won't be able to continue its mission.

Liz is reviewing the IMA Statement of Ethical Professional Practice and has called you, a fellow CMA, for advice on what to do. Based on the IMA Statement, advise Liz of her options and discuss whether the changes to the reports and decrease in transparency are considered fraud or illegal, and/or are in violation of the IMA Statement.

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Embedding a Range in a Word Document

An eight-step process lets you embed linked Excel data in a Word document that will update whenever the workbook recalculates.

By Bill Jelen

Say that you want to embed one or more ranges from an Excel workbook in a Word document. For example, you might be preparing a quarterly report that needs a table from the income statement, another table from the balance sheet, and a third range with some key metrics.

The method described here will create a link between Word and Excel. If the data in the Excel workbook changes, those new values will appear in Word. If the number of rows in the embedded workbook changes, the height of the worksheet in Word will increase.

Say that you're embedding B2:E18 but that the results in that range refer to cells outside of the range. When those cells outside the range change and the cells inside the embedded range change, the Word document will also update to show the numbers.

An IMA® member recently wrote in saying that their method for embedding an Excel workbook in Word had stopped working. If the height of the range increased, the new rows were being truncated from the linked Excel object in Word.

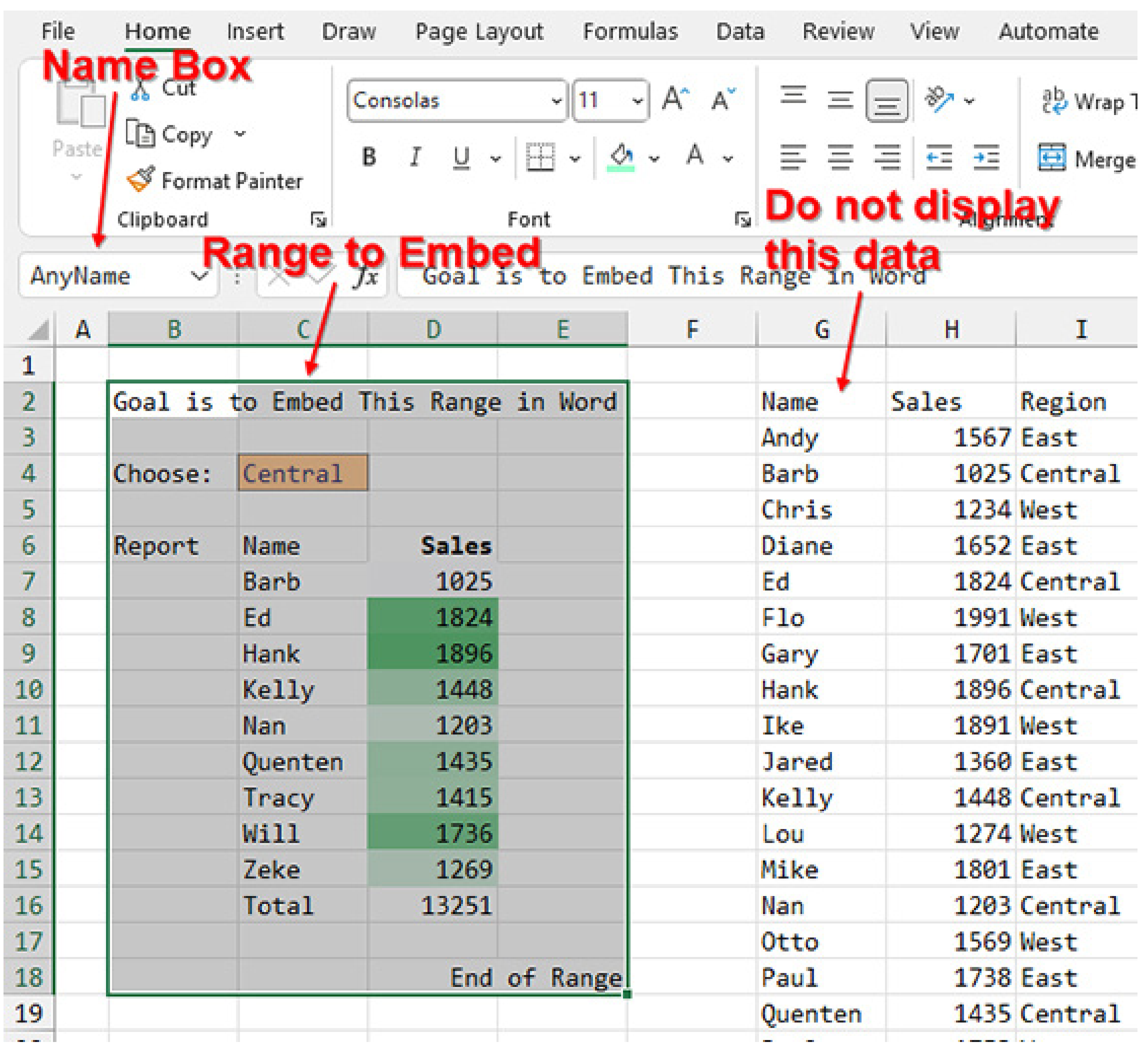
I have found a set of eight steps that successfully embed a dynamic live view of the Excel range in Word. None of the steps is optional. You have to do these steps in this order to set up the live link. In short, you have to name the range to be embedded and then copy the entire range from Excel. When you paste in Word, you have to open a subtle Paste Options menu to choose to create the link.

This is always a frustrating process for me because some of the steps aren't obvious. Here are the eight steps:

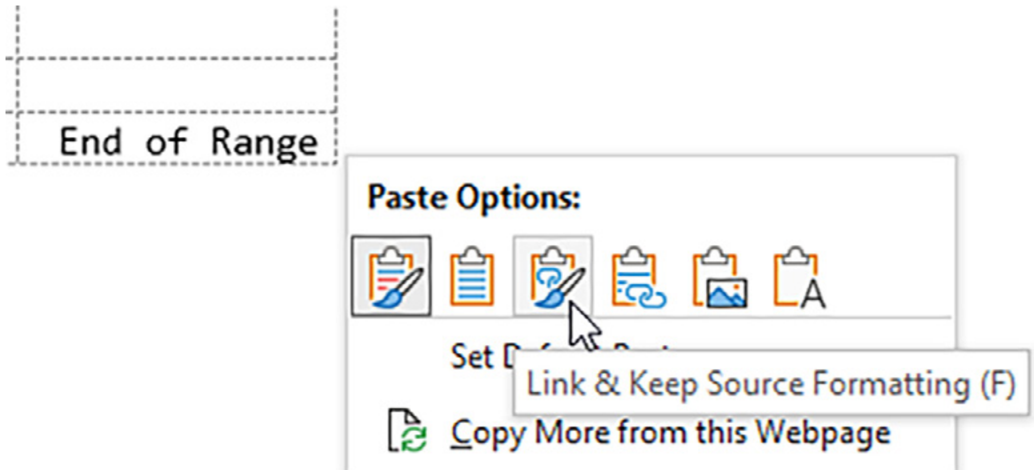
1. Save the Excel workbook with a path and filename. It can't be an unsaved Book1. Whoever will be opening the Word document should have access to the same path and filename.

2. In Excel, create a name for the range that should appear in Word. One easy way to create a name is to select the range, click in the Name Box that appears to the left of the formula bar, type a name without spaces, and then press Enter. For example, valid names might be PartOne, Income_Statement, or SectionOne. After you press Enter, you should see the new name appear in the Name Box. Note that it's also fine to create named ranges using the Name Manager on the Formulas tab if you prefer.

3. Select the entirety of the area described by the Named Range. One easy way is to open the drop-down menu in the Name Box and select the named range. This will jump to and select the entire named range.



4. Copy the range using Ctrl+C or the Copy icon.
5. Switch to your Word document.
6. Place the cursor in the spot where you want the Excel workbook range to appear.
7. Paste using Ctrl+V or the Paste icon.
8. Immediately after pasting, the Paste Options drop-down menu appears just below the pasted range. Open this drop-down and choose the third icon, which has a tooltip saying "Link & Keep Source Formatting." The Link portion of this option makes sure that changes in the Excel workbook will be reflected here. The Keep Source Formatting makes sure that the fonts and colors from Excel aren't changed.



At this point, if both the Excel workbook and the Word document are open, any changes to the Excel document are immediately reflected in the Word document—even before the Excel workbook is saved.

The "instant update" feature stops updating once you close the Excel workbook. If you close the Excel workbook and then reopen it, the Word document won't update automatically. At this point, you could press Ctrl+A in Word and then F9 to update. Or close the Word file and reopen it while the Excel workbook is open to enable instant updating.

In real life, changes will happen to the Excel workbook when the Word document isn't open. When you open the Word document, you'll be asked, "This document contains links that may refer to other files. Do you want to update this document with the data from the linked files?" When you choose Yes, the changes from Excel appear in the Word document.

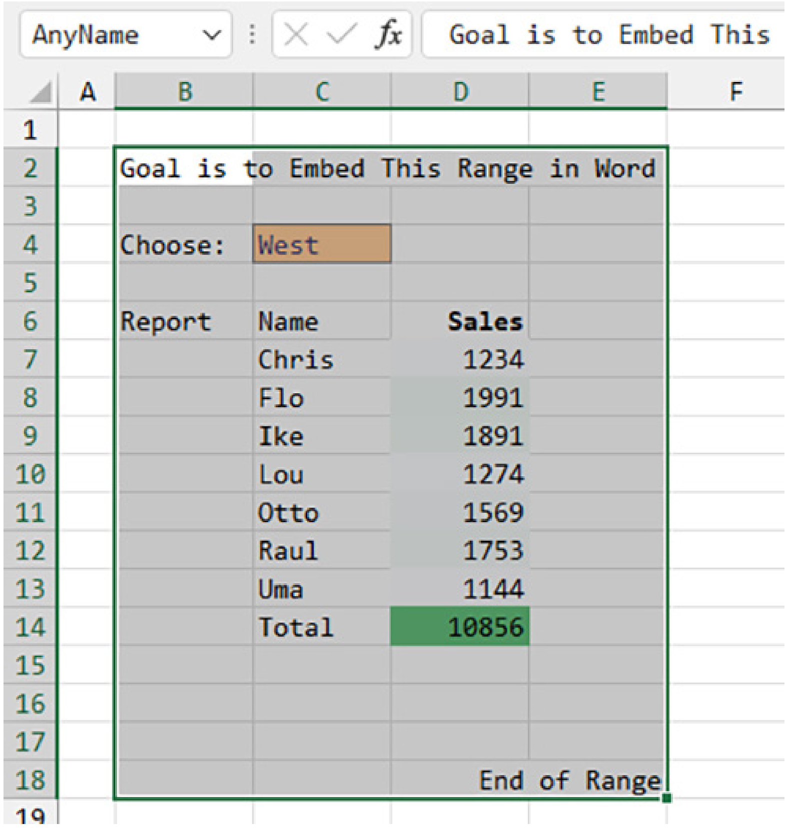
Adding Rows or Columns to the Embedded Range

The Excel workbook might expand over time. In order for any new rows or columns to automatically appear in Word, you need to make sure to insert new rows or columns inside of the named range.

For example, let's say the embedded range is B2:B18.

If you need to add new rows, make sure to insert them above row 18 so the named range automatically expands. In a similar fashion, any new columns should be inserted to the left of column E so the named range includes the new columns.

I often joke that Word is just for people who can't type letters in Excel. But there are certainly times where you need a combination of Word paragraphs and Excel tables all in one package. Using these eight steps will allow it to work seamlessly.



AnyName | Goal is to Embed This

	A	B	C	D	E	F
1						
2		Goal is to Embed This Range in Word				
3						
4		Choose:	West			
5						
6		Report	Name	**Sales**		
7			Chris	1234		
8			Flo	1991		
9			Ike	1891		
10			Lou	1274		
11			Otto	1569		
12			Raul	1753		
13			Uma	1144		
14			Total	10856		
15						
16						
17						
18					End of Range	
19						

Bill Jelen is the host of MrExcel.com and the author of 67 books about Excel. He helped create IMA's Excel courses on data analytics and the IMA Excel 365: Tips in Ten series of microlearning courses. Send questions for future articles to IMA@MrExcel.com.

STRATEGIC FINANCE

Communication Planning for RPA Success

Don't overlook these communication plan essentials when developing a blueprint for RPA implementation.

By Aharon Yoki, DBA, CPA

Employee perceptions of their workplace have been impacted by events of the last several years, including COVID-19, the housing crisis, unemployment, and rising consumer costs. CEOs in the news predict continuing economic uncertainty, asserting the need for cost reductions and embracing efficiency. In the chaotic economy, organizations are implementing robotic process automation (RPA) technology tools to seek a competitive advantage during these times of fiscal uncertainty.

RPA technology automates repetitive, low-value tasks while improving efficiency and reducing errors in manual business processes. Unlike an Excel macro that replicates a few application keystrokes, RPA overlays existing software, spanning multiple applications, and extends the automation reach beyond the desktop. An RPA tool within the procure-to-pay cycle retrieves vendor invoices, populates the accounts payable system, and forwards the payment request to an approver.

Multiple manual tasks that require several employees with multiple computer applications are automated by a single RPA tool that completes the process. While organizations embrace the potential to reduce low value tasks with automation that increases throughput speed and reduces error rates, employees are haunted by implications: "The robots are coming." Employees, cognizant of the potential of AI, RPA, and machine learning, feel increasing job fear from technology. Organizational leadership must act carefully to not damage fragile employee relations while also seeking to avail themselves of the benefits of RPA.

Successful RPA implementation, therefore, requires a structured communication plan that ensures employees receive timely and transparent information. Effective communication tools are fundamental to the project planning and implementation of RPA. As employees become aware of RPA implementation projects, they'll speculate as to the project's impact through a lens of employment fear.

Employees will respond to a lack of information about a project by filling in their own expectations, often a worst-case scenario, and then that topic becomes the unproductive distraction in their day. Such distractions will deflate morale and may have a broader reputational risk long after the technology transition if, for example, lingering social media posts about the perceived fear around the lack of trust from leadership discourages future employment candidates from pursuing opportunities with the organization. A solid communication plan will ensure the early whispers don't translate to distraction and panic.

Manage the Message

Organizations have a responsibility to employees to provide a clear and honest message about the company's intentions. By proactively communicating early in the planning stages, organizations have the opportunity to manage the message and limit the distraction, fear, and disruption.

Within the overall project management plan, the project charter will define major stakeholders, including management, employees, vendors, suppliers, and the community. The project team will look to the project charter to understand all stakeholder roles and identify the timing and mechanism to convey project updates relevant to those stakeholders to ensure that they're all included in the communication plan and, when appropriate, their feedback is solicited.

Prelaunch Phase

The prelaunch message to the organization is vital to success. The message should be delivered from the project sponsor at a senior leadership level sufficient to ensure employees understand both the importance of a successful RPA implementation and to reinforce both the importance of the employees to the organization and the organization's commitment to their professional success.

The message should acknowledge that most of the employees have heard something about the RPA project. The message should provide clarity to the scope of work, which major stakeholders will be impacted, and in what way. The message should convey that all technology projects encounter unexpected challenges in the process, and that leadership will regularly update the organization as the project unfolds.

Leadership should expect that employee job fear will be a natural human response to the unknown. Clearly convey the project goals, expected outcomes, and what employees can anticipate during implementation and after launch. Help diffuse job fear and the organization's reputational risk by announcing that any affected departments will be contacted by a specific date in the near future.

The organization needs to engage with vendors and suppliers to ensure they understand the project goals and seek their support to engage in aspects of the project that impact their operations, such as electronic invoice formats and purchase orders. These partner organizations may have completed similar projects with other partner organizations and have insights into application program interfaces. A collaborative approach will benefit both organizations.

Implementation

Technology implementation may cause planned or unplanned work interruptions and raise employee stress about meeting their goals for timely task completion. A pilot test may require some employees to run simultaneous parallel processes to test the automation's effectiveness and identify exceptions. Communications with exception reporting tools will provide valuable perspectives on implementation progress. Management should provide regular status updates aligned with the schedule provided in the project sponsor prelaunch message.

Project updates should convey any changes to the project schedule and share lessons learned during the implementation phase. When employee feedback is received, it's always important to respond to confirm that management is listening and cares about employee success. Many employees have never experienced a large-scale system integration and aren't aware project planning includes tolerances for variances. It's important for management to communicate that project scope sometimes changes, which impacts scope outcomes and schedules.

Operational Phase

When the RPA tool goes live, the affected departments will need time to adjust to the new normal. Ongoing communication should help cement the organization's commitment to both its employees and the new technology so as to help deflect the potential to step back to the manual processes. Employee surveys and facilitated listening sessions during the project planning, implementation, and operational phases are opportunities to receive key insights into potential risks. Management should also acknowledge the successful technology implementation and the impact on the employees, the organization, and partners. Building consensus for the objectives and outcomes of the project will validate the project in the minds of employees and help as a foundational reference for future projects.

RPA, like other new technologies, has the potential for enterprise-level impacts on internal and external stakeholders. The organization should design a thoughtful project management communication plan to quell fears and help maintain momentum toward a successful project launch.

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Leading Sustainability across Borders

A student's experiences as an IMA volunteer leader inspires her to pursue her Ph.D. in sustainability and be a positive force for change.

By Anum Zahra, CMA

I first discovered IMA® and its vibrant community shortly after moving from my home in Pakistan to study in Dubai. I was a passionate young professional committed to creating positive change, and IMA helped me connect with like-minded individuals in a new country. As my involvement with the organization grew, the exciting possibilities that opened up for me led to a life-changing experience.

The encouragement of my local IMA community gave me the support and confidence to become a global volunteer leader. That led to my selection to participate in the Young Professional Leadership Experience (YPLE) program in 2021. This was a pivotal moment that taught me invaluable lessons in leadership, communication, and professionalism—lessons that have helped me in my career and in life.

With the support of IMA—as well as the people I met through this amazing leadership opportunity—I've tapped into my potential to make a global impact. As one of five young professionals from around the world who comprised the YPLE cohort, I found a platform to express my views and contribute to IMA's mission of advancing the management accounting profession. The experience also strengthened my belief in the power of community and collaboration to drive positive change. Indeed, through my work with IMA, I've been able to see firsthand the impact that individuals and organizations can have on the world.

My experience with the YPLE led me to become even more involved in IMA's mission and goals. Soon after being selected for the YPLE, I was asked to join IMA's Sustainable Business Management Global Task Force. This task force seeks to advocate on behalf of the profession before governments, regulatory authorities, and other organizations regarding sustainable business management and the perspectives of accountants and financial professionals in business. Through my work on this task force, I contribute to IMA's mission to educate its members and the global business community about sustainable business information and management.

Today, I'm committed to using my knowledge and experience to make a lasting impact in the world. The experience and knowledge I've gained has even led me to pursue a Ph.D. in sustainability to apply my passion to help businesses contribute positively to society and the environment. It's been an incredible journey of discovery, and I'm excited to continue making a difference with IMA by my side.

Anum Zahra, CMA, is a Ph.D. candidate at Taylor's University in Malaysia and a member of IMA's Dubai Chapter. You can reach her at anum.zahra75@gmail.com.