Talking shop
What impact will the new lease accounting standard have on retailers?

Changing training
How the training of finance professionals is adapting to meet future demands

Simone Menne
Exclusive interview with the CFO of Lufthansa

A deeper dive
How will Key Audit Matters provide greater insight into the results of the audit?
Dear readers,

Critics of the audit profession often point to the binary nature of audit reports. Their pass-or-fail, boilerplate character has come into question following the financial crisis, with calls for more insight from the auditor.

And now help is at hand. Changes to the auditor’s report mean that it will be extended to highlight the matters of most significance in the audit. The new Key Audit Matters section will describe, in effect, what kept the auditors awake at night.

Users will know what the auditors thought were the most important issues, why they believed this and how they addressed any concerns. It’s a significant step toward improving the way that auditors communicate.

As Reporting’s cover feature points out (page 4), there is nothing to fear and much to gain from the introduction of Key Audit Matters. It will enhance understanding of the audit and help to improve quality and relevance — something that is a priority for us at EY.

However, time is of the essence. The new standards will apply to the audits of financial statements for periods ending on or after 15 December 2016. Senior management, audit committees and auditors need to start preparing now.

Key Audit Matters will help to shine a light on the audit and provide a deeper understanding of the work of the auditor. Similarly, our interviewees in this issue give us equally valuable insights into their own working lives.

In our interview with Lufthansa CFO Simone Menne, she recalls the board meeting when news came through of the Germanwings plane crash and reveals how the CFO can contribute in the aftermath of such a tragic incident. She also talks about being a spokesperson for gender issues in the German business world — a role she never actively sought.

Jennifer Cabalquinto, CFO of the Golden State Warriors basketball team, tells us five things she has learned over her career in the entertainment sector (page 26), while Shonaid Jemmett-Page, audit committee chair at GKN and several other companies, offers her wish list for improving corporate governance (page 14) and shares insights from the years she spent working in Asia.

Elsewhere, our article on training discusses the new challenges that finance professionals will face over their careers (page 10) — is it possible to futureproof the finance function? And our analysis of the converged lease accounting standard (page 28) suggests that it “could have a profound and lasting effect on the financial strategies of global companies.”

I hope you enjoy this issue of Reporting and that it provides you with food for thought. We are always interested in your views and comments, so please get in touch with your EY contact to continue the discussion.

FELICE PERSICO
Global Vice Chair, Assurance
04 Key issues
The IAASB’s new auditor reporting standards introduce a new section called Key Audit Matters. We explain what these are (and what they aren’t) and how this will give stakeholders a greater insight into the audit process.

08 The poll
The 2015 edition of the EY EMEIA Fraud Survey shows a correlation between ethical behavior and revenue growth.

10 Futureproofing the finance function
We investigate how the training of new entrants to the finance profession is changing to provide them with the skills they will need to meet the demands and challenges of the future.

14 My wish list
Shonaid Jemmett-Page, an experienced non-executive director, says the West could learn a lot about governance from Asia.

16 The high flyer
Lufthansa’s Simone Menne on the changing role of the CFO, the challenges of serving on the board of an airline, and gender issues.

20 The buy side
When investing in consumer brands, it helps that you can experience them first hand.

22 A land of contrasts and opportunities
After many years, Myanmar is now “open for business” again. We find out how foreign companies can take advantage.

26 5 things I’ve learned
Jennifer Cabalquinto, CFO of basketball team the Golden State Warriors, on a career spent in the entertainment sector.

28 Lease agreement
The impact of the new lease accounting standard on corporate balance sheets – and on those who prepare them.

32 The missing piece of the jigsaw
Joanne Segars, CEO of the UK’s National Association of Pension Funds, explains why reporting on the workforce would benefit investors, companies and the economy.

35 ... and more
Recent publications from EY, plus books that may be of interest.
Key issues

Management and audit committees need not fear the introduction of the IAASB’s new auditor reporting standards, and particularly the Key Audit Matters section. Sally Percy explains how this will unlock more detail about the audit process.

Enhanced auditor’s reports are already business as usual in the UK and the Netherlands. Soon they will become a permanent fixture of the global reporting landscape.

In January 2015, the International Auditing and Assurance Standards Board (IAASB) issued its new and revised auditor reporting standards, which require auditors to provide more transparent and informative reports on the companies they audit. These standards have been issued in response to demand from users of financial statements, in the wake of the financial crisis, for more relevant information on audits.

The aim of the standards is to produce auditor’s reports that increase the public's confidence in both the audit process itself and the financial statements of companies. The IAASB also believes that enhancing auditor reporting will improve communications between the auditor and investors, as well as between auditors and those charged with governance.

“As a user, it can be challenging to understand what's in the financial statements, let alone how they've been audited,” says Fiona Campbell, a partner in EY’s Australian assurance practice and a member of the IAASB. “The new auditor’s reports are therefore meant to enhance the understanding of the audit of the financial statements among users – investors, analysts, regulators, suppliers, employees and governments. It will give people a better understanding of what we do and how we do it.”

A number of interested parties responded positively to the exposure draft of the new auditor reporting standards when it was issued in 2013. A global accountancy body, the Association of Chartered Certified Accountants (ACCA), was broadly
supportive, commenting: “The report of the auditor is the most visible output of the audit process, and we welcome this initiative of the IAASB to improve its usefulness and relevance to shareholders and other interested parties. The project will also promote financial reporting of the highest quality.”

Since the new standards apply (in many jurisdictions) to the audits of financial statements for periods ending on or after 15 December 2016, management, audit committees and auditors must start preparing for their implementation now.

SIGNIFICANT ISSUES
One of the challenges with financial statements is that they are, as Campbell puts it, “quite complicated beasts.” As a result, the audit is also quite complex and requires the auditor’s assessment of risks of material misstatement to those financial statements to drive the performance of the audit. In today’s “boilerplate” auditor’s report, it is not possible for investors to understand where the greatest of those risks lie in the eyes of the auditor.

For this reason, a particular area of focus within the new standards will be the requirements of the new ISA 701, Communicating Key Audit Matters in the Independent Auditor’s Report. For audits of listed entities, a new section in the report, called Key Audit Matters (KAM), will highlight those issues that, in the auditor’s professional judgment, were of most significance in the audit. According to the IAASB, the description of a KAM should be “clear, concise, understandable and entity-specific.” It should explain why the matter was considered to be significant in the audit and how it was addressed. There should also be a reference to the related disclosure elsewhere in the financial statements.

ACCA has welcomed the issue of the standards. “Key Audit Matters are a big step forward,” says its former External Affairs Director, Sue Almond (she has moved to a new role since this article was written). “They will allow auditors to provide a bit more color on the work that has been done.”

WHAT COUNTS AS A KAM?
ISA 701 includes a judgment-based decision-making framework to help auditors decide which issues from the audit would count as KAMs. Out of all the matters on which they communicated with the company’s management and audit committee, they will select KAMs from those matters that required “significant auditor attention.” In particular, they should explicitly consider areas where there might be a higher risk of material misstatement or those where significant management or auditor judgments were involved.

“The concept is that these are the areas that were of greatest focus in the audit, and typically the areas of greatest risk for the audit as well,” Campbell explains. “Where were the areas of subjectivity? Which areas required a significant application of judgment?” She highlights impairment – of an investment, of goodwill or of another intangible asset – as being likely to feature as a KAM, because of the significant amount of judgment involved with these.

The nature of a KAM will also vary according to the industry sector the company operates in. Revenue recognition is likely to be a KAM for software and telecommunications companies, for example, because they have complicated revenue recognition policies. Mining companies, meanwhile, may have licensing rights to mine a particular piece of ground, but it can be difficult for them to determine the value of that license, as it will depend on the cash flows generated by the mine in future. Therefore, their audits are likely to focus closely on license impairments.

One area that will probably be a KAM for most companies, whichever sector they operate in, is taxation. “For a lot of businesses, tax is really complex,” Campbell notes. “It’s also an area where there is a high amount of litigation, as well as disputes between tax authorities and companies, so it often requires significant auditor attention.”

Campbell’s observations are backed up by a report from the Financial Reporting Council into the implementation of extended auditor’s reports in the UK, published in March 2015. In a survey of more than 150 auditor’s reports, it found that the top five most reported risks were:

- Impairment of assets
- Tax
- Goodwill impairment
- Management override of controls
- Fraud in revenue recognition

POTENTIAL PITFALLS
In some respects, the greatest challenge for auditors is figuring out when an issue is not a KAM. “Just because something is a big number doesn’t mean it’s a Key Audit Matter,” Campbell points out. “And just because it’s where we spent a large proportion of our efforts doesn’t mean it’s a Key Audit Matter either."

A large transaction, such as the acquisition or disposal of a subsidiary, might fit into this category. “It’s not necessarily a Key Audit Matter, because,
although it may have required considerable audit effort, it could be a really straightforward transaction,” Campbell explains. The same applies to share buybacks, where a very large number may be involved, but which can be very simple to audit.

Inghwa Hengefeld, a partner in EY’s Dutch assurance practice, says that it is important that the KAMs in the auditor’s report cross-refer to the financial statements. “If there were something in my auditor’s report that was not in the financial statements, that would look odd,” she says. “The descriptions of the matters should complement, and not repeat or contradict, what has been disclosed in the financial statements, while providing the audit perspective on those matters.”

Nevertheless, Van den Biggelaar believes the enhanced audit reports will bring benefits for investors in Dutch companies. “It is a way of sharing with the outside world the work that the auditor has been doing,” he says. The subject of enhanced auditor’s reports has not come up in any of the discussions Van den Biggelaar has had with investors. “Sometimes, specific risks come up and we have a conversation with reference to the risk disclosures,” he says. “I think investors are not bringing it up because they appreciate our general level of disclosure and explanation as to what our auditor is doing.”

Jargon is another trap that auditors need to avoid falling into, says Campbell; the use of inaccessible language is against the spirit of transparency that regulators expect, and is not in the public interest.

COMMUNICATING WITH THE AUDIT COMMITTEE

So what can a company’s audit committee expect from the introduction of KAMs? The good news is that they are not the headache that some might fear (see case study panels, above) and do not affect the actual conduct of the audit. Nevertheless, Hengefeld says, audit committees should expect their audit firm to communicate with them early, and to communicate well, about the KAMs that are likely to be included in the auditor’s report.

The implementation of expanded auditor’s reports in the Netherlands went smoothly, she continues, precisely because audit firms had early discussions with their clients about the contents of the new, enhanced auditor’s reports, including the KAMs. This
meant that audit committees were not presented with any unpleasant surprises late in the process. Meanwhile, Almond argues that the discussions between the audit committee and the auditor around the KAMs are actually “an opportunity for the audit committee to engage with the auditor.” This increased engagement between the auditor and audit committee on the “selection” or “ranking” of significant audit matters, and discussions around how those matters will be described in the auditor’s report and how they complement the financial statement disclosures, can provide new perspectives for audit committees and auditors. This could have indirect benefits for both audit quality and the quality of the disclosures.

**WHAT’S NEXT?**
The IAASB has a monitoring group in place to observe the implementation of the new and revised standards and to gather feedback from a broad range of stakeholders. It is also planning to undertake a post-implementation review two years after the effective date, to see if the standards have achieved their intended effect.

We can probably expect them to be well received if the outcome of the IAASB’s public consultation on the new standards is a reliable guide. According to the board, the concept of KAMs has “received widespread support among investors, regulators and oversight authorities, accounting firms and national auditing standard-setters.” Meanwhile, the fact that the UK and the Netherlands have already introduced similar measures means that the rest of the world knows what to expect.

“The feedback in the UK is that, while KAMs may not be the perfect solution, the pure act of providing additional information has enabled more dialogue to take place with investors,” Almond says.

Campbell agrees. “It’s got people talking about the auditor’s report for the first time I can think of,” she says. “It’s seen as a positive step forward for the audit profession.”

**Case study: Royal Mail**
Matthew Lester, CFO of UK postal services company Royal Mail, says that the UK experience of extended auditor’s reports shows that there is “nothing to be afraid of.” “From our point of view, the value of the audit comes from the work that is done to challenge our thinking about our systems, processes and presentation,” he says. “My concern was that [the need for an additional commentary] might require the auditors to undertake greater work, or different work, or approach their work differently, and distract them from the value we get out of the audit because of the need to go into greater detail.”

This turned out not to be the case, but nevertheless, Lester says he prefers the “simple, clear” auditor’s reports that existed before.

In his experience, there has been no adverse reaction among investors to the extended reports. “No one asks me about our auditor’s report, because we got an unqualified audit opinion,” he says.

“**Audit committees should expect their audit firm to communicate with them early about the KAMs that are likely to be included.**”

October 2015 Reporting [06/07]
EY’s EMEIA FRAUD SURVEY 2015 SHOWS THAT BUSINESSES CONSIDERED ETHICAL BY THEIR EMPLOYEES ARE MORE LIKELY TO HAVE EXPERIENCED REVENUE GROWTH.

EY’s survey of 3,800 respondents across 38 countries confirms that the current business environment is presenting significant challenges. The impact of market volatility has been compounded by geopolitical instability and big drops in the price of oil. Companies are facing more complex restrictions on the way in which they do business, with sanction regimes changing. Complex risks — such as cybercrime — have the potential to disrupt operations significantly.

Nonetheless, the survey results show that most businesses are still expected to deliver new revenue growth. The report asks the question: what risks are businesses willing to take to achieve this? And, conversely, do ethical conduct and a strong focus on compliance actually drive growth?

Achieving growth and managing risks
The survey results are indicative of a human truth: people like to do business with people they trust. Respondents working at companies seen to have high ethical standards are also more likely to be seeing their revenues grow.

Some employees continue to see compliance as a burden that can damage competitiveness. One-fifth of respondents, for example, state that following their anti-bribery/anti-corruption (ABAC) policy very closely would harm competitiveness. But many of the key results tell a different story. Good compliance and growth appear to go hand in hand.

The results show that businesses that have experienced revenue growth in the last two years are more likely to be seen as ethical by their employees, not only at head office but also across operations in different countries. This correlation was observed across many of the key questions.

<table>
<thead>
<tr>
<th></th>
<th>Results from businesses with increased revenues</th>
<th>Results from businesses with decreased revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>How would you rate your company’s ethical standards when doing business?</td>
<td>31% Very good</td>
<td>18% Very good</td>
</tr>
<tr>
<td>How confident are you that your business’s operations in different countries meet the same ethical standards?</td>
<td>62% Fairly or very confident</td>
<td>41% Fairly or very confident</td>
</tr>
<tr>
<td>Do unethical practices often go unnoticed by head office?</td>
<td>19% Agree</td>
<td>28% Agree</td>
</tr>
<tr>
<td>Have ethical standards got better or worse in your company in the last two years, or have they stayed the same?</td>
<td>43% Got better</td>
<td>20% Got better</td>
</tr>
<tr>
<td>What impact has regulatory activity in your sector had on ethical standards in your company?</td>
<td>30% Positive impact</td>
<td>14% Positive impact</td>
</tr>
<tr>
<td>What impact has regulatory activity in the last two years had upon results in your company?</td>
<td>26% Positive impact</td>
<td>8% Positive impact</td>
</tr>
</tbody>
</table>

57% of respondents agree that managers are under increased pressure to create new revenue opportunities.
Policies and procedures are better, too

The results also show that businesses that have experienced revenue growth in the last two years are more likely to have effective compliance policies and procedures in place. Compared with businesses that have experienced decreased revenue, respondents from companies that have experienced revenue growth are more likely to have policies in place, have penalties for misconduct, deliver training, and support those reporting fraud or corruption.

Results from businesses with increased revenues vs. results from businesses with decreased revenues

<table>
<thead>
<tr>
<th>Policy/Procedure</th>
<th>Increased Revenues</th>
<th>Decreased Revenues</th>
<th>Percentage Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>State that their company has an ABAC policy and code of conduct</td>
<td>63%</td>
<td>53%</td>
<td>10%</td>
</tr>
<tr>
<td>Have attended ABAC training</td>
<td>69%</td>
<td>58%</td>
<td>11%</td>
</tr>
<tr>
<td>Agree that there are clear penalties for breaking ABAC policies</td>
<td>55%</td>
<td>43%</td>
<td>12%</td>
</tr>
<tr>
<td>Have found ABAC training useful</td>
<td>75%</td>
<td>63%</td>
<td>12%</td>
</tr>
<tr>
<td>Agree that people reporting fraud or corruption would be supported</td>
<td>50%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>State that their company uses approved supplier databases</td>
<td>33%</td>
<td>25%</td>
<td>8%</td>
</tr>
</tbody>
</table>

According to the survey respondents, management in companies that have experienced revenue growth are more engaged in monitoring compliance with policies and procedures, and gathering the necessary data to support decision-making and risk mitigation.

Compared with businesses that have experienced decreased revenue, respondents in companies that have experienced revenue growth are more likely to:

- See management visiting local offices at least once every six months
- Be confident that head office management obtains the right data to assess the reliability of business units’ financial results
- Agree that management use this data effectively

Do ethical conduct and a strong focus on compliance drive growth? The survey results suggest that – at the very least – they can go hand in hand. Good compliance is not a barrier to growth or a burden to increased profitability. It is a requirement for sustained success.

For a copy of the full report, Fraud and corruption – the easy option for growth? Europe, Middle East, India and Africa Fraud Survey 2015, please go to ey.com/emeiafraudsurvey2015.
As the global business landscape changes, so do the demands placed on finance professionals. Alison Coleman examines how the training of those entering the profession is being adapted to ensure they have the necessary skills to face the future with confidence.
In a global financial landscape shaped by economic uncertainty and political transitions, the core skills and competencies needed for a career in finance are undergoing change. In the years ahead, those undertaking such a career will need a deep understanding of these forces and their implications in order to be able to deal with the challenges – which have been exacerbated by rapid advances in technology and demographic changes – and capitalize on new opportunities.

Alongside a robust technical skill set, the increasing demand for finance professionals to take account of non-financial information means they must be able to take a broad view of an organization. They also need to be able to communicate cross-culturally, solve problems, and manage and influence upward. Yet today's finance professionals may be falling short in some of these areas.

“The broadening of skills demanded of finance professionals has caused competency gaps to emerge,” observes Ash Noah, Vice President of External Relations, Management Accounting at the American Institute of Certified Public Accountants (AICPA). “This is causing a challenge for finance leaders who not only recruit external talent to fill open positions, but are also seeking to develop their internal talent.”

He continues: “The role of the finance professional is broadening to become more strategic and innovative. Business models are being disrupted by technological innovation, demanding that the finance function acts as a strategic business partner to help organizations make better decisions faster.”

Sharon Spice, Director of Global Student Recruitment at the Institute of Chartered Accountants in England and Wales (ICAEW), agrees. “Businesses want their recruits to display managerial skills much sooner, and those who are earmarked as future finance leaders need to be internationally mobile, with the soft skills to be able to influence a group of stakeholders from different backgrounds, cultures and even time zones,” she explains.

OLD AND NEW SKILLS
Heighened employer expectations are one factor, but macroeconomic events and a more intense regulatory environment also require finance professionals to step up. According to Shaun Robertson, Qualifications Director at ICAEW, the demands on newly qualified accountants are greater than at any other time in the profession's history.

“Regulatory changes are coming at a pace, and the demands of a global economic recovery mean that chartered accountants can’t just be technically competent; they also need to be agile in their professional skills,” he says. “Professional qualifications have not only had to adapt to this change, but anticipate it.”

In the dynamic region of Asia-Pacific, the finance profession is having to evolve particularly quickly in order to keep up with events. “Finance professionals cannot afford to be complacent and just do their traditional role,” says Jonathan Ng, Executive Director in charge of education and qualifications at the Hong Kong Institute of Certified Public Accountants (HKICPA). “So our candidates now do corporate finance, corporate governance, forensic accounting, information technology, management accounting, restructuring, risk management and taxation.”

Given Hong Kong's close geographical proximity to China, finance professionals based in the territory also need to develop both a good appreciation of the way that business is done on the mainland and a familiarity with the Mandarin language (Cantonese is more commonly spoken...)

Build or buy in?
Those with global responsibilities – the CFOs looking to build global finance teams – have the added dilemma of whether to build or buy in top finance talent. They must weigh up the relative advantages of recruiting from outside the company and of retaining existing personnel.

“Recruiting from outside of the business allows organizations to seek the exact talent, skills and experience that are required to fill a vacancy,” says Julie Windsor, Managing Director at Talentia Software UK. “Onboarding, however, can still be a costly process.”

Indeed, recent analysis from Oxford Economics found that it costs businesses more than £25,000 (about US$39,000) on average to get a new recruit operating at a similar level of productivity to a departing staff member. This highlights the importance, from a financial perspective, of retaining key talent wherever possible.

EY’s Riaz Shah insists that most organizations would prefer to build. “You have individuals who are more likely to understand the company, its vision and culture and the way it operates,” he says. “That is very important in a profession or an organization where you are not selling products, but the skills of people who you have invested a huge amount of money in developing.”
Furthermore, an understanding of how taxation applies in cross-border transactions can prove very valuable. “We have a new training program for people who want to specialize in Chinese and international taxation,” Ng explains.

Of course, some of the skills and aptitudes needed for a career in finance haven’t changed and it is unlikely that they ever will: an analytical mind, logic skills, an understanding of risk and good time management, to name but a few. But there are key characteristics and skills that new recruits to the profession will need in order to meet future challenges that may not have been so important in the past. Increasingly, these include an ability to understand big data, which requires a solid grasp of data analysis, forensics and creative thinking. As Ng puts it: “The question is, how can we turn big data into smart data in order to make sense of it, and also to help business growth?”

Riaz Shah, Global Talent Leader, Assurance at EY, agrees with this view. “New finance recruits need to know more than simply how to capture data and how to get it from the client’s systems and analyze it,” he says. “They must be able to relate that data analysis to the client’s sector and business processes, so they need to know about the industry the data relates to in some depth. I believe that data analysis will simply become a core skill for all graduates.”

It’s not just the skills that finance professionals need that are changing. The way in which they learn those skills is also evolving. Already, the finance professionals of the future are learning in a very different way from their predecessors, in a very different type of classroom. The accounting profession is making use of a wide range of training methods to educate its recruits, ranging from online learning and webinars, to videos, workshops and conferences.

Professional services firms in particular are changing their approach to education to adopt more of a “blended learning” approach that encompasses both online and classroom-based simulation learning. Shah explains: “In the ‘flipped classroom,’ you acquire knowledge when you need it outside the classroom, on demand, online, while in the classroom you are dealing with real-world situations and learning how to make the right decisions.”

Yet, while much is changing, what remains constant is that finance professionals must have...
the right attitude and interpersonal skills. “In terms of the personal qualities you need, things like good communication skills, an enquiring mind and the ability to think logically and creatively are still key,” says Andrew Baigent, Director, Group Financial Management at the UK Department of Health. “People joining the profession now have a more flexible attitude to their career and their professional development than they used to. They know that it is not a job for life and they are open to change, but they still give it their full commitment.”

WHAT’S NEXT?
It appears that financial professionals will be expected to play an even greater strategic role in future in order to support their organizations. As a result, Jean-François Fiorina, Associate Dean at French business school Grenoble École de Management, believes that financial training needs to evolve to take into account geopolitics, knowledge of the mechanisms used to commit fraud and cybercrime, alternative forms of financing and how digitization is transforming the working world.

“The world is changing all the time and every event has consequences for finance,” Fiorina explains. For this reason, he says that finance professionals need to have a sound knowledge of management and a good understanding of their company’s strategy so that they can make decisions that are in the best interests of the organization. He adds: “They need to focus on the company’s interests, not their own personal interests.”

So what will happen if finance professionals don’t develop that broader strategic skill set that is so necessary in our fast-moving environment? “They will become totally disconnected from their companies,” Fiorina warns.

A report published in 2012 by the Institute of Management Accountants (IMA) and the Association of Chartered Certified Accountants (ACCA), 100 drivers of change for the global accountancy profession, explored the key factors that finance professionals should be thinking about to prepare for future opportunities and challenges over the next 5 to 10 years.

The report identified the overriding global themes for the decade ahead as shifting wealth and power bases and extremes of economic and political uncertainty. It concluded that for global finance professionals, the challenges were twofold: first, understanding how the key forces shaping the future could affect the organizations they serve; and second, the need to assess the implications for accounting standards and processes, as well as for the accountancy profession as a whole.

Ultimately, the finance function is set to play a key role in futureproofing of global businesses by helping to ensure sustainable growth. To do that, tomorrow’s finance professionals must themselves be futureproof. That means the learning never stops.

Additional reporting by Sally Percy

Talent at the top
It’s not only new entrants to the profession who need to continue learning. Many who reach the position of CFO or audit committee member do so by achieving rapid promotion. While they bring significant experience from within the organization to their senior role, they could potentially be lacking in wider business experience compared with those who have been appointed externally.

Solutions to this include facilitating more rotation for future talent within the business, such as secondments to other organizations or opportunities for voluntary work. Organizations should also ensure that there are opportunities for coaching and mentoring.

So what are accountancy bodies doing to support the career development of senior finance professionals?

In 2012, the AICPA, together with the Chartered Institute of Management Accountants in the UK, launched the Chartered Global Management Accounting (CGMA) designation to address emerging competency gaps. “Through the CGMA program, finance professionals develop the competencies and skills necessary to lead their organizations to make better business decisions,” Ash Noah of the AICPA explains.

Meanwhile, in Hong Kong, the HKICPA is launching a Financial Controllership program to equip its members working within commercial finance functions with the skills that they need to secure financial controller roles. “We want to help enhance our members’ employability so that they will find it easier to find a job, expand their role or get the kind of promotion they deserve,” says the HKICPA’s Jonathan Ng.
My wish list

EXPERIENCED NON-EXECUTIVE DIRECTOR
SHONAID JEMMETT-PAGE SHARES HER
THOUGHTS ON CORPORATE GOVERNANCE
AND COMMUNICATIONS, AND WHAT THE
WEST COULD LEARN FROM ASIA.
A LONG-TERM APPROACH
You see different business practices around the world, and I feel privileged to have worked in a number of countries. There is never just one way of doing things.

For instance, Japanese business culture is very different, but the West can learn from it. In Japan, they often take a supremely long-term approach to life – they will have a 50-year plan. So, while they are worried about the next quarter’s profits, it isn’t the be-all and end-all.

The way decisions are taken in Japanese companies is generally quite hierarchical, but they tend to be socialized from the bottom up. So when a company says “We are doing this,” everyone is pointing in the same direction by the time that decision is taken and you can move quickly. In the West, it tends to be the other way round; the head of the company says “We are doing this” and then the negotiations begin.

LEARNINGS FROM ASIA
Corporate governance in the West is much more formalized and codified than it is in Asia. You see more companies in Asia, even big ones, where the entrepreneur or the family that started the business is still involved. So there is a much more hands-on approach, and the concept of what a non-executive director could bring to the table is less well understood.

But it does mean there is a deep understanding of the business. The person running a multibillion-dollar business will often know the cash figure at the end of the day. They tend to look more at cash – cash is king, and there is a lot to be said for that.

I love the can-do attitude in emerging economies, and, in many cases, the helpfulness of the governments. They are very welcoming to business. In some countries, there is a lot of bureaucracy, it’s true, but in others, they are extremely flexible and help you get a company off the ground.

THE PENDULUM HAS SWUNG TOO FAR
In the financial industries, I think the regulation pendulum has swung too far and needs to find a sensible equilibrium. If London wants to remain a global banking center, the authorities need to think long and hard about the regulations.

The level of responsibility, and the amount of work, that is placed on a non-executive director of a financial institution is extremely onerous. It becomes very time-consuming, and a lot of non-executive directors who would be qualified are steering away from bank and insurance company boards because of the hassle. You can have a much better life working in a non-regulated industry. The talent pool of people who are comfortable with sitting on the board of a big bank, say, is shrinking, and that’s not surprising. It’s a thankless task at times.

THE RIGHT KIND OF DIVERSITY
I am absolutely in favor of diversity on boards, but it’s not just about gender. If you are a global company and half of your business is in China, you need a woman or man from China on the board. That form of diversity is much more important than having an English woman on the board.

So it’s important to get companies to think seriously about creating a more diverse board – and, perhaps even more importantly, a more diverse executive management. The right kind of diversity drives the success of a company. But I don’t agree with quotas for women on boards at all. A board owes it to the company and the shareholders to appoint the best director to the board, be it a man or a woman.

RETHINK THE ANNUAL REPORT
We need a massive rethink about the annual report and accounts. If you talk to analysts and shareholders, they really don’t use the annual report and accounts, so you have to wonder if there is a better way of communicating and reporting. So much effort goes into producing the accounts, yet at present, the chair of the audit committee and the lead audit partner are probably the only two people who ever read them from cover to cover.

I would love to tear up corporate reporting and start from scratch to get to something more user-friendly. There could be a scenario where companies wouldn’t even produce the annual report and accounts. Instead, you would publish your performance against relevant KPIs for your business once a month, and then produce something more discursive every six months, say.

I don’t know what the ideal format would be, but I do know that we’ve currently got this mammoth weight of reporting once a year that nobody really uses, and there must be a better way.
Simone Menne’s 26 years at Lufthansa have seen her overcome a series of challenges. She talks to Serge Debrebant about the changing role of the modern CFO, the pressures of serving on the board of an airline and her unasked-for role as a spokesperson for gender issues in the German business world.

**Once in a while,** Simone Menne, a member of the board at Lufthansa, works as a flight attendant in economy class. She puts on the airline’s iconic blue and yellow uniform, serves coffee and tea, offers meals of chicken or beef and tries to calm passengers, who, she notes, are often under stress.

“You have great interactions with passengers, but it’s also a demanding job: you have to be professional, perform meticulously and always smile, always be friendly, no matter whether a passenger is friendly or not,” Menne says. She doesn’t think she would be much good at it if she had to do it every day: “I don’t know if I would always keep my cool if a passenger got annoyed because we didn’t have the latest copy of Der Spiegel.”

Fortunately, Menne has a different role at Lufthansa. Since July 2012, she has been Chief Financial Officer for what is now Europe’s biggest airline group. It’s a prestigious job, particularly in Germany, where it comes with constant attention from the media, passengers, shareholders and politicians. That attention could be the result of the latest round of pilot strikes, or of profit warnings such as the one issued in June 2014, which caused the share price to drop 14% in one day. Menne is also the first female CFO in the DAX index, which comprises Germany’s 30 biggest companies.

**A DREAM EMPLOYER**

Like many DAX-listed companies, and like many in the aviation industry, Lufthansa has long been male-dominated. “We have a lot of engineers and pilots, and these departments tend to be made up mostly of men,” Menne says. This was even more the case in 1989, when she joined the company. She remembers the recruitment day she attended and the fact that she was the only woman there who wasn’t applying to become a flight attendant. She had studied business administration and worked at ITT, an American manufacturing group, and she was fascinated by the glamour and international scope of a big airline group.

“The travel aspect was attractive,” she acknowledges. “For me, Lufthansa was a dream employer.”

Today, Menne thinks air travel has lost some of that prestige: “Flights have become a commodity,” as she puts it. The airlines operate in a competitive market with thin margins, and former state carriers such as Lufthansa are in a particularly difficult position, squeezed by low-cost carriers in Europe and by well-funded Gulf carriers on intercontinental routes. Lufthansa has responded to these challenges by cutting costs and expanding new offerings, such as Germanwings and Eurowings, while still taking care of its brand appeal.

For a CFO, this situation brings its own set of challenges. In 2013, Menne had to announce plans to close offices in Hamburg and Cologne. But a CFO can do more than lead cost-cutting initiatives; she can also play an important role in transforming Lufthansa into a competitive, diversified aviation group – a notion Menne likes to stress when talking to investors and analysts. “We’re not just an airline, but a group of 13 airlines, and we have successful subsidiaries for repair and maintenance and catering services,” she explains.
Menne has just returned from a trip to New York, where she met with investors and analysts. “It’s part of the job description,” she explains. Menne likes talking strategy, which, she argues, fits the profile of a modern CFO. “Ten years ago, it might have been enough to make sure the numbers added up. But these days, the CFO is more involved in the strategy of the business.”

The word she likes to use when describing Lufthansa’s multilayered corporate transformation is *Kulturwandel* – a cultural shift. In this transformation, Menne sees her role as an advice-giver who interprets the numbers for the board and chief executive and helps them understand the financial implications of strategic decisions.

“It’s important to know whether a certain investment changes the dynamic of the group. We don’t want to grow at any cost; we want to be profitable,” she says. Part of this evolution is a stronger focus on value-based management. This year, the group changed reporting metrics from cash value added to return on capital employed. And this is just an early step. “It will take time for this change of culture to filter through to all departments,” Menne says, “but it will help us make smart investment decisions for the future.”
A COOL HEAD IN A CRISIS

Menne admits that it takes a certain personality to deal with the pressure of a role such as hers, running the finances of a company with 120,000 staff members. She used to have a sticky note on her desk that said (in English): “Please hassle me, I thrive on stress.” “There’s definitely the risk of becoming an adrenaline junkie,” she admits.

There has been no lack of stress so far in 2015. On 24 March, Menne was in a board meeting in Frankfurt, ready to talk about the company’s cargo operations, when a staff member interrupted it with the worst news airline executives can hear: Germanwings Flight 9525 had gone missing. The plane had crashed in the French Alps, killing all 150 people aboard. Over the following days, it became clear that the pilot had intentionally crashed the jet.

“None of us slept that night,” Menne recalls. The board stayed together, working non-stop for the next 36 hours. In her role as CFO, Menne dealt with insurance companies over the next few days and paid out packets of €50,000 each in emergency aid for the victims’ families.

“There were women who didn’t have access to their husbands’ bank accounts, and we had to find a way to hand over cash,” she explains. She flew to Barcelona to meet the Spanish victims’ families and accompany them to the village of Le Vernet, close to the crash site, as well as dealing with the local French authorities.

Of the board members, Menne was the natural choice for this task. Her French is excellent, thanks in part to her having worked for Lufthansa in Paris from 1999 to 2001. It sounds like a prestigious posting, but for Menne it wasn’t. Ever since starting at Lufthansa, she had risen through the ranks, taking risky jobs such as one in Lagos, Nigeria, where she led the finance team for West Africa. Later, she moved to Hamburg, where one of the projects she was responsible for failed. Menne took the blame — and accepted the job in Paris, which effectively represented a step back down the corporate ladder.

“At the time, I thought I was unfairly treated, and I even thought about leaving Lufthansa,” she says now. But she also learned from the experience: why projects of a certain complexity might fail, what it feels like to be in a weak position, and that some colleagues might avoid you when you lose your position of power.

Instead of leaving the company, her fighting spirit won over. She proved her critics wrong and, in 2010, became CFO of British Midlands (BMI), a subsidiary of Lufthansa that was in serious financial distress but had a prized possession: take-off and landing slots at Heathrow Airport in the UK.

Leveraging those, the board organized BMI’s sale to British Airways.

When Stephan Gemkow resigned as CFO of Lufthansa in 2012, Menne gossiped with colleagues about who might get the job, so little did she expect to land it herself. “I hoped that they would appoint me as a CFO of a different subsidiary one day, but not of the whole group,” she remembers. Then she got a call from the head of the supervisory board, who asked her to come to Hamburg the next day. She did, and a job offer followed.

Menne is reflective when it comes to the nature of power. “It can be a good thing: you can only change things for the better if you are in a position of power,” she says. “But it also changes you. I have definitely become more impatient than I used to be.” She relies on old colleagues, her family and a business coach to help her avoid getting caught up in the hype — her own or others.

A DOUBLE-EDGED SWORD

Menne talks freely about the successes and disappointments of her career, perhaps more openly
than many of her male colleagues would. “I always advise women to clearly say what they want,” she explained in an interview with German weekly Die Zeit. “More often than not, they hide, sell themselves short and wait to be discovered.”

Menne has become something of a spokesperson for gender issues in the German business world. It’s a double-edged sword: on the one hand, she doesn’t want to talk about gender issues alone, but on the other, she wants to promote women in business. “It’s a well-known fact that mixed teams perform better than homogenous ones,” she points out. “I hate it when business leaders advocate against quotas on the grounds that the best candidate should get it. The implicit message is that women aren’t the best candidates, and that’s often wrong.”

Instead, she advocates for a pragmatic approach to quotas, using them where it is practical. “For example, at Lufthansa, we have so few female engineers and pilots that it would be hard to find a significant number of women for leadership positions. But there are other businesses within Lufthansa Group where it might make more sense.”

She has also learned to be thick-skinned when it comes to gender issues. In 2013, an anonymous supervisory board member publicly criticized Menne for supposedly mishandling the election of the new head of the board. He was quoted in Der Spiegel as having said: “The lady is still under Welpenschutz.” Translation: a puppy worthy of protection. Menne saw the remark as condescending and was furious. “He wouldn’t have said that if I were a man; and besides, we did handle the election well.”

In 2014, a leading recruitment consultant told Die Zeit that he didn’t know a woman who could become CEO of a DAX organization in the next 10 years. Menne replied in her own way, publicly stating that she wanted to become the first female CEO of a DAX company. She admits she wouldn’t have been so explicit if she hadn’t been provoked, but now says: “Yes, it’s true, I would like to become a CEO of a DAX company – or of any number of other companies.”

She seems to be taking her own advice: stating what she wants and not waiting to be discovered. “But if I end my career without having made that step up to CEO,” she adds, “I will not be an unhappy person.”

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**SIMONE MENNE: CV IN BRIEF**

- A business administration graduate, Menne starts her career as Internal Auditor at American manufacturing group ITT
- Joins Lufthansa in 1989 as Internal Auditor
- Earns her first promotion and becomes Accounting Manager for West Africa in Lagos, Nigeria, in 1992
- Moves back to Germany in 1995. Serves in various positions in Hamburg: Head of Data Processing and User Services, Project Manager for Restructuring Projects, and Managing Director of the subsidiary Lufthansa Revenue Services
- Moves to Paris as Head of Commercial Management and Human Resources South-West Europe in 1999
- Takes on the same position for all of Europe in London in 2001
- Is appointed Vice President Finance and Accounting at the subsidiary Lufthansa Technik in 2004
- Serves as CFO of British Midland from 2010 to 2012
- Joins the executive board of the Lufthansa Group as Chief Officer of Finances and Aviation Services in 2012
A company’s annual report is probably still the single most useful piece of information for investors. It’s drawn up under a fixed set of rules but with room for variations in application. How companies use that flexibility tells you a lot. Some of our best “misses” – when we decided to avoid investing in a company that turned out not to be what it seemed – came from observing how that company chose to account for its business.

The other information we pay a lot of attention to is our fieldwork. We’re looking at consumer-facing brands, many of them with physical shops, so we can put ourselves in the shoes of a customer and experience the business that way. We’re trying to judge the competitive landscape, what a customer’s alternative options are and what drives them to choose a particular business over another that may be in the same street.

We strongly believe that you can lower your error rate by going to study the competitive landscape in action – not just once, but continually, and more so after you have invested than before. We’re drawn to consumer businesses that have some identifiable competitive advantage, because they are usually possible to model with more certainty than the average business.

In terms of whether this approach gives you a relative edge, there are two sides to this. Most money is invested by institutions and, in our experience, they don’t spend much time in the field. If they do, they look at the world through the eyes of a wealthy fund manager, not those of actual customers. Retail investors are much more likely to have real-world experience of these businesses, but what tends to let them down is psychological bias.
INSIGHT: THE BUY SIDE

A DETAILED PROCESS

It usually takes us a few years to understand a business well enough to commit to invest in it, and often much longer. The essence of our approach is to think of a business as using a pot of tangible capital and earning a cash return on it. We look for businesses that earn a high return on that capital in a manner that we can understand and observe and that we believe is sustainable.

We then look to see if it is managed by people of integrity whose interests are aligned with ours. This is key; we’re handing them our money, so it’s essential that they are honest stewards of it.

Finally, we want to pay a price at which, in a downside scenario, we expect to lose no money, and in a normal scenario, we will make 15% per annum in the long term.

Because we value a business almost entirely on its future cash-generating ability, the starting balance sheet does not have much effect on our valuation. We use it to judge risks and evaluate the need for capital.

The key factors that would lead us to reject an investment opportunity are, in no particular order: the business is too difficult or complicated to understand; it doesn’t have the confidence to extrapolate the past; it uses opaque or aggressive accounting; there is a lack of transparency; or there is the threat of innovation to the business’s competitive landscape.

LESSONS FROM WARREN BUFFETT

American investor Warren Buffett has been an inspiration and great teacher for us. He moved value investing on to include businesses with intangible strengths, such as brands. The approach pioneered by Benjamin Graham (the economist and investor who originated the concept of value investing) is a balance sheet-focused, backward-looking approach that would leave you missing some great investments. Buffett shows you how to think about the strength of a business franchise in terms of the return on its capital and the strength of its competitive position. He taught us to see the value of brands in the consumer space because of the pricing power the brand provides and the stability of long-term demographic habits.

His portfolio construction is also concentrated and weighted according to the scale and range of opportunity. We use a very similar approach, where our top five holdings usually account for more than half the portfolio. And we almost always invest in businesses whose end market is growing long-term, so we expect corresponding long-term sales growth. We don’t like businesses in fields of steady decline; we want the passage of time to work in our favor.

In fact, most of the best consumer-facing businesses are not attractively priced at the moment. The factors that drive these companies are the strength and stability of leading brands, the demographic growth of population, the growing global standard of living and the power of global distribution systems. Ultimately, leading-brand food and beverage businesses, in particular, earn wonderful returns – which probably explains why Buffett, through 3G Capital, is still buying them.

PROFILE

Gary Channon co-founded Phoenix Asset Management Partners in 1998 and has managed the Phoenix UK Fund since its launch in the same year. He began his career in 1987 at Nikko Securities Europe, before joining Goldman Sachs in 1989. He then joined Nomura International PLC in 1992 as its Head of Equity Derivative Trading, and ultimately became Co-Head of Equity and Equity Derivatives Trading, a position he held until he left Nomura to found Phoenix.
Myanmar is a land of contrasts. Many see the resource-rich nation as the next great Asian tiger, following the end of the previous military regime. Today, Nobel Peace Prize winner Aung San Suu Kyi is the leader of the biggest political party in Parliament, and change is in the air under President Thein Sein. The general election scheduled for 8 November will be the first open election in Myanmar for 25 years, and dozens of parties are expected to take part.

This remarkable turnaround has allowed foreign investors to focus on Myanmar’s strengths: its 54 million citizens make it one of the world’s 25 most populous countries, and it has a strategic location between India and China – a location that may be even more attractive when China’s planned “new silk road” is completed, linking it to Europe by rail. A recent McKinsey Global Institute report estimates that, by 2025, more than half the people in the world with incomes above US$10 a day will live within a five-hour flight of Myanmar.

At a conference in Singapore in 2012, billionaire US investor Jim Rogers said: “If I could put all my money into Myanmar, I would,” comparing it with China in 1979, when leader Deng Ziaoping enacted economic reforms that introduced market principles. Indeed, between the end of the military regime in 2011 and this year, Myanmar’s aggregate foreign investment has almost tripled. The Economist suggests that this influx of foreign money has exceeded that of any other Association of Southeast Asian Nations (ASEAN) country, except the Philippines, over the same period.

SECTORS TO INVESTIGATE
Talk to investors and professionals on the ground and you begin to get some perspective on these contrasting indicators. Myanmar may be about to see a huge influx of foreign capital, especially from its neighbors, but according to Tin Win, EY’s Country Managing Partner in Myanmar, the current reality is that “China is only investing in Myanmar’s extractive industries, and to date, India has not invested much at all.”

And what of the idea that the country could be the next great source of low-cost labor? Think again, says Pascal Reigner, France’s Foreign Trade Advisor in Myanmar (and Country President of Schneider Electric). “It will not compete in terms of working costs with Bangladesh, India or China,” he says, “but Myanmar could be an alternative, for example, for Japanese businesses looking to move some manufacturing facilities from other countries to mitigate risk.”

While both Tin Win and Reigner are honest about the challenges facing foreign companies wishing to do business in Myanmar, they also see huge
EMERGING MARKETS: MYANMAR

There are a number of legislative options for setting up a business in Myanmar. The main option is through the Foreign Investment Law (FIL) and accompanying regulations, which relate to medium-sized and large foreign investments. Another set of rules is based on the Myanmar Citizen Investment Law (MCIL), which regulates medium-sized and large investments made by Myanmar citizens.

Under the FIL rules, setting up a business may take up to three months from the date of submitting a proposal. Setting up a company in one of Myanmar’s three Special Economic Zones should only take one month, although if and when FIL and MCIL are combined into a single law, setting up a business elsewhere in the country may become easier.

Foreign ownership of land is barred in Myanmar, but foreign companies can lease land from the Government or private parties. In practice, foreign investors often enter into a joint venture with a local partner who already has a lease for the land, in exchange for a reasonable shareholding.

In business terms, Myanmar’s SME sector is still very much under development, with no easy access to finance at reasonable interest rates. There’s also a real lack of infrastructure, with electricity supply the main problem for many manufacturers.

One further issue likely to hold back Myanmar’s economic development is the human element. Myanmar was once part of the British Empire, and its laws are based on British common law. Until the 1960s, it was one of the leading English-speaking countries in Asia, as well as one of the wealthiest; but, after 50 years of military administration, much has changed. Civil servants and local business people can no longer understand English or read it fluently. It may take a decade to develop Myanmar’s human resources.

Viewpoint

The need for further development

Tin Win, Country Managing Partner, EY Myanmar

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That cautious approach is based on a harsh truth. Investors may be excited by the thought of helping to extend the nation’s physical and technological infrastructure, but the real challenge is upgrading the human infrastructure in the key areas of legal framework, skills and corporate governance.

Looking at the legal issues first, Myanmar’s Companies Act was introduced by the British in 1914 and left untouched until 2014, when international experts started updating the framework. Important laws still need to be passed, including new rules concerning intellectual property and arbitration. “For most of these laws, no timeframe has been announced yet,” says Reigner.

This legal backlog hasn’t stopped many new businesses from being launched, and most observers acknowledge that setting up a business in some sectors – outside those with a national interest – has become much easier. However, investors will be required to submit a long list of documents, many of which may need to be

HUMAN INFRASTRUCTURE
The planned launch of the Yangon Stock Exchange represents another huge step forward for Myanmar. International partners are helping to set it up, including Japan’s Daiwa Securities and Japanese Exchange Group (JEG), and Koichiro Miyahara, Senior Executive Officer at JEG, is optimistic: “We need securities companies, accounting firms and law firms to support a capital market,” he says. “There are several good accounting and law firms in Yangon, and foreign firms are coming, so I think there will be enough in a few years to support [it].”

However, Tin Win suggests this development should be treated with some caution. The exchange will initially only deal in Myanmar kyats, and foreign currency shares are some way off. “Many thought that the opening of the Stock Exchange would be a game-changer, but now people are taking a wait-and-see approach,” he says.

“Sectors attracting foreign interest include mining, mobile telecommunications, oil and gas and property development.”
notarized and consularized before being submitted in turn to government agencies.

As for the speed of setting up a business, much depends on the sector. In the services sector, for instance, registration certificates are fairly straightforward to obtain, but joint ventures remain compulsory in sectors such as construction. And it’s still impossible for foreign-invested companies to get a trading license: foreign businesses can’t import goods and products in order to resell them, or buy products locally and resell them.

If a foreign investor does manage to circumvent these restrictions, Myanmar presents a more fundamental challenge: the availability of skilled staff. Reigner says there are some recruitment agencies that can help find the right local people, “but the quantity and quality of leads remain a real concern.”

Once key staff have been recruited, businesses still face corporate governance issues. Tin Win says that corporate governance is improving quickly within foreign companies set up in Myanmar, based on the application of IFRS principles. The bigger challenge, though, remains local businesses, most of which are groups of companies with no holding company structure that are owned by family members under the direction of a “big boss.” “These groups tend to have no meaningful corporate governance, with the big boss deciding things with no regard to IFRS guidelines,” says Tin Win. “More generally, even local banks tend to have no proper corporate governance.”

Indeed, whatever advances have been made in the economic sphere, corruption is still a problem; Transparency International rated Myanmar 156th out of 174 countries in its most recent Corruption Perceptions Index. And it is still on the Financial Action Task Force blacklist, making international transactions involving Myanmar difficult for foreign investors, especially if the transaction is denominated in US dollars.

Given all these challenges, is Myanmar worth the extra effort? Absolutely, says Reigner, though he counsels patience. “Time is not your enemy, so don’t look for shortcuts and quick wins. In Myanmar, business is built around relationships and respect, and understanding the details of the culture takes time.

“Crucially, the choice of a partner or partners is the key enabler of the sustainable development of any activity,” he adds. “Many Asian companies have been active in the market for over a decade, as they were not too involved in the US and EU sanctions. As a consequence, the competition is very active.”

Thanks to Bertrand Régnier, a Partner from the EY French Business Network, for his help with this article.

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Jennifer Cabalquinto is CFO for the Golden State Warriors, the Oakland, California-based team that was victorious in the 2015 National Basketball Association (NBA) Championships. In this role, she oversees all day-to-day and long-term financial planning and accounting for the organization. She is also responsible for the planning and leadership of IT, facilities and business analytics. An accounting graduate from the School of Management at the State University of New York at Binghampton, she has more than 20 years’ experience in a variety of businesses in the entertainment sector, including Universal Studios Hollywood, NBC Universal and Telemundo.
Know your business drivers
The biggest challenge in entertainment is revenue predictability. It’s very easy to predict cost; it’s very difficult to predict revenue. In TV, the costs are certain, but you don’t know if you’re going to deliver the audience. In sports, you're relying on your team’s performance, and an injury to a key player could completely devastate your season. So I've learned to be as flexible as possible in terms of cost commitments. In the case of TV, instead of ordering a full season of a show, you could order half a season and see how it goes. With a sports team, you get the types of insurance that can protect the organization, and you make sure you have cost levers. Identify anything that's variable so that if your revenue isn’t coming in as you’d expect, you can start to shut down some of those variable costs. Thankfully, the Golden State Warriors just had a phenomenal season, so now we have to think about how to maximize that opportunity and make some long-term commitments.

Be strategic, analytical and operational
Being a CFO isn’t just about being a very good numbers person. Being strategic means really understanding your business and what drives it, so that you can be a strategic partner to the president and your operational leaders. Being analytical means really understanding the data from your business and providing insights to the operations people. If you can't operationalize those insights, they have no value. You need to edit down the data to what can really drive growth in your organization. Otherwise, people just tune out.

Avoid surprises
If you are in tune with your business and you can see things coming in the marketplace you’re in, you shouldn’t have to deliver any surprises to your colleagues or shareholders. I try to stay very current in terms of what’s happening in the industry. It makes me a better CFO if I know the business we’re in. And when you have to report difficult news, it’s really important to keep it factual. No emotion, no judgment. Just report the facts and let someone else judge.

Put character first
In TV, your performers are scripted. The NBA is such an incredible brand, but it’s true reality TV. You try to coach the players and give them media training, then you cross your fingers. What I love about the Golden State Warriors is that we recruit on character first. When you start with a high-character organization top to bottom, you worry less about the unscripted things that can happen. That goes for on the court and in business practices. It’s really part of risk management.

Another part of that is educating our employees about social media. If they are in roles where they can be identified externally as representatives of the Warriors, they have to be very mindful about what they put out there. That is a risk issue for us. Things taken completely out of context can ruin an organization's reputation or brand. We take that very seriously.

Listen!
When you start a new position, go on a listening tour. Listen to your hiring manager and find out what they liked and didn’t like about the last CFO, what they were getting that they found useful, what they weren’t getting. Listen to the rest of the senior management team and understand what their needs are. If they aren’t used to a strategic operational CFO, it may take them some time to understand what the finance department may be able to do to help them. Once they start talking about the business and some of the hurdles they’re facing, that often draws out things that the financial organization can help support.

Listen!
The new lease accounting standard will have a significant impact on financial statements under both IFRS and US GAAP. Although it may not be implemented for a few years, it is important to start preparing for the standard now, as Tim Cooper explains.

The new lease accounting standard, which is due to be finalized this year before its likely effective date in 2018 or 2019, is controversial. A report published in 2010, The New Lease Accounting Standard and You, quoted the US Securities and Exchange Commission (SEC) as estimating that the proposed changes would add more than US$1.3t of operating lease obligations to corporate balance sheets. This could have a profound and lasting effect on the financial strategies of global companies.

Whether to classify a lease as an operating lease (which companies do not currently need to recognize in financial statements) or a capital or finance lease (which they do) has been a significant issue ever since the Financial Accounting Standards Board (FASB) first introduced a standard for lease accounting in 1977.

In 2005, the SEC identified particular concerns about the lack of transparency relating to off-balance sheet leases. Following this, the FASB and the International Accounting Standards Board (IASB) started work on a converged standard. The impact on companies, the complexity of the task and the challenges of convergence have all contributed to a lengthy gestation.

Following a discussion paper in March 2009, the boards published an exposure draft on lease accounting in 2010. According to feedback they received, this would not have produced sufficiently useful information, so the boards revisited the proposals and published a new exposure draft in
May 2013. This met with greater approval, and the boards are set to finalize their respective standards soon.

But for people such as Katharina Steimle, Director, Group Finance and Tax at fashion retailer Hugo Boss, the long wait for a new standard has caused significant disruption and distraction. Steimle and her team operate from the company’s headquarters in Metzingen in Germany and monitor accounting for lease contracts in more than 30 countries.

“We have more than 1,000 stores, and therefore a huge number of lease contracts to account for;” Steimle explains. “It is a challenge to assess them all in terms of financial implications. It is also an operational challenge, because we are present in more than 30 markets with different languages. We have not costed the work we have done on this so far, but it is significant.”

DETERIORATING DEBT POSITIONS

Based on the decisions made by the IASB in redeliberations of its 2013 draft exposure, the lessor accounting model will be largely unchanged, but lessees will have to recognize a lease liability and a right-of-use asset on their balance sheet. This could have a major impact on business issues such as debt positions and performance management. Despite this, many companies have not yet started their preparations for dealing with the new standard.

Michael Van Houten, Executive Director, Financial Accounting Advisory Services (FAAS), Australia for EY, explains: “We have seen some fatigue and disengagement because the standard has been such a long time coming. Many are waiting for the new standard before they work through the detail.” He adds that it will affect many companies in Australia and Asia-Pacific, in sectors including retail, transportation and logistics, and any sectors that use large-scale capital assets, such as mining and construction.

It is a similar story in other parts of the world. Thomas Harms, EY’s Retail and Consumer Products Sector Leader in Germany, Switzerland and Austria (GSA), says: “The impact will be tremendous, because companies have spent a lot of energy arranging lease contracts in a way that keeps them off the balance sheet. In Germany, for example, 20% of all investments use leasing, so an enormous amount of money will come onto balance sheets.”

One effect will be that interest-bearing debt on balance sheets will increase, and many companies’ debt positions will therefore deteriorate. Elfriede Eckl, an EY FAAS Partner for GSA, says: “The change could affect balance sheet metrics such as debt-to-equity ratios or long-lived asset ratios. Furthermore, many companies link their performance measurements to such ratios, so this could also dramatically affect the way they measure performance.”

Van Houten says the standard could lead to companies presenting more lease-related expenses in profit and loss as amortization of the leased asset, and as interest expense relating to the lease liability rather than as a single-line expense in operating expenses. This may increase metrics such as earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation and amortization (EBITDA).

“This could be a significant issue, given that many companies manage operating performance using EBIT or EBITDA,” he explains. “Companies that continue to use those metrics should consider adjusting targets and using additional measures for assessing leasing costs. Others may adjust manually for the impact of the standard, or use another measure, such as profit before tax.”

The change could affect balance sheet metrics such as debt-to-equity ratios or long-lived asset ratios.”

Elfriede Eckl, EY

Steimle says that, as with many other multinationals, moving leases onto the balance sheet will increase fixed assets for Hugo Boss. “Accounting for the discounted lease obligations will influence the debt-to-equity ratio,” she adds. “Operating lease expenses also influence our key performance indicator (KPI), EBITDA. If you don’t account for operating lease expenses, but for depreciation and interest, EBITDA will increase. We don’t plan to change our operating performance indicators just because of the change in accounting treatment, but we might adjust some KPIs, including capitalized lease obligations.”

NEW SYSTEMS

The new standard will apply to existing as well as new leases and will require preparers to have complete oversight of all their lease contracts. This means that companies with a large number of leases need to start gathering information and analyzing the impact, says Harms, who adds that this “will be a tremendous effort for many.”

Eckl stresses that such companies cannot wait until the effective date to start this process, because
it could take them a long time to gather the necessary information and enter it into their IT systems. They may even need to adopt specialist systems.

Hugo Boss currently uses an existing database for its lease stock-take. "However, to account for the new standard on more than 1,000 lease contracts manually would be challenging and inefficient," says Steimle. "We are therefore planning to implement a specialist solution. Ideally, it will interface with our enterprise resource planning software to reduce manual workload, ensure compliance and produce an audit trail."

Sue Lloyd, a board member at the IASB, acknowledges that compliance with the new standard will have a significant impact on companies' resources. However, she points out that preparers already have to disclose all the leases they enter into, even if they are not on the balance sheet, so they should already have most of the information they need.

**BENEFITS FOR USERS**

On the positive side, the new leasing standard will improve access to, and comparability of, information for users of financial statements. "Especially in areas such as retail, like-for-like comparisons have always been tough," says Harms. "The new standard will make it easier."

Lloyd explains that, because most leases are off-balance sheet today, financial statement users have to estimate the leases' effect using whatever disclosures are available. "Typically, they multiply the lease expense eight times and estimate the effect on debt leverage," she says. "That is sub-optimal. The new standard will make it easier for users to understand the effects of leases, because companies will calculate it for them in a consistent way. This will also make lenders better informed about the credit risk of those entities."

Both Lloyd and Christine Klimek, a Senior Manager at the FASB, highlight that many analysts already take off-balance sheet leases into account. Klimek says: "Some industries have argued that increased transparency about lease obligations could create a less favorable economic picture of certain companies. But in a 2013 and 2014 consultation, the FASB found that the majority of investors and analysts it spoke to already adjust lessees' reported balance sheets to capitalize operating leases. In fact, they often capitalize larger amounts than would be recognized under the forthcoming guidance."

Steimle says this is in line with her experience. During its 2014 investor day, Hugo Boss voluntarily presented information on adjusted financial leverage to provide more reliable information to analysts and investors based on its own calculations.

**BENEFITS FOR COMPANIES**

The new standard could also bring some benefits for companies. Harms says that, when the one-off data-gathering effort is complete, the new standard should make preparers' roles easier because it will simplify interpretation – especially as it will eradicate the distinction between "finance" and "operating" leases for lessees.

The new leasing standard could also change the attitude of companies toward leasing. Harms says bringing leases onto the balance sheet may make companies more likely to buy assets rather than lease them, negotiate shorter lease terms (especially as leases under 12 months are exempt from the recognition and measurement requirements of the new standard), or use service contracts instead, if it makes sense in the broader commercial context. For example, German automotive company Daimler offers its customers the option of leasing truck capacity, rather than a specific truck.

Van Houten highlights that off-balance sheet financing has often been a selling point for operating leases. Lessors may therefore look for new ways to articulate the benefits of leasing. “Companies could move away from financial institutions and toward leasing companies that take on the risk of owning the assets themselves,” he says. “I also expect to see lessors offer more options in extending and terminating leases; or

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**The new standard in a nutshell**

- The IASB and the FASB have substantially completed redeliberations on new lease standards that, when issued, would require lessees to recognize assets and liabilities for most leases.
- Lessees applying IFRS would have a single recognition and measurement model for all leases (with certain exemptions).
- Lessees applying IFRS would classify leases using the principles in IAS 17; in essence, lessor accounting would not change.
- The boards have made different decisions about lease classification and the recognition, measurement and presentation of leases for lessees and lessors. In some cases, these differences would result in similar transactions being accounted for differently under IFRS and US GAAP.
- The boards will set effective dates before issuing the new standards. We expect the boards to issue the standards toward the end of 2015.
“The standard will continue to increase the workload of accounting functions – by 5%, 10% or more, depending on the efficiency of the IT solution.”

Katharina Steimle, Hugo Boss

She adds that she cannot see potential benefits from centralization. “Hugo Boss would have done this in any case, as we always aim for a high level of consistency, efficiency and automation,” she says. However, she agrees that ownership might become more attractive, especially for office space and stores where the group has a long-term interest in the location.

THE IMPORTANCE OF COMMUNICATION

Unlike Hugo Boss, many companies have not yet communicated the impact of the new standard to stakeholders, says Eckl – for example, how much it will affect the balance sheet or KPIs. Again, this can be attributed to process fatigue. But, says Eckl, preparers now need to work with their investor relations departments to communicate that they are investigating this issue, and to give a timeline for delivery of their findings. “They also need to look at whether their covenants will be influenced and communicate with their bank about that,” she adds.

Despite the fatigue, the consensus is that successful transition will rely on early engagement. Klimek says: “Organizations can start by preparing a timeline for implementing the standard with comparative periods. Transition plans could include employee education and discussions with auditors.” Above all, warns Steimle, do not underestimate the workload for the accounting department.
The missing piece of the jigsaw

Joanne Segars, Chief Executive of the National Association of Pension Funds, explains why better reporting of metrics related to the workforce would be good for long-term investors, companies themselves and the wider economy.

Despite evidence to demonstrate that human capital has a material impact on financial performance and the familiar corporate mantra that “our people are our greatest asset,” it’s disappointing to see that the vast majority of companies still fail to report on the workforce in any meaningful way.

Of the companies in the UK’s FTSE 100 during 2014, for example, fewer than half disclosed their levels of staff turnover, fewer than a quarter reported on their investment in training and development, and only around 1 in 10 provided information about the composition of their workforce. This lack of transparency makes it impossible to see the full picture of a company’s operations, make comparisons between different companies or form a view about if, and how, companies are maximizing the productivity of the workforce.

There is compelling evidence to demonstrate that an engaged, stable and well-trained workforce, which operates within a supportive environment, is likely to be more committed and productive and, in turn, more likely to drive long-term business success. Building a better understanding of the significance of employees to a business can surely provide insights into the drivers of growth. It could also help in finding solutions to the productivity puzzle, which would be to the benefit of the whole economy. But unfortunately, the workforce is all too often a missing piece in the corporate reporting jigsaw.

KICK-START THE DEBATE

The National Association of Pension Funds (NAPF) recently published a new discussion paper, Where is the workforce in corporate reporting?, to kick-start the debate about workforce reporting. Our paper underlines the role of pension funds in the wider global economy, as long-term investors with a clear interest in promoting the long-term success of the companies in which they invest. But it notes that NAPF members still too often struggle to find any clear or consistent reporting with respect to an investee company’s workforce.

Our pension fund members and their underlying scheme members tell us that workforce issues are more important for investors than executive pay and many other more traditional topics. When we asked those aged 18–34 to rank the issues they think are important for their pension fund to take an active interest in, pay and conditions of employees was ranked 80% higher than executive pay and more than 50% higher than environmental impact. Given this demand and the reams of academic evidence demonstrating the financial
“Our members tell us that workforce issues are more important for investors than executive pay and many other traditional topics.”
materiality of these issues, why do we not see clearer reporting in this area?

The root of this problem may lie in the chicken and egg scenario we encounter: companies tell us they would report on workforce issues if only investors asked them to, but too few investors make that request. On the other hand, investors say they would place greater emphasis on this issue if more meaningful information were readily available.

To help tackle this issue, the NAPF has identified four areas that should be developed further in corporate reporting:

- The composition of the workforce
- The stability of the workforce
- The skills and capability of the workforce
- The motivation and engagement of the workforce

One particular issue that has been brought into sharp focus in recent years is that of “zero-hours” contracts [which allow employers to hire staff with no guarantee of work] in the UK – a contentious issue, both politically and in the media. Many investors are interested in understanding what different employment contracts are used by their investee companies and how these contracts are used. This information can help investors’ understanding of where reputational or litigation risks may lie and where employment models may not appear to be aligned with longer-term success.

Another topical issue is that of the gender pay gap. It is widely acknowledged that a gender balance in a company is better for risk management and decision-making, which, in turn, supports sustainable growth. The promotion of gender diversity can also broaden the pool for recruitment, enhance employee retention, ensure that the potential of all workers is maximized and improve corporate image and reputation. Greater focus on the gender pay gap will begin to address this specific issue by shining a light on corporate practices in this area, but it is not the only area that requires greater transparency – we would like action on all four areas identified in our discussion paper.

WHERE NEXT?

Later this year, the NAPF will host a series of roundtables to bring together investors, analysts, companies, standard-setters and policy-makers to discuss how progress can be made to improve workforce reporting. The conclusions of these discussions will be incorporated into the NAPF’s Corporate Governance Policy and Voting Guidelines, as well as our 2016 annual AGM report. We look forward to continuing this healthy debate in the coming months.

For more information and to read the NAPF discussion paper, visit napf.co.uk/policyandresearch.
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New and recently published books

From Big Data to Big Profits: Success with Data and Analytics  
by Russell Walker (OUP USA, August 2015)  
Major companies have moved from serving as data or inventory storehouses, suppliers and exchange mechanisms to monetizing their data and expanding the products they offer, and these changes have implications for both firms and consumers. Walker investigates the use of internal big data to stimulate innovations for operational effectiveness, and the ways in which external big data can gauge, or even prompt, customer buying decisions.

The Agile Organization: How to Build an Innovative, Sustainable and Resilient Business  
by Dr. Linda Holbeche (Kogan Page, June 2015)  
This book focuses on how to build both agility and resilience at individual, team and organizational levels. It draws on a wealth of research, including the experience and learning of managers and human resources and organization development experts, to show how it is possible to “square the circle” – becoming more sustainably agile, while also enhancing employee engagement and resilience.

Bye Bye Banks? How Retail Banks are Being Displaced, Diminished and Disintermediated by Tech Startups and What They Can Do to Survive  
by James Haycock with Shane Richmond (Wunderkammer, June 2015)  
The retail banking business model is set to be the latest to be transformed by tech companies. The authors describe these innovative start-ups and the areas of banking they are targeting. This process is already well under way, and many incumbents are poised to be disrupted as a result. The solution, say Haycock and Richmond, is for traditional banks to reinvent themselves by launching a “beta bank”: a lean, standalone organization fit for the future.
Isn’t it also an art to see the beauty in underlying patterns?

The more we can understand the complete picture, the more we can appreciate it. Using advanced data analytics, our auditors can look beyond the obvious and apparent, delving deeper into underlying patterns and trends to deliver a high quality audit.

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... The better the question. The better the answer. The better the world works.