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The Premier Global Society of Financial Executives



Message from the Chairman

Dear IAFEI members,

Warm greetings to all from the sunny Philippines!

It is my pleasure to present to you the 1st issue of the IAFEI Quarterly for 2019.

I would like to personally thank past Chairman Helmut Schnabel for serving as the IAFEI Quarterly Editor-in-Chief since 2007. Truly, his unselfish service to the IAFEI community is commendable.

Likewise, I would like to convey my profuse gratitude to ANDAF and past Chairman Fausto Cosi for helping Mr. Schnabel in preparing the lay-out and electronic publication for the last 3 years.

Starting with this issue, the IAFEI Quarterly has been guided by an Advisory Board and an Editorial Board depicting a wider participation among IAFEI leaders and member-institutes.

As changes are effected to cater to the constituents of IAFEI, the IAFEI Quarterly will endeavor to feature more articles from its members, its partner institutions and other professionals in its network. With your new leadership, we will provide more value to being an IAFEI member.

As we celebrate our 50th founding anniversary, I enjoin everyone to support all the projects of IAFEI especially the forthcoming 49th World Congress to be held in Matera, Italy on October 25-26, 2019.

Thank you and all the best!

EDUARDO "Ed" V. FRANCISCO
Chairman

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The CFO Reimagined – Finance in the Front Line

by **Mauro Marchiaro**, *Senior Managing Director Accenture, Italy*, and
 by **Riccardo Volpati**, *Managing Director Accenture, Italy*,
 article provided by ANDAF, the Italian IAFEI Member Association

Corporations are facing an era of unprecedented change, where uncertainty and digital disruption are redefining markets, risk profiles and growth opportunities. Volatility and risk abound. The beginning of the new year, with financial markets falling on fears of trade war and Chinese demand slowdown (triggering Apple's profit warning), to jump back by more than 3% few days later the release of good news from US jobs, was just another reminder of the extreme volatility and risk that today's business executives must face. Among them, the CFO is certainly one of the most impacted, as such a challenging scenario makes his role more crucial than ever. A recent study from Accenture takes a deep dive into the dynamic role of today's CFOs, outlining the challenges that they face and the new ways in which they can leverage technology, skills and relationships to position their companies for growth (1). This recently released research covers a panel of more than 700 Finance and C-suite leaders from 9 industry sectors, including 50 CFOs, plus more than 200 up-and-coming finance professionals from countries such as the United States, United Kingdom, Japan, Germany, Italy, France, Australia, Brazil, Spain and Singapore.

CFOs are emerging as "digital stewards", leading the efforts in using data to navigate uncertainty and foster new, digitally driven business models that help evolve the enterprise. "With a unique bird's-eye view of

their companies, CFOs are looking beyond the traditional boundaries of the finance function and collaborating with CEOs to develop data- and insight-driven strategies—creating sustainable growth, long-term value and profound change". In virtually every company we look at, the CFO is becoming the second most important C-level executive. "An effective leadership team depends on the CEO and CFO being a great double act"⁽¹⁾.

What are the most crucial challenges that CFOs are facing in this transition, and what priorities do such challenges entail for CFOs going forward? Key challenges are both operational and cultural. They range from meeting increasing Shareholders, Board and CEO expectations, to coping with increasing business changes, to harnessing the power of larger amounts of data to improve business outcomes, to finally constantly improving control and compliance. Below are some of the key emerging themes for CFOs as they fulfill their increasingly important role.

Continuing to automate. Automation of F&A processes has already become a foundational requirement for virtually all CFO's. As of today only 34% of finance tasks are truly automated, while today's technology would

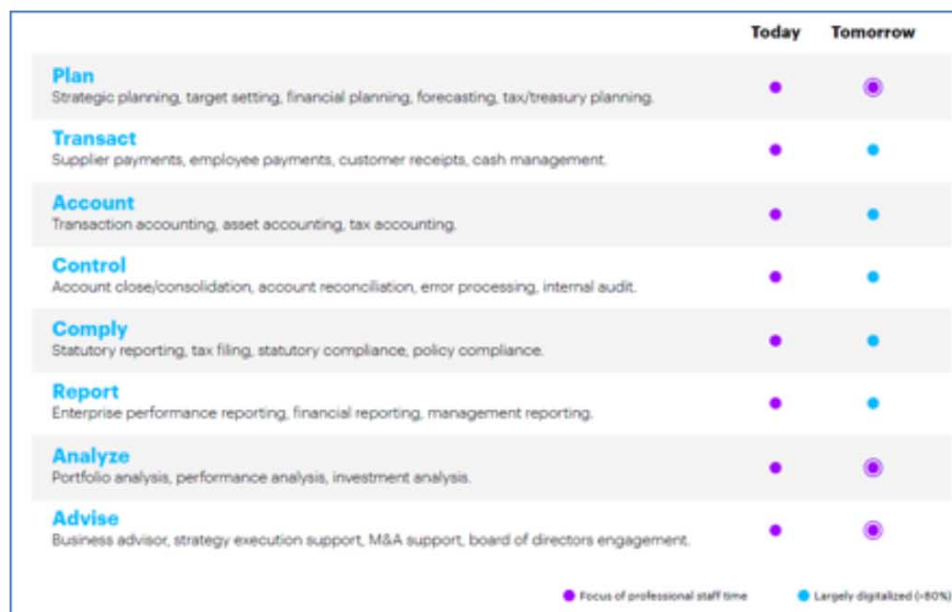
⁽¹⁾"The CFO Reimagined: from driving value to building the digital enterprise", Accenture 2018

allow for 60-80% of traditional, backward looking accounting activities to be touchless. But as introducing and deploying robotics at scale might prove to be complex by itself, that is not the most challenging part of the whole exercise. The first challenge has to do with people's culture. 38% of CFOs are concerned about resistance from employees to work with non-human colleagues. In this perspective, effectively communicating the benefits of automation is a key skill for the CFO. As a matter of fact, automation technologies can augment Finance professional's performance. In economies where demographic trends are affecting workforce availability, as well in contexts with large waves of aging workforce approaching retirement age with constrained succession, automation can also mitigate organizational pressures and create slack for growth. The second most important challenge resides in transforming the operating model. Indeed,

automation is not simply about replacing human efforts with RPA, and piecemeal robotics applied to as-is way of working do not drive sustainable efficiency and performance improvement. It is part of a broader journey whose ultimate goal is to free up time to take on entirely new tasks with broader impact (such as analysis and trendspotting). For that to be achievable, automation needs to be pursued together with:

- Process standardization and streamlining, enabling core operating processes that are candidates for automation, and related processing volumes, to be addressed to the largest extent possible;
- Substantial end-to-end reengineering of the processes with the highest manual effort, to strengthen the case for advanced and "intelligent" automation (e.g. involving machine learning and AI).

Impact of digitalization on Finance operations



Using data to drive value. The ability to capture, organize and process data more effectively to make better decisions and manage related risk-return trade-offs is still the CFO's largest source of untapped potential. Research outlines that Finance organizations are already using advanced

data processing tools such as predictive analytics (74%) and AI (61%). However, 53% of CFOs are concerned that Finance is still reactive and backward-looking and that data and information sharing processes are not fully effective. As analytics solutions have evolved to become extremely powerful,

getting data in order is still the number one requirement to really benefit from such power. And instilling data discipline across the organization to enforce “one version of truth” is still a pre-requisite for the draw actionable learnings from data.



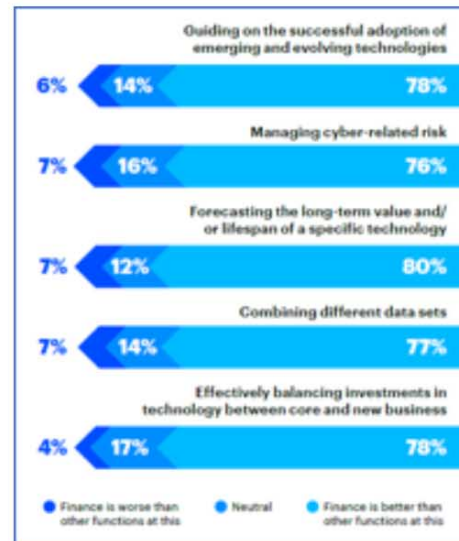
The CFO’s ability to process and synthesize complex datasets and develop rigorous value-focused analysis will be increasingly in demand, as increasingly results-pressured business departments (e.g. sales & Marketing, Business Development) will need objective and forward-looking assessments of how strategies and related investments would translate into value (such as incremental EBIT and operating cash-flow) and incremental risks (e.g. credit risks, liquidity issues, etc.). Provided accelerating pace of innovation coupled with huge volatility and uncertainty experienced across industries, such demand is most likely heading North, and the CFO is uniquely positioned to be the provider of choice.

Taking charge of digitalization. Digital transformation is now a competitive requirement for most organizations. 81% of CFOs see identifying and targeting areas of new value across the business as one of their main responsibilities. 77% believe it is within

their mandate to drive business-wide operational transformation across the whole enterprise. This point specifically indicates the strong involvement and self-empowerment of CFOs in corporate-wide digital transformations, spanning beyond their traditional AFC functional boundaries. In other words, Finance is taking the lead in enterprise digitalization. Some of the root causes outlined for this trend:

- The CFO, together with the CEO, is the only C-Level executive that has sight of the whole enterprise;
- Finance oversees the digital ROI, by evaluating and prioritizing investments in digital technologies;
- Finance in itself is a perfect candidate for digital transformation, resulting in CFOs often being “early movers” in the Corporate space.

But as CFOs take the lead in digitalization, the immediate next topic becomes “how should the role of Finance evolve in the digitalized enterprise?”.



Empowering Colleagues. Many CFOs are convinced that new technologies will drive a more pervasive empowerment of other functions through transfer of responsibility for several basic finance tasks to them. Just like digital native business have shifted a significant portion of admin work on their end customers (supported by apps and new

digital interaction models), Digital Finance should do the same with its “internal customers” from other functions. 67% of Finance executives believe that executives in non-finance functions should be trained to take on to finance activities such as reporting, planning, budgeting and forecasting. 78% believe that digitalization will be the ultimate enabler of a much broader self-service (and self-empowerment) model. By ensuring governance, control and expert support, Finance can help businesses serve themselves, thus providing more personalized user experience, reducing handling times and freeing up Finance professionals for strategic planning and other non-routine activities (e.g. investments assessment, financing strategies, M&A, etc.).

Developing future Finance talent. As Finance takes on more strategic responsibilities across the enterprise, it needs to become better at supporting fresh thinking, collaborative working and strategic insight. Evolution of the CFO’s role calls for an evolution of the CFO’s skills and of the broader Finance talent. Traditionally, young professionals with a quantitative background, reliable and detail-oriented mindset could have been a good fit. But now CFOs need people with a broader range of capabilities to fulfill the increasingly important business partner role. In this context, CFOs and other senior Finance executives are advancing on such skills evolution much faster than the rest of the Finance department, creating an internal competence gap that needs to be managed as well. As a result, 78% of CFOs believe that this change must be “rapid and drastic”. Organizations need to be able to pivot between looking backward and looking forward, be strategic and focused on getting the books closed while ensuring all the proper controls have rigor. It takes strong leadership to strike the right balance. Here is a non-exhaustive, but indicative set of highlights on the new CV must-haves for the finance workforce of the future:

- Adaptability and resilience: open to deal

with uncertainty and to adapt to fast-changing environment

- Intellectual curiosity and inquisitiveness: investigate and crack business issues
- Data and analytics proficiency: draw actionable insights from data
- Storytelling: effectively communicate insights
- Understanding of the business and the outside industry context, its dynamics and key value drivers

Bringing it all together. CFOs are in the front-line of enterprise digitalization, building on their knowledge of data, analytics and finance to navigate uncertainty and shape strategies. Looking ahead, Finance leaders will increasingly focus on a set of priorities that outline a leadership role that goes beyond traditional Finance boundaries:

- Shaping and clearly communicating the economic case for change, driving and overseeing the digital transformation ROI;
- Leading by example, building a digitally enabled Finance function, and developing a broader set of skills to better interact with the business;
- Redefining the Finance operating model to empower other functions and foster better cross-functional interaction.



*Mauro Marchiaro, Senior Managing Director,
Accenture, Italy*

INTERNATIONAL TAX DISPUTE RESOLUTION: NEW EU RULES

by **Piergiorgio Valente**, *Chairman, IAFEI International Tax Committee*
and by **Filipa Correia**, *Secretary, IAFEI International Tax Committee*

International Tax Dispute Resolution: General Remarks

International tax disputes arise, in principle, where

- (i) there is a bilateral or multilateral treaty for the avoidance of double taxation (hereinafter “Double Tax Convention” or “DTC”) or an equivalent instrument¹ and
- (ii) the contracting jurisdictions exercise their taxing power in a manner resulting in violation of its provisions.

In addition, such disputes can also arise without violation of the DTC (including equivalent instruments), if there is disagreement or uncertainty in relation to the correct application of its provisions. In a nutshell, international tax disputes can arise, if there is a framework agreed between two or more jurisdictions regarding the exercise of their taxing power in cases involving both of them (in principle in a DTC).

In their vast majority, existing DTCs provide for the resolution of the above disputes through the so-called mutual agreement procedure or MAP, following the respective provisions of the OECD Model Tax Convention (hereinafter the “OECD Model”)². MAP aims at dispute resolution through agreement between the national tax authorities involved, on the basis of dialogue and cooperation, following request by the taxpayer affected.

MAP is of key relevance for taxpayers and in particular for the protection of their rights under DTCs, e.g. the right not to be taxed multiple times on the same income. It permits those who consider that such rights have not been respected by a certain state to invoke as their ally the other contracting state. Thus, the first state shall have to justify its conduct not only to the taxpayer but also to another sovereign state. It arises that MAP is critical for the integrity of the international tax system, encouraging states to abide by their contracting obligations in DTCs.

In the last few years, the MAP framework has changed substantially, always with a view to ensuring prompt and effective dispute resolution. From an international perspective, on the one hand, MAP was revisited in the context of the OECD’s Base Erosion and

¹An equivalent instrument is the EU Arbitration Convention, which establishes an EU tax dispute resolution framework for disputes following an upward adjustment of the taxable business profit of a multinational enterprise (transfer pricing disputes). Cf. Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (Arbitration Convention).

²OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017, art. 25, OECD Publishing (Paris, 2017).

and Profit Shifting Project, under Action 14³ and Action 15⁴. The actions agreed to improve MAP are currently being implemented, in new DTCs following the 2017 version of the OECD Model and in existing DTCs through the Multilateral Instrument⁵. On the other hand, the EU took a drastic step to the same above end, by adopting a targeted directive on tax dispute resolution, at the close of 2017 (hereinafter the “Directive”)⁶. Such directive has to be transposed into Member States’ legislation within the first half of 2019, to be implemented to cross-border tax disputes arising in the EU from 1 July 2019 and in relation to tax years starting from 2018.

In light of the above, the following paragraphs provide an overview of the key changes the new directive brings to tax dispute resolution in the EU, compared to the existing framework. It is worth noting from the outset that the new directive promises a strong improvement of tax resolution in the EU, in favor of investment and growth in the Single Market.

New Framework: Key Changes

The Directive does not abolish the existing EU tax dispute resolution framework, based on DTCs between Member States and on the Arbitration Convention, but seeks to build thereon, by remedying the deficiencies of established mechanisms.

First of all, the Directive has an extended scope, including all international tax disputes arising between Member States, either on the basis of a DTC or the Arbitration Convention and in relation to their interpretation or application. This means that the same rules shall apply for the resolution of all such disputes, while before the Directive, there was a common framework only for transfer pricing disputes (under the Arbitration Convention). All other disputes were to be resolved as per the rules of the applicable DTC, i.e. different rules could apply between different Member States.

Secondly, the Directive promotes the effective resolution of tax disputes in the EU by providing for mandatory binding MAP arbitration, in case MAP does not lead to resolution within two years from its initiation. Under the previous framework, Member States had, in principle, an obligation only to make best endeavors to resolve a dispute, i.e. they were allowed to fail. Exception were the transfer pricing disputes falling under the Arbitration Convention, which provided for mandatory binding MAP arbitration as well. The Directive upgrades the exception into a rule for all tax disputes between Member States.

Thirdly, the Directive provides for the timely resolution of tax disputes by prescribing a strict timeframe for the several actions that need to be taken in the context and for the purpose of dispute resolution. Such a timeframe may be considered a novelty in relation to DTCs as well as to the Arbitration Convention, which provided a general timeframe only. Most importantly, the Directive ensures that such actions are taken on time by permitting taxpayers’ referral to national courts in case of delay. In essence, in such case and following taxpayers’ request, national courts can substitute the competent national authorities and take the necessary action themselves.

³OECD, Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing (Paris, 2015).

⁴OECD, Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing (Paris, 2015).

⁵P. Valente, BEPS Action 15: Release of Multilateral Instrument, 45 Intertax 3 (Kluwer Law International, 2017).

⁶Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, OJ 265 (2017).

Furthermore, the Directive promotes publicity of the outcome of tax dispute resolution and hence transparency, predictability and tax certainty. Thus, where all parties (tax authorities and taxpayers) involved consent thereto, the whole resolution decision may be published – which was the case also under the Arbitration Convention for transfer pricing matters. In absence of such consent, an abstract of the decision is foreseen to be published, including a summary thereof. The publication of the abstract is a key innovation of the Directive.

Concluding Thoughts

The Directive is not flawless; there is margin for further improvement of the EU framework for tax dispute resolution. By way of an example, taxpayers are only allowed to present their case before the arbitral (or equivalent alternative dispute resolution) panel, with the prior consent of the tax authorities involved. Yet, fair trial and fair dispute resolution proceedings demand that taxpayers are effectively guaranteed such right. In any case, it is not questionable that the Directive signals significant progress for tax dispute resolution in the EU and subsequently, enhances tax certainty in the Single Market.

From an international perspective, the Directive follows a number of changes to the international tax dispute resolution rules, as a result of the BEPS Project and comes amidst their implementation. Although, overall, it moves in the same direction as such changes at the international level, the Directive may be praised for taking further steps compared with the latter towards prompt and effective tax dispute resolution. An example is the potential involvement of national courts to tax dispute resolution proceedings, in case of inaction of competent tax authorities. It could thus be the source of inspiration for additional improvement of the international rules as well.



Piergiorgio Valente, Founding and Managing Partner, Valente Associati GEB Partners / President, CFE Tax Advisers Europe

FRANCE and USA

Recession considered likely by year-end 2019

by **John Graham**, *D. Richard Mead Jr. Family Professor of Finance, The Fuqua School of Business, Duke University* and
by **Philippe Dupuy**, Associate Professor, Accounting, Law and Finance, Grenoble Ecole de Management

IAFEI and a group of partners among which Duke University and Grenoble EM survey CFOs across the world. For the fourth quarter of 2018, the survey ran from 23rd November to 4th December 2018.

- Nearly half of U.S. CFOs believe the nation's economy will enter a recession by the end of 2019
- Worst-case projections would see capital spending drop in 2019 at best small increases in hiring.

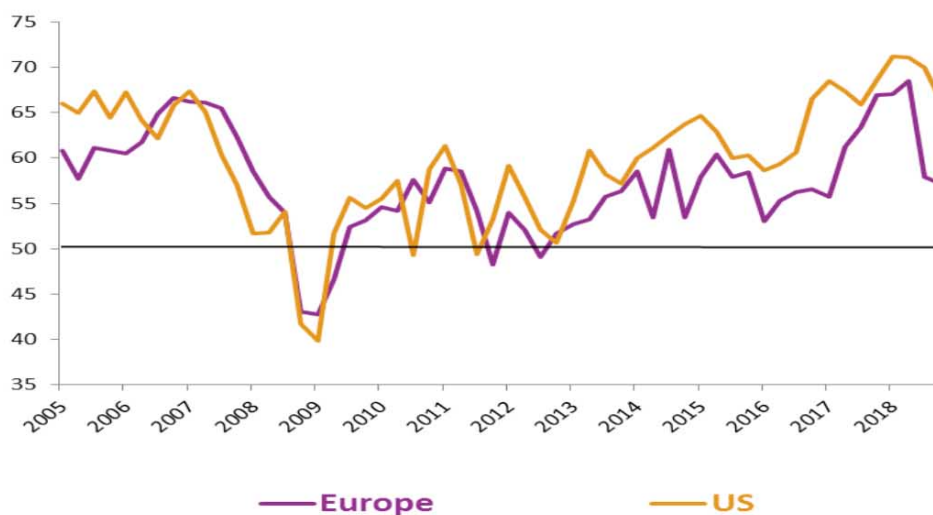
CFOs expect sub-3% growth for the U.S. economy.

Nearly half (48.6 percent) of U.S. CFOs

believe that the US will be in recession by the end of 2019, and 82 percent believe that a recession will have begun by the end of 2020. The end is near for the near-decade-long burst of global economic growth. The U.S. outlook has declined, and moreover the outlook is even worse in many other parts of the world, which will lead to softer demand for U.S. goods.

CFOs are more pessimistic in most other regions of the world. Ninety-seven percent of African CFOs believe their countries will be in recession no later than year-end 2019, as do many CFOs in Canada (86 percent), Europe (67 percent), Asia (54 percent), and Latin America (42 percent).

CFO survey: Optimism index



In 2019, CFOs expect sub-3% growth for the U.S. economy, with accompanying capital spending and employment growth of about 3 percent. Their recession projections suggest most of this growth will occur early in the year.

Moreover, their forecasts are skewed to the downside, with a one-in-ten chance that annual real growth will be meager 0.6 percent. In this worst-case scenario, CFOs would expect their capital spending to fall by 1.3 percent and for hiring to remain flat. CFOs are getting ready for a recession in the next 18 months. All of the ingredients are in place: a waning expansion that began in June 2009 – almost a decade ago – heightened market volatility, the impact of growth-reducing protectionism and the ominous flattening of the yield curve which has predicted recessions accurately over the past 50 years.

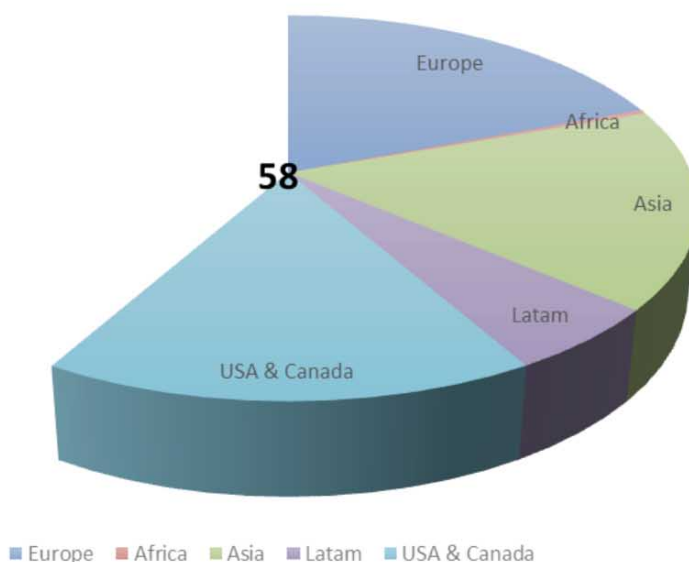
Optimism falls

With recession considered likely, optimism

was mostly static or fell across the world this quarter. The Optimism Index for the U.S. Economy slipped to 66 this quarter, compared to an all-time high of 71 last quarter, CFO optimism about their own firms' financial prospects dropped two points to 69 on a 100-point scale. Both indices were at all-time highs earlier this year. Canadian optimism was steady at 58, on a scale of 0 to 100. Optimism in Europe dropped a point to 57, after falling 10 points to 58 last quarter. Optimism is at 59 in the U.K., 56 in France and 50 in Italy. Capital spending and employment are both expected to grow about 2 percent over the next year.

Once again, the top concern among European CFOs is attracting and retaining qualified employees, followed by economic uncertainty and government policies. Currency risk and employee productivity were also top five concerns.

Average Global Business Outlook



**GDP weighted Average Global Business Outlook
(World Bank GDP constant prices in USD)**

Optimism in Asia dropped eight points to 52 this quarter. Economic uncertainty remains the top concern. Other concerns include difficulty attracting qualified employees and currency risk. Capital spending is expected to grow about 10 percent, and employment 2 percent, over the next 12 months.

Overall Latin American optimism is 63 this quarter, on a scale of 0 to 100. The Optimism Index is highest in Brazil, at 69, where a new president seen as pro-business has been elected just as the country is emerging from a historic recession. Optimism is 53 in Mexico, 57 in Chile, 61 in Peru, and just 34 in Ecuador, where the government remains mired in corruption investigations. Economic uncertainty remains the top concern among Latin American CFOs. Other concerns include government policies, weak demand and currency risk. Capital spending is expected to

grow 2.2 percent and employment 2 percent over the next year.

Business optimism in Africa rebounded to 51 this quarter. Employment should fall about one percent in Africa over the next 12 months. Median capital spending is flat. African CFOs are most concerned about economic uncertainty, governmental policies and regulatory requirements.

About the survey: This is the 91st consecutive quarter the Duke University/CFO Global Business Outlook survey has been conducted. The survey concluded December 7, and generated responses from more than 500 CFOs, including 226 from North America, 48 from Asia, 82 from Europe, 122 from Latin America and 32 from Africa. More information at: philippe.dupuy@grenoble-em.com

Table 1: During the past quarter, which items have been the most pressing concerns for your company's top management team?

	Europe	Latin America	Asia	USA
Economic uncertainty	35.0	63.1	55.1	29.7
Currency risk	23.8	33.8	27.1	4.2
Weak demand	18.8	43.1	14.3	13.7
Government policies	35.0	44.6	25.1	32.1
Access to capital	13.8	24.6	21.3	15.6
Regulatory Requirements	23.8	20.0	19.8	22.2
Difficulty attracting/ retaining qualified employees	46.3	10.8	28.3	46.7
Employee productivity	23.8	13.8	17.3	19.3
Rising wages and salaries	13.8	3.1	10.3	27.8
Employee morale	21.3	1.5	15.5	8.5
Cost of borrowing	5.0	15.4	17.1	12.7
Data security	22.5	9.2	10.1	20.8
Geopolitical / health crises	10.0	12.3	12.7	4.7
Deflation	0.0	1.5	0.0	0.5
Rising input or commodity costs	17.5	13.8	15.0	20.8
Cost of benefits	5.0	7.7	9.0	31.6
Corporate tax code	6.3	13.8	6.8	8.0
Inflation	2.5	10.8	12.1	4.2
Other	11.3	6.2	5.5	9.4

Table 2: Relative to the previous 12 months, what will be your company's PERCENTAGE CHANGE during the next 12 months? (mean by region)

	Europe	Lat in America	Asia	USA
Revenue	5.4	10.7	5.1	4.9
Inflation (Change in prices of own-firm products)	1.5	3.6	1.5	2.7
Capital spending	2.2	2.2	10.0	1.0
Technology spending	3.5	4.2	4.6	4.3
R&D spending	1.7	3.8	3.2	1.4
Advertising and marketing spending	0.7	3.6	3.0	1.3
Employment – full-time	1.6	2.0	2.0	3.6
Wages and Salaries	3.1	3.7	2.2	4.2
Health Care Costs	1.8	4.8	2.1	6.0
Earnings growth	4.2	6.6	6.8	6.6



CFO

**DUKE CFO GLOBAL
BUSINESS OUTLOOK**



John Graham, D. Richard Mead Jr. Family Professor of Finance, The Fuqua School of Business, Duke University



Philippe Dupuy, Associate Professor, Accounting, Law and Finance, Grenoble Ecole de Management

PHILIPPINES

IPO: The Road to Wealth

**by Abelardo V. Cortez, Secretary, IAFEI / Independent Director,
First Metro Philippine Equity Exchange Traded Fund, Inc.
/ 2007 FINEX President**

A company founder or CEO trying to raise additional capital, either by way of equity or debt, has three options of doing so: first, by securing bank loans preferably long term loans; second, by seeking funds from cash-rich individuals (relatives perhaps) or institutional investors; and third, by selling 20% to 25% of the company's shares by way of an IPO (initial public offering). The latter appears simple and it is.

Assuming you've decided to do an IPO (initial public offering) here are the basics. Assess realistically the debt-carrying capacity of your company. Review the impact of the planned IPO on the possible share dilution of existing shareholders. Review thoroughly your business and growth prospects. Do they have favorable economics? Are they sustainable? What's your standing within your industry? All these should be factored in as you transform your company into a publicly listed one.

In addition, you must have a compelling and credible business plan along with compelling story on why you're selling shares to the public. Your company's ratios like your projected P/E, revenue estimates, and other vital numbers on sales, production, operational costs must be credible, realistic and justifiable. In all likelihood, investors will raise questions on these over and over again: What are you going to do with the funds you'll generate in your IPO? The success of an IPO depends, as observed, largely on the

coherence and credibility of your IPO story. One major reason why some companies fail to raise as much equity capital is traced to their failure to convince investors there's "gold in the mine" in their IPO story. Put it this way, a well prepared business plan, crafted with the assistance of your experienced investment bankers, is a major selling tool in any IPO drive.

In an IPO, timing is always crucial. Avoid coming out with an IPO offer price that may be high at a time when the market is soft like what's happening now . Check the market's mood. Is it bullish or bearish? Are share prices rising or falling? Is the trading volume up or down? What's the investor's sentiment? You could certainly minimize some risks if your IPO is launched at the most appropriate time. Equity market is sending ambiguous signals now. It may take sometime before investors really start to sit-up and take notice.

Global growth is slowing and the world economy is reportedly headed for a recession in 2019. Most of the world's major economies outside the United States showed clear signs of slackening growth in the fourth quarter of 2018. But strong start to the US earnings season, along with trade optimism and hopes of a slower pace in the Federal Reserve's interest-rate hikes have helped S&P 500 recoup some of its losses from recent rout. Trade wars are also seen as danger, noting that tariffs are bound to hurt markets. Still,

most economists are hoping it will be a soft landing rather than outright recession.

No one can anticipate when surprises occur, or when investors' "Black Swan" will suddenly appear in the business horizon. Arguably, worries about recession, inflation, capital impairment of major banks, political crisis, currency uncertainties may cause major distortions in the global economy rendering investors to be more cautious going back into the financial markets.

When you're confronted with a chicken-and-egg situation such as this, it helps to pause and recall the words of legendary investor Warren Buffet: "The market, like the Lord, helps those who help themselves. But unlike the Lord, the market does not forgive those who know not what they do."



*Abelardo V. Cortez, Secretary, IAFEI /
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Equity Exchange Traded Fund, Inc.
/ 2007 FINEX President*

GREECE

Geopolitics and Economy: The Case of Greece

by **Vassilis Karayannis**, *Business and Management Advisor / Member of
Employment Committee, Hellenic Chamber of Commerce*

Exxon Mobil announced that it has made the world's third biggest natural gas discovery in two years, off the coast of Cyprus in the Eastern Mediterranean basin which represents a major geopolitical development. In addition, there are several other projects concerning exploration of natural gas which occur in various other countries of East Mediterranean such as Israel, Egypt and Greece.

It is evident that the discovery won't only add significant value to the economy of Cyprus but also creates a new geopolitical landscape. Furthermore, these developments will have a positive impact to EU's efforts to diversify its energy sources and reduce its dependence on Russia.

It is highly probable that there will positive impact on employment, income and business outlook of local economies. Those countries won't only become energy independent but could be subjects of significant investments as well.

In addition, the natural gas a) needs to be extracted safely and b) needs to be transferred safely mainly to Europe, which represents the main buyer of energy in this part of planet.

For this reason, a new alliance of countries is emerged, consisting of Greece, Cyprus, Israel and Egypt. Additionally, the extracted natural gas needs to be transferred safely from East Mediterranean basin to European Union.

Examining the case from theoretical point of view, all countries involved in natural gas exploration could prevail in competition vis-à-vis other neighboring countries of East Mediterranean. The term competition is addressed in a systematic manner in Adam Smith's 1776 book named "Wealth of Nations". Based on Smith's theoretical framework, all countries which have discovered natural gas resources will prevail in competition among other countries of the region.

In modern times this has not been always the case. For instance, Venezuela's proven oil reserves are recognized as the largest in the world. However, Venezuela represents one of the poorest countries of the planet, maintains a hostile investment environment and a source of regional instability in Latin America.

Unlike Adam Smith who is a macro economist, Michael Porter who systematically addresses this subject in his book "Competitive Advantage of Nations", lies in his micro economic perspective on the problem of competitive advantage. More specifically, he considers nations as the sum of the performance of individual businesses and industries and analyses their interdependences.

Based on Porter's theoretical framework, the discovery of natural gas resources in East Mediterranean basin, represents a necessary but not sufficient condition that the countries will transform these discoveries into competitive advantage.

For instance, Greece is one of countries involved either in exploration projects or transferring natural gas to continental Europe because a) it is the nearest country of continental Europe to natural gas basin of East Mediterranean and b) Turkey is going through a lengthy, severe political and economic crisis and has been moving away from Europe from political and cultural point of view.

However, it appears that Greece cannot take full advantage of the positive geopolitical developments and transform them into competitive advantage, yet. Although it currently attracts foreign direct investments concerning energy infrastructure which will transfer natural gas from East Mediterranean to Europe, it can hardly attract significant investments which will increase added value of energy hub to local economy and/or investments in other parts of its economy.

In general, there is the sense of some steps being taken in the right direction in some sectors of Greek economy i.e. tourism, and the general economic and political concerns are subsiding. However, foreign direct investments concern small amounts of capital, definitely below those required for the country to return to robust growth.

In addition, Greece needs foreign direct investments in order to address significant its time bombs which undermine its economic outlook such as a) ageing population b) high levels of unemployment which are currently close to 18% (70% of it concerns structural unemployment), c) significant Brain Drain which cannot be transform to Brain Gain and d) extremely high, non performing private debt.

The low level of foreign direct investments as a percentage of GDP (2.0%) is the result of diminishing competitiveness, as it appears at Global Competitiveness Index of World Economic Forum.

The country needs to enhance its competitiveness in order to attract foreign direct investments and maximize the added value of geopolitical developments i.e. discovery of natural gas resources in East Mediterranean or increase of trade between Europe and Asia which could emerge the Port of Piraeus as the biggest port of Mediterranean Sea.

In practical terms, the country must address its cumbersome bureaucracy, high tax rates and predictability of taxation policies, weak institutions and a slow pace of justice. All above, weigh heavily on investors' decisions when they come to assess Greece as a place to do business. Last but not least, Greece needs foreign direct investments which will also transfer innovation and associate local economy with 4th industrial revolution.

For this reason, it has to implement a program of structural reforms in order to a) liberalize its economy, b) reduce the level of involvement of state sector and c) create a friendly investment environment which will generate many, well paid, competitive jobs.

Some positive results have already been achieved, such as the privatization of the Piraeus and Thessaloniki ports, the 14 regional airports and National Natural Gas System Operator (DESFA). However, Greece is far from being considered as a popular investment destination by global investor community. Greece needs investment shock.

Based on the above, it becomes apparent that Greece is a typical case which shows that positive geopolitical developments represent a necessary but not sufficient condition for a country to create competitive advantage. Hopefully, this will change and Greece will take full advantage of positive geopolitical developments and return to a virtuous, sustainable growth cycle soon.



Vassilis Karayannis, Business and Management Advisor / Member of Employment Committee, Hellenic Chamber of Commerce

GREECE

The Difference between A BOSS and A LEADER

by **Anastasios Rodopoulos**, *General Manager, HMA*
Area President EME, IAFEI

I spent quite a few years compromising myself for the sake of a paycheck, trying to insure a lifestyle of security and consistency for my sons. I was forced to decide between what I loved to do for a job in a place I despised when I'd left a dozen years earlier and all because I listened to the wrong people.

I listened to people who were not going to have to endure the garbage and toxicity in the place where I was being sent. I worked with people I had nothing in common with, most who had checked out years earlier and who reveled in the misery of others.

Why? Why would anyone go to a job where they knew they would hate it and couldn't expect to have any cohesiveness with the people there? For our children of course. For the paycheck that people kept insisting was the only reason I should have a job.

Imagine, going to the people who are supposed to be guiding you and what they do is simply tell you to keep your head down, question nothing and be grateful for that paycheck.

- Are we being set up to work for a leader or a boss?

- How can you tell the difference?

Sit down and write your resume. Write about your current position and your every day duties. List the skills needed to complete those tasks. It will either be easy to do or very

difficult to do. Now weigh what you've done at your job/career over the years you've done it.

- Has doing the same tasks and functions created an expert in those tasks?

- Have you learned new skills over the years you've been there?

- Do your skills translate well on the page or are you looking at the same skill sets over a long period of time?

A leader learns all they can about their employees. They interact with them on a consistent basis and learn about their strengths and weaknesses, inside as well as outside of the work day. A boss does not. A boss shows up once a month, says a few words and leaves just as effortlessly as the person delivering your breakfast order that morning.

A leader recognizes where more training is needed and provides it. A leader cross trains and motivates the employees to want to produce more, produce better for a team as well as an individual. A leader is like a coach, who can be gruff but who inspires excellence and does not evoke hatred or disrespect.

A leader will nurture their team into a championship team, not out of competition but out of pride for the team and the end results. A boss just wants to get whatever they can from people and not bother to get to know them - not even care.

A leader teaches the team to see the best of each other, recognizes more than just result, and recognizes effort.

A boss insists on obedience and doesn't care if the employees don't want to be there or not.

A leader elevates their team with pride and recognition and doesn't see it as a budget constraint. An employee breakfast goes a long way when you're sincere and you want amazing results from your people.

On the other hand complaining about spending \$50 for breakfast for a team becomes petty when it's obvious you'd rather be anywhere but with the team you are responsible for.

In the eight years I spent working in a place I hated, with people I despised, doing absolutely nothing of value except for when I took my time into my own hands and offered my assistance to others, the only skills I'd learned to add to my resume I had acquired on my own. Many were never promoted because their careers were never cultivated to do more than the clerical shortsighted needs of the current tasks.

So, if you are an amazing clerk then over the years you should be able to list the different programs or processes you've learned and mastered, correct.

If you've been in one place and have done the same thing over, is that skill that you've mastered something that other companies are using and want or need right now, today? Is there a new program coming your way? Is your area offering classes in it? Or like me, do you go to the source of that new program and take classes yourself? Do you go out and seek to master it before it arrives? Yes.

Does your resume show an elevation of learned skill-sets or are you stagnant in them?

A leader takes you and all the team members along the journey. A journey that includes projects and tasks and assignments. A leader is there for the long haul, not once a quarter because it's the least amount of work they can put in. A leader is someone you can respect because they respect you.

A leader is someone who works with you to make you a better team member because it's the team who gets the glory and the accolades, not just them. A leader takes pride and shows off its team, not degrades it by never being there and then complaining and making demands at the last minute. If the person you work for doesn't do any of these things then you know, you do not work for a leader.

Well, I've come close to making that million within the last dozen years and I'd give every cent back to get those years back. Nothing is worth more than your self respect, your peace of mind and knowing your worth. I would have made more money in those years had I been working in a place that was more about real productivity and real results and not sugar coating core competency keywords or the latest corporate buzzwords from Forbes or Inc. Magazine.

I blame myself of course. It was my career, my life and I blinked. I grinned and bared the brunt of working with people whose idea of excellence were far removed from my own. For every leadership and management course I took and then later taught young people the chasm between my unfortunate reality and the reality outside grew larger. It sickened me, physically, emotionally and in the only way they could threaten me - financially.

Finding myself now, happier than I've ever been, sleeping better, enthusiastic about my contributions to others who recognize true passion and pride in one's work, I realized the difference was in who was placed in charge. Not a leader but a boss. A very bad one.

After having placed myself in the position of

leader along the way all those years I was able to not only salvage some of that time wasted but also able to cultivate my skill sets outside. I've helped others do more and be more, for themselves as well as the projects we committed ourselves to.

My only regret was listening to those people who didn't have a clue on how to mentor and guide others. I sought out real experts and leaders in areas of interest to me. I sought out coaches and mentors and enhanced my skill sets all with the anticipation to be more, give more and in the end produce quality service with true purpose. Those people are still doing the same thing and therefore offer nothing new, fresh or current. Don't become one left behind.

Even if you don't plan on leaving where you work today, if you dislike it, if you don't think that what you do would command the same or greater pay for the skill sets that you have, then take your own career into your own hands and get the experience outside.

You may be working for a boss but you can become your own leader and lead your way out to a much brighter and better future elsewhere.



*Anastasios Rodopoulos
General Manager, HMA
Area President EME, IAFEI*

“We are a total return stock”

Interview with Mr. Wolfgang Schäfer, CFO of Continental Group, from Börsen-Zeitung, Frankfurt am Main, Germany, article provided by GEFIU Association of Chief Financial Officers Germany, the German IAFEI Member Association.



Mr. Schäfer, two profit warnings, a massive loss of share price at the stock exchange, which overshadows the plans for the restructuring of the group: Has 2018 been one of the most difficult years since you took over the responsibility for the finance function of the Continental Group in 2010?

It was not the most difficult one. In 2010 and 2011, for example, we had great challenges as to the financing. We had to issue bonds in a difficult market environment. The group was in quite a different situation than today regarding cash generation, operating earnings and equity.

In this year, we shall not attain, with our results, the expectations which we had formulated in January 2018. This is disappointing, but we are not alone with this in the current year in our business sector. However, the adjusted operating margin will still be above 9 %. This is still a very favourable result.

By which factors have the two profit warnings been caused this year?

Predominantly external factors had the effect that the producers of and suppliers to the automobile industry had to adjust their forecasts. Our first adjustment in April was first of all caused by changes of foreign exchange rates. The second adaptation in August resulted essentially from sales reductions, which we had to suffer through in several situations especially in two markets, Europe and China.

As how strong do you regard the deterioration of the situation?

It is a turning point in the production of vehicles in these two markets which belong to the most important ones worldwide.

Continental at a glance

Group Numbers (each from January to September)

Sales in billion Euro

2017	32,7
2018	33,2

Adjusted Ebit-Margin* in %

2017	10,5
2018	9,0

Group Result in billion Euro

2017	2,3
2018	2,2

Free Cash-Flow in million Euro

2017	472
2018	-5

Debt Ratio in %

2017	21,0
2018	16,9

* Result before interest and tax

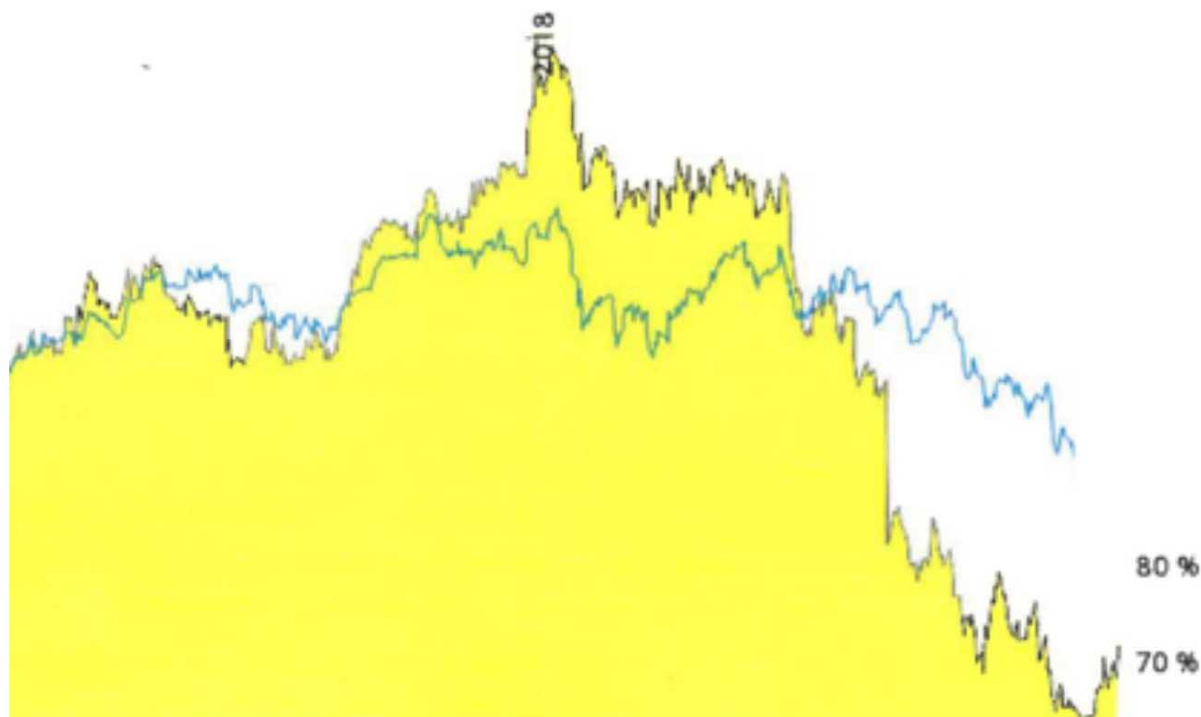
How do you judge the situation of the 4th quarter? Can the lately advised sales of roundabout 44,5 billion Euro, after foreign exchange effects, be achieved in this year?

We are moving in the 4th quarter within the framework of our expectations. Our sales target of roundabout 44,5 billion Euro will probably be achieved.

Continental AG, 133,70 Euro Share Price as of January 21, 2019, German Stock Exchange Xetra

Index Price Chart, Index-base as of January 2, 2017 = 100

- Black line: Continental AG Share
- Blue line: DAX German 30 Companies Large Cap Stock Index



Could you have taken notice of the turning point sooner?

No, practically all the industry suppliers and automobile manufacturers had to reduce their sales and profit expectations at the latest in the 3rd quarter. We with our correction of forecast have been one of the first ones, which also went along with an increased attention.

After the crisis a decade ago, Continental has delivered what had been promised for many years. Would you, with the view to the planned restructuring of the group and the necessary trust of the investors, have gone more cautiously than usually into the current business year?

At the beginning of the year, we are checking the possible market developments. The scenario which we regard as the most probable one then is the basis for our outlook. At the beginning of 2018 we could not expect that it would come to the sales setback in China up to 30 % in the 3rd quarter, and that there would be a significantly weak market in Europe at the same time. There have been no forecasts at the beginning of the year which have expected such a market decrease.

The Continental-share has reached its alltime high in January 2018 of € 257, and since then, it has lost more than 50 % of this valuation. How do you regard this stock price loss?

We are disappointed, there is no question about that. With our stock price development, however, we find ourselves in the middle field of the total automobile supplier industry.

Are the profit warnings a hint that the forecasts of automobile manufacturers and supplier are generally becoming more difficult – because of increasing business cycle risks, but also because of increasing regulation?

We are acting in a cyclical industry, for which it always has been difficult to exactly forecast turning points in the development of sales. What is new is that in the meantime there are more product groups where regulation is interfering than before. So, as an example, at the electric mobility. In markets like China, the government can rather quickly change the framework by comparison, it thus also influences the composition of the products which will come to the market. Forecasts are being made difficult by this. Market estimates and evaluations, however, are also becoming more difficult when government administrations like at present the US American one again and again discuss about changes of the framework.

Which would be the consequences for Continental, should higher US import duties on automobiles from Germany and the European Union be introduced?

As said, it is not easy to predict such consequences. As a matter of principle, it is true, that our products in an automobile which has been produced in Europe are not strongly different from those in an automobile which is being built in the USA. When, thus, the automobiles which are not being built in Europe and as a consequence also are not being exported into the USA, instead are being built as American automobiles in the USA and purchased there, then increased tariffs should not impact us so strongly. We are very well represented in Europe and in North America.

This is a hypothesis.

This is correct. Forecasts remain difficult. The trade disputes could also lead to a larger purchasing reticence at car purchasers, while these possibly might expect that regulations could be changed again on the short term and that government enhancement programs for the support of the automobile industry might be introduced. Such a purchasing reticence would hit us immediately because for the supplier industry especially the number of the produced cars is decisive.

What do you expect for the upcoming year?

The risks of volatile market developments still exist. This is true, for example, with a view to tariff disputes between the USA and China, but also between the USA and Europe. The weak market in China will as per our evaluation in the first two quarters of 2019 continue, as well as the problems in Europe in connection with the adaptation to the new exhaust screening standard WLTP are not yet solved. Business cycle risks also result from the volume of Italian government debts and there is also the discussion about Brexit. We expect, however, in the coming year a small increase of the worldwide production of cars and light trucks by 1 %. And here the growth impulses should be bigger in the second half of the year because of the mentioned reasons.

Is it possible this year that the lost trust at the investors and shareholders can be regained with a view to the planned restructuring of the group and the partial IPO (Initial Public Offering) of the drive division (Powertrain) planned for starting in the middle of 2019?

We are very well positioned with our product portfolio in our group. This is also true for the division Powertrain. In so far, we are very confident as to the capabilities for the future of Continental.

The rough letter which the group managing board in early September sent to the “Senior Executives” and which was also carried to the public, was – it seems – meant to contribute to stop the loss of trust with a view to the upcoming year. How do you evaluate the effect of this letter?

The target group of the letter was our roundabout 400 top executives worldwide, not the broad public. We had the impression that not everybody in the group had understood that everybody has to contribute

– in order to secure the capability of Continental for the future over the medium and the long term. At the same time, we have seen that important markets were developing weaker than originally assumed. Therefore, it is so much more important that all of us work intensely for achieving our objectives. We have written the letter in order to carry these messages into the group. With this, we have awakened the entire Continental executive team. It is fair to say that we would have formulated, from today’s point of view, one or the other section of the letter in a different way.

In what sense?

We would have pointed out even stronger the joint responsibility of all, the team spirit.

In this letter, you have mentioned half a dozen business units which have fallen back behind the expectations. How is the execution of the improvement measures developing?

Plans for measures have already been executed, and their application has already started in large parts of the group.

When will the units be there where you would like them to be?

The objective is the total application of the measures at Contitech and the units of the automotive group in 2020. First results should already be seen in the year 2019.

How big is the uncertainty in the group at the end of this year?

The market development on the short term has produced uncertainty in parts of the organisation. But we have quickly reacted. Therefore, we all continue to work in a highly concentrated way towards the achievement of our adapted targets for the year. In addition to that we continue to be very well positioned with our product-portfolio. Regarding the IPO of Powertrain, this is for us alone to put this

division on its own feet and to successfully prepare the IPO. I am confident that we will achieve this.

Which criteria must be fulfilled, in order that the IPO of the Powertrain division can take place in 2019?

We are endeavouring to achieve the carve-out of the division at the turn of the year. The preparations of the partial IPO also have already begun, and they are developing according to plan. We are well on our way, in order to – as announced – be capable for the IPO of the Powertrain division by mid 2019.

It is said that a share of up to 25 % should be brought to the stock exchange market. On what depends the size of the share to be placed?

Decisive will be the market environment. A worldwide car production growing stronger in the second half of the year should supply good conditions for an IPO. But then, there also has to be a suitable IPO time window in the capital market.

Which consequences would have a failure of the IPO plans in the upcoming year?

If the market environment in the second half of the next year from our point of view is not attractive enough, then we will defer the IPO.

To defer the IPO, is this your plan B?

Yes. A worse market environment will also recover again.

For what will you use the cash inflow retained from the IPO?

Our objectives are unchanged. On the one hand, we want to decrease over the long term our share in the cyclical supply products for the automobile producers from now 70 to 60%, respectively increase our share in the less cyclical business in the tyres as well as the automobile repair parts and in the industry

business from 30 to 40 %. Also, we want to increase our technology know-how where it will help us to expand our business areas.

With which cash flow are you calculating?

It is too early to talk of this at the present.

How probable – after the IPO – will be a large acquisition for the improvement of the software competence?

Such an acquisition cannot be excluded. We want to increase our special capabilities in the software area. Already today, more than 60 % of our products in the automotive area are digitalised or are using sensors. A third of our more than 47,000 engineers has already a software or IT-background. These trends will continue to increase.

How large could be an acquisition?

Presently, we have the ability to spend up to 5 billion Euro for one or more company acquisitions together.

What plans do you have after the Powertrain IPO, with a view to the business with hybrid and electro-motors as well as battery-activities?

We continue to expect that the hybrid and electro-motors starting in 2020 will grow more strongly and we expect that in 2025, roundabout 10 % of the produced automobiles worldwide will be pure electro mobiles. The product development in this business area will accelerate the growth significantly.

When will the business be profitable?

We will comment on our outlook regarding the business with hybrid and electro vehicles in connection with the planned partial IPO.

On what depends your decision to go into the production of battery-cells?

There must result for us an attractive business model on the basis of a suitable technology. We must have know-how which will permit that we can bring technologies early on to the market and with characteristics of exclusivity. Only if a sustainable attractive return in this capital intensive area is possible, the Continental Group will enter this business segment. We expect that only after 2020, we will come to a final evaluation of the prospects.

Will you look for partners?

Partnerships or a consortium would certainly be necessary as well as with a view to the necessary know-how as well as to the diversification of risk.

From your point of view: Is it absolutely necessary that there will be a competency for battery cell production in Germany and in Europe?

The automobile industry in Europe needs its own production capacities. Already for pure logistical reasons.

Should German corporations play a leading role in the production of battery cells in the future?

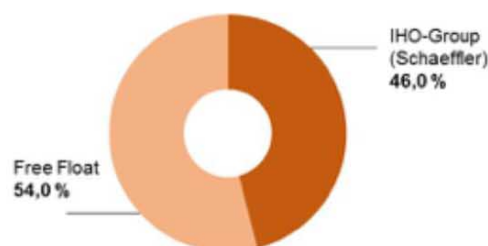
We are welcoming the discussion in Germany and Europe, because it is a strategically important subject. It is a joint duty of politics and industry to create framework-conditions for a competitive cell-production in Germany.

What effect has the restructuring of the group, beyond the Powertrain IPO, for the financing strategy?

The financing strategy will not be changed by the restructuring. We continue to pursue in an unchanged manner a sustainable financing mix.

Continental

Shareholder-Structure



Market capitalization
Status January 21, 2019

26.7 billion Euro

Source: Corporation, Thomson Reuters

In July, a 750 million Euro bond has been repaid. In February 2019, a 500 million bond will mature, in 2020 two bonds by a volume of together 1.35 billion will mature. What are you planning here?

In this year, there had been no refinancing activities, because we have been financed sufficiently. We will maintain our liquidity pool also in the future on a level which we regard as adequate and necessary. In the past years we have maintained an liquidity of around 5 billion Euro. New debt financing means depend on the profile of our repayments as well on the development of our business and of our cash flows. As a group with a good rating, with a low indebtedness and a strong equity quota, we are not worried that we might not be able, when necessary, to refinance ourselves on the capital market.

How do you see the cashflow-development in this year?

The cashflow will be in the order of what we have announced for 2018 – roundabout 1.6 billion Euro. This amount is adjusted by M&A-activities and by additions to our US-pensions scheme.

Will your dividend policy remain unchanged within the planned restructuring of the group?

Yes. We are a total return stock. As in the past years, our payout-ratio will move within a range of 15 – 30 %.

How will the dividend for 2018 be when the profit will be smaller after the dividend for 2017 has been increased by 25 Cent to 4,50 Euro per share, a continued increase in the 6th year?

Naturally, we also know that the expectations of the capital market, in a situation in which the share price has decreased, are aiming at a stable dividend payment. As said, we are well positioned regarding our financing structure.

In this situation, will you exceed the upper limit of the dividend payment corridor?

This could be the case in such a situation.

One more question: Your employment-contract runs till end of 2019. Will you continue?

About the extension of the employment-contract decides the supervisory board. This can be decided at the March-meeting of the supervisory board at the earliest.

The interview was made by Carsten Steevens.

About the Person

Experienced Manager

Since the beginning of 2010, when Wolfgang Schäfer took over the responsibility in the managing board of Continental for the areas finance, controlling, compliance, law and IT, the automobile industry supplier has significantly changed when measured by the numbers. Not only sales increased from 20 billion Euro end of 2009 to expected 44,5 billion Euro in 2018, and the number of employees from 133,000 to almost 245,000. At the same time the net corporate debt shrank from 8.9 billion Euro to 3 billion Euro

(September 30) and the debt ratio from 219 to 17 % whereas the equity quota improved from 17.6 to 44.6 %. The upturn of the group, after the heavy turbulences in connection with the takeover of Siemens-VDO before the hight of the financial market crisis 10 years ago, also led to better ratings: So presently the long term rating of Continental at Standard & Poor's is at "BBB+", and thus today 6 notches higher than at the beginning of 2010, "B+".

The finance head Schäfer significantly participated in the stabilisation, which can be seen in the increase of the share prices from € 36 nine years ago to the all-time high of over € 257 on January 9, 2018. Two profit warnings, however, produced a massive loss of trust at the stock exchange in 2018: The Conti-share fell to the lowest level since the fall of 2013.

It is in this environment that the MBA now works on the partial IPO of the drive division, who has worked, before changing to Continental, for the automobile industry supplier Behr at Stuttgart, Germany, as CFO and head of the German business. Until the middle of 2019, the plan is to have the Powertrain division mature for an IPO – by then the experienced manager from the German state of North-Rhine Westfalia will have become 60 years old.

From *Börsenzeitung*, Frankfurt am Main, Germany, December 8, 2018.

Responsible for English translation: GEFIU, the Association of Chief Financial Officers Germany, the German IAFEI Member Association, translator: Helmut Schnabel, Chairman, GEFIU,

EUROPEAN UNION

Integrated Thinking and Reporting for SMEs: The Why and How

Why should SMEs consider integrated thinking and integrated reporting? How can SMEs start their integrated reporting journey?

by **Paul Thompson**, *Director, European Federation of Accountants and Auditors for SMEs*

The world's largest companies are often regarded as leading the way for small- and medium-sized entities (SMEs). But that's not how it is or at least not how it has to be. The evidence, from government statistics through to academic research, demonstrates that SMEs not only have the greatest impact on economy and society but they are also the primary drivers of innovation and change. And, where SMEs lead in product and service innovation they can also lead in the innovation for integrated reporting.

There's a fast growing body of compelling evidence on the substantial benefits organizations gain from integrated reporting. But what about the benefits for SMEs? Perhaps most strikingly, the B20 (the G20's business arm) recommended promoting integrated reporting as a key means of improving SME reporting with a view to building trust around past and future performance. And some commentators and researchers have written on integrated reporting's relevance and value to SMEs.

There is a clear, concise and persuasive case why SMEs and their stakeholders, from owner managers through to end consumers, stand to benefit greatly from considering integrated thinking and integrated reporting. This article summarizes this case and goes on to provide a starter kit on how SMEs can best go about doing it with suggested initial steps and directions to helpful resources including

illustrative examples.

Small- and Medium-Sized Entities

SMEs globally account for the majority of private sector economic activity, employment, social impact, and environmental footprint. In their midst are tomorrow's largest, most influential, and impactful companies. Amazon, Alibaba, Uber, and Didi Chuxing were yesterday's SMEs. But unlike many larger companies, SMEs often have the latitude to take a long-term view and pursue objectives above and beyond simply profit. Many SMEs are run by owner managers who see business as integral to and a reflection of their lifestyle and values. This lends itself to a way of thinking, and corresponding reporting, that stresses the long term over the short term, the future over the past, and principles over profit.

Integrated Reporting

Integrated reporting is a generally-recognized international framework that helps SMEs better understand and better communicate how they create value (see this short video for additional details). It provides a roadmap for SMEs to consider the multiple capitals and connectivity that make up its value creation story. This makes an integrated report much more than a conventional annual report—it's a more complete corporate report. But it need

not demand much, if any, more effort to compile. And perhaps more importantly, it will help SMEs understand the core drivers of their business so they can implement a business model that will help them grow.

SMEs, like larger entities, leverage a range of resources and relationships to create value. The International Integrated Reporting Framework calls these “capitals”. There are six capitals, including the familiar, financial, and the less familiar, manufactured, intellectual, human, social and relationship, and natural capital. Properly nurtured, these capitals can release value over time while simultaneously growing their capacity as a store of value. How these capitals can operate in an SME are detailed in IFAC’s Creating Value for SMEs through Integrated Thinking: The Benefits of Integrated Reporting.

The guiding principle of connectivity is critical to understanding and communicating the way SMEs create value. It’s about the interplay between three aspects of value creation: the capitals, external environment, and significant internal factors. It prompts consideration of the effects of connectivity. For example, between the SME’s strategy and business model and the specific risks and opportunities it’s facing. Or between the nature and rate of change in technology and how this affects the capacity of the SME to continue creating value in future.

Integrated Reporting Benefits

The International Integrated Reporting Council (IIRC) summarizes compelling research findings in “How Valuable is Integrated Reporting? Insights from Best Practice Companies” and “Realizing the Benefits”. But let’s focus on what matters most to SMEs, which include improved risk management and decision making, strengthened internal dialogue and improved stakeholder communication.

Better Understanding, Better Management

An integrated reporting approach helps SMEs build a better understanding of the factors that determine its ability to create value over time. Using what’s called “integrated thinking,” SMEs can make better decisions that result in better outcomes. Integrated thinking is a connected view of the SME, including its use of and effect on all the capitals central to its business model and future strategies, that enhances strategy planning, execution, and evaluation.

Integrated thinking helps SMEs gain a deeper understanding of the mechanics of their business. This will help them assess the strengths of their business model, spot any deficiencies, and address them quickly. These insights facilitate a forward-looking stance and sound strategic decision making. This may sound familiar to SMEs already using elements of an integrated reporting approach in substance if not in form or name.

Better Reporting, Better Communication

We live in an age in which information can quickly and easily be collated, summarized, and communicated, and one in which society and stakeholders demand to know more of businesses, big or small. Businesses have a story to tell their stakeholders—from current and prospective equity investors, banks, and other providers of financial capital through to employees, customers, creditors, and other stakeholders—as to their purpose, prospects, profit, principles and planetary impact.

Furthermore, SMEs are increasingly in the business of providing services. Compared with their “mom and pop store” predecessors, these SMEs have few, if any, tangible assets you can see, touch, and hear. Instead, they might rent office space, equipment, and fast internet and pay salaries or consultancy fees to knowledgeable staff. As such, under conventional accounting rules, such as the IFRS for SMEs, their balance sheets, essentially a snapshot of financial capital, will fail to provide a complete picture as to its ability to create value. The other capitals, which manifest themselves as

employee expertise, customer loyalty, and intellectual property, are missing. While past financials can be important where they exist, they are only one aspect of an SME's value creation story. The upshot is that many SME stakeholders are left with insufficient information to make an informed decision. This is where integrated reporting comes in.

The external communications resulting from integrated reporting, most notably an integrated report, invariably include key financials. But that information is kept in context alongside, and connected to, significant "non-financial" measures and narrative information. By providing the full picture—not just "the numbers" but a succinct story as to how the SME creates and will continue to create value—integrated reporting helps fulfill the communication needs of financial capital and other stakeholders. In so doing, an integrated report can optimize reporting.

Starting Out

For good reason, SMEs often complain that they are too busy to even consider taking on integrated reporting. But insufficient thought today about tomorrow's strategy means SMEs may end up simply here today, gone tomorrow. Integrated reporting can help ensure SMEs grow and prosper in a way that can have a positive impact in all senses of the word: economically, socially, and environmentally. And the integrated reporting journey, with the right road map, need not be a difficult one.

While integrated reporting may differ in an SME context as compared with a large listed entity, especially as to sophistication and extent, the goal of thinking in an integrated manner will be advantageous if not already embedded. The principle of connectivity should inherently be easier for SMEs. SMEs can use the concepts embodied within integrated reporting as a business improvement tool. It does not mean more reporting, rather better reporting: concise,

relevant, and accessible. It does not mean more mandatory reporting but rather voluntary reporting that is responsive to the information needs of users. It does not mean yet another report, rather a basis for the rationalization and harmonization of existing reports and communications.

Ultimately, integrated reporting may be better suited to larger SMEs, which have a number of external stakeholders seeking a better understanding of the business and its value story through better communication. In this way, SMEs can lead integrated thinking and reporting's development rather than having to adopt as a result of supply-chain pressure. Let's start by burying a few misconceptions.

Removing Barriers to Integrated Reporting

Integrated reporting is not about more reporting or endless detail. While it's important for an integrated report to include sufficient context for a reader to understand your SME's strategy, governance, performance and prospects, it should not be burdened with less relevant information. Where appropriate, an integrated report can link to information elsewhere, like more detailed information (e.g., full statutory financials), relatively static information (e.g., a list of production sites), or external sources (e.g., economic forecasts on a government website).

Integrated reporting is not "just adding another report." The flexibility of integrated reporting means it can be used as a springboard to rationalize and harmonize other reports and communications. Depending on jurisdiction, in time an integrated report may replace some obligatory, but otherwise redundant, reporting requirements. For example, it may enable rationalization of reporting through merging financial, sustainability, and governance reports, and with savings in report production and distribution costs. It may also become part of the supply chain reporting suite demanded of SMEs by larger customers.

An evolutionary step-by-step approach might be the best approach to integrated reporting implementation, according to Stratton Craig. SMEs can transition from conventional annual reporting to integrated reporting over a few reporting cycles. This will enable SMEs to leverage and incrementally adapt existing reporting structures and processes and put new systems in place to engage with staff, stakeholders, and potential investors gradually.

Specific Applications of Integrated Reporting to SMEs

The table below looks at three specific applications of integrated reporting to SMEs.

Application 1: SME Seeks Buyer
<i>A prospective buyer will be paying for future profitability and cash generation. As such, they are interested in knowing the value creation story: about the capital base available for trading and growth (financial capital); the tangible assets available for production (manufactured capital); the processes and intellectual property that can be used (intellectual capital); the expertise and know-how of employees and management that can be leveraged (human capital); the key connections it has with its customers and suppliers (social and relationship capital); and the proximity and access to resources like water, power, and infrastructure (natural capital). A buyer needs to understand the business beyond what can be gleaned from historic financials.</i>

Application 2: SME Seeks Finance
<i>SMEs may seek funds to acquire a competitor, adopt new technologies, spend on research and development, replace outdated equipment, expand into new markets, etc. It may seek these funds via equity or debt, family, friends, venture capitalists, crowdfunding, banks, the markets, or other sources. Whatever the reason, type and source, the SME will need to convince finance providers of its ability to create sufficient value to pay dividends or interest and repay capital. They'll also want to see evidence of how the business identifies and manages key risks. These financiers, like prospective buyers, need to understand the business beyond what can be understood from historic financials. For service providers with little in the way of tangible assets and for start-ups with little or no financial history, integrated reporting is potentially even more persuasive as it stresses capitals other than financial. According to the B20's Task Force on SMEs and Entrepreneurship, integrated reporting is expected to facilitate the ability of SMEs to raise finance.</i>

Application 3: SME Seeks Contract

Increasingly, government agencies and not-for-profit organizations seek commercial partners that can supply the goods and services needed and do so in a manner that's both reliable, ensuring continuity of supply in the long-term, and responsible, ensuring reputational risk is mitigated. Tendering processes often seek to understand the characteristics of the businesses that tender that may extend beyond its ability to reliably and cost effectively deliver to include its ethical stance, corporate social responsibility, and community ties. Integrated reporting can provide this.

Initial Steps

Embracing integrated thinking is the overarching theme: integrated reporting is dependent on, and helps achieve, integrated thinking. Connectivity is critical for the benefits of integrated reporting to be realized.

Let's now examine the initial steps SMEs can take as part of their integrated reporting journey.

Step 1: Issue a statement of intent. Advise stakeholders of your intentions: briefly explain the aims, ambitions, and rationale and consider reaffirming a commitment to good governance, transparency, long-term strategic thinking, and sustainability. It should also outline the implementation journey, including timeframe and key milestones.

Step 2: Conduct a stakeholder mapping exercise. Identify principal stakeholders, such as primary customers, staff, local community, and bank. SMEs need to understand who its stakeholders are and their expectations of the business today and tomorrow.

Step 3: Think about value creation. In what ways does the business create value? Does it manufacture goods or provide services? Does it invest in the local community? How does it look after its employees?

Step 4: Consider the business model. Are your stakeholders highlighting any risks or

opportunities to be managed or leveraged? How well does your business model and strategy support value creation? Does your business model reflect your stakeholders' expectations? Do you need to adjust your business model and strategy?

Step 5: Determine what resources are needed. Now is the time to consider required resources to implement any changes to your business model and strategy. These include attracting and retaining new staff, enhancing product design and innovation, etc.

Step 6: Improve cross-organization communication. Are the right people talking to each other internally? Is enough being done to break down silos and encourage cross-organizational communication and engagement with business strategy?

Many businesses, especially SMEs, will reap most of the benefits of integrated reporting from the integrated thinking it demands. For some, if not most, SMEs the final report, if there is one, will be the icing on the cake. The final report will need to pass a litmus test for clarity and conciseness to ensure its benefits far exceed its costs. Yen-pei Chen outlines some key approaches to passing this test. These include focusing on material items both in terms of length and topics and using various presentation techniques to enhance navigability and readability, such as cross referencing and links to additional materials online. For the report to yield the greatest benefit, it will need to reflect the challenges and opportunities unique to the SME.

SME Starter-Kit

Introducing Integrated Reporting – a short video

Creating Value for SMEs through Integrated Thinking: The Benefits of Integrated Reporting

Integrated Reporting: Focus on Integrated Thinking—a handbook on the change journey step-by-step

Preparing an Integrated Report: A Starter's Guide

Integrated Reporting for SMEs. Helping Businesses Grow: Case Studies

Integrated Reporting Examples Database, including Getting Started section

ABOUT EFAA

The European Federation of Accountants and Auditors for SMEs ("EFAA") represents accountants and auditors providing professional services primarily to small and medium-sized entities ("SMEs") both within the European Union and Europe as a whole. Constituents are mainly small practitioners ("SMPs"), including a significant number of sole practitioners. EFAA's members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, tax and business advice) to SMEs.

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Defining a “business”: the new approach under IFRS

by **Víctor Hugo Vázquez**, VP of the National Technical Committee
of Financial Information of Instituto Mexicano de Ejecutivos de
Finanzas (IMEF)

Seeking to answer the concerns of financial information preparers about the ambiguity of the current guidelines to analyze whether an acquired set of activities and assets complies with being a “business”; in October 2018 the International Accounting Standards Board (IASB) published the amendments to the International Financial Reporting Standard (IFRS) 3 applicable to business combinations. As a result of its application -effective from 2020 with early adoption allowed for 2019-, it is expected that fewer transactions will result in the purchase of a business, which is the result of applying more specific and stricter rules. The importance of this analysis lies mainly in the different financial reporting implications that involve accounting for the acquisition of a business versus the purchase of only a set of assets.

Review of the current definition and main critics of its application

In accordance with IFRS 3 (prior to its amendments), a business “consists of inputs and processes applied to those inputs that have the ability to create outputs”. Thus, the current definition of a business is explained by the existence and interaction of these three elements: inputs, processes, outputs. To understand if a “set” of activities and assets is a business, it must be validated that these elements are present; as a review, let's remember what each of these elements refers to:

- **Inputs** – Generally have to do with the assets acquired within the set, such as buildings, land, plants, machinery, equipment and other physical

infrastructure; intangible assets such as patents, licenses and any other intellectual property that allows the development of an economic activity. Existing contracts and non-specialized workforce are usually considered inputs as well.

- **Processes** – Typically represent the know-how of conducting a business, and range from strategic operating processes of business management to protocols, manuals, systems, policies and rules that are necessary to know and apply in order to generate outputs. A highly experienced and specialized workforce is usually considered a necessary process in conducting the business. Administrative processes, such as billing and accounting, are generally not considered “processes” for purposes of this analysis.

- **Outputs** – Currently, IFRS 3 states that outputs can be “in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants”. Although generally, a business involves the generation of outputs, under the current guidance it is possible to argue that a business exists even though outputs are not yet generated.

It should be noted that it is common that in the purchase of a business there are missing elements, which the standard resolves by evaluating the ability of a “market participant” to replace them without major complications. In practice, the absence of outputs does not restrict a set from being considered a business, although the technical support of this determination may not be sufficiently clear in current IFRS 3, which

emphasizes that what is acquired can be conducted as a business, regardless of the missing elements or the intention of the buyer.

Although the presence of the elements of a business may be clear in some transactions, in some other genuine questions may arise where the current guidance may not be sufficiently clear to answer them. For example, by consulting the Basis of Conclusions on the amendments to IFRS 3 (as well as the arguments used also by the FASB, in its similar project carried out since 2017¹) the main concerns of the preparers applying the current guidance can be observed. Questions such as how to be sure if one process is more important than other and what exactly is a "market participant" have frequently arisen. Likewise, these concerns support the idea that the current standard is very broad or general, which at the end of the day leads to different companies to arrive at different conclusions about the same transactions, depending on the judgments made.

Some other critics to the current guidance under IFRS 3 are present in form of a challenge. For example, some stakeholders suggested that, under the current definition, a business could lack processes, arguing that there were cases where outputs are generated with only inputs, as it happens in contracts where a building is leased, that is, without greater involvement, an income is received. This concern has existed for some time in the real estate industry, especially in cases where a portfolio of assets for rent was purchased. Likewise, another position that could have legitimacy based on the current guidance is that the purchase of a set of assets that implied acquiring some processes, however simple, could make the set to be considered as a business (issue that shows the lack of forcefulness of the current standard to differentiate degrees of relevance in the processes that are acquired). On the other hand, there were challenges to the definition of outputs, especially on those obtained in the form of lower costs, since some critics took the situation to the extreme of arguing that buying a new machine and knowing how to operate it could achieve cost efficiencies, and thereby proving that the elements of a business are present.

Changes to the definition: a new way of analyzing what is acquired

In response to the challenges and questions that frequently arose from stakeholders, the IASB took action on the matter and implemented changes that will lead to a new way of conducting and documenting the analysis and main arguments so that a company can conclude whether or not what it purchases qualifies as a business. The following are the main changes introduced:

- Fair value concentration test – It is an optional test to rule out, in advance, if what is acquired is a set of assets or not. In accordance with the amendment to IFRS 3, "the concentration test is met if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets". There is reference literature to know how to translate and apply the "substantially all" concept, for example, in the leasing guides, where generally 90% would be acceptable in a quantitative exercise.

Various rules are introduced to accompany the test, such as guidelines that prohibit aggregating financial assets with non-financial assets or intangibles with tangibles (and that allows the aggregation of interrelated assets, such as land and buildings), or that any cash received and deferred taxes must be excluded from the calculation of the "gross value" of the assets acquired. If the test is failed, it is necessary to perform additional analyzes. This test is named "Screen" in the homologous resolution by the FASB, although under this framework it is not optional, but it is a first and necessary step to take in similar purchase evaluations.

- Narrowed definition of an "output" – The amendment to IFRS 3 eliminates the achievement of "lower costs" as a valid output in the purchase of a business, focusing only in goods and services provided to customers ("performance

¹In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2017-01, "Clarifying the Definition of a Business". In this document, the standard setter details its reasons for making a change to its business definition in the ASC 805. The reasons given therein are very similar to those that moved the IASB to make its amendments to IFRS 3. They take into account the feedback obtained from stakeholders who showed their concerns about the ambiguity of applying the guidelines, as they were, which could lead to the same transactions being accounted for differently, depending on the particular judgments that each entity will take.

obligations", in connection with the new revenue standard), investment returns (dividends, interest) and other income from ordinary activities (such as rental income).

- **Substantive processes, only** – Clarification is made that for a set to qualify as a business, there must be at least one input and a process that comply with being substantive, that together significantly contribute to the ability to create outputs. If the fair value concentration test is not passed, it is necessary to perform an additional analysis, which makes a distinction between whether the set, at the acquisition date, already generates outputs or not. In the case of processes, only those that are "critical" will play, that is to say, that play, that is to say, that "significantly contribute to the ability to continue producing outputs" and that are considered to be unique or scarce, or that could not be replaced without incurring significant costs or efforts, taking into account the overall context of the transaction.

- **Others** – The IASB removed the evaluation of whether market participants could replace missing elements of a set. In addition, it provides a series of new examples of the application of the amended principles, which include, among others: the acquisition of real estate, a drug candidate, a television station, a manufacturing facility, brands, and a loan portfolio.

The application of these amendments to IFRS 3 will eventually lead to fewer purchase transactions resulting in business acquisitions, mainly because of applying the fair value concentration test and stricter rules that privilege processes that are critical in the generation of outputs.

Why is it important to know if what is purchased qualifies as a business or as a set of assets?

It is worth remembering some of the differences in financial reporting when the acquired set qualifies with being a business or a set of assets:

• **Applicable standards** – If the set acquired is a business, the applicable principles and requirements are those contained in IFRS 3, "Business Combinations", which include measurement and disclosure rules specific to

these transactions. On the contrary, if what was acquired was a set of assets, different standards (and, therefore, different measurement, presentation, and disclosure rules) could be applicable, such as IAS 16, "Properties, Plant and Equipment", IAS 38, "Intangible Assets", IAS 40, "Investment Property", among others, depending on the nature of each item of asset acquired.

• **Measurement principles** – In accordance with IFRS 3, an entity shall account for each business combination by applying the acquisition method, which, among other things, implies for the acquirer to measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values (for which, there is a measurement period of up to 1 year). On the other hand, if what is acquired is a set of assets, the different standards referred to above generally indicate an initial measurement based on the cost of the assets, which is generally limited to what is paid.

• **The existence of goodwill** – When a business is acquired it is very likely that goodwill will have to be recognized. In simple terms, the goodwill represents the difference between the consideration paid and the fair value of the net assets acquired, which may result in the recognition of a separate intangible asset, when the difference is positive, or in a gain in the income statement, when the difference is negative. Goodwill presented as an intangible asset represents the synergies and future economic benefits that are acquired when buying a business, so it could not exist as a separate intangible when what is acquired is a set of assets (generally what is paid is what would constitute the cost of the assets). It should be noted that goodwill is not an amortizable asset, but subject to constant review for impairment (so the pattern of expense in the income statement could be different if only assets are acquired).

• **Recognition of contingent liabilities** – The existence of contingent consideration to pay for a set acquired is common. These are assumed liabilities whose value would be conditioned to certain performance metrics being met. If what is acquired is a set of assets, the international standard IAS 37 restricts the recognition of contingencies unless it is demonstrated that they can be measured reliably and that their settlement is "probable" (conditions for the recording a

provision" liability). However, under IFRS 3, whenever a contingent liability can be reliably measured (and as long as its existence is "possible", although not "probable"), it must be recorded as a liability assumed at the acquisition date, directly affecting the measurement of any resulting goodwill, in a clear mismatch with the principles of IAS 37.

- **Treatment of acquisition-related costs** – In the purchase of a set, a variety of costs can be incurred, ranging from legal fees and other professional services contracted (valuation and accounting advisors, etc.) to administrative expenses of a specific area within the company, for example. In a business acquisition, said costs must be expensed as incurred, i.e. when services were received, while in a purchase of assets it is usually possible to capitalize, as part of the cost of the assets, the different fees that are paid so that the assets work as desired.

- **Other differences** – Some other financial reporting differences that could arise between buying a business vs a set of assets, could have to do with deferred tax implications and the applicable rules when the set is intended to be disposed of.

As can be seen, the financial reporting effects of buying a business versus buying a set of assets can be diametrically different. That is why having the preliminary analysis (under current and amended IFRS 3) well documented and based on the facts and circumstances of the transaction is a strategic first step to ensure that the financial statements faithfully reflect the essence of what is being acquired.

Technical references

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The Global Impact of CFOs

by **Ciaran Ryan**, Editor, Accountingweekly.com /
Presenter, CFO Talks

In the first international interview for CFO Talks, Fernando Lopez Macari provides fascinating insight to the Mexican economy.

CIARAN RYAN: This is CFO Talks and today we are very pleased to be joined by Fernando Lopez Macari, national president of the Mexican Institute of Finance Executives or IMEF. Fernando was born and raised in Mérida, Yucatan, which is in Mexico and graduated from Marist University with a degree in public accounting and later studied strategic business administration at Boston University in the United States. He is a certified coach in leadership development and emotional intelligence and has a certificate in investment strategies and portfolio management from the Wharton School at the University of Pennsylvania. He is currently studying the masters programme in international finance at Universidad Panamericana. Fernando is the founder of Grupo Esfera, a professional services company that specialises in management consulting and financial strategy. With a team of more than 30 professionals, Grupo Esfera partners with each client to provide better value, serving different industries in the most influential cities in Mexico. With more than 15 years of experience in corporate finance, he works with boards of directors, executive management teams and other stakeholders to help implement sustainable financial and operational change plans with a focus on value maximisation. He has extensive experience in conducting complex restructurings, bankruptcy proceedings, mergers and acquisitions agreements, capital subscriptions and participation in

multi-stakeholder negotiations, reconciling the interests of the parties involved, including the negotiation of restructuring plans, valuation analysis and effective response strategies with multiple accredited groups. So we are delighted to welcome Fernando Lopez Macari, national president of the Mexican Institute of Finance Executives, to CFO Talks, welcome, Fernando.

FERNANDO LOPEZ MACARI: Ciaran, it's a pleasure to be here talking to you and your audience.

CIARAN RYAN: Fantastic, I am curious to find out about the Mexican Institute of Finance Executives, perhaps you can explain what this is and why you decided to become part of it and, in fact, you're its national president, so please just explain a little bit about that.

FERNANDO LOPEZ MACARI: The Mexican Institute of Finance Executives is a group of 1200 multi-disciplinary professionals around the country and it's divided into 20 chapters in the different cities or regions of Mexican territory. It has a lot of influence in economic politics of the government, it has a lot of influence in the decision-making of financial executives around the country and on a monthly basis it publishes a forecast of the economic environment of the country. Every month we publish this document and we also take it to a press conference and our press

conference is covered by the major media in the country and this guarantees that whatever we have to say it finds an audience not only in financial executives but also in CFO's, CEO's and boards of directors. So it is a multi-disciplinary association of financial executives who work also in technical committees, we have 17 committees like social security, like tax planning, like transparency and anti-corruption policies and so on. So that is how we work and that is how we create value for our associates and the business community in general.

CIARAN RYAN: Okay, so it looks like this body, IMEF, is quite important to the commercial life of Mexico, is that correct?

FERNANDO LOPEZ MACARI: It is, it is important to the commercial life of Mexico and it is also important to the authorities, they are constantly checking back with IMEF to see if the forecast and the predictions that we have in the economics are aligned with what they have. Sometimes if we are in disagreement we will sit down and try to work it out.

Accounting laws and regulations in Mexico

CIARAN RYAN: Maybe just to talk about that for a little bit, can you give us some idea of how you've influenced the commercial life in Mexico, for example are you lobbying for a change to some laws, a change in regulations for auditors, for example, to improve standards of auditing and accounting performance in the country.

FERNANDO LOPEZ MACARI: We are lobbying all the time, not only in the federal government but also in the local governments of the communities where we are participate. We created a document that we call 2019-2024 agenda, which contains the proposals that IMEF has for the federal government to amend in terms of loss or create policies that will impact change in the Mexican economic growth, our GDP. We are constantly looking at ways to promote that

document, which is current right now, and we sit down with decision-makers, not only in the government but also in the big corporations and small corporations of Mexico to let them know and communicate our vision of the country for 2024.

CIARAN RYAN: Can you tell us a little bit about yourself and your career, it seems that you studied both in Mexico and the United States, and also while doing that tell us about the role of the finance executive and how you think that is changing in the US and Mexico. For example, it seems that finance executives are far more involved in strategic decision-making than was the case in the past. So if you could just kick off and tell us a bit about yourself and how you got to where you are today?

FERNANDO LOPEZ MACARI: I started my career in a small family accounting firm that was founded by my grandfather and it was continued by my father. So my initial background was in accounting, auditing, compliance, tax and basic regular accounting practices. After I finished my career in Mérida I had the opportunity to join courses at Boston University. At Boston University I took a course in strategic planning for management and in that course I learnt the value of putting together the strategic vision of the company, along with the financial strategic plan. When I came back from Boston I decided to create my own firm, so I talked to my family and we came to an agreement and we transformed what was a very recognised firm in what we call right now Esfera, and Esfera in Spanish means sphere, this round concept of like the world is round and everything has to go around. What we created with Esfera was the vision that we had to give more added-value to our clients and they were already satisfied with our accounting work, with our auditing work and all that but we had to go further and that's exactly what we did. Then I joined IMEF, this is probably 12 years ago, I joined IMEF and then I started to get this vision of how through finance we can add value to the strategic plan

of a corporation. For example, if a corporation decides to open new branches and expand around the country, if that's the commercial vision and that's the commercial plan then there has to be a financial plan to back up that growth, otherwise cash flow will be compromised. There could also be problems with risk assessment and other circumstances that are not taken into account when you want to grow a company. On the other hand, if you don't want to grow a company but you want to consolidate business and you want to decide which market, which products, which clients to preserve in your business and where are the most profitable ones, then you also have to analyse the financial background of the operations and historical data and then make decisions upon that. So that's exactly what I envisioned back then and we created Esfera with the intention to give the CFO's of the corporations a coach, a partner, an advisor who will help them to gather the data, analyse the data and make a strategic financial plan for them to propose to the board of directors or for them to propose to whatever governance institution they have in their business.

CIARAN RYAN: I think it's quite interesting that you mentioned that one of the services you're offering is personal coaching for chief financial officers. I don't think that's something that we particularly have seen in this part of the world. What you call a finance executive would that include the CFO or is it something quite different?

FERNANDO LOPEZ MACARI: No that's exactly the CFO, when we refer to financial executives here in Mexico we're talking about the CFO's.

An overview of Mexico's economy

CIARAN RYAN: Mexico seems a long way from South Africa, where I am based, so maybe you can just spend a minute talking about the main pillars of the economy in Mexico and how the economy there is performing.

FERNANDO LOPEZ MACARI: Mexico is a country that has a lot of natural resources and it has a very young population. This, along with the strategic geographical situation of the country, since we are neighbours with the world's biggest consumer, which is the United States, and we have a very long border with them that gives us a very good advantage to compete in a worldwide economy. We are one of the countries that has more international trade agreements, free commerce trade agreements in the world. So this has helped Mexico to attract investors from Asia, Europe, America and also Africa to set up their operations in Mexico to provide services or goods to the American economy, which is 24.5% of the worldwide GDP. Along with this the Mexican economy is based on oil, we have one oil corporation, which is Pemex, and it's the biggest corporation in the country, and it's owned by the government, it's owned by the Mexican people. At this point Pemex is going through a change in its organisational plans and it's opening to have more joint venture agreements with international corporations for them to come and explore the oil and gas in Mexican territory. So a big portion of our economy is based on services and goods that we produce for the American market. Going back to the American market, we are big on plasma TV's and we are big on the production of TV's in general and we are also big on transportation and car fabrication and auto parts. Then we have the other arm of our economy, which is the petroleum, the oil and gas industry and in recent years Mexican oil production has been going down but there are strategies that were taken by the government lately to increase production of the oil and gas, so we're hoping to have better years in that matter. That is an outlook of the Mexican economy, our annual GDP is around 2% and we have inflation of 4% annually, and we have a very solid bank system with a central bank that is independent and it takes decisions only in maintaining the value of the Mexican currency. So that's pretty much an outlook of what I would call the Mexican economy.

CIARAN RYAN: Let's turn back to the Mexican Institute of Finance Executives, what is your role in this organisation as its national leader and what is it that the organisation is trying to achieve?

FERNANDO LOPEZ MACARI: My role as president, I am the president of the board of directors, it's work that consumes most of my time. Even though I don't live in Mexico City it requires me to be here in Mexico City basically the entire week. My role is to guide the organisation through relationships with financial executives, corporations, governments, my role is to represent, I am the only legal representative of the institution and I am the only one allowed to declare or give positions or to give the media an opinion related to how the financial executives in Mexico think or how we see things. So I am like the representative of the financial community in Mexico. We have a board of directors and we have monthly meetings, and we also have to attend a number of technical events like our energy forum, our business summit or our technological symposium. So we have these events around the country and I have to co-ordinate all the efforts of the 20 chapters around the country and trying to support the 1200 associates that we have because we do not associate corporations, we associate individuals.

CIARAN RYAN: On another point, do you think there's a need for a global CFO designation, this is something quite new in the world, particularly in the world of finance executives, and if you do believe that, why?

FERNANDO LOPEZ MACARI: What do you mean global CFO designation?

CIARAN RYAN: There is a move that has been started here in South Africa to launch what is called the CFO, for example, CFO (South Africa) designation or the CFO (Mexico) designation, as you would have a similar designation with, let's say, chartered accountants or CPA's in the United States. Do you have any opinion on that, is there a need for such a thing?

FERNANDO LOPEZ MACARI: I think every day now we are facing a more global economy and whatever happens in South Africa may have an impact in the Mexican economy now. But in the past, 20 years ago, we wouldn't believe that something that happened in South Africa could have an impact in the Mexican economy because South Africa and Mexico are in the same bracket of emerging markets and for big portfolio managers they are in the same investment portfolio. That's the same with Russia, Turkey and some other countries. So what I think is that every day a CFO has to be aware of what is happening in the world economy and how is the world economy developing. Mostly emerging markets because emerging markets are right now the drivers of global GDP, they are the ones that change the tendency between a recession or an expansion economy. By saying this I do feel and I do support that there are movements that are looking for a global CFO certification or accreditation or whatever. I do think that every day the CFO's need to be much more involved in the global impact of the economy.

Corruption and scandal has no borders

CIARAN RYAN: Now, in South Africa we're reading quite a lot in the press about some major corporate scandals that seem to involve high-level accountants and there's also a lot of talk and some action in cleaning up the profession through tougher disclosure rules and regulations and that sort of thing. Give us an idea is corruption a problem in Mexico and how is this being addressed?

FERNANDO LOPEZ MACARI: Corruption is a problem in Mexico, yes. IMEF have issued several papers regarding how to give more transparency into the government, into the corporations. Where we have in terms of research and analysis... I think corruption is much more of a problem in that not only is it affecting the Mexican economy but also the worldwide economy because every time we see more and more of these white-collar

crimes or financial crimes or lack of financial ethics, we have to go back to the 2008/2009 worldwide crisis and that's a crisis that started based on financial lack of ethics. So I do feel that to eliminate corruption and to create a better environment for financial executives we do need to regulate how they make their decisions and how they analyse and what products and services they are putting into the market.

CIARAN RYAN: One of the points that you touched on a little bit earlier, and just talking about corruption and the role of accountants and you mentioned ethics, how can finance executives and CFO's become more involved in rooting out corruption? Is it a matter of regulation or is it a matter of just raising the standard expected from CFO's and finance executives?

FERNANDO LOPEZ MACARI: I think it's a combination of both. I think we all have to raise the standard and we have to get more involved, as the Mexican Institute of Finance Executives we have to be more involved in how we form financial executives, what the academy is doing, what the corporations are doing, we have to be communicating the value of a sustainable financial strategy. This will give the board of directors and the businessmen an idea of the value a CFO can add to the management team of a corporation because sometimes we feel that CFO's are constantly stressed by results because all corporations want to have is results and results and results and there's a lot of stress in that. We believe that by creating financial strategies that will not only create results but sustain these results, in the long term that could be a better way to create a more ethical environment and fight against corruption.

CIARAN RYAN: We're running out of time here but I have one other question for you, any books that you would recommend, books that have impressed you or that you feel have captured the spirit of the age? Also just tell us a little bit about what you do for leisure in Mexico.

CIARAN RYAN: So you're obviously living on the coast somewhere?

FERNANDO LOPEZ MACARI: Yes, I live in Mérida, it's a city that's based 30 kilometres from the coast, so it's a short drive to the beach. So that's what I do for leisure. In terms of reading I have read a couple of books lately that really changed my way of seeing things and influenced my thoughts, one is *Everybody Lies* by Seth Stephens-Davidowitz.

CIARAN RYAN: Why do you like that book?

FERNANDO LOPEZ MACARI: It's a book that talks about big data, new data and how the internet is affecting the decision-making of people and the consumers' habits. It also tells us how we really are, it tells us what people have in their mind, what they're thinking because right now, think about it, if you don't know the answer to one question or if you're looking into new data or if you want to learn about something you go to Google or the internet. All these searches of data that people do are recorded and they can be obtained and they can be used to make decisions in terms of finance or commercial strategies or elections or whatever. So that's one book that really impressed me lately. The other one is about exponential organisations and the book is called *Exponential Organisations* by Salim Ismail and it talks about the new organisations and how these new organisations like Facebook, Airbnb and Uber are ten times better, are faster and they are cheaper and much more efficient than older organisations. These organisations are building the web in the cloud, they have very few employees and that's why they are selling 22 or 26 times their EBITDA value. They are really changing the way of doing business in the world and how the consumer is changing their habits. So those are two books, I am 41 years old, so I am part of this computer generation but I am not fully a millennial, so we have to keep track of these changes and implement them in our day-to-day life.

CIARAN RYAN: Okay, so those two books, *Everybody Lies* by Seth Stephens-Davidowitz and *Exponential Organisations* by Salim Ismail, those are definitely two books that I am going to look out for. But we're going to have to leave it there, Fernando, for the moment. It's been fascinating talking to you and getting a viewpoint from Mexico and the Americas about the state of the economy and the state of the finance executive world. Thank you very much for your time and we wish you the best of luck.

FERNANDO LOPEZ MACARI: Thank you, it's also been a pleasure for me and I'll be glad to do this again whenever you guys feel it's good for your audience.

CIARAN RYAN: Absolutely, we will check in with you every now and again to see how things are going.



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