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CONTROLLER'S REPORT
MEMBER BRIEFING

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CONTENTS

BUDGETING

Common Budgeting Process Challenges and Best Practices for Solving Them (Quick Code 071401)

Traditional budgeting processes are rife with glitches, and controllers must work hard to ensure the usefulness and accuracy of these processes. Yana McConaty, co-founder of Neubrain, a Washington, D.C.-based company that specializes in analytics for budgeting, forecasting, and reporting, explains four common budgeting challenges controllers need to be aware of. She also offers key best practices for keeping the budgeting process on track.

Challenge #1: Traditional budgeting does not adequately link financial investments to results or outcomes, which makes it difficult for controllers to perform in-depth analysis or to understand the likely return on any given business investment.

Best practice: Use a performance-based approach that allocates resources to specific objectives or activities based on appropriate KPIs and metrics.

"Many organizations are used to thinking of budgeting as a purely fiscal or financial exercise, but budgeting should be viewed as a financial representation of your organizational strategy," says McConaty. "In order to be more agile and fiscally responsible, you need to be able to track budget requests to specific objectives, priorities, or outcomes the organization would like to generate. This is called performance-based budgeting or budgeting for outcomes."

Departments within an organization should be basing their budgets on what performance targets they are aiming to hit. "Budgets should always be framed around the appropriate performance goals, KPIs, and metrics," stresses McConaty. "Managers need to look at the budgeting process in a more strategic way. Never simply look at last year's numbers and increase them by three percent to reflect inflation. This approach overlooks opportunities to optimize investments and achieve returns that are aligned with strategic goals."

Challenge #2: Budgets tend to be created on the basis of requests from stakeholders who are all competing for the same dollars—and who are focused on the needs of their specific functional area rather than the strategic goals of the organization.

"This budgeting is based on who screams the loudest: whichever department manager pushes the hardest will get the most money, whether or not this department is engaged in work that is truly critical for the organization to meet its most strategic objectives for that budget year," says McConaty.

Best practice: Use an evaluation framework that is based on priority.

"Instead, look at this year's strategic plan for the organization and then establish targets and priorities based on this year's strategic goals and communicate them to all stakeholders involved in the budgeting process. This will save a tremendous amount of time in terms of time spent coming up with ineffective budgets as well as time spent haggling over those budgets.

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Organizations will enjoy shorter negotiations, quicker decisions, and less time-wasting conflict."

Challenge #3: Traditional budgeting is often based on inaccurate assumptions.

Best practice: Use a business-driver-based approach to create more accurate assumptions.

"When you start creating a budget, do your homework and build in correct assumptions from the beginning," says McConaty. "Look at operational drivers such as FTEs, customers, units of output, square footage of space, and then make assumptions and projections in multiple scenarios to see what the impacts would be if your assumptions are incorrect. Make sure to do best-case and worst-case scenarios."

Driver-based budget planning uses mathematical, linked relationships to create detailed budgeting and forecasting models with fewer inputs than traditional models. This approach reduces errors and saves time by using preset calculations based on operational activities.

Challenge #4: Budgets are often set in stone and difficult to adjust.

Best Practice: Establish a clear and workable process for changing the budget if necessary.

It is a major problem if there are emergencies or changed priorities during the year that necessitate a rapid reallocation of funds. Unexpected situations calling for fast budget changes could include natural disasters, hacking or other security breaches, a catastrophic system failure, or a dramatic change in the market, says McConaty.

"Most organizations do not plan for this. To be successful, budgets should be updated as needed in response to changes in economic, organizational, and other variables, rather than viewed as set in stone. Organizations need to create a formal process for quickly changing the budget based on certain parameters," stresses McConaty. This process needs to have a high level of visibility; have mechanisms in place for approvals that include where to submit budget changes and how to execute those changes; and have the technical capabilities in place to do transfers of funding to move money from one department or unit to another.

"Organizations also need to track their actuals very closely to determine whether the budget is in fact appropriate for their needs as they go through the year or whether a change needs to be made," McConaty adds. "They might need to reprogram the budget or move funds around."

The bottom line: "The better organizations know their risks, the better prepared they will be to respond if there is an emergency that calls for a reallocation of funds," says McConaty. "Budgets that take into account performance under 'what-if' scenarios will serve an organization better than budgets that ignore future risks and are based too heavily on the past."

Editor's Note: For additional budgeting process challenges and best practices, go to http://info.neubrain.com/iofm to read McConaty's guide on overcoming budgeting process challenges, implementing best practices, and leveraging new technologies to automate and simplify the budgeting process. ❑

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REGULATORY AND TAX COMPLIANCE

FATCA: A Compliance Checklist (Quick Code 071402)

The provisions commonly known as the Foreign Account Tax Compliance Act (FATCA) were added to the Internal Revenue Code in March 2010. According to the U.S. Internal Revenue Service (IRS), FATCA targets non-compliance by U.S. taxpayers with foreign accounts. FATCA focuses on reporting:

- By U.S. taxpayers about certain foreign financial accounts and offshore assets; and
- By foreign financial institutions about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest.

The objective of FATCA is the reporting of foreign financial assets. Withholding is the cost of not reporting.

According to Marianne Couch, J.D., Member/Manager, COKALA Tax Information Reporting Solutions, LLC, there are several steps organizations can take in order to ensure their compliance with FATCA's provisions and avoid penalties. These steps are as follows:

➢ **Create a task force within the organization to review FATCA impacts.** This task force should include representatives from all global operations and global business units as well as global tax, legal, and IT representatives. If such a group already exists at the company, find out what the task force has already identified that could change your practices.

➢ **Know which individuals or businesses constitute your organization's "foreign entity" payees.** If a strategy does not already exist, establish a way to identify preexisting accounts so they can be properly tracked going forward.

➢ **Be able to identify prima facie foreign financial institutions (FFIs).** Determine whether qualifying for some clients will require registration with the IRS as a participating or registered deemed-compliant FFI.

➢ **Make sure that practices and procedures regarding the due-diligence review of account information are compliant with the new FATCA requirements.** Make sure that your organization is ready to handle the most recent W-8 forms and FATCA payee classifications.

➢ **Have all the right documentation.** You will need W-9s or documentary evidence of U.S. status from the U.S. payers, corporations, and other financial institutions that you were exempting from 1099 reporting under the "eyeball test" to avoid FATCA withholding in 2014.

➢ **Check your accounts.** Evaluate whether your organization holds CDs, money-market deposit accounts, or other products that pay deposit interest. Check to see whether your company pays insurance premiums that will require the development of new withholding capacities.

➢ **Look at IT and coding considerations.** Assess IT capabilities to determine what supporting operations and system changes will be necessary to allow FATCA compliance. Determine whether your current system will be able to handle new codes for covered and exempt FATCA income to enable both proper FATCA withholding and 1042-S reporting for 2014. Keep in mind that new income codes and new withholding codes will be needed to support both FATCA withholding and 1042-S reporting.

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➢ **Add FATCA to your staff training list.** Finance staff in accounting and AP will require training in FATCA compliance.

"It will be critical to quickly get a handle on the impact on any offshore affiliates," Couch stresses. "Also, you must think about the methods of filing, filing formats, and record layouts you will need to have in place for the new reporting responsibilities."

"The biggest issue controllers need to focus on is understanding how entities are defined for FATCA purposes," says Couch. "Right now, the only place to find the definitions is in the regulations, which is a hard slog to get through."

"The definitions will presumably be included in the Form W-8BEN-E instructions, but we don't have those from the IRS at print time, which is another issue, as the FATCA effective date is July 1," says Couch. "Further, beyond just the complexity of complying with the FATCA requirements, the other big issue is having to obtain W-9 forms from U.S. corporations that could previously be 'eyeballed' out of the 1099 reporting requirements."

"The biggest required systems change, among the many that are required, is probably a realization that AP accounting systems need to include mechanisms for tax withholding. Tax withholding on AP payments is not a new requirement; it has existed in the 1099 and 1042-S world for years, but most organizations are working with platforms that do not easily allow for withholding. With the FATCA implementation, that's going to have to change," says Couch.

Editor's Note: Marianne Couch, Principal, Cokala Tax Information Reporting Solutions, will present a Sales & Use Tax workshop and "Form 1099 Update" at the Controller's Conference & Expo, September 14-16. For more information, go to http://www.iofm.com/controllers-conference. ❑

DUE DILIGENCE

The Controller's Role in the Due-Diligence Process

(Quick Code 071403)

By Bob Sefton, Controller, Nomacorc

In a competitive business environment it is likely that controllers will be engaged in the due-diligence process. This article identifies some of the key expectations of the due-diligence process and outlines the potential roles of the controller.

An organization's prospective commercial undertakings could either provide financial benefit or be a source of financial disappointment. To become aware of the risks and improve the chances of a positive outcome, the company on the buying side will engage in the process of *due diligence*—the informed decision-making process of investigating all facts, conditions, rules, regulations, financial information, data metrics, and other performance indicators.

The scope of due diligence can be very broad, cover a large array of information, and involve third-party professionals such as lawyers, audit firms, tax specialists, and other experts who require different forms of evidence, factual information, historical trends, and other supportive data. The due-diligence process always entails requests for data. Requests for data can take on many formats and reflect different methodologies that dramatically contrast with current or past financial format and company practice. The format of a request for data is fully dependent on the focus of the initiating organization to the target organization.

The process itself will require contributions from a cross-functional team drawn from assorted company disciplines (including finance, of course) and must satisfy a legion of independent data-gathering professionals and potential decision-makers. In this situation, the controller must take on several key roles:

➢ **Facilitator and coordinator.** The controller must play the part of a facilitator and coordinator of the process and may be asked to act as the primary intermediary between the target business and the third-party interests. Whether the controller is from the initiating organization or the target company, the burden will be to establish focused protocol and organizational discipline.

All documents used in the due-diligence process, which are viewed by key outside decision-makers, can make or break the deal. "Protocol" in this context refers to the set of rules that needs to be followed in the presentation and content of these documents. For example, the presentation may need to be in standardized format (such as PowerPoint) and based on a specific template, may have to be on company letterhead, may need to be in the form of a bound booklet, or may need indexing criteria as specified by third-party information requesters. "Organizational discipline" refers to the level of strictness and confidentiality in the due-diligence process—for example, who should have access to information and who is allowed to provide information to third parties.

➢ **Negotiator.** The controller must be prepared to negotiate internal and external data requirements to ensure that they are reasonable and achievable and can be completed within the defined time frames.

➢ **Process monitor.** The controller must balance resources for the due-diligence project, provide for continuity of day-to-day operations while finance people are involved in gathering information and engaging in other activities for the due-diligence process, make assignments, define responsibilities of the parties who will contribute to the process, and—finally—monitor progress. The controller could also develop checklists and guidelines for the goals of each step of the process.

➢ **Data-gatherer.** During the due-diligence process a special confidential, centralized, and shared data directory needs to be established. This directory includes key information for such categories as financial, legal, marketing and sales, operational, environmental, technology, and human resources.

While many companies retain good financial data, much

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Master Guide to Controllers' Best Practices of the data requested during the due-diligence process will be non-financial or statistical. This data may not exist as requested and may need to be explored, gathered, recreated, and documented. Usually, historical data trends are required that may go back five to 10 years. For example, the controller may be asked for a list of the top 20 suppliers and customers for each of the last 10 years, along with volumes by product and the average purchase/sales prices.

While this may sound pretty straightforward, the requested data could be variable and situational from year to year based on operating economics or market conditions, and would therefore require explanation for the data requesters who do not understand the reasons for the variation. The controller must be flexible in accommodating requests for the same information that might be made multiple times but in different formats by different parties or with an assorted level of data analytics required.

The controller must also know where to retrieve data, anticipate variations in format, and build files that can be expanded from a basic set of information to accommodate variations in analytics. Requests might include organizational charts and process flows from each company functional area of the organization. Most companies have organizational charts handy but do not have process flow information, which may need to be created. This type of request needs to be handled in as simple a manner as possible in order to keep the information basic and understandable to satisfy the general need of the data requesters from the other company.

Understand the Process

The scope of due diligence is situational and diverse. The controller needs to understand that the process of due diligence is different from any normal process, such as financial reporting or traditional audit engagements. Everything could be subject to situational analytical review by third parties.

For the initiating organization, the successful completion of due diligence means that the company has obtained enough information to proceed in making an effective and informed decision. For the target organization, due diligence should be a benchmark learning experience and provide for a comprehensive and expansive database that could lead to greater opportunity, improvement, and profitability. ❑

FINANCIAL LEADERSHIP

How to Shift a Culture That's Eroding the Bottom Line

(Quick Code 071404)

By Mike Sbrocco,
Director of Finance/Controller, Junxure

Your CEO has just announced that the culture at your company has gotten too lax and change must happen ASAP. Or you just came on board as controller at a new company and you're concerned about workplace behaviors that are eroding productivity and efficiency. Or you simply wake up one Monday morning after spending another weekend worrying about excessive social media use and socializing at your office and decide "something's got to change!"

Controllers often find themselves in the position of needing or wanting to effect a culture change at their organizations. This is a challenge, to say the least—especially if you are new to your role. After all, nobody wants to be regarded as the "bad guy" who is making work life difficult or unpleasant! Even we "numbers people" are human beings, right?

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Still, as controllers, we are obligated to take some type of action when we know it is in the best interest of the company's bottom line. While it can be difficult to quantify the effects of lax cultures on finances, the impact is there nonetheless—and it's up to us to do something about it. So what can we do? Here are some suggestions:

Understand the root of the problem by gathering as many facts as possible. Is this situation isolated or does it exist across an entire department or across the company? Is the issue a lack of policy, or are employees simply flouting the rules? Are managers in different departments applying policies differently, or cutting lots of slack for long-time or favored employees?

For example, some companies may have a work-from-home policy but Manager A may let people work at home whenever they feel like it, while Manager B may allow it only when an employee has a sick kid or there's bad weather. But the issue is more complicated—people who work from home may be even more productive than those who work in the office. It may bother you that so many people in Department A are working at home, but is this really negatively impacting the performance of that department?

Peel back the layers of the onion and look at such issues as: Are deadlines being met, are productivity numbers where they need to be, and are departments meeting their performance and bottom-line goals? This will help you determine whether the behaviors that trouble you are in fact symptoms of the need for culture change.

Address the problem with the appropriate supervisor. If it's just that one employee is really taking advantage of the work environment, you could simply address the problem with the person's department head or supervisor. (If the situation involves staffers in finance, your job is relatively easy; you can simply talk with the employees and request a behavior modification.)

Assess the way things are now and what would constitute reasonable change. Before you go to your CEO to bring up your concerns, document what you are observing and come up with clear ideas for how things need to change. For example, did you notice that three out of five times you walked by certain employees' desks they were on social media sites or surfing the Web? Or have you consistently seen the same group of staffers hanging out in the break room gabbing for lengthy periods of time? Does the issue concern only one department, or is it across the board?

Keep in mind that most progressive workplaces understand the saying about "all work and no play," so consider what would be reasonable before you suggest implementing a stringent new policy.

Gauge the effects on morale. When one employee (or a small group) consistently gets away with murder, this negatively impacts team morale. This, of course, can erode productivity and the bottom line. It's frustrating if one person is working his or her butt off and the person sitting next to her is surfing the Web. So morale is something controllers need to consider when making the case to leadership that the culture needs to change and new policies are in order.

Do your best to quantify the numbers. It is hard to quantify the bottom-line effect of a lax culture, but there are research studies out there that give figures on the cost of time spent on the job engaged in non-work activities, as well as trends, such as online shopping peaks around holiday time and millions of dollars lost in productivity during "March Madness" season. Controllers should pull statistics from these studies when making their case to management.

Present the problem to upper management. Controllers need to say, "Here's what I am noticing, I think we should address it, and here are some ways to do that."

Keep an open-door policy and listen to your people. It's important for controllers to listen to their employees and let them vent, even if a culture problem cannot really be solved. For example, say there are a few people in the sales department who consistently submit their expense reports to AP late. The controller has tried talking with the head of sales but the culprits are long-time salespeople who have been allowed to get away with flouting the rules for many years, so the problem persists. In such a case, the controller needs to sit down with AP staff, listen to their frustration, acknowledge their feelings, and tell them they'll just have to deal with it.

The bottom line: The controller is in a great position to drive positive culture change, but you have to be willing to step out of your comfort zone and challenge the status quo. If you notice that people are spending too much time on the Internet, and that is affecting productivity and the bottom line, you need to be willing to address the problem.

If you take your concerns to upper management and they decide not to act on your suggestions, at least you've done your job. And there is always the risk that you will be perceived as the "bad guy" if significant changes are implemented because you raised a red flag—but the flip side is that a lot of people could respect you. Most employees don't appreciate it when their coworkers are spending their day doing non-work-related stuff online. The conscientious workers will appreciate you for taking a stand. ❑

PAYROLL COMPLIANCE

Payroll Record Retention: How to Avoid Penalties

(Quick Code 071405)

By Raeann Hofkin, CPP

Under the Fair Labor Standards Act (FLSA), the Wage and Hour Division of the U.S. Department of Labor requires that all employers keep certain records for all employees. Most of these records are to be retained for two to four years. Failure to maintain proper records can be costly in terms of noncompliance penalties as well as penalties for violating record retention requirements. Here's how to avoid those potentially costly penalties.

What Needs to Be Kept and for How Long

The DOL requires that the following records be retained for at least two years for all employees:

- Wage rate tables,
- Piece rate schedule,
- Work time schedules for hours & days of employment,
- Basic employment and earnings records, and
- Timesheets.

Employers are required to retain the following basic records for all employees for at least three years:

- Home address (including apartment no. and zip code),
- Birth date (if the employee is younger than 19),
- Sex and occupation (to determine compliance with the Equal Pay Act),
- Work week begin dates and pay period ending dates,
- Hours worked and total hours worked each work week,
- Total overtime earning for the work week, overtime premium,
- All additions to/deductions from employee's wages,
- Total wages paid each pay period, and
- FMLA records.

Employers are required to keep the following basic records for all employees for at least four years:

- Employee's full name, occupation, and SSN;
- Pay period beginning and ending dates, and pay dates;
- W2, W3, and W4 forms;
- Tip reporting statements;
- Fringe benefits paid;
- 941s, 940s, and other tax returns and proofs of payment; and
- The employer's EIN.

Miscellaneous Record-Retention Guidelines

The Department of Labor has also established miscellaneous record-retention guidelines. These are as follows:

✓ State unemployment laws require record retention for three to five years (depending on the state).

✓ Unclaimed wages depends on state requirements and can be up to 10 years.

✓ I-9s need to be kept for at least three years after date of hire or one year after termination, whichever is later.

✓ OSHA and safety-related data should be kept for a minimum of five years.

Format Is Flexible

While organizations must ensure that their records are accurate and complete, the Department of Labor has no requirement that employers keep records in any particular format. The important thing is to keep records accessible.

For example, if records are retained electronically, the employer must have the ability to retrieve them within 72 hours of a notice from the Department of Labor.

Penalties Can Be High

Poor recordkeeping leads to incomplete records, which could lead to compliance penalties. For example, if an

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Master Guide to Controllers' Best Practices employee files a lawsuit claiming that the employer failed to pay the required minimum wage or overtime, and the employer has incomplete or missing records, the court will most likely accept the employee's evidence of hours worked and wages received.

Willful violations of recordkeeping requirements can bring criminal penalties as high as $10,000 and/or imprisonment for up to six months. To avoid trouble, create a company policy governing record retention as well as a policy for the destruction of records. A consistently applied policy of retention and destruction is a best practice and an organization's strongest defense against penalties.

In the event that there is a lawsuit and the employer lacks written policies, destruction of records might be taken as proof that only documents damaging to the employer were destroyed. The policy should also address how the employer properly disposes of such information by taking "reasonable measures" to protect against unauthorized access to personal information. ❑

PROCESS IMPROVEMENT

How Controllers Can Become Process-Improvement Pros

(Quick Code 071406)

There is more pressure than ever on controllers to go beyond the "basics" of their jobs (as if they didn't have enough on their plates) and focus on improving processes. To find out how controllers can become strong process-improvement experts, *Controller's Report* interviewed Alan Hart, a consultant with Pacific Shine Group, a West Coast-based firm that specializes in accounting, financial, and compliance services.

Hart has more than three decades of experience in the accounting and finance professions, including executive roles as controller, VP of finance, and CFO in such diverse industries as manufacturing, high-tech, software development, publishing, retail, and wholesale.

"Today controllers must be much more than experienced accountants," says Hart. "No matter what industry a controller is in, or the size of the organization, the fundamental requirements and expectations are the same: lead the accounting department in delivering an accurate, complete set of financial statements and other data and reports while contributing to the increased financial performance of the organization. This means having leadership skills, drive, and the willingness and ability to make changes to major processes."

Here are the steps Hart recommends:

Listen and learn to pinpoint where improvements are most needed. "Controllers can become good process improvers by listening to employees and managers and learning what the real issues and obstacles are," he says. "Also, controllers must invest time and effort in learning and understanding what the organization's existing technology capabilities are, as many of the needed changes will depend on making maximum use of, and/or upgrading, this technology."

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Ensure that all accounting processes are well defined and accurate. "One of the controller's highest priorities is to ensure all accounting processes are thoroughly defined, understood, and documented," Hart says. "In a well-implemented, computerized accounting system or ERP solution, a well-designed chart of accounts and accurate and complete integration of all subsidiary systems and automated/IT controls will substantially increase the accuracy and completeness of the bulk of accounting transactions."

"The rest of the processes—some of which are manual in nature—will be easier to monitor once they have been documented and fully understood. The importance of the investment in time and effort controllers must make in this area cannot be overemphasized," Hart adds.

Achieve maximal internal control via automated processes. "It is well established that automated/IT controls, once tested, approved, and implemented, will continue to perform consistently and reliably until they are changed (or tampered with). A solid change-management process, as part of IT controls, will ensure that all changes are authorized, reviewed, and tested before actual implementation in the live/production system," Hart explains.

"A modern-day controller must be confident that these controls are both correctly designed and effective," he continues. "This will ensure that most of the accounting transactions flow correctly through the system and end up in the right places in the financial statements."

Example: Manufacturing employees log production or job hours into an automated time-collection system, where their employee ID, machine, or work center, product or job/work order data are automatically captured along with the operation/ routing sequence time. With the proper IT controls, this data will automatically translate into absorbed labor and overhead in the correct product made or job performed, in the right amount required to add value to inventory work-in-process (WIP).

"In this example, the controller has to simply review and verify that absorption of labor and overhead into inventory closely matches the anticipated expenses that should be applied to inventory," Hart explains. "This is in contrast to using a manual control of reviewing employee paper time cards, and reviewing accuracy and completeness of data entry performed in order to accomplish what the automated system does completely unattended."

The end result: fewer exceptions. Exceptions inevitably require manual adjustments to transactions, manual journal entries (with their own required manual controls of reviews and approvals), and other research of actual transactions. "This places additional demand on accounting staff and the controller," Hart points out. "When there are fewer exceptions there is less work for everyone and better mitigation of risks to financial statements."

With automated controls in place, Hart says, controllers have greater confidence levels that financial statements are reasonably free from misstatements that could occur if the IT controls were not in place (or were not properly designed and tested for effectiveness). "The controller can become more of a process designer than an accountant who constantly reviews and corrects transactions," he notes.

Turn errors into improvements. When errors take place, controllers can turn those errors into opportunities to implement a process improvement, Hart points out. "Investigate, understand the reason behind the error, and immediately design and implement a process change, with a new or revised control that will mitigate the risk of such an error occurring in the future," he advises.

Organizations are relying on their controllers to move from a reactive mode of continually struggling to correct recurring errors to a proactive mode of eliminating errors through strategic process improvement. "When controllers implement automated/IT processes and controls in accounting and reduce exceptions and errors, it frees up time that can be used in performing analysis and other tasks that will streamline reporting processes and increase company profitability," says Hart. ❑

STRATEGIC PARTNERSHIPS

Collaboration Between Finance and Supply Chain Makes Good Dollar Sense (Quick Code 071408)

Leaders in both finance and supply chain need to focus on building a collaboration in order to effectively unlock both the cost and agility advantage of the supply chain. Through this collaboration, finance leaders can support supply chain leaders in ensuring greater alignment with corporate strategy, better investment decisions, better risk management, and improved supply chain insights through analytics capability.

Keith D. Dabbs, MBA, APM, Senior Manager of Procurement and Sourcing at Riverside Health System (Newport News, VA), suggests the following ways supply chain and finance can build strong collaboration and partnership:

Have regular interdepartmental meetings. "We hold joint supply chain-finance meetings every other Wednesday to discuss any issues that need to be addressed, and look at how well we're doing with our PO invoice payments," Dabbs says. "Meeting attendees include our VP of finance, director of AP, director of supply chain, supply chain analyst, and our P2P coordinator."

Create and track clear performance metrics. "Our VP of finance has worked out a formula for average days to pay an invoice. We track our numbers on an ongoing basis to see if we are doing better or worse. We are paying invoices faster than ever—our number of days is one-third of what it was two years ago," Dabbs reports.

"We have a sheet that shows how many invoices are still in the approval queue; this helps us stay on top of outstanding invoices."

Use an item master and order templates. "We utilize an item master file that shows all the inventory items that are purchased by our health care organization. Each item has been given an item number in our Lawson system and for each item there is information on pricing, description, unit of measure, vendor name, and vendor code. We work with finance to ensure that all pricing and vendor information remains current and accurate," Dabbs says.

"We facilitated the P2P process by preparing order templates that allow our end users to order supplies by simply calling up the template, popping a number into the 'quantity' field, and submitting their orders. The orders go to supply chain, where someone reviews and approves the orders, and then the orders are automatically sent to the vendors. We have reduced costs by eliminating the need for paper orders and postage to send them by postal mail. When we have our biweekly meetings with finance, we talk about this process to make sure everything is going smoothly," Dabbs notes.

Establish policies and procedures. "Supply chain supports finance in being good stewards of the money that has been budgeted for purchasing goods. We follow clear policies and procedures to make sure all of our practices are aboveboard—from buying, sourcing, inventory, distribution, and payment. We make sure that everything that is purchased matches the negotiated pricing in the contract and the vendor numbers match. Checks are not cut until we ensure that everything matches electronically, and purchases have gone through the proper signature authority levels," Dabbs says.

Ensure adherence to budgets. "Supply chain works with finance when budgets are created so we can all be on the same page. We support the budget process and help ensure that departments adhere to their budgets. We do this through examining the reports we get from our Lawson system and ensuring purchases have the proper signature authority for approvals," Dabbs notes.

"We're writing the checks and we play a large role in helping finance to balance the budget," he adds. "We are committed to being good stewards of the money we're spending on behalf of the patients who depend on our health care organization." ❑

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Master Guide to Controllers' Best Practices

SPEND CONTROL

Keep Spending Under Control in *Good* Times

(Quick Code 071407)

After a period of economic anxiety, shrinking revenues, and belt-tightening, it can be natural for companies to want to loosen the reins on spending. But this is exactly what companies should not do, cautions Wayne Spivak, president and CFO at SBA * Consulting LTD, a firm that provides outsourced and interim finance leaders to a wide variety of organizations.

"During the recent recession, many companies squeezed costs too tightly, in my opinion," Spivak says. "Now that revenues are increasing, it wouldn't be unreasonable to ease up on spending controls a bit, but it's important to maintain balance and not go too far in the other direction."

Here are four areas Spivak advises controllers to pay special attention to so they do not allow spending to get out of control:

T&E. "When the economy improves, this is the biggest thing that immediately gets out of control. The biggest culprits are sales people and business owners," he points out. "For sales people, all travel should be business-related. They should be able to quantify that there was a financial benefit from their expenditures—for example, 'I spent X dollars to take this client to lunch and the results were a sale of Y dollars.'"

"Business owners sometimes look at the corporate budget like it's their personal piggy bank. They might overindulge in first-class plane tickets and accommodations when business class would be perfectly satisfactory," Spivak notes. "This can cost the business ridiculous amounts of money. There has to be a happy medium. This can be a difficult conversation for controllers to have but it's important to keep an eye on this kind of spending and not allow it to run rampant. The economy will inevitably swing back negatively—and then you'll be in trouble."

People who travel on behalf of the company in rented automobiles can also be tempted to splurge on every available option when times are good. "Costs vary widely for monthly car leases," Spivak points out. "Controllers need to impress upon business travelers that they don't have to get every option under the sun."

Facility improvements or expansions. "When revenues are on an upswing, companies can be tempted to spend millions of dollars on improvements to their buildings in redesigns and additions, as well as cosmetic items such as exorbitant new signage," Spivak says. "This is definitely an issue controllers need to address. Controllers have to sit down with leadership and take a hard look at such proposed plans to assess whether they are genuinely necessary."

Healthcare plans. "This is a very touchy area," Spivak acknowledges. "Costs keep going up. Companies may be tempted to offer the 'Cadillac' of available plans when the 'Kia' would be sufficient. Companies still need to keep a tight rein on healthcare costs. They may be able to reach a compromise and offer employees a great plan but ask employees to chip in more to cover the costs."

Telephone service. "Employees can really abuse their cell phones, especially if the company is doing well and they don't think anyone will care. Controllers need to keep an eye on phone usage and charges and raise a red flag if something doesn't look right," Spivak advises.

"For example, I once saw a situation where an employee with a company-issued cell phone was constantly calling the same overseas number and engaging in lengthy phone calls. When I checked the approved numbers in the Rolodex, the number wasn't there. It turned out those calls were not at all business-related; she was calling her boyfriend in the UK on the company dime," Spivak recalls. "A solution might be to give each employee a fixed phone budget; if they go over that, they have to pay for it."

The bottom line: "The controller always needs to focus on controlling expenses, even when times are good. In fact, that can be the most important time to pay close attention to spending, because that's when it can really get out of control," Spivak stresses. "Remember that once your company makes a deal on rent, for example, that monthly payment is not going to change for the life of the lease. Don't enter into a situation you won't be able to afford once the economy fluctuates in a downward direction, as it inevitably will." ❑

BENCHMARKS & METRICS

Five Metrics Every Finance Dashboard Must Include

(Quick Code 071409)

By Rodd Mann, Adjunct Professor and doctoral candidate, Concordia University (Irvine, CA)

Editor's Note: *Rodd Mann has many years of experience as a controller, most recently at Kingston Technology. He will be speaking at the IOFM Controller's Conference and Expo, September 14-16, 2014 in Chicago. For more information, go to http://www.iofm.com/controllers-conference.*

Businesses need to set strategic goals and objectives that form the basis for every aspect of performance that is measured within the organization—most critically, the key ratios and metrics controllers use in finance. A lot of businesses set so many metrics that the most important ones are lost in the mix, but in reality, only five metrics are critical for controllers to include in an effective dashboard for finance.

These metrics are as follows:

#1: Sales. When measuring sales, controllers should keep in mind that all measurements need to be looked at in qualified, not absolute, terms. For example, what is the cumulative annual growth rate (CAGR)? If the market on average is growing at a rate of 20 percent and a company's sales are growing at only 10 percent, then that company is losing market share.

Controllers need to look at sales in terms of time, trend, and industry. It is impossible to determine a trend without looking at data over at least a three-year period of time. Also it is critical to look at sales data against what is happening in the industry as a whole in order to determine whether this key metric is strengthening or weakening.

#2: Manufacturing costs. These can be expressed as a percentage of revenue, or subtracted from revenue to get the gross profit margin. Manufacturing costs include materials costs along with labor and overhead needed to build the product.

Materials costs can comprise up to 90 percent of the total cost of a product. It is vital for controllers to get a handle on these supplier-related costs, as well as their internal labor and manufacturing overhead (utilities, equipment depreciation, and supervisory salaries to name a few). It is also important to analyze each of these cost categories separately, looking carefully at variances between the standard or target costs compared to the actual manufacturing costs.

#3. Operating expenses. Controllers that are not at manufacturing companies need to take a close look at their operating expenses. They can look at these as a percentage of revenue and also relative to their competitors' expenditures. Operating expenses include human resources, finance, security, MIS, advertising and marketing, general administrative expenses, as well as salaries of executives.

#4: Profitability. Profitability can be measured in three different ways: as a percentage of revenue, as a percentage of total equity, or if the company is a manufacturer, as profitability divided by assets in place. For example, if the company has made a huge investment in machinery and equipment, are those assets generating sufficient profitability?

When calculating profitability, the denominator could be revenue, equity, or assets; this all depends on your perspective. For instance, the COO or general manager would probably track profitability as a percentage of sales. If a manufacturing company has invested heavily in a semiconductor fabrication facility, perhaps upwards of $3 billion to $5 billion, that company would need to measure the profit-generating capability of those assets in place.

#5: Cash flow. A business can be very profitable and perhaps also be growing quickly—yet, somewhat surprisingly, it can run out of cash. Sadly, this has happened to many profitable, fast-growing companies that didn't see how much cash it takes to increase inventory and accounts receivables.

Why? Businesses can run negative cash flow if they are spending a lot on property and equipment, or have too much revenue tied up in their receivables and inventory, so these are areas that need to be tracked closely. Other areas affecting cash flow that need to be tracked would include total compensation and other people-related costs such as travel.

In addition to tracking these five dashboard items on a predetermined basis, typically monthly, controllers can take the following steps to contribute greater value to their organizations:

➢ Help to make sure everyone within the organization is clear about, and on board with, the business's strategic objectives by translating the goals of the management team into clear, concrete metrics. (Also make sure the ERP is set up to support measurement and reporting of those metrics.)

➢ Communicate clearly up and down the management chain how everyone is doing against those performance metrics—for example, by sharing results when the monthly financial statements come out. Controllers can get creative with their dashboard—for example, using a red, green, and yellow light coding system to show areas where metrics are tracking well, where there is trouble, and where remedial action needs to be taken.

➢ Focus on finding ways to make employees and suppliers happy (and customer satisfaction and loyalty will naturally follow). For example, work to ensure that employee benefit packages are fair and suppliers are paid in a consistently timely manner.

➢ Help design incentive and compensation systems that are set up around performance metrics and goals. This will help ensure that people have the focus and motivation to engage in the right behaviors that will yield the right business results.

While it's true that controllers have a fiduciary duty to follow U.S. GAAP and close the books in a timely fashion, the modern role of a controller is developing into a person who adds value to the business by helping to establish a sound dashboard and uses that dashboard to demonstrate what is and is not working. Controllers need to become an integral part of the business, helping in decision-making about everything from whether to outsource and where to build a new plant to what investments to make. This means being able to pull together a lot of the data that is available now and then converting that data into knowledge and information that will help the business fulfill its current objectives as well as establish effective new goals for the future. ❑

NEWS BRIEFS

Quick Code 071410

HOW FINANCE AND HR MAKE A PROFITABLE TEAM

Partnering for performance, a global survey of 550 CFOs and chief human resource officers (CHROs) conducted by professional services organization EY, revealed that there is a direct correlation between a strong finance-HR relationship and superior business performance.

At those organizations in which finance and HR have been collaborating more closely over the last three years, there is significantly higher reported EBITDA (earnings before income tax, depreciation and amortization), increased growth, and stronger improvement across a range of human capital metrics, including employee engagement and productivity. Here are some key findings:

- More than two-fifths (41 percent) of high-performing companies experienced EBITDA growth of greater than 10 percent, compared to only 14 percent of non-high performers.
- Nearly half (44 percent) of high performers report a significant improvement in employee engagement, compared to 9 percent of others.
- Almost the same number (43 percent) has had a marked increase in workforce productivity compared to 10 percent of the other companies surveyed.

What has been driving greater collaboration between finance and HR? EY identified the following factors:

➢ Labor costs are rising and talent in the current job market is hard to come by.

➢ As organizations are struggling to identify, hire, and develop top talent, they are realizing they need to better understand the relationship between cost and performance to help prevent costly attrition.

➢ Although HR has traditionally been a support function, far removed from strategic decision-making, it is now becoming more important within the corporate hierarchy; as this happens, organizations are recognizing the need for closer alignment between their corporate and human capital strategies.

EY also found there are four elements that set high-performing companies (those with greater than 10 percent EBITDA growth in the last year) from the rest:

1. **Organizational structure and operating model.** On average, high performers spend 50 percent more time on the CFO-CHRO relationship (62 percent of high performers are peers versus 42 percent of others). They also report better integration between finance and HR across processes, teams, technologies, and systems.
2. **Strategic planning and decision-making.** At high-performing companies, the CFO makes a bigger contribution to strategic workforce planning and there is greater collaboration between finance and HR on this activity. In addition, 58 percent of high performers rate the collaboration on the business strategy and development as excellent versus 22 percent of others.
3. **Use of analytics.** High performers use analytics to understand the workforce better; there is great evidence of data-led decision-making in HR.
4. **Measurement.** High-performing companies have a more rigorous approach to identifying and tracking key HR metrics. Nearly half (49 percent) of high performers consider their company to be excellent at using data analytics to improve HR performance, as opposed to 16 percent of others. Further, more than half (51 percent) of high performers say that the finance leader in their organization is heavily involved in identifying and tracking HR metrics, as opposed to 10 percent of others.

EY suggested that by involving both finance and HR leadership in the strategic decision-making process, organizations can better ensure that both the financial and human impacts of corporate decisions. "To really maximize employee engagement and improve workforce productivity, while keeping pace with the ever-changing dynamics of the global labor force, the CFO and the CHRO need to find ways to increase collaboration effectively and efficiently," says Jay Nibbe, Chair, Global Accounts Committee at EY.

"This collaboration will empower CFOs to allocate the necessary resources required to deliver the company's strategy, and the CHRO can ensure the alignment of 'right people, right place, at the right time.'"

Editor's Note: For a PDF copy of the report, go to http://www.ey.com/Publication/vwLUAssets/EY-Partnering-for-performance-the-CFO-and-the-supply-chain/$FILE/EY-Partnering-for-performance-the-CFO-and-the-supply-chain.pdf.

NEWS BRIEFS

PRIVATE COMPANIES ARE SEEING SALES GROWTH AND HEALTHY PROFIT MARGINS

Good news for private companies: according to the *Private Company Report of 2014* from Sageworks, balance sheets and income statements are showing that the performance of privately held companies appears to be relatively stable and strong. Statements ending in 2013 show that companies' sales are growing at an annual rate of 8 percent. Although this rate is slightly lower than for 2012, it still indicates strong revenue growth. As Sageworks' Chairman Brian Hamilton remarked, the report was, on the whole, "very positive."

Sageworks found that privately held businesses are seeing higher net profit margins (8 percent)—higher in the most recent period than in previous years. The financial statement analysis of major sectors reveals similar stability and strength trends for retail, wholesale, construction, and manufacturing. The study looked at accounts payable (AP) days as well as other measurements of a business's cash conversion cycle, and found that several health care and service industries had the lowest average AP Days.

Sageworks releases a quarterly update on the health of privately held companies in the United States. It includes metrics on the average U.S. privately held company, as well as the performance of notable sectors and industries.

Editor's Note: The complete report is available for free download at https://www.sageworks.com/pdf/Private_Company_Report_04282014.pdf

FEAR OF FRAUD DRIVES FINANCE LEADERS' PLANS FOR AUTOMATED EXPENSE REPORTING

In a recent survey of finance leaders by Chrome River, more than half (54 percent) of finance leaders report that they plan to automate expense reporting in 2014. One of the biggest drivers of this trend is concern about fraud.

"There is tremendous worldwide concern about security and fraud. Expense-management processes inside companies and organizations can be tempting targets," says Alan Rich, co-founder and chief executive officer of Chrome River. "Implementing an expense-reporting system is prudent in this climate, and that is driving the adoption highlighted by the survey data. Organizations are also increasingly moving away from reimbursing employee expenses incurred via personal credit card and towards corporate credit cards. The automation that occurs with corporate card implementations not only reduces fraud, but is much more time and cost efficient."

The study also reveals the following challenges and goals for finance departments:

Primary challenges facing finance include approval/routing workflow, lack of controls, and weak analytics. "Unnecessarily complex approval processes and general lack of controls have both been drivers of automation in the past, and the data shows that continues to be the case," says Rich. "However, the fact that 46 percent [of respondents] feel their analytics are weak shows there is work that still needs to be done. Luckily, organizations are becoming increasingly aware of the sophisticated analytics tools now available. Once adopted, these tools have the potential to be game-changing."

For nearly three-fourths (69 percent) of respondents, "improved spend visibility" is a key goal for automating travel and expense processes. "Travel expenses are one of the most controllable areas of expense within a business, and they can offer extremely tempting opportunities for employees to commit fraud," Rich points out. "Finance teams are more aware that getting real-time data on how money is being spent is the only way to truly know what's happening inside the business—and to prevent both fraud and waste."

Editor's Note: For more information about the survey, go to http://www.chromeriver.com.

THE CONTROLLER'S CALENDAR

IOFM's Controller's Conference & Expo 2014, Sept.14-16, 2014, The Westin O'Hare, Chicago, IL. For more information, e-mail Andrew Fitzpatrick at afitzpatrick@divcom.com.

AFP Annual Conference, Nov. 2–4, Washington, D.C. For more information, go to www.afponline.com.

AICPA Controllers Conference, Nov. 18-19, Caesars Palace, Las Vegas, NV. For more information, go to www.aicpa.org.

12th Annual MIT Sloan CFO Summit, Nov. 20, Boston Marriott Newton, Newton, MA. For more information, go to www.mitcfo.com.

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