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Disruption and the Cash Conversion Cycle

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Barbenheimer Meets Business Strategy

The hugely popular *Barbie* and *Oppenheimer* films provide key lessons for accounting and finance professionals.

By Richard T. Brady, CMA, CGFM, CDFM

In the realm of entertainment, movies often have served as more than just a source of amusement. They also offer valuable insights into various aspects of life, including business strategy. Two such films that provide intriguing lessons in this regard are collectively known as “Barbenheimer.” *Barbie*, directed by Greta Gerwig, and *Oppenheimer*, directed by Christopher Nolan, although seemingly disparate in subject matter, share common threads that can impart significant lessons for accounting and finance professionals.

The *Barbie* movie, primarily associated with the iconic doll, goes beyond its playful exterior to deliver a message about adaptability and brand evolution. Just as the Barbie doll has evolved over the decades to cater to changing tastes and societal norms, businesses must also possess the ability to adapt to shifting market dynamics. In a rapidly changing business landscape, embracing innovation and diversification becomes essential for sustained success. Barbie showcases the importance of identifying opportunities to reinvigorate a brand and appeal to new generations while maintaining core values.

Furthermore, *Barbie* underscores the significance of effective marketing and brand storytelling. The doll's enduring popularity is largely attributed to the compelling narratives that accompany each iteration. In the business world, the ability to tell a captivating story around a product or service can forge a strong emotional connection with customers, leading to brand loyalty and increased customer engagement.

Seemingly at the other extreme, *Oppenheimer*, which depicts the life and work of J. Robert Oppenheimer, sheds light on strategic leadership and ethical decision making. Oppenheimer's central role in the development of the atomic bomb illustrates the complex interplay between innovation, ethics, and societal responsibility. Business leaders can draw parallels from Oppenheimer's challenges in navigating moral dilemmas and ensuring that the long-term impact of their decisions aligns with broader ethical standards.

Oppenheimer also emphasizes the significance of collaboration and cross-functional teamwork in achieving ambitious goals. The Manhattan Project's success was a result of interdisciplinary collaboration, bringing together scientists, engineers, and military personnel. In the business realm, fostering a culture of collaboration and synergy across departments can lead to groundbreaking innovations and a competitive edge.

Finally, both movies highlight the importance of calculated risk taking. Barbie's brand evolution and Oppenheimer's groundbreaking scientific pursuits involved inherent risks. Successful business strategies often necessitate stepping outside of comfort zones, embracing uncertainty, and making calculated decisions based on thorough analysis. The movies serve as a reminder that strategic risk taking can lead to remarkable outcomes.

Where does management accounting fit into all of this? Accounting and finance professionals play a crucial role in assessing risk, developing strategy, and aiding decision making within organizations. They can employ various techniques, such as risk analysis, sensitivity analysis, and scenario planning, to identify potential vulnerabilities and their potential impacts. By providing accurate financial data and insights, management accountants enable informed choices, helping businesses allocate resources effectively, mitigate potential pitfalls, and seize opportunities. Their expertise empowers strategic decisions that align with an organization's objectives and enhance overall performance.

From adaptability and brand evolution to marketing storytelling, ethical leadership, collaboration, risk taking, and globalization, *Barbie* and *Oppenheimer* touch on key principles that align with the world of business. I encourage you to consider how you can draw inspiration from these movies to develop strategies that lead to sustainable success, innovation, and positive societal impact.

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.

Carl Menconi Case Writing Competition

Position yourself as a thought leader—submit an ethics case to the Carl Menconi Case Writing Competition by January 19, 2024.

By Daniel Butcher

IMA® (Institute of Management Accountants) is now accepting entries for the annual Carl Menconi Ethics Case Writing Competition. Don't wait to start working on your submission because the deadline to submit an entry is January 19, 2024.

The winning case will be selected by IMA's Committee on Ethics and featured in *Strategic Finance*. The case author or team of coauthors will be recognized at the IMA 2024 Accounting & Finance Conference (IMA24), which will be held June 9-12, 2024, at the JW Marriott San Antonio Hill Country Resort & Spa in Texas. Winners will also get one free conference registration and a $500 prize. Additionally, winners will have the opportunity to adapt their article into a slideshow and present it in an IMA Faculty Friday webcast.

The competition works to develop and distribute teaching cases focused on business ethics with a specific application to management accounting and finance issues. It's open to accounting and finance practitioners and academics, as well as students. Joint submissions from more than one contributor are encouraged.

Your submission must reference the *IMA Statement of Ethical Professional Practice*. Learn more about the competition and submission guidelines.

This annual program is named in memory of Carl Menconi, who held various leadership positions within IMA for many years, including serving as the chair of IMA's Committee on Ethics. He also taught part-time at his alma mater, Northern Illinois University.

The 2023 winner is When Change Isn't So Good: New Management Brings Ethical Dilemmas by Dawn Schwartz, DBA, CMA, CPA, CFE.

The 2022 winner was Ethics and Controls at Accountable Coffee Co. by Justin Stearns, Ph.D., CMA, CPA; Michael Fore, J.D.; and Sarah Feltus, Ph.D., CPA.

The 2021 winner was Disclosure Strategy: A Case of Ethics in Financial Reporting by Thomas D'Angelo, DPS, CMA, CFM, and Marco Lam, Ph.D., CMA, CPA, CGFM.

The 2020 winner was A Painful Dilemma at Southwest Hospice by Wendy J. Bailey, Ph.D., and Robert Ewing, Ph.D., CMA, CPA.

The 2019 winner was Bexley Box Company by Susan F. Weiss, Ph.D., CMA, CFM, CPA, CGMA.

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.

Welcome, New CMAs: July 2023

957 IMA members became CMAs between July 1 and July 31, 2023.

By Ella Suponitskiy, CMA, CPA, CAE

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

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Yuanyuan Zhao
Zihui Zhao
Chaoyue Zheng
Mengjiao Zheng
Ruqi Zheng
Yanglin Zheng
Yawen Zheng

Zuxin Zheng
Li Zhong
Zhe Zhong
Aihong Zhou
Binru Zhou
Fanbing Zhou
Huiling Zhou
Jie Zhou
Junji Zhou
Lian Zhou
Qi Zhou
Ruiyang Zhou
Shuang Zhou
Shuyu Zhou
Tao Zhou
Xiaohui Zhou
Xiaoyan Zhou
Xinyi Zhou
Yanju Zhou
Ying Zhou
Jiawen Zhu
Jundong Zhu
Luhong Zhu
Mengru Zhu
Shiyu Zhu
Siyang Zhu
Wenjing Zhu
Wenjuan Zhu
Xiaoshuai Zhu
Xingyu Zhu
Yanqing Zhu
Yao Zhu
Yingling Zhu
Zhenyu Zhu
Zheyi Zhu
Peyton Zivkovich
Yueyuan Zou

The Board of Directors Role: A Primer

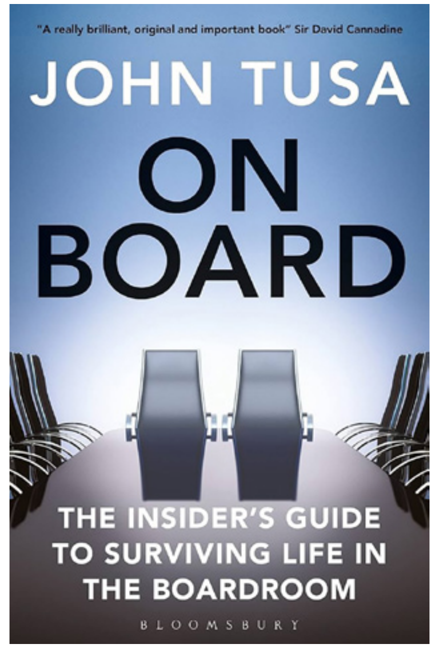
It's crucial for board members to understand their role and responsibilities in the organization and governance best practices.

By Colleen Lucero, CMA

In his book *On Board: The Insider's Guide to Surviving Life in the Boardroom*, John Tusa, an arts administrator and radio and television journalist, retells personal stories along with his colleagues' accounts of having served on American as well as British and other European companies' boards of directors. The book provides helpful insights into what being a board member actually involves and the larger question of defining the role and its responsibilities.

The human complexities within board interactions make the subject of board governance a difficult subject to teach. There's no single model or formula for achieving success and personal and professional satisfaction from serving on a board. Tusa relays his experiences in an entertaining storytelling tone. He includes a helpful section with reflections on key lessons learned both at the conclusion of each chapter and at the end of the book.

Understanding exactly what governance is and board members' proper role in the organization are the themes underpinning the book. Tusa demonstrates that there's no meaningful difference between governance on a corporate board vs. an arts board. He notes that effective governance has more to do with understanding how humans think and behave rather than strictly employing a rigid management theory.



Board members are often faced with reconciling these four sets of factors: responsibility and power, accountability and interference, support and complacency, and compliance and speculation. The board chair, for example, is ultimately accountable for the organization, but they shouldn't interfere with how it's managed in any way, as that's the C-suite's job. The relationship between the chair and the CEO and CFO is foundational and vital for this reason. How this relationship is managed can often determine the success or failure of the board and the management team's ability to accomplish the organization's strategic aims.

The importance of collecting and sharing information is also a notable topic that surfaces in Tusa's recounting of his board experiences. In some cases, information was used as a political smoke screen when presented to the board. Tusa emphasizes that "the quantity and detail of papers set before the governing body should facilitate effective supervision. Sheer volume of papers should not be used to obstruct and frustrate. Too much information is almost worse than too little." With so much information at our fingertips in this Big Data environment, this is an important point to remember. Whether serving on the board or working on the management team, it's a vital task for accountants and finance professionals to ask incisive questions and relentlessly promote the transparency of information, as well as ensure its veracity.

On Board is a useful read that would assist any management accountant to better understand and meet the demands of board leadership. It also provides great insight into the values that will likely lead to a much more successful and fulfilling experience when serving on a board.

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SECURE 2.0 and Individual Taxpayers

The SECURE 2.0 Act of 2022 introduces and modifies tax laws for taxpayers to encourage increased retirement investment.

By Yamini Rege and Anthony P. Curatola, Ph.D.

The Setting Every Community Up for Retirement Enhancement (SECURE) 2.0 Act of 2022 was signed into law on December 29, 2022, and made several modifications to the retirement tax provisions for both businesses and taxpayers. But not all the changes are immediately available; the effective date for some of the tax sections is 2024 and for others it's later years. Accountants must appreciate the modifications for the current and forthcoming tax years so that taxpayers are eligible to take advantage of them.

Saver's Match

Internal Revenue Code (IRC) §25B was introduced as part of the Economic Growth and Tax Relief Reconciliation Act of 2001. The intent of introducing the saver's match was to enhance the ability of low- and middle-income taxpayers to save for retirement by providing a 50%, 20%, or 10% tax credit depending on the taxpayer's filing status and adjusted gross income (AGI). Section 103 of SECURE 2.0 modifies the saver's match tax provision by providing a 50% tax credit depending on the taxpayer's filing status and AGI. The modification, however, doesn't take effect until 2027.

The matched amount is no longer a tax credit but rather a contribution to the taxpayer's individual retirement account (IRA) or retirement plan. The benefit is to increase the taxpayer's retirement savings, but it may no longer enhance the ability of low- and middle-income taxpayers to save for retirement.

Catch-up Contributions

SECURE 2.0 makes two significant changes to the catch-up contribution tax provision. Act §108 introduces indexing to the IRA catch-up contribution provision for taxpayers aged 50 and older beginning in 2024. Although this catch-up provision of $1,000 is significantly lower than the catch-up amounts for SIMPLE (Savings Incentive Match PLan for Employees) and non-SIMPLE retirement plans, it will allow individuals with IRAs to make small additions to their IRAs.

Act §109 introduces a new higher catch-up option for taxpayers who are aged 60 to 63. Beginning in 2025, the higher catch-up contribution is 50% more than the standard catch-up limit for SIMPLE and non-SIMPLE plans. For example, the catch-up limit for a non-SIMPLE plan in 2023 is $7,500 and for the SIMPLE plans it's $3,500, which means the higher limit for the 60-63 group would have been $11,250 (i.e., 150% of $7,500) and $5,250 (i.e., 150% of $3,500) if this higher limit were available in 2023.

Required Minimum Distributions (RMD)

Previously, under the SECURE Act of 2019, a taxpayer needed to take a minimum distribution from their retirement plans beginning in the year that they reached age 72.

SECURE 2.0 §107 increases the age to 73 beginning with tax year 2023, which means they can delay taking their first RMD until April 1, 2024. But the second RMD must be taken by December 31, 2024; hence, it might be wiser to take the first RMD by December 31, 2023, and avoid two RMDs in 2024. SECURE 2.0 further increases the RMD age to 75 beginning in tax year 2033.

Qualified Longevity Annuity Contract (QLAC)

Under the rules preceding SECURE 2.0, an individual could partition their retirement plan by purchasing a QLAC within the retirement plan. The benefit of this purchase is that the distribution from the QLAC is delayed until the individual reaches age 85 instead of the RMD age. The spreading out of the distribution amount from one's retirement plan would lower the individual's taxable income and possibly lower their Medicare Part B premiums. The QLAC is limited to the lesser of $145,000 (indexed for inflation) in 2022 or 25% of the retirement account's balance.

Act §202 significantly modifies these rules by increasing the limit to $200,000 (indexed for inflation) beginning with the enactment of SECURE 2.0 (December 29, 2022) and repealing the 25% contribution limits. In addition, the QLAC is now permitted to include spousal survival rights.

Exceptions to the Early Distribution Penalty

To discourage individuals from taking distributions from their IRAs and retirement plans, Act §72(t) imposes a 10% early distribution tax on distributions that don't satisfy one of the exceptions such as being over 59-and-a-half, disabled, and so forth. SECURE 2.0 introduces several new exceptions to this early distribution penalty.

Act §314 allows domestic abuse survivors to withdraw up to the lesser of $10,000 or 50% of their account's balance after 2023 without incurring the 10% penalty. Yet the individual is still required to include the distribution in taxable income. Even more significant is that the individual can repay the withdrawn amount over three years and recover the taxes paid on the withdrawn money. Treasury, obviously, will need to issue regulations on this exception and its repayment procedure.

Act §326 allows an individual who's certified by a physician as terminally ill to withdraw their retirement savings after the enactment date (December 29, 2022) without incurring the 10% penalty. The distribution amount, however, is included in taxable income. The term "terminally ill" is defined in IRC §101(g)(4)(A) to mean an illness or physical condition that can reasonably be expected to result in death in 24 months or fewer after the date of the certification. For this provision, 84 months is substituted for 24 months. In addition, the amount distributed may be repaid within three years in the same manner as given in the repayment rules for a qualified birth or adoption (IRC §72(t)(2)(H)(v)(I)).

Act §115 provides an exception to the 10% penalty for a distribution used for emergency expenses. An individual can take only one distribution per year up to $1,000 and can repay the amount within three years. Once an emergency distribution is taken, another one can't be taken during the three-year repayment period unless the withdrawn amount has been repaid. An individual can take advantage of an emergency distribution beginning in 2024.

Although the expressed intent of the SECURE 2.0 Act is to encourage individuals to save for retirement, several of these modifications seem to encourage individuals to treat their retirement plans as savings accounts for a rainy day and not for their retirement years.

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Future Accountants Need Top-Notch Ethics Education

Accounting professors Chevonne Alston and Di Wu stress the importance of grounding lessons on ethical principles in actual cases.

By Chevonne Alston, Ph.D., CPA, CFE, and Di Wu, Ph.D., CMA, CPA

Ethics is a very important subject in accounting and finance education. Students should be exposed to accounting ethics issues regularly from an early stage, but cultivating ethical reasoning skills in students can be challenging. The following strategies can be particularly helpful and effective.

1. When teaching accounting ethics or auditing classes, assign students to share a weekly story, news article, or case study about an accounting ethics dilemma or an instance of fraud that they can find from sources such as news coverage from a website or TV program, documentaries, *The Wall Street Journal*, *The Financial Times*, or a local newspaper. This approach helps students connect with real-life business cases, fostering motivation and engagement in the development of awareness and ethical reasoning skills.

2. Integrate accounting ethics questions into class projects whenever possible, even in technical accounting subjects, such as financial, managerial, and tax accounting. By demonstrating the connection between accounting theories, quantitative methods, and ethical considerations in practical scenarios, students gain a deeper understanding of how ethics is intertwined with their technical knowledge in a practical way.

3. Adopt open-ended questions or role-play simulations in accounting ethics topics. Open-ended questions allow students to explore ethical considerations from different perspectives through discussions and conversations. Role-play simulations engage students in applying ethical reasoning skills in realistic scenarios.

4. Evaluate the effectiveness and efficiency of professors' teaching strategies. Pre- and post-assessments of student skill development in ethical reasoning can provide valuable insights for faculty members teaching ethics. Using pre- and post-assessments is of great importance for faculty to identify the methods, student engagement techniques, and instructional materials that have the most impact on student knowledge and skill development in ethics subjects.

Inside and outside of class, engagement is essential to cultivate a learning environment where students retain key ethics skills and information. Storytelling is an art form used in various disciplines that's praised for increasing student performance and retention. Frequently, this is seamless with the integration of case studies with ethical components into the classroom. Case studies that tell stories and discuss real-world scandals offer an opportunity for students to examine and explore accounting and finance issues as they see them relayed with a business segment or industry vertical familiar to many students. This helps to take relevant topics and key concepts discussed in class beyond any given textbook with application to real-world business environments.

Professors always let students know that accounting/finance is the language of business. While it might be viewed as a foreign language initially, using real-world case studies incorporates a valuable application of ethical principles and standards that's relatable and helpful as students enhance their critical-thinking skills in preparation for future business situations and finance function processes.

Connecting Academia to Practitioners

Real-world case studies are a phenomenal tool that connects the dots between what's being discussed, researched, and debated within academia and what's happening in the private sector of the business world. The case study model offers students an opportunity to develop their analytical skills while enhancing their writing skills through the use of a real-world business setting as a prompt for ethical analysis. This type of classroom activity or homework assignment has the potential to improve students' communication skills while working in a team environment.

In addition to real-world case studies, "accounting and finance in the news" links are now being incorporated by many textbook authors and publishers in their support materials. This model offers the ability to discuss different news articles in class, which many students find compelling. In our classes, we incorporate an "accounting in the news" assignment where each student selects a recent article related to a concept covered in class, which often ties into ethics. Their classmates can comment on the discussion board, which becomes another chance to connect the dots between what's discussed in the textbook and what's happening in the profession. This helps to engage students through conversations on topics such as professional ethics within the classroom and create a sense of community.

Overcoming Teaching Challenges

There are several typical challenges in teaching ethics. Students in any class bring with them a wealth of diverse backgrounds, life experiences, and interests, which is highly valued by professors. On the other hand, the development of students' values can vary greatly across a wide spectrum of cultures and backgrounds, which brings a challenge to achieving learning objectives. One way for professors to overcome it is by using various cases and scenarios that involve ethical issues in instruction. That can create a dynamic learning environment that resonates with students' diverse perspectives. To maximize the effectiveness of these cases, professors may facilitate discussions and provide guidance throughout the learning process. Rather than focusing on standard answers, the goal is to promote critical thinking and encourage empathy and understanding when studying examples of real-world ethical dilemmas.

Another common challenge in teaching ethics is that students may feel uncomfortable or unsafe expressing their opinions when participating in discussions, particularly on topics or cases involving ethical controversies. To overcome this, professors can first focus on the establishment of trusting relationships with their students. Hence, professors may create a supportive and collaborative environment where students feel supported and valued, which in turn encourages their active engagement in classroom discussions. Additionally, professors should work with students to create a judgment-free safe zone, allowing everyone to freely express their opinions without fear of criticism or belittlement, which fosters open dialogue. Faculty members must ensure that students' diverse perspectives are respected and their freedom of speech is protected.

Accounting professors may not necessarily come from a philosophy background and may not possess comprehensive knowledge of ethics. It can be challenging to facilitate discussions on ethics-related issues due to the diverse range of questions and perspectives. A way to overcome this is by always being well-prepared for discussions of ethics and anticipating potential questions. Acknowledge in class that you strive to provide guidance and answers, but there may be certain questions for which you don't have immediate solutions. Assure students that you'll follow up with additional information later; you can even occasionally invite philosophy experts and practitioners whose ethics knowledge and skills complement yours to present to your classes as guest speakers. Offering alternative viewpoints, insights, and experiences will likely enrich and broaden students' understanding of ethics.

Further Academic Research Potential

The areas related to ethics that remain ripe for further academic research include pressure to manipulate figures, sins of omission, information security, confidentiality issues, and whistleblowing. While this isn't an exhaustive list, it's broad enough to capture key topics that continue to plague the accounting and finance profession.

Accountants are considered trusted advisors within the business community, and we're expected to approach each interaction and situation professionally with honesty, integrity, competency, independence, and objectivity. While these hallmarks of the accounting and finance profession remain the same, it's vital that we teach students about various ethical challenges.

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Supporting LGBTQIA Staff in the Workplace

Voluntary self-identification programs can advance a company's diversity, equity, and inclusion efforts.

By T. David Colgren

According to PwC, with up to 85% of a company's costs tied up in people, stakeholders are looking to allocate investment dollars to better understand how management sees the company's strategic and operational requirements. What is clear is that human capital management, which includes diversity, equity, and inclusion (DE&I) efforts, better increases productivity and thus profitability of a company and its employees. The more investment a company makes in its employees, the better chances of its productivity and success.

Part of effective human capital management is advocating for the inclusion of lesbian, gay, bisexual, transgender, queer, intersex, and asexual (LGBTQIA) employees. An organization's investment in all of its employees really matters—and critical to strengthening a company's culture and building resilience in an ever-changing landscape is ensuring the sustainability of a safe culture for LGBTQIA persons.

There's growing recognition of the importance of a safe culture competency in the workplace, both from an employee perspective and at the organizational level, to achieve better DE&I. Some organizations have established a safe cultural competency via legislation/mandates, accreditation standards, and service training programs. A safe cultural competency is ultimately a set of diverse behaviors, attitudes, and policies that can come together inside an organization to continuously work in cross-cultural situations and a methodology to achieve them to support all employees. According to a U.S. Chamber of Commerce report, 76% of companies that instituted inclusive practices saw increased employee engagement and a 53% improvement in employee retention.

To build this identified safe culture, it's imperative that organizations use voluntary self-identification programs (VSIPs) with internal controls to help measure their progress toward diversity goals during and after the talent acquisition process. Without effective VSIPs, companies can face real challenges related to economic uncertainty, employee burnout, and disconnection in remote or hybrid work environments.

The lack of these VSIPs is taking a toll. There's currently no LGBTQIA identification benchmark in the workplace. Today, an estimated 4%-10% of the U.S. population—11 million persons—are LGBTQIA, but 88% who are employed aren't directly identified in the workplace. According to a recent study from the UCLA Williams Institute, 62% of LGBT are people of color and under 34 years old.

In addition, based on a study of more than 3,000 current and former U.S. accounting professionals from underrepresented backgrounds by IMA® (Institute of Management Accountants), the California Society of Certified Public Accountants (CalCPA), and the International Federation of Accountants (IFAC), about one in five LGBTQIA respondents are leaving the accounting profession due to inequitable and exclusive experiences.

Companies need to establish critical protocols for LGBTQIA employee voluntary self-identification in the workplace in order to help recruit, retain, and better connect to LGBTQIA communities in the United States.

DE&I Solutions

If companies want to move forward with inclusion of LGBTQIA persons, they need to create a VSIP infrastructure so that these employees can begin to be counted in company disclosures like the U.S. Equal Employment Opportunity Commission (EEOC) EEO-1 Component 1 report, which is used for better human capital impact investing. Consequently, management accountants can play an important role in helping companies create VSIPs and support disclosure reports, as they do with financial statements, by including management to better connect LGBTQIA employees to allies and mentors for a more diverse workplace. As a direct result, VSIPs can expand dialogue at all management levels (including LGBTQIA mentors and allies) around diversity goals and help create programs that support diverse employees by connecting to underrepresented groups. Doing so keeps and attracts current and future LGBTQIA employees by measuring through a VSIP for better DE&I management.

The EEO-1 report provides information on race and ethnicity linked to various job categories but doesn't include employee information related to LGBTQIA, disabled, and veteran employees. It can, however, be used as a best practice as a possible human capital public disclosure framework that may be mandated by the U.S. Securities & Exchange Commission and the U.S. federal government (the largest employer in the country). To do so, a company must set up a VSIP to connect LGBTQIA persons in the workplace to account for better human capital management and enhanced value.

Another way to advance DE&I efforts is to expand LGBTQIA board membership in companies. The Association of LGBTQ+ Corporate Directors estimates that on average, 0.6% of all seats of publicly listed companies are occupied by voluntary self-identified LGBTQIA persons. With half a percentage of all seats, LGBTQIA people are the most underrepresented group on U.S. boards, according to ISS Corporate Solutions, Inc. and Spencer Stuart. Out Leadership reported that, "Few, if any, *Fortune* 500 boards ask for LGBTQ+ metrics in their annual Director & Officer Questionnaire, and less than 0.4% of directors in the *Fortune* 500 are LGBTQ+."

By having LGBTQIA board representation, top management is perceived to be supportive of LGBTQIA efforts, including VSIPs, and it indicates the company has mentors and allies for LGBTQIA persons inside the organization. By having mentors and allies, connections and networking can help to increase LGBTQIA employee retention.

Executive Order

In January 2023, the White House released two reports required by the June 2022 Executive Order 14075: Advancing Equality for Lesbian, Gay, Bisexual, Transgender, Queer, and Intersex Individuals: *Federal Evidence Agenda on LGBTQI+Equity* and *Recommendations on the Best Practices for the Collection of Sexual Orientation and Gender Identity Data on Federal Statistical Surveys*. Critical to these efforts is the establishment of ensuring privacy and confidentiality that includes safeguarding the privacy of employees who choose to voluntarily self-identify as LGBTQIA.

Within the *Federal Evidence Agenda on LGBTQI+ Equity* report are the following critical elements needed for data information guidelines collecting LGBTQIA, disabled, and veteran sexual orientation and gender identity (SOGI) data on company forms and other administrative contexts:

- Ensure relevant data is collected and privacy protections are properly applied (ensure LGBTQIA self-voluntary identification isn't used against them in any adverse manner);
- Prevent adverse legal actions against using the data against intent for VSIP purposes;
- Make responses voluntary;
- Rely on self-attestation; and
- Be consistent and intentional in efforts to collect and house such information within said entity.

The Biden administration has issued recommendations to agencies on collecting self-reported statistics on sexual orientation and gender identity under the 2022 executive order. The *Federal Evidence Agenda on LGBTQI+ Equity* report lists considerations for including such items on surveys, collecting and reporting the information, and safeguarding the data. Once an LGBTQIA employee has voluntarily made a disclosure to human resources or the appropriate office within a company, the most successful policies provide for ongoing communication between the employee and the employer. The executive order sets a "floor" in terms of protection against discrimination on the basis of sexual orientation or gender identity.

Once a VSIP has been created, organizations can then better develop mentorship and allyship programs that connect LGBTQIA employees with senior leaders or experienced professionals who can provide guidance and support. Companies can foster allyship within the organization by encouraging employees to be supportive advocates for LGBTQIA colleagues and ultimately connect to outside LGBTQIA communities for enhanced business development opportunities.

By monitoring and measuring LGBTQIA identification in reports like EEO-1, organized protocols can be used to track and measure progress. Collecting and analyzing DE&I data on the representation, engagement, and experiences of LGBTQIA employees can better identify areas for improvement and inform human capital decision-making processes. Overall, collaboration with companies and government agencies can better engage with industry groups, professional associations, and government agencies that promote LGBTQIA inclusion in the workplace.

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STRATEGIC FINANCE

The Best Leaders Learn from Others' Experiences

Leading by example means preparing, working harder than anyone around you, and demonstrating resilience in the face of setbacks.

By Bud Kulesza, CMA, CFM

Experience is said to be the best way to learn, but it doesn't have to be your own experience. By leveraging the experience of others and seeking out learning and continuing professional education opportunities, you can gain knowledge, skills, and abilities that will help you to outperform your peers who take a passive approach to upskilling and professional development.

Observing or listening to the experiences of others, asking them questions, and leveraging the lessons they learned have helped me to become a more effective and successful finance leader. While technical skills are a requirement, soft skills such as an effective leadership style and persuasiveness play an even more significant role in our success. There's a basic approach that can have a positive impact on career success and enable us to more effectively use all the management tools in our toolbox.

After many years of experience in leadership roles observing and managing others, I've come to appreciate the benefits of a simple, consistent, and disciplined approach in all we do and its subsequent impact on professional development. Success is often derailed when we lack discipline or perspective and disregard simple elements in all we do as finance leaders. When I only partially commit to following best practices, I don't achieve the same level of results as when I do follow them. The three steps are preparation, perspiration, and perseverance. They're simple, but they require discipline to implement.

Preparation

Intuition and gut feelings are important, but we still need to be disciplined enough to prepare ourselves properly to achieve a level of comfort with the facts, context, and actions necessary to address issues successfully. That means delving below the surface to attain a deeper understanding of a situation and the people involved in it and acquire additional background information to better grasp the nuance and context of the issues in question.

Whether making a presentation or taking part in a meeting, individuals should never be caught unprepared. Don't wait until just before a meeting or event to review the material, as you probably won't have sufficient time to master it and put your best foot forward. Take time to prepare for a discussion or presentation well in advance so you can add the most value. Your review of the subject matter should go beyond just the material being presented. As you prepare, ask yourself questions that can only be answered by going beyond the basics. Take the time you need to find those answers. Prepare for a broader discussion of the material being discussed by broadening your perspective and deepening your knowledge.

I always prepare for questions that might go beyond the distributed material. This approach establishes me as more knowledgeable and consequently a person who's often asked for their opinion, rather than having to find an opportunity to share my perspective. I listen to others to gain an understanding of different perspectives rather than focusing on my response to their comments. But if I'm asked for information that's beyond my knowledge base, I'm never afraid to admit that I don't know. When that occurs, I fill that knowledge gap.

Being proactive and prepared is a differentiator that sets you apart as a respected leader. This diligent approach will garner you the respect and support of your colleagues and the recognition of your superiors. My rule of thumb is once you think you're prepared, go over it one more time for good measure. Practice makes progress, as they say.

Perspiration

Since being a successful leader requires more than intuitive knowledge, we all need to devote the effort to make certain that we perform our duties properly. I call this step "perspiration" because it takes work and effort to make certain that you're intimately familiar with all the material at hand, and that often means investing the "sweat equity" to master everything you need to know to lead a team, department, or organization. When managers don't make sufficient effort, they can get themselves into trouble by assuming they know more about the issues at hand because of their closeness to the subject, either through position, experience, or education.

I often review material at least two or three times to make certain that I'm confident in my understanding of the relevant facts of a situation, issue, decision, or undertaking. I do this to reaffirm my views and understand different perspectives.

Lead by example. Work harder than you expect the people who report to you to work. If you're not sweating, then you probably aren't working hard enough.

Perseverance

Even the best leaders experience setbacks, disappointments, and even failures. When the going gets tough, perseverance comes into play. Successful leaders seek an understanding of all positions, especially during a challenging period or crisis. They make certain to consider others' knowledge and opinions to ensure that the best possible decision is made, not just to reaffirm their own position. They seek various perspectives, so they see all sides of an issue.

Leaders persevere in the face of dissent and obstacles to seek a greater degree of understanding, making certain that even if all parties can't agree with the decision made, they can at least follow the rationale used to make it. Leadership isn't about building consensus; it's about having conviction and convincing the team to support the decision. Sometimes the best decisions include compromise, while other times they don't. In either case, successful leaders persevere during tough times to bring closure to the decision-making process so the organization can make progress.

Leaders need to persevere in the face of challenges to bring focus and unity to the team and boost morale when the organization experiences difficulties. Successful people never give up when things don't go according to plan. One of the best analogies for perseverance over time is the Grand Canyon in the United States, which started out as a small stream, became a river that carved out a gulley, turned into a deeper ravine, and over time became a massive canyon. It symbolizes how people tasked with a pursuit that requires continuous efforts over time can overcome all obstacles and achieve their goal through perseverance.

If you're well prepared and you invest the necessary time and effort to garner deep knowledge and varied experience and have the tenacity to stick with the task at hand regardless of headwinds, over time you'll achieve sustainable success and make a positive impact on your career, your employer, and the profession. Preparation, perspiration, and perseverance are key elements of my simple yet sometimes elusive approach to being a successful leader.

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Leading the Way by Prioritizing DE&I

Bonnie Chan, CFO of H+K International, and Dee Merriwether, CFO of Grainger, stress the importance of DE&I best practices.

By Daniel Butcher

A recent survey by Willis Towers Watson found that 70% of employers are placing a broader emphasis on diversity, equity, and inclusion (DE&I) strategies as a recruitment and retention tool, but there's more work to do. A report on DE&I in the accounting and finance profession by IMA® (Institute of Management Accountants), California Society of CPAs (CalCPA), and the International Federation of Accountants (IFAC), which surveyed more than 8,500 finance and accounting professionals globally, found some startling statistics: Fewer than 60% of respondents of all genders found the profession to be either equitable or inclusive, and 42% of female respondents have left a company due to a perceived lack of equitable treatment or inclusion.

In a conversation with *Strategic Finance*, **Bonnie Chan**, CFO, COO, and board of directors member at **H+K International**, and **Deidra "Dee" Merriwether**, senior vice president and CFO of **W.W. Grainger, Inc.**, talk about the benefits of prioritizing DE&I initiatives and the perils of giving them short shrift.

SF: How can accounting/finance professionals contribute to their organization's DE&I initiatives and culture?

Merriwether: It's important for the finance profession. Like many, we have opportunities in the DE&I space. Fewer than one in five CFOs in the S&P 500 and Fortune 500 are female. As a profession, we've doubled that number over the last 10 years—that's good progress—but when you count CFOs with racial and ethnic diversity, the number turns to one in 10. Black CFOs increased from 12 to 20 from 2020 to 2021. That's 2.9% of 678 sitting CFOs. Meanwhile, Black Americans represent about 12% of the [U.S.] population.

Dee Merriwether

I'm one of the few Black female CFOs in the *Fortune* 500 today. Mathematically, we can't turn those statistics around unless everyone in the profession plays a role—men and women of every race and ethnicity. Every organization needs to make more meaningful progress to embrace inclusion.

SF: How can finance leaders promote advancement in the profession by women, people of color, and LBGTQIA populations?

Chan: At my company, I've been charged with the responsibility of driving the progress of our DE&I program. Some of our customers are well-known household names and therefore aligning our goals with our customers' goals on DE&I is very natural. As a result, not only does the senior leadership stand behind the initiatives, but our board of directors also looks for a clear plan to ensure success and periodic reporting to monitor the progress of our people strategy.

While buy-in and support from the top are there, our challenges rest with data collection due to decentralized operations across the globe, a lack of a single human resources information system, and inconsistent data definitions in various repositories. This is where finance professionals are well poised to bridge the gap and can truly add value. Unbiased objectivity and a methodical predisposition are ingredients of success when carrying out managerial accounting or similar work.

Additionally, corporate performance management doesn't need to stop with financial data. In fact, it's a competitive advantage when HR and governance [personnel] are served and supported by finance to measure status as an initial assessment; analyze the data to uncover insights, patterns, and trends; compare performance with benchmarks such as Equal Employment Opportunity Commission guidance or industry statistics; and present findings to senior management to drive actions. We have to have objective, unbiased measures to get into the plan-do-check-act cycle to drive continuous improvement if we want to see successful outcomes from our DE&I program.

Merriwether: The finance profession isn't where it needs to be. So often we approach DE&I issues like other business issues and wait for the business case before we take action. We don't need a business case for this work. It's clear there are opportunities—the population in the U.S. is more than 50% females, but the majority of our profession and the vast majority of senior roles are held by nondiverse males. As a profession, we should be willing to spend time investing in and developing all populations.

One area of focus for Grainger is addressing unconscious bias. In 2018, Grainger's Women's Business Resource Group launched unconscious bias training for the top female leaders at Grainger, and in 2019, we invited top male leaders to join the training and the conversation. Last year, all Grainger leaders and team members participated in a learning course about "Managing Unconscious Bias." The course helped us as individuals learn what unconscious bias is and how and why most people experience it in our day-to-day work and identify behaviors to better manage it. By the end of the year, people reported having more awareness of their biases and motivation to take action to reduce bias in the workplace. I'm confident this program's outcomes will help us on our journey to hire, retain, and develop the best talent.


Bonnie Chan

SF: How important is it for young people of diverse backgrounds to gain early exposure to what an accounting career is all about?

Chan: Progress has been made, yet more can be done. Foundational success has to start when young people are still in school. While on an advisory board for a university's business school, I witness how senior finance leaders can make a difference by bringing the younger generation along through speaker bureaus for classrooms, career days, work shadowing at offices by students, internship programs, career fairs, and mentoring.

SF: Do you see implementation of DE&I strategies as a way to combat the talent crisis?

Merriwether: DE&I initiatives can help companies tap into a wider pool of talent by intentionally recruiting from diverse sources and removing barriers that prevent certain groups from applying or being selected for jobs. For example, we focused on partnering with universities outside of the Midwest where we'd typically recruit from. I'm an alumnus of North Carolina A&T State University, where we continue to strengthen our employer brand and attract talent in a challenging market.

Chan: Most definitely! The framework of talent retention at my company consists of training, recognition, and rewards. When these three components are working hand in hand with each other, the circle becomes stronger and more difficult to break, hence creating a culture of success and inspiration.

We also have a culture club in each location that's sponsored by a senior executive but entirely run by employees. The club members have almost 100% discretion in determining and organizing related activities at a local level. This self-driven type of association gains more credibility than [mandates] pushed from the top.

SF: What are essential elements of a corporate DE&I program?

Merriwether: At Grainger, we think about DE&I at every stage of the team member—from recruiting to retaining to exiting. Many times, companies only think about when diverse candidates join the organization. If those candidates don't feel comfortable in the work environment, then they end up leaving. That isn't sustainable. You need a strong sense of psychological safety, trust, and respect, and an invitation to be authentic. This is why our DE&I strategy is intentionally connected with our talent strategy. We have core programs for every part of our talent strategy that cater to diverse talent. We still have more work to do, but I feel we're on the right track.

SF: How can professionals at companies faced with pressure to cut costs make the case to maintain the organization's financial commitment to DE&I even during tough times?

Chan: Instead of considering the spend on DE&I as a pure cost or burden to the organization, I see the smart spend as a competitive advantage and an investment. We all know happy employees are more productive and are less prone to burnout or job hopping. This is where financial accounting may not present the whole truth of opportunity cost. We simply can't underestimate the soft cost of recruiting and onboarding new employees, disruption to operations, and loss of continuity.

Merriwether: Leaders make key business decisions every day to achieve their objectives. I don't typically see business cases for all of those non-DE&I decisions and investments, so the call to question just the DE&I investments during tough times is odd to me. To be bold, the focus on improving DE&I in our workplaces and with our supplier partners is to ensure that our workplaces and relationships reflect society and to be more inclusive in our thinking, practices, actions, and how we invest.

To be inclusive doesn't necessarily mean that people need to spend more money but rather be more intentional about improving on their biases. Ask yourself when you're looking to hire for a role whether you've considered all available talent or are you just looking in the talent pools you have traditionally looked to? If you're about to award a contract to a supplier, have you been inclusive with building relationships with diverse and nondiverse potential suppliers? Build relationships early, because if you wait until the last step to look for diversity, it'll be too late—you may not know anyone, or they won't know you or enough about the opportunity to apply. So to answer your question plainly, no, I don't feel like tough times are a reason to diminish our focus on DE&I.

How Finance Leaders Can Help Their Organization Achieve DE&I Objectives

Grainger's Merriwether says, "CFOs and finance leaders should sponsor DE&I initiatives and get involved. Participate in your business resource groups. Be active in the recruitment, development, and sponsorship processes. Communicate with the organization constantly about the importance of achieving long-term objectives that support inclusion. And seek and listen to multiple points of view. Work with your organization's management team to ensure diverse voices are heard at all levels of the organization, including the board room.

"In early 2020, we began a program at Grainger called BeBrave conversations to support our inclusion journey and set us up to be more prepared during the social unrest that followed that year. BeBrave conversations create a safe space between leaders and their teams to have real conversations about identity and equality, with an initial focus on race, gender, age, and sexual orientation. We've heard positive feedback from team members who can share their own perspectives and backgrounds and seek different points of view."

SF: What's the best way to measure the success of an organization's DE&I efforts?

Merriwether: Our DE&I efforts are tied directly to our talent strategy, which is measured through a series of people analytics, such as performance management, turnover, talent acquisition and compensation data, and engagement results. We have a strong set of leading indicators that help us understand our progress vs. only focusing on lagging indicators such as representation.

SF: How can accounting/finance leaders become advocates for better reporting of DE&I metrics and benchmarks?

Chan: A few metrics can be helpful measuring the long-term success of DE&I initiatives—staff turnover, tenure retention, time gaps between leavers and new hires—but they need to be measured over a long period of time to remove outliers and to observe the trend. The efforts can be cumbersome, yet finance professionals are capable of streamlining the data collection, analysis, and reporting process for longer-term success.

Qualitative responses gathered from exit interviews can oftentimes offer insight, but there may not be a systematic way of cataloging the data. The partnership between CFO and CHRO [chief human resources officer] is important to create ongoing communication channels so that the insights and learnings are laddered up and shared. Particularly at budget time, the investments in people need to be reviewed with spend mix such as training, recognition, employee relations, etc., adjusted accordingly to enhance spend effectiveness.

Merriwether: Data transparency is crucial. Our DE&I data transparency journey has been ongoing, and we continue to make progress. In 2022, we focused on streamlining access to our data, and many of our teams are building relationships with diverse and nondiverse talent pipelines in the communities they reside in and that we serve.

SF: What are the risks to an organization's reputation of not prioritizing DE&I or not thoroughly disclosing its DE&I data/metrics?

Chan: We frequently hear "people are our assets," but actions speak louder than words. Both organizations and leaders are being judged on being authentic. Continuous improvement is fundamental to the long-term success of DE&I strategy.

Merriwether: There are long-term risks and costs to consider—reputational risk is a big one. The workforce of today is very focused on a company's mission, including all areas of ESG [environmental, social, and governance]. Those that aren't intentional about creating an inclusive environment for talent open themselves up to above-market people costs related to higher turnover and lower morale.

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FEATURE

Strong Team Identity and Internal Whistleblowing

Depending on certain circumstances and perceived justifiability, strong social identity can either aid or deter whistleblowers.

By Hui Xu, Ph.D.; Yuebing Liu, Ph.D.; and Zhenfeng Liu, Ph.D.

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Whistleblowers have traditionally been employees within an organization who lack the authority to stop fraudulent activities but choose to report them nonetheless. But in today's business environment, whistleblowers can also include individuals outside the organization, as functions like IT, human resources, and accounting are often outsourced.

As individuals and external parties gain access to sensitive information, they possess the ability to expose unethical or illegal activities through whistleblowing. This includes situations where buyers, suppliers, or business partners become aware of misconduct and choose to report such wrongdoing. Given that business partnerships rely on trust, any perceived breach of that trust may lead the affected party to blow the whistle. In addition, consumers may also have the potential to report wrongdoing, such as questioning sustainability claims or ethical production practices.

These external factors increase the need for businesses to establish and maintain a strong ethical control function, showcasing their commitment to addressing misconduct and meeting the expectations of investors, regulators, customers, and consumers.

Previous research indicates that the type of wrongdoing significantly influences an individual's decision to blow the whistle. For instance, misconduct involving physical harm, such as sexual assault, is more likely to be reported compared to misconduct involving economic or psychological harm, like discrimination. Furthermore, the severity of the fraud plays a role in the decision to blow the whistle. Instances of material financial reporting fraud are more likely to be reported than cases of immaterial fraud. Moreover, there's a perception that certain types of fraudulent activities are viewed as more severe. Accepting bribes or stealing company funds is viewed as more severe than position abuses, unfair advantages, or discrimination.

Factors of Whistleblowing

Fraud encompasses a broad range of actions, including financial reporting fraud, tax evasion, bribery, discrimination, sexual harassment, false advertising, pollution, occupational health and safety violations, unjust dismissal, mobbing, aggressive behavior, unjust career advancements, nepotism, and more (see Barbara Culiberg and Katarina Katja Mihelič, "The Evolution of Whistleblowing Studies: A Critical Review and Research Agenda," *Journal of Business Ethics*, 2017, pp. 787-803). To promote effective whistleblowing, practitioners must recognize the diverse nature of fraudulent activities and acknowledge the varying likelihood of their disclosure.

Other factors can also influence the decision to blow the whistle, including individual characteristics and situational factors, but the findings related to individual characteristics like gender, age, education, and pay are often inconclusive. Some studies suggest that men are more likely to report misconduct (see also Marcia P. Miceli and Janet P. Near, "Characteristics of organizational climate and perceived wrongdoing associated with whistle blowing decisions," *Personnel Psychology*, September 1985, pp. 525-544), while others indicate that women are more inclined to blow the whistle (see also Jessica R. Mesmer-Magnus and Chockalingam Viswesvaran, "Whistleblowing in Organizations: An Examination of Correlates of Whistleblowing Intentions, Actions, and Retaliation," *Journal of Business Ethics*, 2005, pp. 277-297). There are also studies that have found no significant relationship between gender and whistleblowing (see also Julia Zhang, Randy Chiu, and Liqun Wei, "Decision-Making Process of Internal Whistleblowing Behavior in China: Empirical Evidence and Implications," *Journal of Business Ethics*, April 2009, pp. 25-41).

On the other hand, situational factors have been found to have greater explanatory power and consistency. A robust ethical culture within an organization that promotes and supports whistleblowing can enhance the intention to report misconduct. Moreover, the broader national culture can also impact the inclination to blow the whistle. For instance, if the legal environment provides protections for whistleblowers, individuals may be more inclined to report wrongdoing.

When deciding whether to blow the whistle, employees also need to choose a reporting channel, which can be either internal or external. Internal whistleblowing involves reporting misconduct to individuals within the organization, usually through a confidential hotline or other designated channels. On the other hand, external whistleblowing entails reporting wrongdoing to entities outside of the organization, such as the media, governmental agencies, or professional organizations.

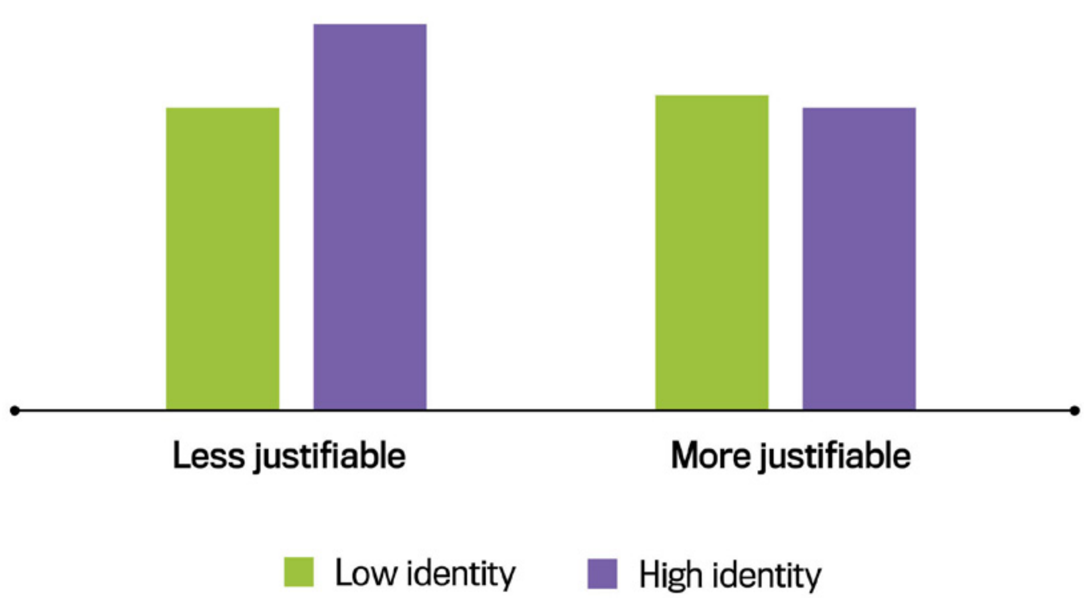
Internal whistleblowing hotlines play a crucial role in organizations' efforts to detect fraud. According to a survey conducted by the Association of Certified Fraud Examiners in 2022, employee tips accounted for 42% of fraud detections, making it the most common method for uncovering fraudulent activities. Other methods included internal audit (16%), management review (12%), document examination (6%), and accidents (5%). These findings underscore the significance of internal whistleblowing programs in identifying and addressing fraudulent behavior. The implementation of regulations such as the Dodd-Frank Wall Street Reform and Consumer Protection Act has further emphasized the importance of strengthening internal whistleblowing programs. These regulations have increased the pressure on organizations to enhance their internal reporting mechanisms in order to effectively address and remediate misconduct or fraudulent behavior. In the current regulatory environment, distinguishing between unethical conduct and unlawful behavior is often challenging. Therefore, organizations must take a proactive approach to identify and address misconduct to avoid potential investigations, fines, and reputational damage from regulatory bodies like the U.S. Securities & Exchange Commission (SEC) (see also Bill Libit, Todd Freier, and Walt Draney, Elements of an Effective Whistleblower Hotline).

Effect of Social Identity

While maintaining effective internal whistleblowing programs is vital, recent research has highlighted the significance of organizational context, particularly group identification, in influencing these programs. Internal whistleblowing often requires employees to report misconduct by their colleagues or teammates because they're most familiar with the behaviors of those they interact with regularly. This raises the question of whether factors related to group dynamics, such as identification with the group, impact an employee's willingness to blow the whistle. Understanding these dynamics can help organizations create a supportive environment that encourages reporting while addressing potential barriers to reporting within group settings.

In a recent study, Yuebing Liu and Hui Xu investigated the influence of social identity and the perceived justifiability of questionable behavior on individuals' willingness to blow the whistle ("The Effects of Social Identity and Justifiability of Questionable Behavior on Whistleblowing," *Journal of Forensic and Investigative Accounting Research*, July–December 2021, pp. 302–318). The study involved presenting two hypothetical business scenarios to a group of accounting students. In both scenarios, the focal person engaged in questionable practices to meet earnings targets: one by arbitrarily changing accounting estimates without a legitimate reason and the other by excessively producing products. The findings, presented in Figure 1, revealed intriguing insights. When the focal person arbitrarily changed accounting estimates to inflate earnings, the students were more

FIGURE 1: EARNINGS MANAGEMENT CASE FINDINGS

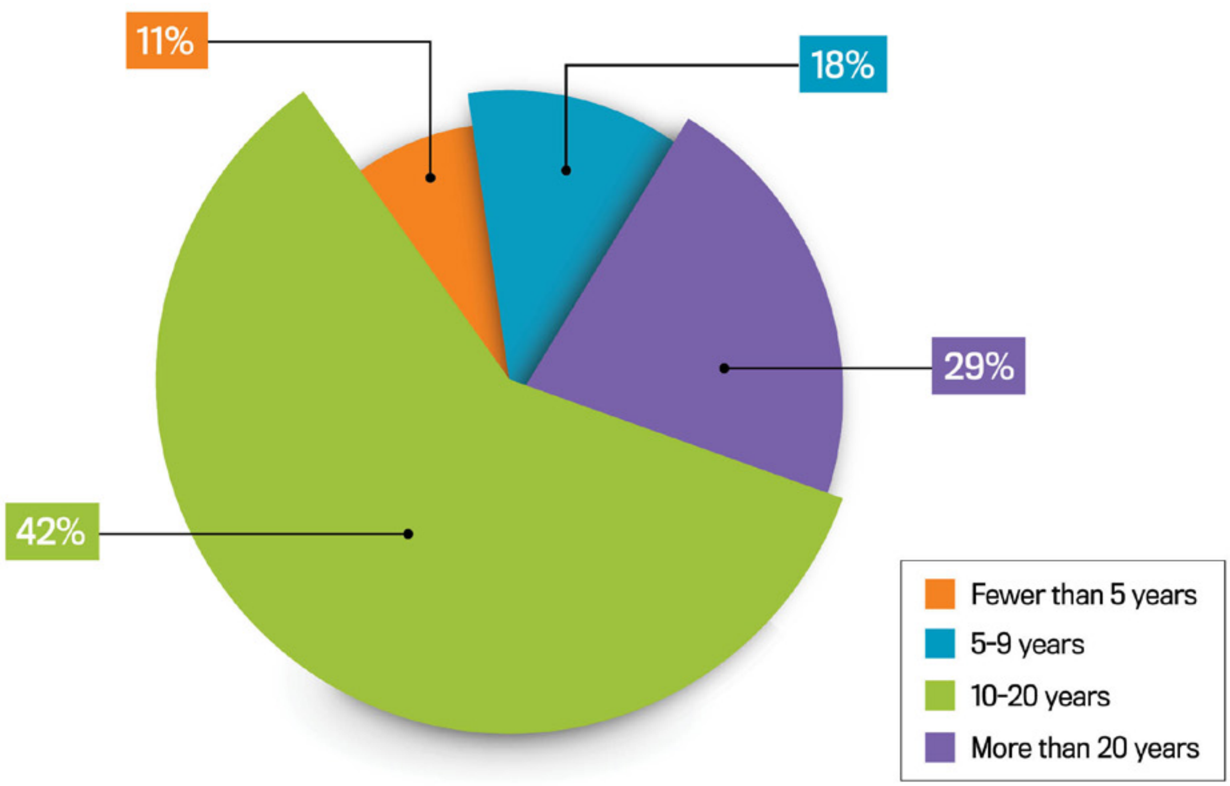


likely to report the misconduct if they shared the same social identity with the focal person. But when the focal person inflated reported earnings through overproduction, there was no significant difference in the likelihood to report the questionable behavior, regardless of social identity.

These results indicate that social identity can indeed influence the reporting of fraudulent activities, but it may not have the same impact when questionable behavior is perceived as somewhat justifiable. This study sheds light on the complex interplay between social identity, justifiability, and whistleblowing, highlighting the importance of considering these factors when designing interventions to encourage reporting and deter unethical behavior within organizations.

The authors further validated their initial findings through a second study involving experienced participants who were presented with potential scenarios of consumer data breaches. Figure 2 displays the distribution of participants' years of working experience, with a majority having more than 10 years of experience and approximately 29% having more than 20 years of experience.

FIGURE 2: PARTICIPANTS' YEARS OF WORKING EXPERIENCE

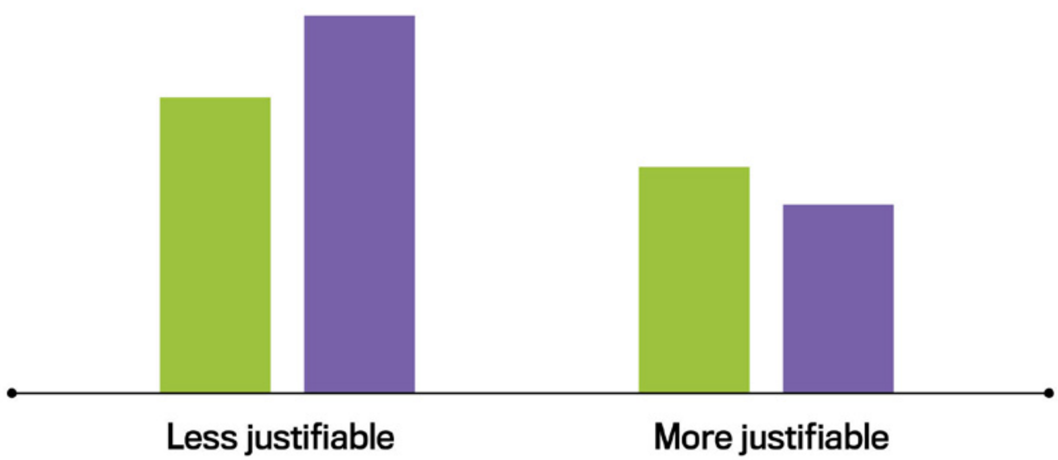


In one scenario, the vendor's credentials for the focal company were accidentally exposed, but the consumers' private information remained secure and wasn't accessed. In the other scenario, the consumers' private information was accessible due to a successful hack of the company's system. In both cases, the focal person took action to address the immediate security concern by removing the exposed account but didn't take additional measures to enhance the overall infrastructure security or report the incident to upper management. The behavior of the focal person in the former case can be seen as somewhat justifiable since the consumers' private information remained secure. But the behavior in the latter case, where the company's system was hacked, is more difficult to justify.

The results, depicted in Figure 3, mirror the findings of the first study. When the questionable act was less justifiable (i.e., the company's system was hacked, and consumer private information was accessible), the participants were more likely to report the incident if they shared the same social identity with the focal person. But when the questionable act was more justifiable (i.e., the vendor's credentials were accidentally exposed, but consumer private information remained secure), this tendency was either attenuated or reversed. In such cases, participants who shared the same social identity with the focal person were less likely to report the incident compared to those who didn't share the same social identity.

The authors propose that the findings of the two studies can be explained by social identity theory, which suggests that individuals derive a sense of belonging, pride, and self-esteem from their perceived membership in social groups. This theory indicates that individuals are

FIGURE 3: CONSUMER DATA BREACH CASE FINDINGS



motivated to maintain a positive image of themselves and the social groups they identify with. This motivation can lead to biased judgment and behavior toward individuals from different social groups, favoring those within their own group, a phenomenon known as in-group favoritism.

Interestingly, under certain circumstances, an in-group member may be judged more negatively than an out-group member, known as the "black sheep" effect. This finding may seem to contradict social identity theory, which generally predicts that in-group members are favored over out-group members. But the black sheep effect can be seen as a more nuanced expression of in-group favoritism. When a group member engages in deviant behavior that threatens the group's image, other group members may attempt to distance themselves from that individual by portraying them in a negative light. This strategy ultimately serves to protect and maintain a positive image for the rest of the group.

Under what circumstances does in-group favoritism or the black sheep effect occur? How do individuals determine the acceptability of questionable behavior? These questions depend on various factors, including the alignment of the behavior with laws, codes of conduct, social norms, and ethical principles. Individuals are more likely to blow the whistle when they perceive the behavior of an in-group member as clearly wrong because they view the wrongdoer as a threat to the group's reputation and feel an obligation to protect the group's positive image. In this case, the black sheep effect dominates the judgment. If the wrongdoer is punished and excluded from the group, the group's image can be restored.

On the other hand, when the questionable behavior is ambiguous and potentially justifiable, it may not pose a threat to the group's positive image. In such cases, in-group favoritism dominates judgment, leading to a lower likelihood of whistleblowing when the behavior is committed by an in-group member compared to an out-group member. Observers may be more inclined to rationalize such behavior, consciously or unconsciously, when it's performed by an in-group member. Furthermore, if the questionable behavior isn't perceived as threatening, individuals may not feel a sense of obligation to report it. This argument is supported by the findings of Liu and Xu, who assessed participants' perceived obligation to report questionable behavior in a post-experimental questionnaire.

In summary, the study suggests that while a strong social identity can enhance the ability of internal whistleblowing programs to identify severe fraud, it may also hinder the ability to identify potential fraudulent activities at an early stage when they aren't yet illegal and may be more justifiable. As a result, companies must carefully consider the costs and benefits of using social identity in their management control systems and weigh the potential risks and rewards.

What Should Management Do?

Management may consider two approaches inspired by the research findings: fostering stronger bonding among employees and enhancing employees' moral standards. Strengthening the bonding among employees can lead to a higher level of social identity, resulting in improved team outcomes such as enhanced coordination, knowledge sharing, and creativity. Recognizing the significance of team identity in shaping employee attitudes and behaviors, it's crucial for managers to proactively establish and nurture a strong team identity. To achieve this, we propose the following 4C approach for managers aiming to build a robust team identity:

1. Clarity: A manager must engage in a collaborative process with team members to establish a clear and mutually agreed-upon mission and vision for the team. This involves defining specific team goals and clarifying the roles and responsibilities of each team member. Providing a clear sense of purpose and structure fosters a greater sense of belonging and cohesion among team members, leading to improved productivity and performance. Having a shared mission and vision aligns individual efforts and motivations with overall team objectives, promoting a sense of ownership and accountability.

2. Commitment: Cultivating a strong sense of commitment among team members is essential for fostering a cohesive and productive team. One way to achieve this is by promoting a culture of mutual accountability, where everyone is responsible for upholding the team's goals and standards. Such a culture creates a shared sense of purpose and motivates teamwork. In addition, it's vital to recognize and value each team member's contributions as a way to build pride and ownership in their work.

3. Contribution: To maximize the team's potential, managers should carefully assess the unique strengths and weaknesses of each team member. This involves conducting a thorough analysis of their skills, experience, and expertise to determine the most effective ways to delegate responsibilities and optimize their contributions. Understanding individual working styles and needs enables managers to make well-informed decisions and allocate resources efficiently, leading to increased productivity and success for the team.

4. Communication: Effective communication is critical for any successful team, and managers play a crucial role in promoting open and honest communication among team members. Encouraging open dialogue, setting aside dedicated time for discussions, and ensuring transparency in decision making are essential strategies. By fostering an environment where team members feel comfortable expressing their thoughts and concerns, managers can facilitate the timely resolution of problems and issues, ultimately creating a more positive and productive working environment.

Using these 4C tips, managers can effectively establish and cultivate a strong team identity that promotes teamwork, commitment, and a sense of belonging among employees, ultimately leading to better outcomes for the team and organization. To enhance employees' moral standards, we propose the following 5C approach for managers:

1. Culture: To enhance employees' moral standards, organizations must cultivate a pervasive ethical culture that emphasizes integrity, transparency, and ethical conduct. Managers play a key role in establishing this culture by defining a robust ethical framework and core values embedded in the organization. These values should serve as guiding principles for employees, shaping their actions and decisions. By celebrating and reinforcing ethical behavior, promoting open discussions about ethical dilemmas, and providing ethical training and resources, managers can foster an environment where employees are dedicated to upholding high ethical standards throughout the organization.

2. Code of conduct: Managers should establish a comprehensive code of conduct that clearly outlines the organization's ethical standards and expectations for all employees. The code of conduct should provide specific guidelines on appropriate behavior, address potential ethical dilemmas employees may encounter, and highlight the consequences of misconduct. Ensuring that employees are well-versed in and adhere to the code of conduct creates a consistent and ethical work environment, fostering trust and integrity. Regular communication and training on the code of conduct further reinforce its significance and encourage ethical decision making among employees.

3. Compliance training: It's critical for managers to provide comprehensive compliance training to all employees to ensure a clear understanding of their legal and ethical obligations. The training program should encompass relevant laws, regulations, industry standards, and company policies, enabling employees to make informed and ethical decisions while taking appropriate actions. Regularly scheduled training sessions and workshops can reinforce the importance of compliance and ethics, nurturing a culture of responsibility and accountability across the organization. In addition, managers should actively engage with employees during the training process, encouraging open discussions and addressing any questions or concerns that may arise, thereby nurturing a strong commitment to ethical conduct at all levels of the organization.

4. Communication: Managers should foster a culture of open and transparent communication within the organization, encouraging employees to voice their ethical concerns, provide feedback, and report any misconduct through confidential reporting mechanisms. Moreover, it's essential to establish and promote communication channels that facilitate ethical dialogue, ensuring that employees feel comfortable and supported in expressing their views. By valuing and respecting ethical communication, the organization can create an environment of trust and accountability, facilitating the prompt and effective resolution of ethical issues.

5. Continuous improvement: To optimize the impact of ethical practices, continuous evaluation and improvement of the organization's ethical practices and compliance efforts are essential. Conducting regular audits, assessments, and reviews helps identify areas of improvement, address gaps or weaknesses, and adapt policies and procedures to evolving ethical standards and legal requirements. Emphasizing the value of learning from past experiences and utilizing insights gained drives positive changes, strengthening the organization's commitment to ethics and compliance.

By implementing the 5C approach, organizations can enhance their employees' morale and cultivate a robust ethical culture throughout the organization. The concept of social identity offers significant advantages in driving team outcomes within organizations. But it's crucial for organizations to be mindful of its potential negative implications for internal whistleblowing programs. By adopting the recommended 4C and 5C approaches, organizations can harness the productivity benefits of a strong social identity while proactively mitigating its potential drawbacks. These approaches not only enhance team cohesion and productivity but also fortify the organization against fraud and misconduct, safeguard its reputation, and foster a more ethical work environment. Striking this balance will lead to a healthier and more sustainable organizational culture, where employees are empowered to uphold high ethical standards and contribute to the overall success of the organization.

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Auditor Independence and the C-Suite's Growing Role

The C-suite has a distinct role to play in addressing threats to auditor independence, especially those involving business combinations.

By Weishi Jia, Ph.D., CIA; Laura K. Rickett, Ph.D., CPA; and Deborah L. Smith, Ph.D., CPA

As the consulting work performed by Certified Public Accountant (CPA) firms increases and mergers and acquisitions (M&As) become more complex, regulators are signaling their concern over auditor independence. Cautionary reminders have been announced, action has been taken against firms and individuals, and regulatory authorities worldwide have updated the rules for auditor independence. The U.S. Securities & Exchange Commission (SEC) is increasing enforcement, issuing disciplinary actions, and calling on all parties, including auditors, audit committees, and executive leadership, to remain vigilant in monitoring independence. As a result, the C-suite has a critical role to play in identifying and addressing situations that could impair independence, such as M&As. The SEC has put audit firms on alert due to the significant growth in consulting work, which has more than doubled since 2010, during a time when corporate M&As are also on the rise. According to Dealogic data, worldwide M&A value increased more than

25% between 2016 and 2021. The SEC is concerned that the result will be auditors performing prohibited work for audit clients and is therefore implementing new initiatives to investigate independence violations.

Renewed Scrutiny on Auditor Independence

Public comments by top regulators indicate that the SEC is intensifying its focus on enforcing independence violations. According to Dave Michaels in Big Four Accounting Firms Come Under Regulator's Scrutiny, the SEC's enforcement director, Gurbir Grewal, warned in December 2021 that the SEC "will have a firm commitment moving forward to continue to target deficient auditing by auditors, auditor independence cases, [and] cases around earnings management." Michaels also reported that the SEC's Miami office sent requests for information about auditor independence to the Big Four and smaller public accounting firms. Firms were asked about liability contracts and contingency fees dependent upon specific outcomes.

How serious is the SEC about the violation of independence rules? In October 2021, the SEC's acting chief accountant, Paul Munter, issued a press release to "all gatekeepers in the financial reporting ecosystem (auditors, management, and their audit committees)" for vigilance regarding auditor independence. He cautioned that the responsibility for independence belongs to the audit committee and the client, as well as the auditor. Munter cited an example of non-audit services and business combinations, noting that management, the audit committee, and the auditor should proactively monitor situations that could impair auditor independence prior to business combinations.

Munter clarified that, given that all listed firms are required to hire an independent auditor, they share this responsibility. Therefore, as the client, the C-suite has a distinct role in monitoring independence issues that could arise from consulting engagements and M&A activities. As part of the executive-level responsibilities in setting and implementing strategy related to organizational goals, the C-suite has direct insight into factors that could impair auditor independence. Munter issued a similar public statement in June 2022 to reemphasize that accountants, audit firms, registrants, and their audit committees should continually "assess and approach auditor independence for purposes of considering, beginning, or continuing an audit engagement under Rule 2-01(b)."

A crucial aspect of the increased SEC scrutiny is the taking of names. Not only are the CPA firms named and disciplined in SEC enforcement actions, but individual audit professionals are also identified and sanctioned. In the SEC enforcement action against KPMG for the College of New Rochelle case in February 2021, where KPMG failed to identify serious fraud, the audit manager was personally named and received a one-year suspension and disciplinary action. In a 2021 case, not only were the audit firm and audit partners charged with violating auditor independence rules, but the issuer's then-chief accounting officer (CAO) was also charged for his role in the misconduct. The SEC expects client executives to share the responsibility for independence; thus, C-suite executives should exercise vigilance because they can be held responsible for independence violations.

Recent enforcement actions reflect the SEC's renewed focus on breaches of auditor independence. Although few SEC enforcement actions have named firm executives as the cause of violations to date, at least one recent case named the CAO and set a tone for the current regulatory climate. See Table 1 for examples of major auditor independence violations charged by the SEC in recent years.

A Summary of Independence Rules

According to the principles in the Code of Federal Regulations, Section 201.2-01, independence is impaired when "a relationship or...service:

- Creates a mutual or conflicting interest between the accountant and the audit client;
- Places the accountant in the position of auditing their own work;

TABLE 1: RECENT SEC ENFORCEMENT ACTIONS

Year of Enforcement	Target Company or Individual	Case Description
2019	PwC	PwC was charged with designing software for an audit client, a service disallowed under SOX regulations. The firm was also accused of participating in the management functions of its client. The violation included a failure to maintain quality control within their audit firm to prevent and monitor matters of independence. The audit partner was barred from auditing publicly traded firms for four years and fined $25,000. The fine for PwC was just under $8 million.
2014	EY	EY was accused of inappropriately aiding an audit client by lobbying congressional staffers to support a favorable bill, a service that's disallowed because it's advocating for the client. EY settled the investigation for $4 million.
2014	KPMG	KPMG settled an accusation of providing a publicly traded client with bookkeeping services, which is disallowed under the SOX regulation. Members of KPMG held stock in audit clients or related entities, also violating independence in appearance and fact.
2021	EY, an EY manager, a former EY partner, and the vice president of corporate taxation for Cintas	In December 2021, the SEC charged three EY professionals. EY violated independence rules by allowing a tax principal to provide tax and incentive services for a contingency fee. The disallowed services occurred during the period between 2009 and 2018. Also named and charged were an EY manager, a former EY partner, and the vice president of corporate taxation for Cintas. All those named had their licenses suspended from practicing before the SEC for one or two years. Those involved didn't admit to or deny the findings of the investigation.
2019	RSM US LLP	RSM US LLP, named in 2022 as one of the top accounting firms in the world (**bit.ly/3KzzRFo**), was charged in August 2019 for providing bookkeeping, payroll, information system design, and secretarial services to a publicly traded audit client. The services were provided by a partner from an international office of RSM who served voluntarily on the board of one of the audit client's affiliates in Australia. Although the violation occurred in 2014 and 2015, it wasn't discovered until 2016. RSM paid a penalty of $950,000.
2021	EY, one EY partner, and two former partners	The SEC charged EY, one partner, and two former partners for independence violations for improperly interfering with the issuer's auditor selection process by soliciting and receiving confidential competitive audit committee information from the issuer's then-CAO. The SEC separately charged the issuer's then-CAO for misconduct in withholding key information from the issuer's audit committee and causing the issuer's reporting violations. EY was charged a civil penalty of $10 million and forced to implement detailed compliance requirements. The partner and former partners were collectively required to pay civil penalties of $85,000 and faced suspended practice permissions. The issuer's then-CAO was ordered to pay a $51,000 penalty along with practice suspension for two years.

- Results in the accountant acting as management or an employee of the audit client; or
- Places the accountant in a position of being an advocate for the audit client."

Auditors are primarily governed by three regulatory bodies based on the type of clients they audit:

- Auditors of publicly traded firms in the United States must register with the Public Company Accounting Oversight Board (PCAOB) and aren't permitted to provide their publicly traded audit clients with any of the services listed below because they're deemed to impair independence.

- Bookkeeping
- Financial information systems design and implementation
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- Actuarial services
- Internal audit outsourcing services
- Management functions or human resources
- Broker-dealer, investment adviser, or investment banking services
- Legal assistance and expert services unrelated to the audit

- Auditors of privately held firms in the U.S. adhere to rules set forth by the Auditing Standards Board (ASB), a 19-member committee designated by the American Institute of Certified Public Accountants (AICPA).

- Auditors of international firms fall under the regulation of the national auditing standards of the 130 member countries and jurisdictions of the International Federation of Accountants. The professional accountancy bodies representing each area are encouraged to eliminate material inconsistencies compared to the International Auditing and Assurance Standards Board.

In addition, countries can impose their own restrictions; for example, Europe allows consulting for audit clients but restricts the total revenue earned.

Updates Regarding Auditor Independence

Auditors of all firms face new auditor independence rules for publicly traded, privately held, and international clients. In order to play an active role in monitoring and maintaining independence, the C-suite should remain up to date on auditor independence rules.

The SEC changed its rules on auditor independence in an update published on October 16, 2020. The SEC press release revealed that auditors will no longer be considered to have impaired independence due to standard consumer and student loans. For example, when an audit partner who isn't on the audit engagement has a student loan with an audit client that's a large student loan company, this no longer results in an independence violation.

Another amendment addresses problems with non-audit services to entities prior to a merger or acquisition of a client firm, or non-audit services provided to client affiliates that aren't considered influential. The new rules effectively relax the standards for independence in these situations. Over the past decade, SEC staff conducted a number of consultations where otherwise unaffiliated audit clients created an independence violation for an auditor because the firms were all portfolio companies of an investment fund. When one firm goes public, the allowed services to other portfolio firms become an independence violation for the auditor of the client registering with the SEC. Other than the investment fund relationship, the other firms "have no impact on the entity under audit in any way and do not affect the objectivity and impartiality of the auditor in conducting the audit for Company X," yet independence was violated because of the portfolio fund investment.

The amended independence rules resolve these issues that previously triggered auditor independence violations but represented no significant threat to the auditor's objectivity. The amended rules also provide a transition provision for independence violations resulting from M&As. But the SEC expects the independence violation to be promptly corrected and preferably before the effective date of the merger or acquisition.

The new SEC rules prompted the Professional Ethics Executive Committee (PEEC) of the AICPA to reevaluate the rules for auditors of privately held clients. Among the concerns addressed are certain consumer and student loans owned by auditors, and the proposed change would allow more flexibility for auditors, similar to the change by the SEC. But the PEEC is also considering the addition of loans held by immediate family members in determining independence. Another proposed change is to add guidance regarding whether services provided to a client affiliate impair independence due to a merger or acquisition. The new rules were adopted in March 2022 and went into effect at the end of the year. Early adoption is allowed.

The International Ethics Standards Board for Accountants (IESBA) is strengthening independence requirements by changing the term "listed entity" to "public interest entity" (PIE) to refer to publicly traded firms and improving the definition of what firms qualify as PIEs. Transparency requirements are also being improved, requiring auditors to disclose the independence requirements of PIEs publicly. The new rules aren't effective until December 15, 2024, but auditors are being encouraged to adopt the provisions before then. Corporations operating globally can benefit from gaining an understanding of what qualifies as a PIE and independence disclosure requirements to ensure they can adopt the new provisions before the deadline.

The Reasons for Scrutiny

Independence rules for publicly traded firms are subject to Sarbanes-Oxley Act of 2002 (SOX) rules that don't allow firms to provide consulting services to audit clients. When SOX initially took effect in 2002, CPA firms reduced consulting services dramatically.

When the sweeping SOX regulations went into effect in June 2002, CPA firms were cautious in providing consulting services, but over time the proportion of consulting revenue at the largest auditing firms has climbed dramatically. Amanda Iacone reported on Bloomberg Tax that while audit revenue only increased by 19% since 2010, global consulting revenue grew by 136%. Tax and legal services revenue increased by 59% globally. In the U.S., three of the Big Four CPA firms initially spun off their consulting work after the SOX legislation but over time either acquired consulting firms or marketed consulting services to non-audit clients. Consulting revenue increased for Big Four firms in the U.S. from just under $5 billion in 2007 to almost $25 billion in 2018.

Iacone further noted that accountants may encounter unforeseeable independence violations due to the increasing complexity of the markets. M&As create a challenge in distinguishing between audit and non-audit client affiliates. If a consulting client is acquired by an audit client, auditors may face independence violations. This potential issue is also discussed in Paul Munter's statement in June 2022. Munter noted that "[a]nother notable and increasing area of concern involves the provision of non-audit services. While non-audit services are often not provided directly to the company being audited, OCA [Office of the Chief Accountant] staff encounter circumstances in which the extent and magnitude of the non-audit services and business relationships between the accountant and affiliates and non-affiliates of the company being audited would make it difficult for a reasonable investor to conclude that the accountant could exercise objective and impartial judgment in its audit." Overall, the increasing complexity of business restructurings and the provision of non-audit services could lead to independence violations if the auditor and the client firm fail to consider the implications for auditor independence.

Although few, if any, documented cases to date of independence violations are a result of M&A activity, this is likely due to the SEC's transition provisions. But the SEC expects these independence violations to be corrected before the effective date of the business combination. Meanwhile, although the SEC's revised independence regulation may improve the situation, another conflict arises if an auditor has provided advisory services for a potential buyer of an audit client or a potential target firm. Collectively, these new dynamics in auditor independence point to the central role of the C-suite in working with its auditor to maintain auditor independence and address potential threats to independence promptly.

TABLE 2: NAVIGATING THE NEW LANDSCAPE

No.	Actionable Item	Explanation
1.	Maintain the tone at the top.	The C-suite should focus on a tone at the top that emphasizes the importance of integrity in the financial reporting process and the independence of the audit.
2.	Avoid the "checklist compliance" mentality.	The C-suite, along with the auditor, should caution against a checklist compliance mentality that treats the SEC's independence rules as a mere checklist of prohibitions and ignore the general standard. This mentality assumes no independence violations as long as a certain situation isn't explicitly listed in the prohibitions, which can be dangerous since the list of violations provided are nonexclusive. The C-suite and the auditor should always consider the general principles of auditor independence when evaluating independence issues.
3.	Remain apprised of updates on independence rules.	The C-suite and CPA firms should work together to remain apprised of updated independence rules for the different regulatory bodies they fall under but also consider whether their current independence evaluation procedures are adequate to identify all potential independence violations.
4.	Determine threats to auditor independence.	The C-suite should partner with its CPA firms to determine threats to independence, especially those arising from business combinations.
5.	Evaluate potential and recent M&A activities.	The C-suite should work with its auditor to carefully review potential and recent M&A activities to determine if services provided to related entities might impair auditor independence. Consider hiring a new auditor for either the acquiring or target company. Resolving independence violations may disrupt or delay the merger or acquisition, and this is an incentive for executive leadership to address potential independence issues early.
6.	Monitor corporate changes or other events affecting auditor independence.	The C-suite should put policies and procedures in place that closely monitor corporate changes or other events that could affect auditor independence and communicate these events and changes to the audit firm in a timely manner.
7.	Review independence rules both nationally and internationally.	The CFO and audit committee should advise other members of the C-suite and should regularly review the independence guidelines set forth by the SEC and PCAOB in the U.S. and internationally with the *International Code of Ethics for Professional Accountants* (issued by the IESBA). In addition, for non-U.S. clients, national or regional requirements may be more restrictive, so a careful examination of the rules associated with those jurisdictions is necessary.
8.	Utilize authoritative resources to gain a deeper understanding of auditor independence.	A useful resource published by the AICPA's Professional Ethics Division, *Plain English guide to independence* (November 2021; **bit.ly/44FU1EM**), can help the C-suite understand independence requirements under the AICPA Professional Code of Conduct and other applicable regulatory agencies.

Independence in the U.K., India, and Australia

Recent developments on the international stage indicate increased restrictions on auditor independence. In the U.K., following several high-profile accounting failures, the Financial Reporting Council (FRC) recently issued a reform package requiring the Big Four to split their audit and consulting businesses within the next four years. The new requirements are intended to address audit quality issues due to the significant growth in consulting revenue. The FRC reports that audit fees make up only about one-fifth of the Big Four's combined total revenue of $13.7 billion.

In India, several firms like Deloitte, PwC, and Grant Thorton have halted the performance of non-audit services for their audit clients. Although these actions will result in significant loss of revenues for these firms, the voluntary action is seen as being in "the spirit of self-regulation and extends beyond non-audit services permissible under prevailing rules and regulations in India" (Deloitte to Stop Offering Non-audit Services to Their Audit Clients). Deloitte stated it expects the change to increase the public's confidence in auditor independence.

In Australia, Edmund Tadros of the Australian Financial Review reported that EY plans to spin off its audit services practice to facilitate independence. The same can't be said for the other Big Four firms at this time. According to Tadros, KPMG and PwC don't plan to separate their audit services for now, and Deloitte has no comment. But John Dumay, a professor at Macquarie University, predicts that, since the Big Four firms were already ordered to split their audit and non-audit practices by 2024, Australian regulators will be pressured to do the same.

These examples highlight another vital element of the C-suite's role in auditor independence issues. An auditor who has developed valuable expertise on the company's audit engagement over several years may have to cancel the audit relationship. The C-suite should consider whether or not such an outcome leads to increased audit risk as a result of the lost expertise on the audit engagement.

Takeaways

Overall, the SEC is signaling increased efforts in enforcing auditor independence violations. The stakes related to independence are high because, combined with any other missteps in due diligence, a violation of independence draws intent into question should errors occur. The SEC calls explicitly on the audit committee and firm executives to play a part in ensuring auditor independence, and the C-suite has the distinct, high-level view to be able to monitor and identify situations that could potentially impair auditor independence, especially those involving business combinations.

CPA firms and firm executives who violate independence rules can face SEC fines, sanctions, and impaired reputation. Fortunately, there are practical and actionable items that can help firm executives navigate the changing landscape of auditor independence (see Table 2).

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FEATURE

The Financial Close Process: Insights from Europe

A study of German companies identifies accounting challenges and assesses best practices in the financial close process.

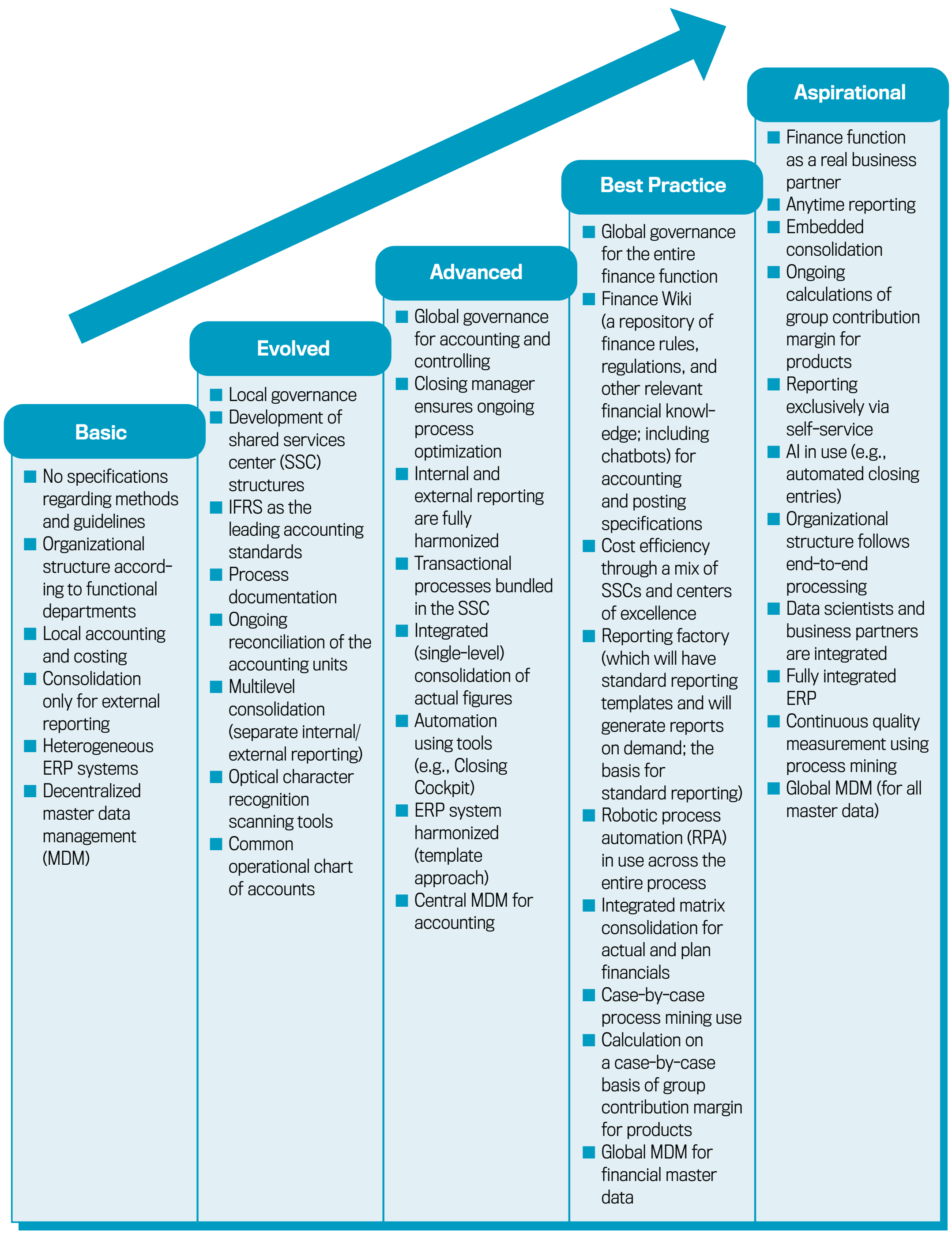
By Ashutosh V. Deshmukh, Ph.D., CMA, CPA, and Maximilian Holzmeier, Ph.D., CTA

The financial close process is variously defined by auditing standards, consultant reports, and academics. It involves a complex set of activities that includes updating subsidiary ledgers, applying accounting policies and principles to year-end transactions, making adjusting entries, and preparing financial statements. The "last mile of finance" is a term that refers to a series of steps that culminate in the publication of the financial statements, which may include financial close process management, reconciliations management, intercompany transactions management, consolidations, financial control compliance, and financial statement production and disclosure management, among others. Mary Driscoll summed up the last mile of finance as a close-to-disclose process (The Last Mile of Finance: Growing Scrutiny). The types and sequence of steps vary from company to company.

The speed of the financial close process and the quality of the financial statements are arguably inversely related. A rapid release of quality financial information is generally advantageous to publicly listed corporations. In the late 1990s, Cisco reengineered the closing process and reduced the time frame to less than 24 hours, responding to market criticisms of its not having visibility into its financial statements.

Additionally, U.S. Securities & Exchange Commission regulations are shortening reporting periods, and new mandates such as eXtensible Business Reporting Language (XBRL) and complex accounting standards require more time to produce financial statements. Based on existing and projected developments in this area, we developed a continuum of the financial close process from basic to aspirational (see Figure 1). Given the uneven implementation of technology in the financial close process, we believe that internationally, "basic" to "best practices" scenarios simultaneously exist to varying degrees.

FIGURE 1: THE EVOLUTION OF THE CLOSING PROCESS



Most of the research in this area is U.S.-centric. Only two previous empirical studies examined the number of days in the financial close, and both were conducted by consulting companies. These studies weren't published in peer-reviewed journals. Since data collection is a prime problem in this area, we believed there was an opportunity to make a unique contribution in this area and decided to conduct our own study.

As a result, in 2019, we surveyed 55 German corporations to assess the challenges faced in the financial close process (see Table 1). Approximately 80% of the companies were public or going public.

In a series of questions answered on a Likert-type scale, we assessed the challenges faced in the accounting, technology, organizational, and peripheral areas. We then examined the effectiveness of best practices that are often prescribed in the literature but that aren't empirically evaluated. We also collected data regarding the number of days to close and whether the respondents thought the days were appropriate or needed downward remediation. Additionally, we asked the respondents about the financial consolidation packages used in the financial close.

TABLE 1: DEMOGRAPHIC INFORMATION FOR RESPONDENTS, INDUSTRY, AND SIZE

Respondents by Position

	Chief Financial Officer	Vice President of Finance	Director of Finance/ Accounting	Accounting Manager	Accountant	Controlling Manager	Controller
Frequencies	12	2	22	5	2	10	2
Percentages	21.82%	3.64%	40.00%	9.09%	3.64%	18.18%	3.64%

Companies by Industry

	Manufacturing	Retail and Wholesale	Services	Utilities and Energy
Frequencies	26	12	12	5
Percentages	47.27%	21.82%	21.82%	9.09%

Companies by Revenue*

	Less than €10	€10-25	€25-50	€50-100	€100-250	€250-500	€500-1,000	€1,000-2,000	More than €2,000
Frequencies	7	4	3	3	5	13	11	3	6
Percentages	12.73%	7.27%	5.45%	5.45%	9.09%	23.64%	20.00%	5.45%	10.91%

*All figures are in millions.

Legally Independent Entities in the Consolidated Financial Statements

	Fewer than 25 Units	25-50 Units	51-100 Units	101-200 Units	201-500 Units	501-1,000 Units	More than 1,000 Units
Frequencies	18	10	8	8	5	5	1
Percentages	32.73%	18.18%	14.55%	14.55%	9.09%	9.09%	1.82%

Top Accounting Challenges

Accounting challenges were defined as problems related to the recording, processing, and structuring of transactional data. The main problem identified by the respondents was the lack of uniform company-wide procedures for data collection, recording, and reporting (see Table 2). This problem was more pronounced for medium-sized and larger companies. The

TABLE 2: EFFECTIVENESS OF BEST PRACTICES TO AID IN THE FINANCIAL CLOSE PROCESS

Accounting-Specific Challenges					
	Very Low Effectiveness	Low Effectiveness	Moderate Effectiveness	High Effectiveness	Very High Effectiveness
Standardization of accounting procedures with a common chart of accounts	0.0%	12.7%	41.8%	29.1%	16.4%
Simplification of the common chart of accounts	1.8%	18.2%	34.5%	32.7%	12.7%
Standardizing of collecting, presenting, and measuring transaction information	1.8%	9.1%	30.9%	40.0%	18.2%
Structured process for subsequent adjustments (based on the materiality concept)	3.6%	10.9%	30.9%	41.8%	12.7%
Regular close (usually monthly) of subledgers and journals that feed data for the general ledger	1.8%	10.9%	34.5%	43.6%	9.1%
Reconciliations of subledgers to general ledgers or intercompany transactions are performed on a continuous basis and not at the end of the period	1.8%	3.6%	45.5%	36.4%	12.7%
Create automated entries for depreciation/amortization, accruals, and provisions	3.6%	16.4%	36.4%	27.3%	16.4%
Minimize complex calculations for provisions and inventory measurement during the year	1.8%	14.5%	40.0%	27.3%	16.4%
Minimize manual data entry	0.0%	16.4%	34.5%	29.1%	20.0%
Technological Challenges					
	Very Low Effectiveness	Low Effectiveness	Moderate Effectiveness	High Effectiveness	Very High Effectiveness
Powerful consolidation system for integrated financial consolidation purposes (in terms of matrix consolidation)	1.8%	7.3%	40.0%	40.0%	10.9%
Organization is standardized on ERP level (template or one ERP approach)	1.8%	12.7%	38.2%	32.7%	14.5%
New media and tools (e.g., artificial intelligence, machine learning, process automation with robotics) are broadly used	10.9%	23.6%	29.1%	20.0%	16.4%

Organizational Challenges					
	Very Low Effectiveness	Low Effectiveness	Moderate Effectiveness	High Effectiveness	Very High Effectiveness
Establish clear responsibility for closing tasks in a closing schedule	3.6%	12.7%	23.6%	34.5%	25.5%
Establish adherence to deadlines	0.0%	9.1%	25.5%	40.0%	25.5%
Establishment of clear and regular communication	1.8%	5.5%	27.3%	45.5%	20.0%
Document your closing process	1.8%	12.7%	32.7%	45.5%	7.3%
Assign responsibility for resolving discrepancies (intercompany reconciliation)	1.8%	7.3%	29.1%	49.1%	12.7%
Develop cross-departmental collaboration to solve recurring cross-functional problems (in the sense of end-to-end)	1.8%	7.3%	32.7%	38.2%	20.0%
Introduction and monitoring of key performance indicators in relation to the closing process	3.6%	14.5%	29.1%	50.9%	1.8%
Approval processes are automated	5.5%	14.5%	27.3%	34.5%	18.2%
Key performance indicators are standardized	1.8%	10.9%	30.9%	41.8%	14.5%
Distribution of key performance indicators to line managers in real time	1.8%	18.2%	32.7%	29.1%	18.2%
Peripheral Challenges					
	Very Low Effectiveness	Low Effectiveness	Moderate Effectiveness	High Effectiveness	Very High Effectiveness
Reduction of investigation levels	3.6%	14.5%	40.0%	32.7%	9.1%
Move routine work (noncritical activities) out of the closing crunch	1.8%	7.3%	38.2%	32.7%	20.0%
Prepare forms (e.g., checklists) in advance	1.8%	16.4%	29.1%	40.0%	12.7%
Pare down the content of reports	1.8%	14.5%	41.8%	38.2%	3.6%
Use of accruals and estimates to shorten close	3.6%	7.3%	41.8%	41.8%	5.5%
Input all recurring journal entries (such as accruals, depreciation/amortization, allocations) at one time	3.6%	10.9%	32.7%	41.8%	10.9%
Cross-functional personnel in accounting	3.6%	10.9%	32.7%	34.5%	18.2%

secondary issue was the presence of more than one operating chart of accounts. This problem is more acute in multinational companies that need to meet local and central accounting requirements. In addition, an inadequate quality assurance system, which resulted in excessive adjustments, also delayed the financial close process.

Technological challenges in the closing process relate to the automatic, accurate classification and aggregation of data. We found fragmented financial systems to be the biggest problem. Data is often collected from paper, spreadsheets, diverse databases, and occasionally even from different enterprise resource planning (ERP) systems. The second issue was the need for advanced financial consolidation tools. This includes proper selection, configuration, application, and training with these tools, all considered essential in the last mile of finance.

Organizational challenges refer to the misalignment of organizational structure with the financial close process. Here we didn't find any significant problems. The respondents reported that top management was committed to the closing process, responsibility for the closing process was clearly assigned, and internal and external accounting systems were harmonized. While the majority of respondents reported that the closing process was decentralized, they said it didn't result in any significant problems.

Peripheral challenges in the financial close process include changes in the external environment that affect the process. Approximately 50% to 60% of respondents indicated that the close process was adversely affected by mergers and acquisitions activity and rapid growth or restructuring within the company. As expected, this problem was more pronounced in large and, to some extent, midsize organizations.

Best Practices Assessment

Financial close process literature often prescribes various best practices. We developed a series of best practices based on the literature survey, discussion with consultants, and our own experiences. Next, we organized each one across accounting, technological, organizational, and peripheral dimensions. Finally, we asked respondents to assess the effectiveness of these best practices (see Table 2).

In the accounting area, more than 80% of the respondents rated the identified nine best practices to be moderately to highly effective. The top three practices were as follows:

1. Reconciliations of subledgers to general ledgers or intercompany transactions are performed on a continuous basis, not at the end of the period.

2. Standardizing of collecting, presenting, and measuring transaction information.

3. Standardization of accounting procedures with a common chart of accounts.

The next two best practices are a structured process for subsequent adjustments based on the materiality concept and regular close (usually monthly) of subledgers and journals that feed data into the general ledger. If you recall the top accounting challenge stated previously, the identification of these best practices is evident. The final three best practices are the following:

1. Create automated entries for depreciation/amortization, accruals, and provisions.

2. Minimize complex calculations for provisions and inventory measurement during the year.

3. Minimize manual data entry.

Keep in mind that all of the identified nine best practices in Table 2 are effective to some extent in the financial close process, according to the respondents.

The following were considered the most effective best practices in the technology area. First, a powerful consolidation system for integrated financial consolidation purposes is necessary. Approximately 50% of companies consider this to be a highly or very highly effective best practice. Second, the organization needs to be standardized on the ERP level (template or one integrated ERP system running all functions). Finally, the ratings for the role of AI, machine learning, and robotics in the close process were low. We attribute this finding to the nascent stage of tools in this area. This rating will no doubt be different in five years.

In the organizational area, at least 80% of the respondents rated all 10 best practices as moderate to very high effectiveness. The top four best practices were the following:

1. Establishment of clear and regular communications.
2. Establish adherence to deadlines.
3. Assign responsibility for resolving discrepancies (intercompany reconciliation).
4. Develop cross-departmental collaboration to solve recurring cross-functional problems.

The rest of the best practices revolve around establishing clear responsibility for tasks in a closing schedule, automating approval processes, and standardizing key performance indicators. Again, notice the interplay between organizational and technological issues, as some of the process issues are best handled by technology.

Finally, in the peripheral area, our identified best practices revolve around the accounting process. There are no best practices that can reduce mergers, acquisitions, or restructuring activities identified as peripheral challenges. The top three best practices in this area are the following:

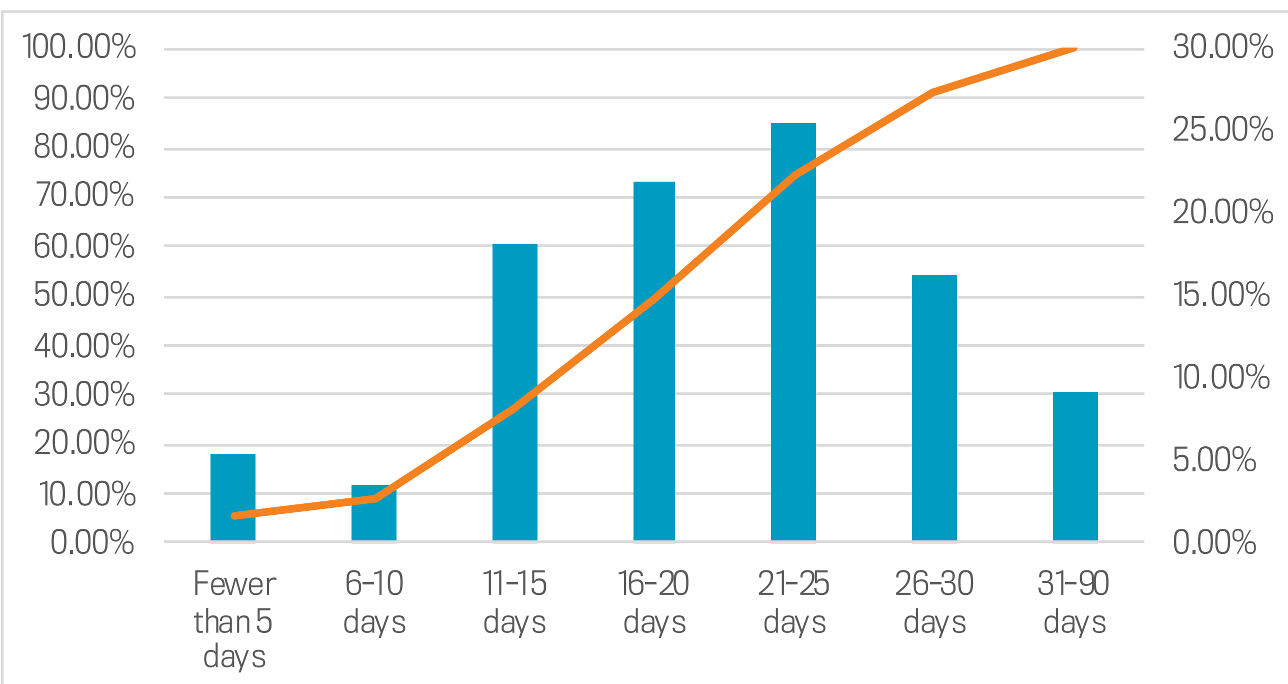
1. Move routine work or noncritical activities out of the closing time period.
2. Prepare checklists in advance.
3. Input all recurring journal entries at one time.

Prescriptive best practices are often mentioned in the literature, but the empirical evidence is sparse. This survey provides some basis for identifying best practices and ranking them.

Days to Close

As mentioned earlier, we also collected information regarding the number of days to close for each company—monthly, quarterly, and annually. The distribution of the annual days to close is shown in Figure 2.

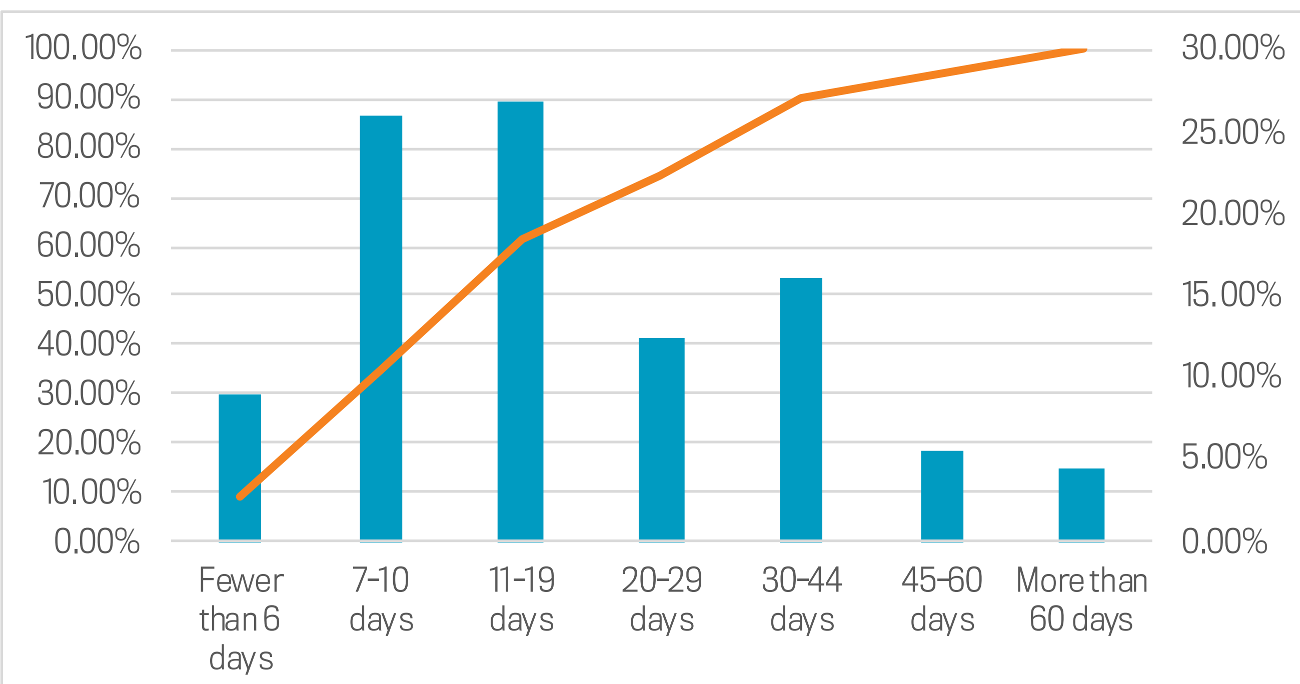
FIGURE 2: DAYS FOR ANNUAL CLOSE FOR GERMAN COMPANIES, 2019



We discovered, not surprisingly, that monthly and quarterly days to close are lower than annual days to close. The monthly close takes the fewest days, the quarterly close takes more days, and the annual close takes the maximum number of days. Given the importance of annual numbers, the managers allocate significantly more time to the annual close. Approximately 9% of the companies complete the close in fewer than 11 days or take 31 to 90 days. The majority of the companies complete their close within 11 to 30 days. The most interesting result was the appropriateness of the days to close. Approximately 84% of the respondents indicated that the days of their closing process were appropriate. There's no real desire among managers to accelerate the closing process further. The data analysis shows no differences among small, medium, or large-sized corporations regarding this issue. We conclude that many German companies have found the sweet spot for the number of days to close the books and the resulting quality of the financial information.

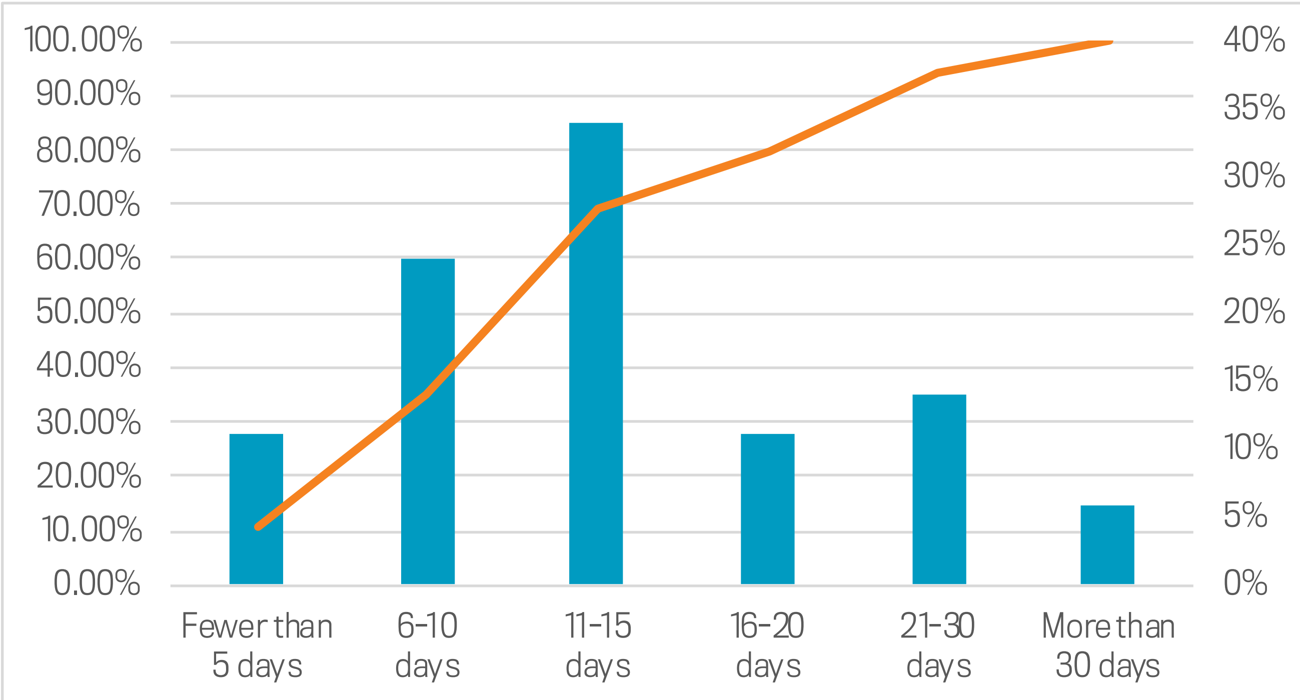
The Institute of Management and Administration (IOMA) 2010 report, *Improving the Financial Close: Benchmarks and Best Practices*, gives information regarding the annual closing days for U.S. corporations (see Figure 3). The intervals are slightly different. It appears that U.S. corporations need a slightly lower number of days to close, but the differences aren't statistically verifiable. It's unclear if the U.S. managers also think that the days for annual close are appropriate. Another survey conducted by SVG & Co. in the Philippines in 1997 showed results similar to our results and the IOMA survey results ("Business Consulting: Closing the Books," SGV Bulletin, May 3, 2001, pp. 1-9; see Figure 4). Interestingly, three different time periods and three different regions of the world show a similar number of days to close. A visual examination of the cumulative line in the graphs clearly indicates a similar pattern. Thus, the critical question is: What are the minimum days to produce quality—at least, compliance with Generally Accepted Accounting Principles or International Financial Reporting Standards (IFRS)—financial information? Is the cost to reduce the days to close justifiable in light of the benefits? The answer to this question can be helpful to consultants and financial consolidation tool vendors.

FIGURE 3: DAYS FOR ANNUAL CLOSE FOR U.S. COMPANIES, 2010



Source: IOMA, *Improving the Financial Close: Benchmarks and Best Practices*, 2010.

FIGURE 4: DAYS FOR ANNUAL CLOSE FOR PHILIPPINES COMPANIES, 1997



Source: SVG & Co, "Business Consulting: Closing the books," *SGV Bulletin*, May 3, 2001, pp. 1-9.

Top Tech Tools

We also collected information regarding technology tools used in the process. These tools are used in four phases of the last mile of finance—financial consolidation, financial and corporate reporting, close management, and reconciliations management. The top four ranked vendors in each category are SAP, Microsoft, IBM, and Oracle. The dominance of SAP is expected, given that data was collected for German corporations and SAP is based in Germany. Many companies use multiple tools in these phases, for example, BlackLine or Host Analytics (now Planful).

Overall, this article provides empirical findings in the financial close process. Literature in this area offers a number of insights into the process, but they need to be evaluated in a real-world setting. We identified the major accounting, technological, organizational, and peripheral challenges faced by German corporations and found that standardization of accounting data collection, recording, and reporting; multiple charts of accounts; inadequate quality assurance systems; fragmentation of financial systems; the need for powerful consolidation tools; and decentralization of the closing process are among the significant problems.

We also investigated the respondents' perceptions regarding the effectiveness of the best practices that aid in the financial close process. The primary issues identified by the survey respondents concern reconciliations, standardization of workflows, communication, and cross-training. On the technology side, a powerful consolidation system (one ERP system) is considered critical to the financial close process. Additionally, most respondents think that days to close are appropriate for their corporations. These findings will be helpful to managers, consultants, and vendors involved in the financial close process.

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STRATEGIC FINANCE

Disruption and the Cash Conversion Cycle

When facing disruption, accountants can employ CCC for insights into operational efficiency and working capital requirements.

By Bishal BC, Ph.D.; Yatin Bhagwat, Ph.D.; and Marinus DeBruine, Ph.D.

When faced with market disruptions going forward, organizations can apply vital lessons from the COVID-19 pandemic, which caused significant economic disruption, pushing companies into crisis mode and prompting substantial changes in their operating and financing strategies. To prepare for the uncertainty, some companies began hoarding cash and suspended stock buybacks and dividends, saving more than $250 billion in 2020 (Davide Pettenuzzo, Riccardo Sabbatucci, and Allan Timmermann, "Outlasting the Pandemic: Corporate Payout and Financing Decisions During COVID-19," CEPR Discussion Paper, May 1, 2021). A survey later that year revealed a notable decrease in capital spending plans. Other companies preserved cash for working capital needs that soon ballooned as sales dropped in the early months of the pandemic, while optimized supply chain systems profoundly failed in the ensuing months.

In the early months of the pandemic, with lockdowns in multiple states, many companies burned through cash as they were assessing their longer-term prospects that included weighing the cost savings of employee layoffs in the short term against the future costs of finding and training new hires after the pandemic eased. Although the lockdowns hit airline and cruise ship operators particularly hard, the effects of the pandemic reached beyond leisure and transportation into many other industries. Government interventions, such as the Paycheck Protection Program (PPP) and stimulus checks, prevented an economic collapse. Although the stock market recovered quickly, supply chain disruptions persisted, labor shortages continued, and companies had to reevaluate sourcing and inventory management.

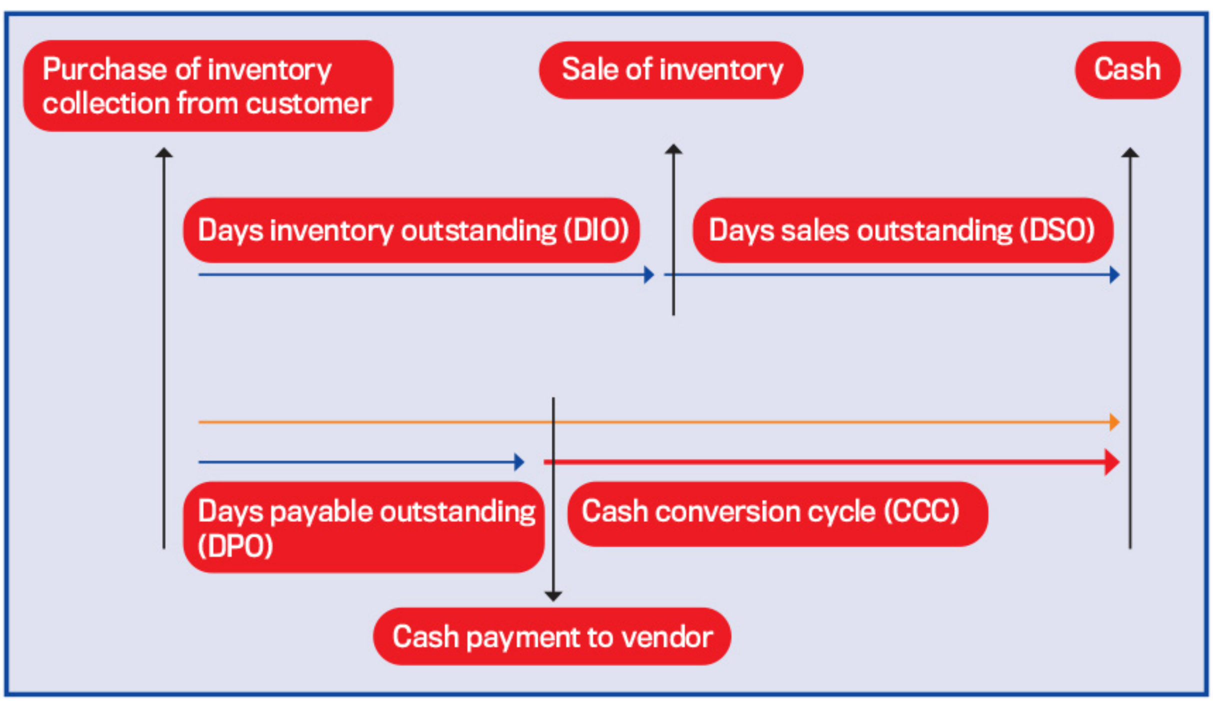
In addition to seeking new financing and delaying capital expenditures, companies managed working capital accounts—such as inventory, accounts payable, and accounts receivable—to generate cash flows. A popular measure for gauging the efficiency of a company's working capital management is the cash conversion cycle (CCC), which reflects the time it takes to transfer cash payments for purchases into cash collections from sales. The strategies of various organizations in different industries show how the CCC length and its determinants—days sales outstanding (DSO), days inventory outstanding (DIO), and days payable outstanding (DPO)—fared as U.S. companies persevered through the economic disruption caused by the pandemic.

Why CCC Matters

Management accountants should prioritize the analysis of their company's CCC, as it provides valuable insights into operational efficiency and working capital requirements. A shorter CCC indicates a more effective use of working capital. Therefore, management accountants should proactively seek opportunities to reduce this metric whenever feasible. By closely monitoring and analyzing the CCC, they can assess internal performance, identify potential issues, and find practical solutions to maintain efficiency and ensure a healthy liquidity position.

The CCC has three key components: inventory management, customer collection, and supplier payment (see Figure 1 for the CCC in this context). If any of these components underperform, it can adversely impact the business. For instance, retailers like Target, Walmart, and Kohl's

FIGURE 1: CASH CONVERSION CYCLE IN CONTEXT



Source: Operating Cycle, CFI.

experienced inventory mismanagement in 2022, leading to negative consequences associated with excessive inventory buildup. Kohl's, for example, witnessed a significant increase from year-over-year change in inventory of 1% in the third quarter of 2021 to 18% in the fourth quarter of 2021, 40% in the first quarter of 2022, and 48% in the second quarter of 2022, creating liquidity risks and operational challenges.

Management accountants can track the CCC over multiple quarters to evaluate whether the company's operational efficiency is improving. If they observe an increasing CCC, they can delve deeper into its reasons, such as an increase in DIO. By identifying specific product lines or items that aren't selling well, they can provide insights to upper management, enabling informed decisions. For instance, they might recommend discounting or disposing of slow-moving inventory.

Comparing a company's CCC with its competitors is also valuable for management accountants. Suppose the analysis reveals that the company has a significantly lower DPO than its peers. This information can be used as leverage in negotiating more favorable credit terms with suppliers. Access to suppliers' capital essentially equates to interest-free funding for the company, enabling improved liquidity or additional investment in growth initiatives. Consequently, the calculation and analysis of CCC and its components empower management accountants to identify areas for streamlining operations and contributing value to their organization. See Figure 2 for the components of the CCC.

FIGURE 2: COMPONENTS OF THE CASH CONVERSION CYCLE

Days inventory outstanding (DIO) = 365 / Inventory turnover
where
Inventory turnover = Cost of goods sold / Average inventory

Days sales outstanding (DSO) = 365 / Accounts receivable turnover
where
Accounts receivable turnover = Net sales / Average net accounts receivable

Days payable outstanding (DPO) = 365 / Accounts payable turnover
where
Accounts payable turnover = Cost of goods sold / Average accounts payable

and the cash conversion cycle (CCC) = DIO + DSO – DPO

The outbreak of the pandemic in early 2020 had a profound impact on various industries. The focus here is on two familiar industries that were significantly affected: airlines and retail stores. During the initial months of the pandemic, media coverage highlighted deserted airports and empty stores, capturing the extent of the crisis. Our objective is to explore the measures taken by airline companies and retail stores to manage their cash positions and illustrate how the pandemic-induced disruptions affected their CCC.

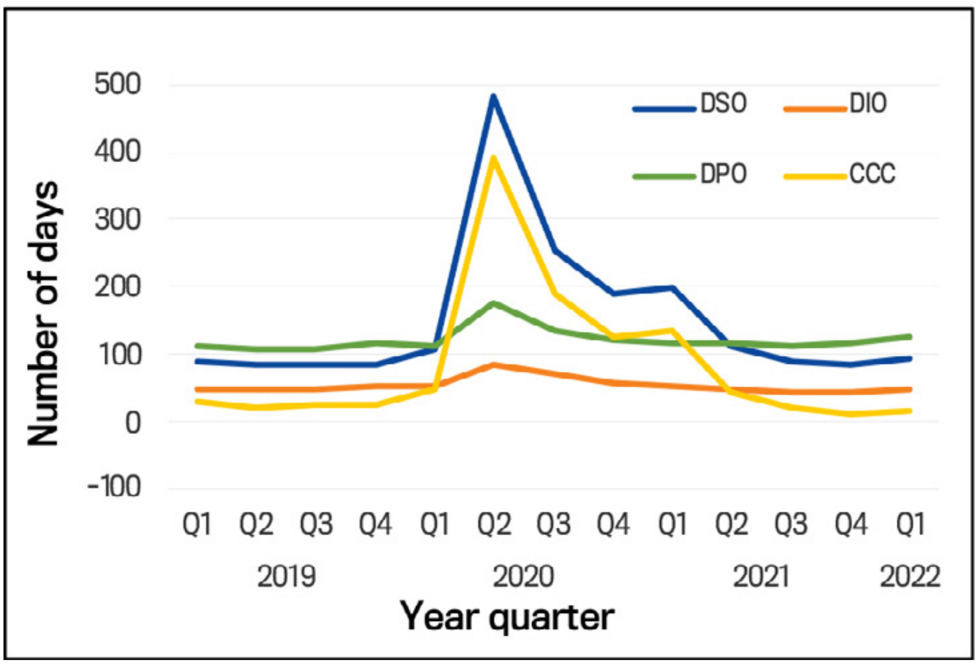
Airline Examples of CCC Management

Leisure and business travel form the most significant part of the air transportation sector. With the arrival of the pandemic, both types of travel abruptly ceased. During the second quarter of 2020, air travel practically disappeared. The Payroll Support Program (PSP) authorized by the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 and the Coronavirus

Response and Consolidated Appropriations Act (CRCA) of 2021 provided substantial economic aid totaling approximately $60 billion to airline companies. This assistance was crucial in preventing bankruptcies and providing a lifeline for airline companies to adapt their operations and manage their cash effectively.

Under normal circumstances, airline companies may exhibit a negative CCC since passenger revenue is collected before travel. But due to the pandemic, passenger travel drastically declined, causing cargo transport and auxiliary services to become relatively more significant components of their operations. An analysis of 14 airline companies, including Delta Air Lines, Southwest Airlines, and American Airlines, revealed a notable trend. As air travel revenue plummeted faster than receivables, the average DSO skyrocketed from fewer than 100 days to nearly 500 days during the second quarter of 2020 (see Figure 3; quarterly calculations overstate the number of days by a factor of 4). As air travel gradually resumed in mid-2020 and increased in the fourth quarter, the DSO decreased to 200 days, which was still twice the pre-pandemic average. Eventually, by the second quarter of 2021, the DSO returned to the customary 100 days. This trajectory of DSO closely mirrored changes in the CCC over the same period, as increases in DPO nearly offset increases in DIO.

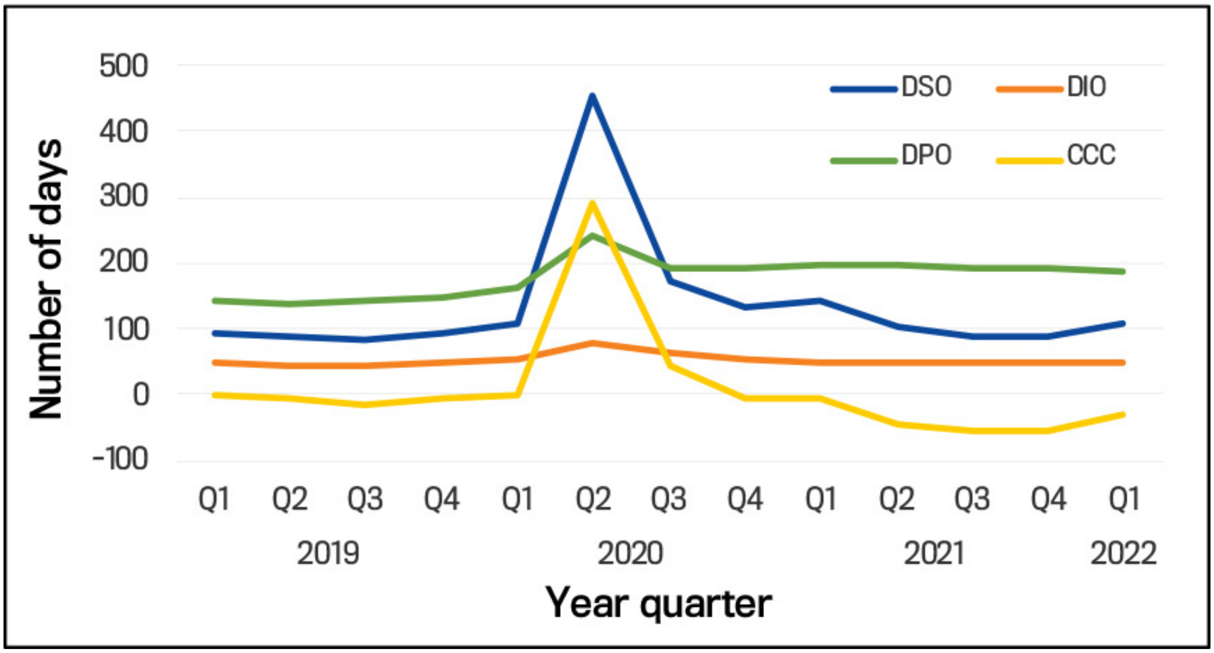
FIGURE 3: CCC MANAGEMENT AT AIRLINE COMPANIES



Delta represents major airlines with substantial domestic and international operations, while Southwest Airlines is a low-cost carrier primarily focused on domestic travel. How did the pandemic impact these two prominent carriers? Domestic travel resumed earlier than international travel, and these companies adopted distinct strategies for managing their CCC.

Delta experienced a significant decline in air travel revenue during the second quarter of 2020, dropping by approximately 95% compared to the same period in 2019 (see Figure 4). But its cargo revenue only decreased by 33%, providing some stability amid the pandemic. Delta's situation mirrored that of the broader airline industry, struggling to manage its DSO but effectively increasing its DPO by leveraging its relationships with suppliers. As a result, Delta managed to reduce its CCC length from zero to -50 days by the end of 2021.

FIGURE 4: CCC MANAGEMENT AT DELTA AIRLINES



On the other hand, Southwest Airlines, about one-fifth the size of Delta in terms of pre-pandemic revenues, also faced a drastic 95% decrease in traffic compared to 2019 (see Figure 5). But unlike Delta, Southwest proactively raised cash during the second quarter of 2020 by issuing stock and debt to mitigate a substantial weekly cash burn. The graph demonstrates a spike in DSO and CCC length during the second quarter of 2020, reflecting the decline in air travel. Throughout the remainder of 2020 and 2021, Southwest maintained relatively high levels of DSO and CCC length. This indicates that Southwest had a more comfortable cash position than Delta and the airline industry overall. Additionally, Southwest's DPO remained relatively low, as it didn't face the same need to preserve working capital or negotiate better credit terms with suppliers.

Lesson for accountants: Access to suppliers' credit is vital for effective liquidity management. Companies like Delta can depend on their relationships with suppliers to navigate liquidity challenges during times of crisis. On the other hand, companies that are unable to negotiate improved credit terms with suppliers, such as Southwest, due to size or other factors, should establish an emergency liquidity plan. This plan should encompass various strategies, including the possibility of issuing equity or debt. By understanding a company's influence over its suppliers, accountants can develop more efficient contingency plans to address a crisis.

Retail Examples of CCC Management

Unlike airlines, many retailers experienced significant customer traffic through their online channels during the lockdowns. Analyzing the graph for 164 retailers, including Kroger, TJX Companies, Best Buy, Kohl's, and Home Depot, we observe that their DSO didn't spike like it did in the airline industry (see Figure 6). Retailers predominantly receive cash or credit card payments, resulting in lower accounts receivables, and the impact of lockdowns on sales didn't have a major effect on their DSOs. But due to reduced sales, retailers held onto their inventory for a longer duration, causing their average DIO to increase from approximately 400 days in 2019 to more than 450 days in early 2020 (quarterly calculations overstate the number of days by a factor of 4).

With the introduction of government stimulus checks to consumers, sales gradually returned to previous levels by the end of 2020. These liquidity injections led to frequent stockouts as supply

FIGURE 5: CCC MANAGEMENT AT SOUTHWEST AIRLINES

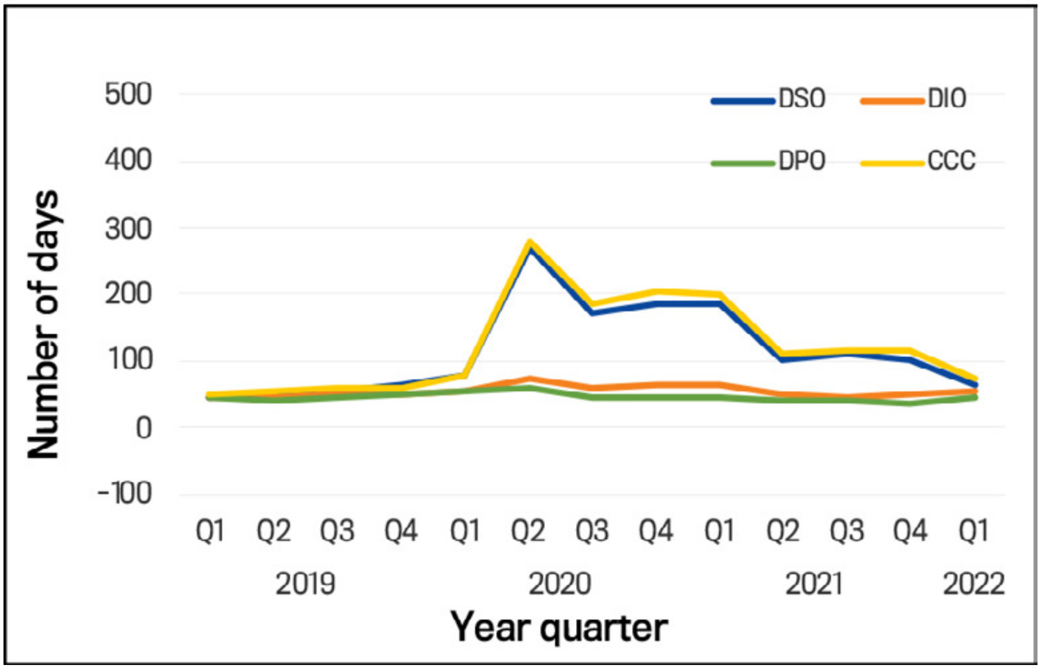
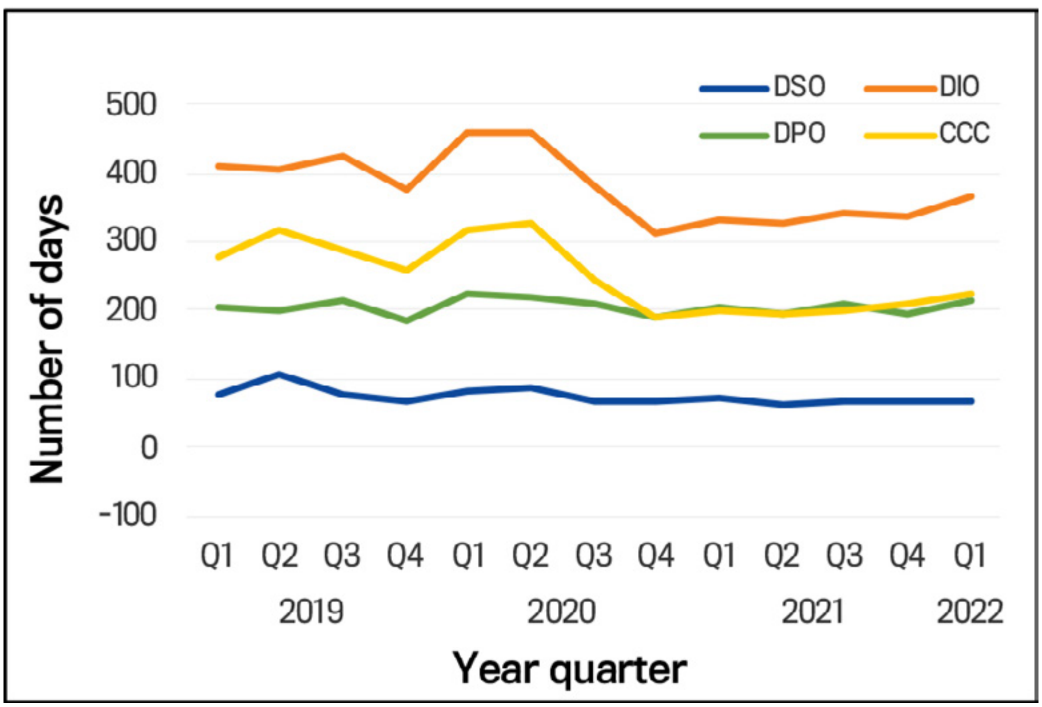


FIGURE 6: CCC MANAGEMENT AT RETAIL COMPANIES



chain disruptions affected inventory levels. The average CCC trajectory closely followed the DIO trajectory, and retailers successfully reduced their CCC and working capital requirements.

Target, a company selling consumer staples and a wide range of other consumer goods, and Home Depot, a home improvement store that experienced increased customer traffic during the pandemic (see Figure 7 and Figure 8, respectively), highlight the contrasting effects of the pandemic on different sectors of the retail industry. Due to the pandemic, people transformed

FIGURE 7: CCC MANAGEMENT AT TARGET

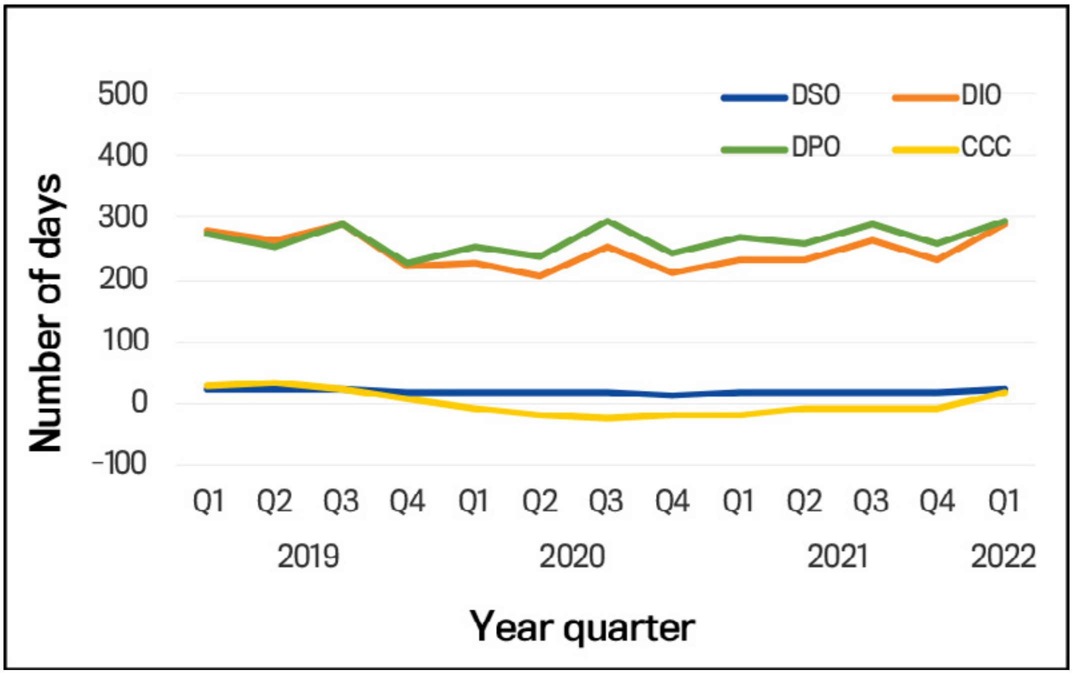
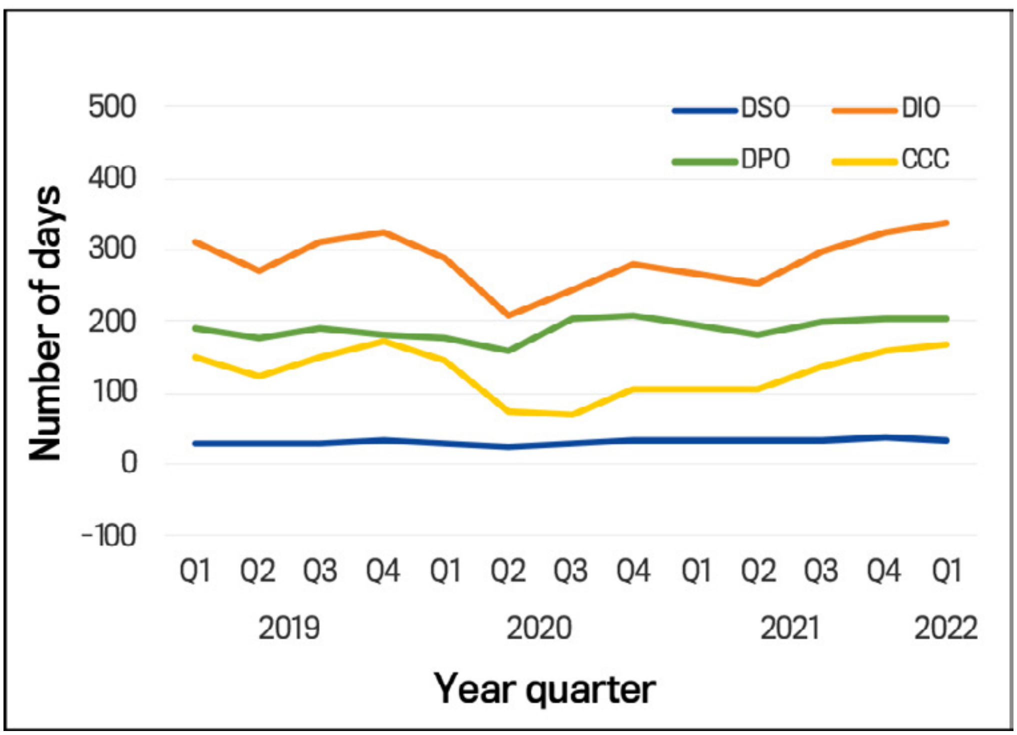


FIGURE 8: CCC MANAGEMENT AT HOME DEPOT



their homes into makeshift schools or offices, leading to increased spending and high revenue but low inventory for Home Depot. In contrast, Target's consumer goods inventory is highly seasonal, evidenced by the repeated inventory buildup during the third quarter and the sale of said goods during the fourth quarter.

The graph shows fluctuations in the DIO curve for Target, indicating restocking challenges. The delayed unloading of container ships caused Target to increase its orders in late 2020, and these were slowly delivered throughout 2021 due to supply chain congestion. In 2022, Target faced the issue of managing late-arrival inventory amid changes in consumer demand. Fortunately, Target's size allowed it to postpone payments to vendors, improving its DPO and maintaining a stable CCC length during that period.

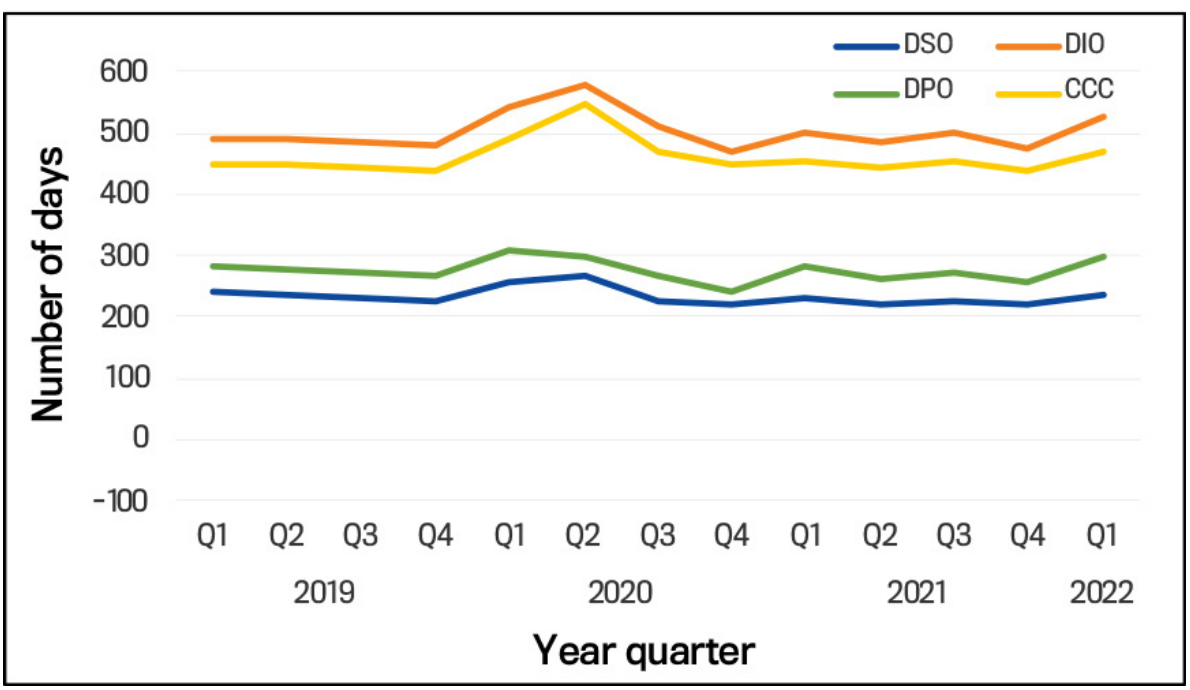
Home Depot's DIO curve significantly dipped in the second quarter of 2020. Out-of-work homeowners or individuals working from home utilized their stimulus checks to undertake home improvement projects, benefiting Home Depot. Concurrently, the DPO curve improved by approximately 50 days in the latter half of 2020. These factors combined to reduce Home Depot's CCC length by more than 100 days for nearly 12 months after the start of the pandemic (quarterly calculations overstate the number of days by a factor of 4).

Lesson for accountants: Inventory management is the apparent driver of CCC for retailers because their DSO and DPO curves are relatively stable. Together with the purchasing department and suppliers, the management accountant plays a significant role in inventory management. For instance, Home Depot's accountants can act as "voices of reason" to mitigate or prevent the bullwhip effect caused by overestimating demand.

By recognizing that the surge in demand during the early stages of the pandemic, driven by employees working from home, was likely a temporary occurrence that included projects brought forward from the future, accountants could have adjusted expectations for future demand. Consequently, as the sample period progressed from the second half of 2021 to the end, Home Depot's DIO (and thus its CCC length) returned to pre-pandemic levels and increased. This inventory accumulation was not unique to Home Depot but affected other retailers such as Target, Walmart, and Kohl's, prompting significant discounts to clear excess inventory. While each crisis differs, accountants can learn from the inventory management challenges many companies faced during the pandemic to better prepare for future unique crises.

These examples aren't isolated cases. They're representative of an overall trend. An analysis of publicly traded U.S. companies reveals a similar pattern in CCC, where most companies experienced an initial increase during the peak of the pandemic in 2020 but were able to recover and return to pre-pandemic levels. Consequently, our observations likely apply to countless companies across various sectors of the American economy (see Figure 9).

FIGURE 9: CCC MANAGEMENT AT U.S. COMPANIES



The pandemic prompted many companies to revisit an effective cash preservation tool: managing their CCC. The resilience of two key industries—airlines and retailers—that play a crucial role in the consumer-oriented U.S. economy show how organizations can take different approaches to successfully restore their CCC to pre-pandemic levels by implementing appropriate management strategies specific to their circumstances.

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Using a Picture as the Lookup Value in Excel

A new image data type in Excel allows you to find the name or description from a picture stored in a cell.

By Bill Jelen

A new method for inserting pictures into Excel is rolling out to Microsoft 365 customers. When you insert a picture into a cell in Excel, it's treated as a new data type, and the picture can be used in Excel formulas.

Before this new method, pictures were inserted into a drawing layer that floats above the cells in the Excel grid. You could use the Size and Properties settings to lock a photo so it would move and/or resize it with the cells underneath the photo.

Once you have the new feature, you'll see that Insert, Pictures leads to two choices: Place in Cell, which creates an image stored in the cell, is the new method; Place over Cells, which adds a picture on the drawing layer, is the old method (see Figure 1).

You can insert several pictures in a single command. I have a folder of some of the public domain photographs created by NASA and the NASA Jet Propulsion Laboratory. In Figure 2, with

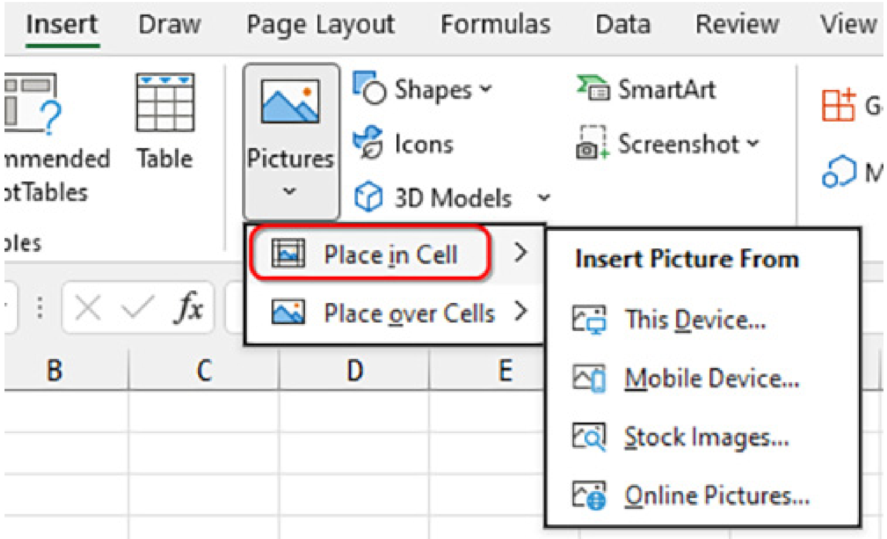

Figure 1

cell B2 as the active cell, I used Insert, Pictures, Place In Cell, and From This Device and selected eight planet photos. Excel embedded one image per cell, filling cells B2 through B9.

To create a lookup table, I typed the planet name to the left of each image. Note that a typical row in Excel has a Row Height of 15. This will make the images very small. For the lookup table used here, I increased the Row Height to 30. As the row becomes larger, the image will automatically resize to fill the available space. Eventually, you might need to increase the Column Width as well.

In Figure 3, I have created a larger cell by merging cells D2:D7. A formula in cell D2 will pull one of the images into D2: =INDEX(B2:B9,C2).

The images stored in a cell can be used in the XLOOKUP formula. The three required arguments in the formula are =XLOOKUP(lookup value, lookup array, return array). In Figure 3, the lookup value is the image in D2. You're asking Excel to find that image in the lookup array stored in B2:B9 and to return the planet name from the return array in A2:A9.

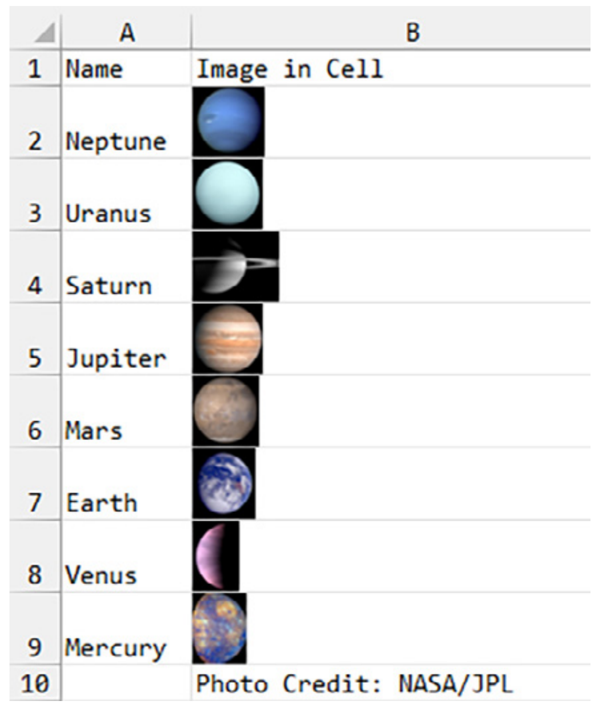

Figure 2

The result of the formula is the name "Earth" shown in D8. Note: The ability to use the image as the lookup value was discovered by Excel MVP Leila Gharani, who posted the tip on her YouTube channel. For great Excel content, be sure to subscribe to it.

The lookup can reverse the lookup array and return array to return an image associated with a name. In Figure 4, several moons from our solar system are listed in column F. The planet that each moon orbits around is in column G. To use the lookup table in A2:A9 to get the planet image in column H, use a formula such as =XLOOKUP(G2,$A$2:$A$9,$B$2:$B$9).

Improving the Feature

When you insert an image in a cell, the formula bar for that cell uses a generic value of "Picture." Initially, the only way to change the name associated with a picture in a cell was to use a Visual Basic for Applications (VBA) macro to insert the image. But in July 2023, Microsoft released an improvement to Picture in Cells. As shown in Figure 5, right-click the picture in cell B2 and choose View Alt Text.

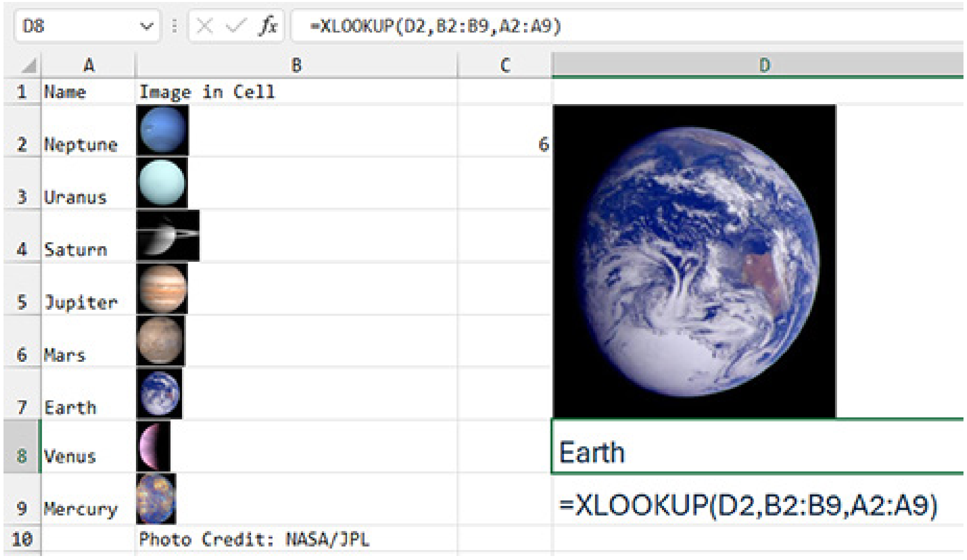

Figure 3

This opens the Alt Text panel on the right side of the screen. Normally, Alt Text is used to assist someone who's using a screen reader to view your spreadsheet. The Alt Text panel suggests one to two sentences of detail for alt text. In this case, however, a simple bit of alt text of "Neptune" will suffice as shown in Figure 6. After typing "Neptune" in the Alt Text panel, click on cell B3 and add alt text of Uranus. Continue for each of the images in your table.

Note: Using the Alt Text panel is fine for a small table with two to 10 photos. If your table contains dozens or hundreds of rows, the VBA method for changing the name while inserting the image is described in this video.

Figure 7 shows the result of adding alt text to each image in B2:B9. When the XLOOKUP formula in H14 brings the planet image into the report, it brings the Alt Text value along as well. If you use the Data, Filter command to add Filter drop-downs, the alt text is displayed in the Filter for Planet Image, allowing you to quickly filter to the moons in orbit around Jupiter.

You might use other methods for filtering, such as the AutoFilter icon in the Quick Access Toolbar, or right-clicking an image and choosing Filter, Filter by Selected Cells Value. These also work correctly after you've added alt text to each image in the lookup table.

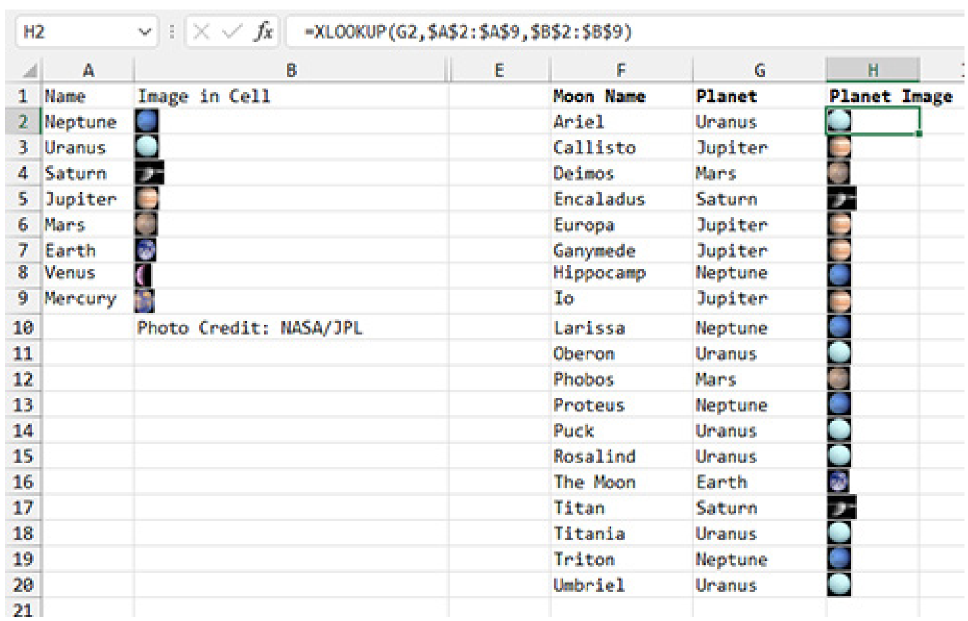

Figure 4

Seeing a Larger Picture in a Preview Window

The new Picture in Cell feature uses the Linked Data Type feature introduced in 2018 and described in Excel: New Geography Data Type in the December 2018 issue of Strategic Finance. If you select a cell that contains an image and press Ctrl+Shift+F5, Excel will temporarily display a larger version of the image to the right of the cell as shown in Figure 8.

In Linked Data Types, the Ctrl+Shift+F5 shortcut displayed what Microsoft calls a Data Card. In the new Picture in Cells feature, the window is called a Preview. You can right-click the cell, choose Picture In Cell, Show Preview to display the card.

File Size Considerations

The Excel team used a clever method to reduce file size. When an image is initially inserted into

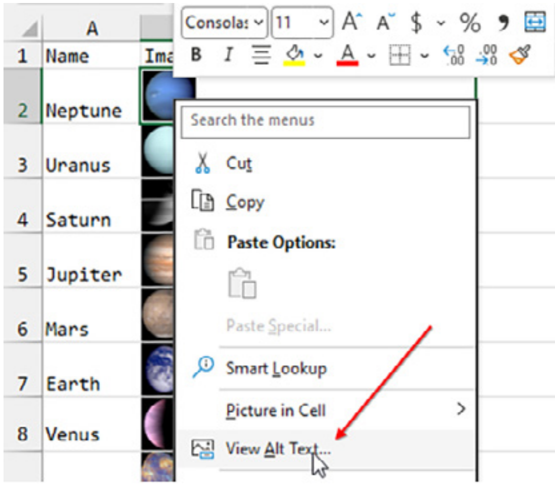

Figure 5

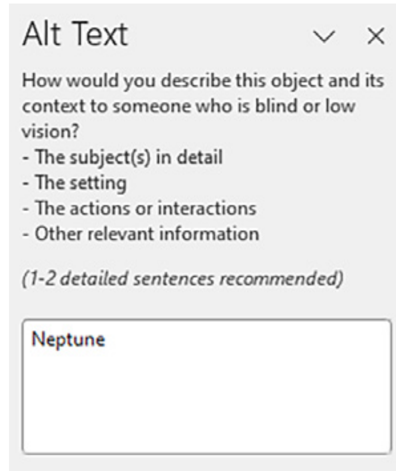

Figure 6

a cell in the lookup table, the image is embedded into the Excel workbook and the size of the workbook grows. But then, if you use a formula to pull the image from the lookup table and repeat the image 100 times, the file size barely increases. For example, the image of Jupiter is 452,816KB on disk. Adding Jupiter to the workbook increased the file size by 438,475KB. But then repeating Jupiter 100 times using an INDEX function added only 1,840KB.

Embedding images inside of cells as if they were another type of data is a great improvement

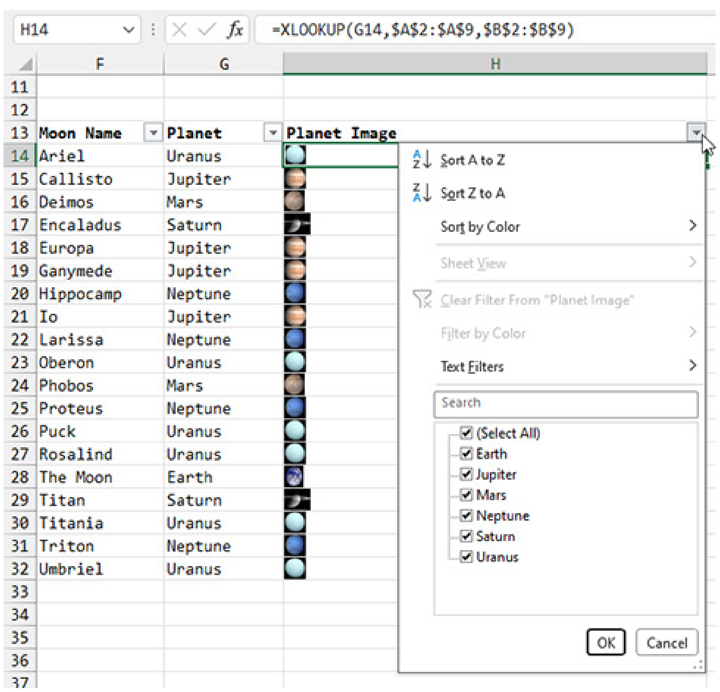

Figure 7

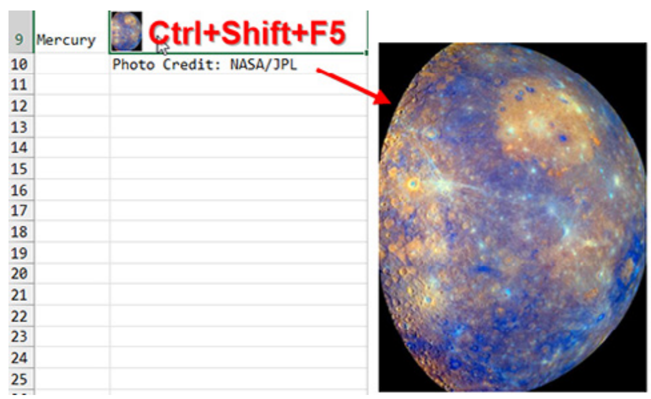

Figure 8

for Excel. There will be many applications where you can add an image of a person or a product to a dashboard report and have that image change in reaction to slicers or other inputs. If you're eager to try out this feature now, ask your IT department to enroll you in the Office Insiders beta program for early access to features.

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.

Digital First: The ESMA Data Strategy

The European Securities and Market Authority plan is a useful road map for developing an organizational data strategy.

By Kristine M. Brands, CMA

In June 2023, the European Securities and Market Authority (ESMA) released its ESMA Data Strategy 2023–2028 to present a framework to digitize data collected from its European Union (EU) member stock exchanges supporting its strategy to develop the European Single Access Point (ESAP) data hub. ESMA is an independent EU market authority that oversees EU security trading. Its mission is to protect investors, facilitate market stability, and promote orderly market functioning. To achieve its mission, the authority developed a data strategy plan to address the rapid changes in technology and reporting requirements that will soon be effective for its new regulatory mandates: the Corporate Sustainability Reporting Directive (CSRD) and its proposed ESAP portal.

The CSRD is a game changer for environmental, social, and governance (ESG) reporting that becomes effective for EU companies in 2024, while the ESAP portal is a single digital access point for EU companies' publicly reporting financial and sustainability information. The plan is significant because it lays out ambitious objectives to provide data transparency and comparability to its many stakeholders. This dynamic document will be updated to accommodate new developments in technology and future supervisory mandates issued by the EU and supervised by ESMA. ESMA's data strategy plan serves as a model that management accountants can adapt to their organization.

ESMA's Data Strategy Motivation

ESMA issued its initial data strategy in 2017 and recognized that it needed to be updated to address changes that occurred since then. In 2021, ESMA assessed its data and analytics maturity level and found that it fell in the opportunistic category, considered low-maturity or basic. Gartner defines this category's level as an organization with business units that pursue stand-alone projects or initiatives without a common, coordinated, integrated structure across the organization.

ESMA's data is a strategic driver to support its enforcement of consistent and clear regulatory mandate reporting standards. ESMA collects its members' reporting data and analyzes it to support its supervisory role. ESMA's analytics was suboptimal, impacting the value of the data for its stakeholders. Hence it needed to develop a data strategy to achieve its mission. Verena Ross, chair of ESMA, said: "Our goal is to provide easier access to financial data, both through enhanced data sharing with authorities across the EU and at national level. Initiatives such as ESAP will provide access to financial data to the wider market, including retail investors."

Data Vision Statement

After the maturity level assessment, ESMA developed a data vision statement. ESMA's data strategy vision is to "contribute to ESMA's mission with high quality data and analytical information." To achieve the vision, ESMA identified three goals: data efficiency to reduce compliance costs and improve data quality, share reported information and knowledge and its tools with the National Competent Authorities (EU member-country stock exchanges governed by ESMA), and support ESMA decisions with evidence-based data. The data strategy will be supported by annual work plans, projects, and programs to operationalize its strategy.

ESMA also created a data intelligence and technology department to manage the data life cycle for the plan's activities and to develop competencies necessary to implement it.

ESMA's Six Data Strategic Objectives

ESMA established six data strategic objectives with a proposed implementation between 2023 and 2028. The objectives are fluid and will be modified as necessary as data needs evolve.

1. Create an enhanced data hub: Ensure accessibility to securities transactions, interoperability, and usability with member states' systems. While the EU is focusing on a centralized data hub, each member state has its own proprietary regulatory reporting system that needs to securely connect to ESAP.

2. Serve the public interest through transparent and easily accessible data access: The data will be collected and disseminated in a machine-readable format to serve stakeholders' needs, including those of investors and regulators. The format of the data hasn't yet been defined, but Inline eXtensible Business Reporting Language (iXBRL) is a leading candidate.

3. Implement data-driven supervision: Enable and leverage technology to achieve effective data-driven governance and supervision.

4. Develop thought leadership: Pursue thought leadership and collaboration on data standards, technologies, and reporting innovations.

5. Create an efficient data policy: An efficient, centralized, transparent, and cooperative data policy reduces compliance costs and burdens for all stakeholders and meets data requirements.

6. Develop a structured and standardized data usage policy: Ensure that relevant and data-driven systems support compliance requirements to reduce costs and promote efficiency. Focus on evidence-based policy development that carries through to oversight.

Implication for Management Accountants

All organizations face the double-edged sword of technology's rapid growth: disruption and opportunities. Understanding and leveraging technology to manage data will lead to value creation and a competitive edge. The ESMA plan is an excellent model for management accountants to study as they develop their organization's data strategy.

The initial plan provides a high-level road map toward optimizing an organization's data and analytics strategy employing a standardized development approach: define, design, implement, run, and use. After the plan is developed, it's converted to projects with measurable project objectives. An organizational imperative is to develop an agile data strategy plan to address the challenges to stay competitive. Management accountants' participation in this initiative is key to achieving this objective.

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Set an Attainable Goal

Breaking her study plan into manageable bites enabled this CMA Scholarship awardee to earn one of the highest exam scores.

By Brandy Via

In spring 2020, I was fortunate enough to receive the CMA® (Certified Management Accountant) Scholarship through Kent State University, an honor that would allow me to take both parts of the CMA exam at no cost. At the time, I was a stay-at-home mom and a part-time student pursuing my master of science in accounting. After that spring semester wrapped up, I attempted to start studying for the CMA without any concrete study plans. I flipped through some study materials and quickly grew overwhelmed. Before I knew it, I was derailed from the goal I had set for myself, which was to pass both parts of the CMA exam and earn my certification.

For the next two years, I continued to pursue my accounting degree. It wasn't until summer 2022 that I began reflecting on the generosity of the faculty who entrusted me with the CMA Scholarship and on all of the opportunities the CMA certification might bring me in the future. With newfound resolution, I decided to take both parts in the fall 2022 exam window before my scholarship ran out. I knew it was an aggressive goal, but I was determined to stay focused and give it all I had. I first purchased study materials and came up with a study plan. My plan was to evenly distribute the study materials into the days before each part of the exam, allocating a few days for a final review right before each test day.

Over the next few months, I focused on executing my plan. Every day, I would first scan the study materials for that given day and then quiz myself using a batch of timed multiple-choice questions. I would then review the questions I missed and attempt another round of questions. I repeated this process throughout the day until I felt comfortable with the material and my speed. For my final review, I took mock exams and revisited areas where I struggled. This part was crucial because it not only helped me identify my weak areas, but it also helped me become familiar with the test structure and how to manage my time during the actual exam.

When the exam day arrived, it was all about putting everything I knew on paper. My main goal was to stay focused, think positively, and remain calm. I told myself that I had put in the time, and I should know enough to pass. I watched the clock closely in order to keep a steady pace. And if I didn't immediately recognize the material that was asked in a question, I would make an educated guess and move on. I was very surprised (even to this day) that somehow I not only managed to pass the exam, but I also received the Priscilla S. Payne Outstanding Student Performance Award for earning the highest exam score for the September–October 2022 testing period.

If I could share some advice for prospective CMA candidates based on my own experience, I'd say come up with an attainable study plan that works with your schedule and be consistent. There will be days when you don't want to study or you feel discouraged, but you should find a way to get up and do what's needed. Remember, that's the only thing that separates you from your goal. Obviously, it's easier said than done, but there's no easy way out.

Best of luck to those of you pursuing the CMA!

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