INTERNATIONAL ASSOCIATION OF FINANCIAL EXECUTIVES INSTITUTES

*The Premier Global Society of Financial Executives*

# I A F E I Q U A R T E R L Y

47th Issue
2020 Mar

# Message from the Chairman

Dear IAFEI members,

Greetings from Manila, Philippines!

It is my pleasure to present to you the 47th issue of the IAFEI Quarterly, the first for 2020.

The first quarter of 2020 has been very difficult, primarily due to the COVID-19 pandemic. The number of those who contracted the disease is increasing day by day. This crisis does not only affect our personal well-being, the global economy is also being hit. Lock downs and community quarantines are being implemented causing lost of livelihood for some.

I would like to thank all the medical frontliners, and the government workers of each nation, who are risking their lives to counter this contagion.

Despite all these, I believe that we can surpass this global calamity. We should be optimistic for the days to come. 2020 is far from over.

As we begin the next decade, we will continue to improve the services that IAFEI provides to your organization by providing new value proposition. I am excited to update you on the new programs soon.

For this year, I would like to introduce your Executive Committee:

| | |
|---|---|
| CHAIRMAN | Eduardo V. Francisco (FINEX-Philippines) |
| VICE CHAIRMEN | Liu Ping (CACFO-China) |
| | Juan Alfredo Ortega (IMEF-Mexico) |
| SECRETARY | Abelardo V. Cortez (FINEX-Philippines) |
| TREASURER | Carlo Locatelli (ANDAF-Italy) |
| AREA PRESIDENTS | |
| AFRICA | Nicolaas van Wyk (SAIBA-South Africa) |
| AMERICAS | Fernando Lopez Macari (IMEF-Mexico) |
| ASIA | Hiroaki Endo (JACFO-Japan) |
| EUROPE & MIDDLE EAST | Anastasios Rodopoulos (EIOD-Greece) |

I would like to thank all of you for all the support in 2019 and I hope for the same in 2020.

For any suggestions and comments, you may share it through the IAFEI Secretariat at m.vinluan@iafei.org and secretariat.iafei@gmail.com.

Thank you and all the best!

Sincerely,

EDUARDO "Ed" V. FRANCISCO
Chairman

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# Determination of the function currency: not a one-time analysis

**by Victor Hugo Vázquez Aguilar,** VP of the National Technical Committee of Financial Information of the Mexican Institute of Finance Executives (IMEF)

What is the functional currency of my company? This is a genuine question to be asked on more than one occasion in the lifetime of a business. The different stakeholders trust that it is raised and answered on a timely manner, so that their decision-making is not compromised, as this determination plays a key role in the preparation of financial statements, having the ability to affect the reported profits and even the risk management of the companies. However, the answer is not always obvious, since a detailed analysis could require a high degree of judgment and may have to change dynamically over time following the evolution experienced by the business.

This article is a reminder of what the functional currency analysis is about, why it is important, who and how should determine it, and, above all, a reminder that this is not a one-time analysis, as although the technical way to assess the functional currency has not undergone recent major changes, the way of doing business could be experiencing substantial transformations.

**Determining the "functional currency", a continuous challenge**

The functional currency is generally defined as the currency of the primary economic environment of an entity. This definition gives rise to one of the basic principles to maintain: the functional currency is not a decision, but a matter of economic facts and circumstances, which may imply a high degree of judgment and even involve particular aspects of industry, making this exercise a real challenge, which can sometimes be even highly complex.

An emphasis aspect worth rescuing is that the functional currency of a company is not necessarily the legal currency of the country where it is incorporated and operates. Sometimes this is a generalized perception, and although it could reflect the economic reality of some entities, generalizing would not be technically appropriate. To conduct this analysis adequately, there are technical guidance provided by practically any financial reporting framework, such as IFRS (issued by the IASB) or USGAAP (issued by the FASB), including various local GAAP. Later we will dive into the main evaluation factors that should be considered when performing this analysis.

Thus, it can be understood that if the facts and circumstances of the primary economic environment of an entity change, the functional currency may also have to change. It is strategic to establish internal processes for the continuous monitoring of the main factors and arguments that were originally considered to determine the functional currency, to be sure if a change in one of them merits a change in functional currency.

**Why it is important?**

A foreign currency is any currency other than the functional currency. That is, the definition of a foreign currency is tangled to the definition of the functional currency, and therefore this analysis can influence the financial results of the companies. Based on this definition, we can understand that exchange gains or losses should not be presented for transactions carried out in the functional currency.

For example, if a company has the U.S. dollar as its functional currency but records its financial information in an accounting system parameterized in euros, the transactions carried out in dollars will generate a foreign exchange effect in the system, although this effect should not be reported in the financial statements, because according to the economic essence of the business, the real exchange gains or losses are those caused by any currency

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Other than the dollar. In this example, the volatility recognized in the income statement for exchange differences should not be significant if most operations are carried out in dollars.

Therefore, by principle, the financial information of a company should be recorded in the functional currency. When this does not happen, there are in the different accounting frameworks well established mechanisms for the conversion (remeasurement) of currencies, which will be relevant as far as a company is in the situation of having a recording currency different from the functional currency, and a presentation currency different from the functional currency. By doing so, exchange effects would not be recognized for the transactions carried out in the functional currency, thus reducing volatility in the income statement and ensuring a correct presentation of the financial information.

The functional currency also affects the risk management decisions of companies, for example, when contracting foreign exchange hedges (or when determining the existence of embedded derivatives), so these hedges should not cover transactions in the functional currency but in foreign currencies. Why should you hedge a currency that does not generate currency fluctuation?

**Who should perform this analysis continuously?**

All entities should determine their functional currency and timely assess whether it has been subject to any change; therefore, in a group, this analysis would have to be carried out by each of the legal entities that comprise it, whether they are conducted in the form of a subsidiary, associate, joint venture and even branches. This includes holding entities, that by their nature they present additional challenges due to their investment functions, payment of dividends and the provision of services to the group companies. This analysis should be performed by each entity in a group, individually, as it could operate in a primary economic environment that is different from that of the rest of its affiliates.

**How to determine the functional currency?**

To support this analysis, financial reporting standards provide technical guidance that is based on different factors that consider key aspects of an entity's operations. It is worth mentioning that although there could be some differences between the different accounting frameworks the need to determine the functional currency and the way of conducting the analysis are the same. For this article the IFRS guidance is taken, contained it the standard IAS 21, "*The Effects of Changes in Foreign Exchange Rates*" (IASB 2019), which provides a series of hierarchical indicators. These indicators are shown below by way of questions, along with some important considerations.

**Primary indicators**

| | |
|---|---|
| What currency mainly influences sales prices for goods and services? | This will often be the currency in which sales prices of goods and services are denominated and settled. It is important to assess whether the economy that gives value to the currency analyzed impacts the company, and to differentiate this from simple billing conventions. Generally, entities that sell a commodity exchanged in international markets have the U.S. dollar as functional currency in the operational stage; however, this is not conclusive and other factors must be evaluated. |
| What is the currency of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services? | It may be an aspect to analyze under this indicator the fact that the products or services sold depend on a regulated price (tariff) or a regulation that directly affects the determination of prices or in general the economic activity of the business. |
| What is the currency that mainly influences labour, material and other costs of providing goods or services? | This will often be the currency in which main costs of doing business are denominated and settled. Possibly for many companies this is the key indicator, especially if their way of establishing the pricing of products and services is through a "cost plus a margin" method. Depreciation (and impairment) of fixed assets is not considered for this analysis, since the main economic environment is where the entity generates and spends cash. The relevance of this indicator could depend on the life cycle of the company, especially when no revenues are generated. |

## Secondary indicators (additional evidence)

| | |
|---|---|
| **What is the currency in which funds from financing activities are generated?** | **It is necessary to assess in which currency the debt and equity instruments are issued. Generally, in a preoperative stage this indicator can be decisive.** |
| **What is the currency in which receipts from operating activities are usually retained?** | How the company is deciding to invest or use the cash excess that result from its operation could also be relevant for this analysis. |

## Other indicators

| | |
|---|---|
| **Degree of autonomy** | **This indicator could be as important as the primary. It involves evaluating the extent to which a company is dependent on another. If an entity is not autonomous, its functional currency may be the same as that of the entity with which it has dependence. Elements to be considered, among others, are the level of sales transactions held with another company, if the financing depends, to a large extent, on the support of another company and if the investment decisions are taken by another entity of the group (for example, if all the excess cash is always sent to another entity, such as the holding company).** |

## How to know if the functional currency has changed?

As we saw, the determination of the functional currency is a matter of facts and circumstances, so if they change considerably, it would be necessary to reassess if the functional currency remains the same or if it has changed. Some companies usually experience pronounced cycles, going through moments where they do not generate revenues from contracts with customers (they only incur in costs and expenses) to others where a new business models came into action. It is not uncommon for these companies to have different functional currencies throughout their history.

A change in functional currency is usually associated with a major change in the business. Some questions that may be useful to identify when to make a new functional currency analysis are, among others:

- Has my client profile changed?
- Have my main costs changed?
- Is the way I determine my pricing (profits) different from how it was done before?
- Is there a new business model?
- Do I export or import more intensively to / from other countries?
- Has the way I mainly financed my operation changed?
- Does the business depend on a new technology?
- Is the business conducted differently than before?
- Is the company going through important moments of disruption (buying and selling business units, new management with new vision, new core business?

## Conclusions

It is important not to lose sight of the fact that the functional currency is a key aspect for the risk management of a company and an adequate accounting, that is the basis to faithfully report its financial situation and results of the operations, aligned with its economic reality. By not doing so, the stakeholders decision making could be misinformed. Therefore, it is necessary to have the appropriate processes for the identification of moments in the life of the entity that could trigger a change in the functional currency, since the facts and circumstances that were first analyzed will not necessarily be maintained in time, especially when facing substantial changes that affect the way of doing business.

**References:**

International Accounting Standards Board (2019). International Accounting Standard 21, "The Effects of Changes in Foreign Exchange Rates" (IFRS.org).

# FRANCE and USA

## CFOs stockpile cash

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

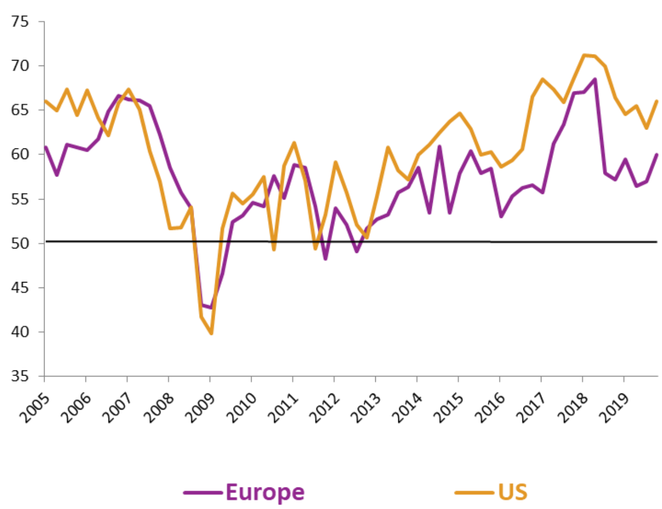
IAFEI AND A GROUP OF PARTNERS AMONG WHICH DUKE UNIVERSITY AND GRENOBLE EM SURVEY CFOS ACROSS THE WORLD. FOR THE FOURTH QUARTER 2019, THE SURVEY WAS RUNNING FROM 21ST NOVEMBER TO 6TH DECEMBER 2019.

- More than half of U.S. businesses expect a recession to occur in 2020
- Firms will hold cash and cut costs to prepare

The CFO survey has been conducted for 95 consecutive quarters and spans the globe, making it the world's longest-running and most comprehensive research on senior finance executives. Results are for the U.S. unless stated otherwise.

More than half of U.S. businesses expect a recession to occur in 2020, coinciding with the timing of the presidential election according to fourth-quarter results from the Duke University / CFO Global Business Outlook.

CFO survey: Optimism index



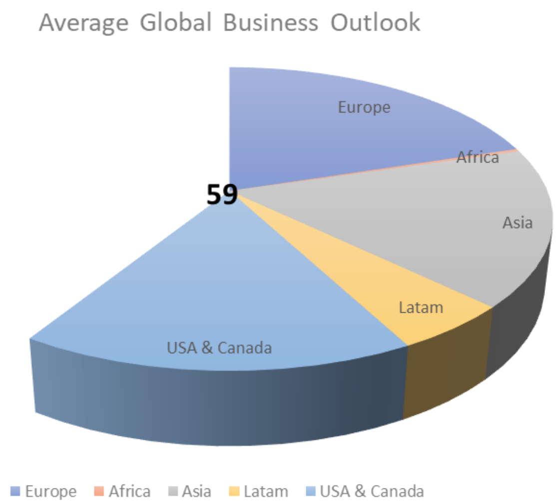

### 2020 Recession

More than half (52%) of U.S. CFOs believe the U.S. will be in an economic recession by the end of 2020, and 76% predict a recession by mid-2021. Business leaders continue to expect an economic slowdown in the U.S. before or concurrent with the presidential election. We would expect uncertainty about the election itself to cause firms to slow expansion in the summer and fall of 2020.Seventy-nine percent of CFOs in Asia believe their countries will be in recession by the fourth quarter of 2020, as do the majority of CFOs in Africa (77%), Canada (67%) and Latin America (55%). Forty-nine percent of CFOs in Europe expect a recession by the end of 2020.

### Cutting Costs and Stockpiling Cash

Fifty-six percent of U.S. companies indicate they are taking steps to prepare for a recession. Among these firms, 59% are strengthening their balance sheets, 58% are reducing costs, 49% are increasing liquidity, and 31% are scaling back or delaying investment. During the last recession, CFOs could genuinely say that their lack of planning was a result of a sharp downturn that was a surprise to most. However, it would be foolhardy to claim that the recession in 2020 or 2021 was a surprise. Although recessions are not controlled by CFOs, the impact on their firm is, to a large degree, managed by the CFO. This time around, CFOs will be judged by their preparations.

## CFO survey: Optimism index




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

**Companies continue to increase their cash holdings due to economic uncertainty.**

Hoarding cash and reducing debt are the most obvious tactics to dull the blow of a recession.

Fifty-four percent of U.S. firms indicate they are unlikely to spend their cash holdings during 2020 to preserve liquidity and spending power should a recession take hold and tighten lending markets.

### Most Pressing Concerns

Difficulty hiring and retaining qualified employees is the top concern among U.S. companies, with nearly half of CFOs indicating that hiring is one of their most pressing concerns. Economic uncertainty is the second highest concern, followed by data security worries and the high cost of employee benefits.

Economic uncertainty is also a major concern among CFOs around the globe. Nearly 70% of Latin American CFOs list uncertainty as a top concern, as do 58% in Asia and 51% in Europe. Many executives in developing countries are troubled by currency risk and government policies, while executives in Europe are concerned about regulation.

### Business Optimism Index

Even with a pending recession, the U.S. continues to lead the world in terms of optimism about the general business environment. Optimism in the U.S. is 67 on a scale of 0 to 100, compared to Europe (60), Latin America (58), Canada (57), Asia (52), and Africa (44).

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About the survey: The Duke University/CFO Global Business Outlook survey has been conducted for 95 consecutive quarters. The survey period ended Dec. 6 and generated responses from more than 800 CFOs, including nearly 500 in North America, 87 from Asia, 87 from Europe, 139 from Latin America and 40 from Africa. For more information: philippe.dupuy@grenoble-em.com

**Results for 434 U.S. firms (own-firm changes expected during the next 12 months)**

| Weighted Averages for | Dec 2019<br>Expected growth in next 12 months | Sept 2019<br>Expected growth in next 12 months | Jun 2019<br>Expected growth in next 12 months | Mar 2019<br>Expected growth in next 12 months | Dec 2018<br>Expected growth in next 12 months |
|---|---|---|---|---|---|
| Earnings growth* | 4.5%<br>Median=5.0% | 3.3%<br>Median=5.0% | 4.1%<br>Median=5.0% | | 4.5% |
| Capital spending | 4.7%<br>Median=2.0% | 0.6%<br>Median=2.0% | 3.4%<br>Median=2.0% | 8.2%<br>Median=5.0% | 1.0%<br>Median=2.0% |
| Advertising and marketing spending | 1.6%<br>Median=1.0% | 1.6%<br>Median=1.0% | 2.8%<br>Median=2.0% | | 1.3% |
| Technology spending | 4.1%<br>Median=3.5% | 5.0%<br>Median=3.0% | 4.8%<br>Median=2.0% | | 4.3% |
| R&D spending | 2.7%<br>Median=1.0% | 0.6%<br>Median=0.0% | 2.1%<br>Median=1.0% | | 1.4% |
| Employment – full-time | 3.0%<br>Median=2.0% | 2.1%<br>Median=1.0% | 3.4%<br>Median=2.0% | 4.6%<br>Median=2.0% | 3.6%<br>Median=3.0% |
| Wages and Salaries | 4.4%<br>Median=3.0% | 3.9%<br>Median=3.0% | 3.8%<br>Median=3.0% | 5.1%<br>Median=3.0% | 4.2%<br>Median=3.0% |
| Inflation (Chg in prices of own-firm products) | 2.2%<br>Median=2.0% | 1.7%<br>Median=2.0% | 1.4%<br>Median=1.0% | | 2.7% |
| Health Care Costs | 6.4%<br>Median=5.0% | 6.1%<br>Median=5.0% | 6.2%<br>Median=5.0% | | 6.0% |
| Revenue | 5.5%<br>Median=5.0% | 4.8%<br>Median=3.0% | 5.1%<br>Median=4.0% | 6.3%<br>Median=5.0% | 4.9% |

* indicates public firms only. All other numbers are for all survey respondents (including private). The reported averages are weighted by revenue or number of employees, so that large firms are weighted more heavily.

## U.S. BUSINESS OPTIMISM
## Duke's Fuqua School of Business / CFO Magazine Global Business Outlook

| | Dec 2019 | Sept 2019 | Jun 2019 | Mar 2019 | Dec 2018 |
|---|---|---|---|---|---|
| | Compared to last qtr. | Compared to last qtr. | Compared to last qtr. | Compared to last qtr. | Compared to last qtr. |
| Optimism about the U.S. economy | More opt: 28.1%<br>Less opt: 33.6%<br>No chg: 38.3% | More opt: 11.8%<br>Less opt: 55.2%<br>No chg: 33.0% | More opt: 19.8%<br>Less opt: 40.1%<br>No chg: 40.1% | More opt: 24.1%<br>Less opt: 36.8%<br>No chg: 39.1% | More opt: 16.6%<br>Less opt: 45.0%<br>No chg: 38.4% |
| U. S. optimism level (0 to 100) | 66.6 | 62.6 | 65.7 | 64.6 | 66.4 |
| Optimism about own company | More opt: 43.2%<br>Less opt: 24.1%<br>No chg: 32.7% | More opt: 32.4%<br>Less opt: 36.0%<br>No chg: 31.5% | More opt: 44.3%<br>Less opt: 27.0%<br>No chg: 28.7% | More opt: 48.3%<br>Less opt: 21.9%<br>No chg: 29.9% | More opt: 35.1%<br>Less opt: 32.7%<br>No chg: 32.2% |
| Own company optimism level | 75.0 | 67.1 | 68.1 | 70.4 | 68.5 |

## Results for 84 European firms (own-firm changes expected during the next 12 months)

| | Dec 2019 | Sept 2019 | Jun 2019 | Mar 2019 | Dec 2018 |
|---|---|---|---|---|---|
| Weighted Averages for | Expected growth in next 12 months | Expected growth in next 12 months | Expected growth in next 12 months | Expected growth in next 12 months | Expected growth in next 12 months |
| Earnings growth* | -9.7%<br>Median=0.0% | 3.6%<br>Median=2.0% | 2.3%<br>Median=3.8% | | 6.2% |
| Capital spending | 0.0%<br>Median=0.0% | 5.3%<br>Median=0.0% | 7.1%<br>Median=4.6% | 8.5%<br>Median=5.0% | 2.2%<br>Median=0% |
| Advertising and marketing spending | 1.0%<br>Median=0.0% | -0.7%<br>Median=0.0% | 4.0%<br>Median=0.8% | | 0.7% |
| Technology spending | 3.7%<br>Median=2.1% | 2.0%<br>Median=0.0% | 3.6%<br>Median=0.0% | | 3.5% |
| R&D spending | 1.5%<br>Median=0.0% | 2.9%<br>Median=0.0% | 4.5%<br>Median=4.7% | | 1.7% |
| Employment – full-time | -1.8%<br>Median=-1.0% | 0.1%<br>Median=0.0% | -0.3%<br>Median=0.0% | 1.8%<br>Median=1.0% | 1.6%<br>Median=1.0% |
| Wages and Salaries | 1.3%<br>Median=3.0% | 2.5%<br>Median=2.0% | 4.7%<br>Median=3.0% | 2.9%<br>Median=2.0% | 3.1%<br>Median=2.0% |
| Inflation (Chg in prices of own-firm products) | 0.4%<br>Median=1.0% | 1.7%<br>Median=1.0% | 4.8%<br>Median=2.0% | | 1.5% |
| Health Care Costs | 1.6%<br>Median=1.0% | 0.7%<br>Median=0.0% | 3.7%<br>Median=2.3% | | 1.8% |
| Revenue | 1.9%<br>Median=0.0% | 2.4%<br>Median=2.0% | 8.5%<br>Median=5.0% | 3.5%<br>Median=3.0% | 5.4% |

* indicates public firms only. All other numbers for all survey respondents (including private)

## European BUSINESS OPTIMISM

| | Dec 2019 | Sept 2019 | Jun 2019 | Mar 2019 | Dec 2018 |
|---|---|---|---|---|---|
| | Compared to last qtr. | Compared to last qtr. | Compared to last qtr. | Compared to last qtr. | Compared to last qtr. |
| Optimism about the country's economy | More opt: 22.9%<br>Less opt: 37.3%<br>No chg: 39.8% | More opt: 24.2%<br>Less opt: 45.5%<br>No chg: 30.3% | More opt: 20.3%<br>Less opt: 50.8%<br>No chg: 28.8% | More opt: 26.2%<br>Less opt: 38.3%<br>No chg: 35.5% | More opt: 11.0%<br>Less opt: 54.9%<br>No chg: 34.1% |
| Country optimism level | 59.7 | 59.2 | 56.5 | 59.5 | 57.2 |
| Optimism about own company | More opt: 30.5%<br>Less opt: 20.7%<br>No chg: 48.8% | More opt: 26.2%<br>Less opt: 35.4%<br>No chg: 38.5% | More opt: 28.8%<br>Less opt: 32.2%<br>No chg: 39.0% | More opt: 42.4%<br>Less opt: 25.1%<br>No chg: 32.5% | More opt: 32.1%<br>Less opt: 33.3%<br>No chg: 34.6% |
| Own company optimism level | 63.7 | 64.1 | 62.2 | 67.5 | 64.1 |

## Results for 87 Asian firms (own-firm changes expected during the next 12 months)

| | Dec 2019 | Sept 2019 | Jun 2019 | Mar 2019 | Dec 2018 |
|---|---|---|---|---|---|
| Weighted Averages for | Expected growth in next 12 months | Expected growth in next 12 months | Expected growth in next 12 months | Expected growth in next 12 months | Expected growth in next 12 months |
| Earnings growth* | -4.9%<br>Median=5.0% | 1.6%<br>Median=0.0% | 3.0%<br>Median=2.1% | | 6.4% |
| Capital spending | -2.6%<br>Median=0.0% | -0.1%<br>Median=0.0% | 4.7%<br>Median=2.0% | 11.0%<br>Median=5.0% | 10.0%<br>Median=3.4% |
| Advertising and marketing spending | -2.2%<br>Median=0.0% | 4.3%<br>Median=0.0% | 3.8%<br>Median=1.0% | | 3.0% |
| Technology spending | 4.9%<br>Median=5.0% | 1.6%<br>Median=3.2% | 4.5%<br>Median=2.0% | | 4.6% |
| R&D spending | 2.5%<br>Median=3.0% | 1.2%<br>Median=2.2% | 4.5%<br>Median=5.9% | | 3.2% |
| Employment – full-time | 1.7%<br>Median=1.0% | -0.9%<br>Median=0.0% | 2.3%<br>Median=2.5% | 3.0%<br>Median=1.0% | 2.0%<br>Median=3.0% |
| Wages and Salaries | 3.4%<br>Median=3.0% | 1.0%<br>Median=2.2% | 3.7%<br>Median=3.0% | 6.1%<br>Median=5.0% | 2.2%<br>Median=2.0% |
| Inflation (Chg in prices of own-firm products) | -0.4%<br>Median=0.0% | -4.1%<br>Median=0.0% | 0.9%<br>Median=0.0% | | 1.5% |
| Health Care Costs | 2.1%<br>Median=0.0% | 0.4%<br>Median=0.0% | 1.8%<br>Median=0.0% | | 2.1% |
| Revenue | -1.3%<br>Median=0.0% | 1.1%<br>Median=3.0% | 2.2%<br>Median=-0.4% | 10.4%<br>Median=7.4% | 5.1% |

* indicates public firms only. All other numbers for all survey respondents (including private)
** numbers in the bracket are GDP-weighted results

## ASIA BUSINESS OPTIMISM

| | Dec 2019 | Sept 2019 | June 2019 | Mar 2019 | Dec 2018 |
|---|---|---|---|---|---|
| | Compared to last qtr. | Compared to last qtr. | Compared to last qtr. | Compared to last qtr. | Compared to last qtr. |
| Optimism about the country's economy | More opt: 18.6%<br>Less opt: 61.6%<br>No chg: 19.8% | More opt: 18.5%<br>Less opt: 61.1%<br>No chg: 20.4% | More opt: 25.9%<br>Less opt: 55.6%<br>No chg: 18.5% | More opt: 47.4%<br>Less opt: 29.6%<br>No chg: 23.0% | More opt: 16.2%<br>Less opt: 64.3%<br>No chg: 19.5% |
| Country optimism level | 51.9 | 50.7 | 53.8 | 64.9 | 51.9 |
| Optimism about own company | More opt: 29.4%<br>Less opt: 40.0%<br>No chg: 30.6% | More opt: 35.2%<br>Less opt: 40.7%<br>No chg: 24.1% | More opt: 22.2%<br>Less opt: 37.0%<br>No chg: 40.7% | More opt: 60.7%<br>Less opt: 19.3%<br>No chg: 20.0% | More opt: 20.6%<br>Less opt: 50.2%<br>No chg: 29.1% |
| Own company optimism level | 60.2 | 58.1 | 58.6 | 69.6 | 58.8 |

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

# GERMANY

## "We have the stamina to go the whole distance"

Interview with **Dr. Tobias Ohler**, the CFO of Wacker Chemie AG, Munich, Germany, describes how the Group with its polysilicon business is holding against the subsidized Chinese competition, from Börsen-Zeitung, Frankfurt am Main, Germany, January 11, 2020, article provided by GEFIU, Association of Chief Financial Officers Germany, the German IAFEI member association. The interview was made by Joachim Herr

**Mr. Ohler, has the business with polysilicon for solar panels still a future in the Wacker Chemical Group ?**

Absolutely. The global resolve to get the climate issue under control will lead to further strong growth in the solar market. We are well positioned with three production sites and are quality leader. In addition, we still have sufficient potential for further cost reduction.

**In 2019, you plan for an impairment on polysilicon production facilities in the order of €750 million, which you expect will lead to an equally high net loss for the Group. This is more than a quarter of equity and almost a quarter of property, plant and equipment: a hard blow.**

We have to regularly examine with impairment tests, whether the cash flows are sufficient to cover the asset values. We will have to make this significant write-down in our 2019 financial statements because we have lowered our price expectation for polysilicon. This will also reduce the Group's equity ratio to around 30 %.

**At the end of 2018 it was still 44 %.**

The significantly higher pension provisions stemming from the low discount rates also play a role in this decline. However, one must also consider the classic financial debt. We continue to see ourselves well positioned in this respect. When we disregard the effect of the new IFRS requirements governing the accounting of leases, our financial debt remains at the level of Ebitda. This is respectable in a difficult year in which we have continued to invest.

**You explain the problems of your polysilicon business by the fact that the sharply fallen prices are not recovering due to the high overcapacities of Chinese producers. And what has gone wrong in your company?**

Nothing, it's just external causes. Prices have more than halved since the beginning of 2018 and capacities in China have more than doubled over the last four years. The global solar market is growing, but China has not contributed to this growth in 2019. China dominates the value chain with around 90% of solar wafer capacity, but in photovoltaic installations China had less than a quarter of the total market in 2019. In other words, it is predominantly an export business for China.

**Isn't it risky to expect the Chinese market to remain strong? Not least because of the considerable influence of government subsidy policies there..**

It is, after all, the largest market and the largest energy consumer in the world, which has its hands full trying to get its environmental problems under control. China has to expand its solar energy. Therefore one must reckon with this country.

**China's significantly lower electricity prices for the energy-intensive production of polysilicon are another problem for Wacker.**

This is why we are fighting in Germany for an electricity price based on that of our competitors. Subsidized Chinese competitors are paying less than half as much for electricity as we do, and in some cases even less. We advocate an industrial electricity price and place this prominently. Politicians listen to us, but do nothing yet.

### Wacker Chemie at a Glance

#### Group Numbers, each January to September

| | | |
|---|---|---|
| Sales, Mio € | 2018 | 3790 |
| | 2019 | 3772 |
| Ebit, Mio € | 2018 | 353 |
| | 2019 | 208 |
| Ebitda Margin, % | 2018 | 20,0 |
| | 2019 | 16,6 |
| Net Cashflow, Mio € | 2018 | 55 |
| | 2019 | 63 |
| CapEx, Mio € | 2018 | 289 |
| | 2019 | 290 |

**Do you contact Berlin and Brussels?**

Exactly. We need an electricity price under 40 € per megawatt hour. Presently it is around 60 €. We can't compensate for this through efficiency measures only. By the way, this affects not only us, but also all energy-intensive industries in Germany.

**You are trying to convince the politicians also by pointing out the environmental aspect.**

With our polysilicon, thanks to photovoltaic power generation, we can save over its entire life cycle twenty times the carbon dioxide emitted during its production.

This is a very powerful lever for climate protection. Our manufacturing process is twice as efficient as the Chinese one. The 3 million tons of $CO_2$ generated annually in our polysilicon production would double if our volumes were to migrate to China.

**What quantity can one imagine by that?**

3 million tons correspond to the amount of $CO_2$ that around 300.000 Germans emit each year. That's roughly the population of the German city of Bonn. And thanks to the solar panels produced with our polysilicon, the emission of 60 million tons of $CO_2$ is avoided. If we could not competitively operate the world's most efficient polysilicon production in Germany, that would be a disservice to global climate protection.

**Apart from Burghausen in Upper Bavaria and in Nünchnitz in Saxony, Wacker is producing polysilicon in Charleston, in USA. How much is the cost of electricity there ?**

Lower than in Germany. This was one of the reasons for choosing Charleston. We don't quantify the difference.

**Is it an option to expand the plant in the USA and reduce capacity in Germany?**

Currently we are not considering an expansion. In the chemical industry, relocation is not easy to achieve, namely because of the closed material loops at a site. We cannot simply dismantle everything and rebuild it elsewhere. That's why we want to secure our competitiveness by getting the most out of our existing production sites.

**Your Chinese competitors also have lower labour costs.**

We estimate labour costs in China to be one-fifth compared to Germany.

**What makes you confident about your polysilicon business despite the cost disadvantages, overcapacity and price pressure?**

Overcapacities may well persist for several years to come. However, market growth may be stronger than currently forecast. So far it always exceeded expectations. The second point is a shift towards higher quality polysilicon. The race for ever higher efficiency levels in the solar industry may well play a decisive role. We are well positioned in this respect.

**Why don't you achieve significantly higher prices for your higher quality products?**

We actually do, but there are still multicrystalline solar modules - even though this market segment is not growing any more. But I can imagine that in five to ten years only monocrystalline solar cells will be produced. The race is still a long one. We have the stamina to go the whole distance.

**Wacker's ultra-pure starting material can be used to produce more efficient monocrystalline solar modules that are superior to multicrystalline modules in terms of overall cost, too. Wacker's global market share in the mono segment is over 20%.**

Exactly. We know our way: It is a specialty strategy, i.e. to produce polysilicon for highly efficient solar cells. In addition, only the solar business is under strong price pressure. We also supply polysilicon for the semiconductor industry. Here the prices are significantly higher and more stable. In the meantime, we have become the market leader for semiconductor-grade polysilicon and thus system-relevant for the digitization. We are trying to further expand this market position, also because it stabilizes our business.

**And how will competition for solar silicon develop in China ?**

This will depend on whether China will continue to keep alive economically not viable enterprises with subsidies. In the long run, electricity and labour costs will rise there as well. In the future, there should also be a fair pricing of CO2 in China. In any case, the environment is now a high priority for Beijing. I am also confident about our own cost-reduction potential in the polysilicon business.

**How much potentialdo you see?**

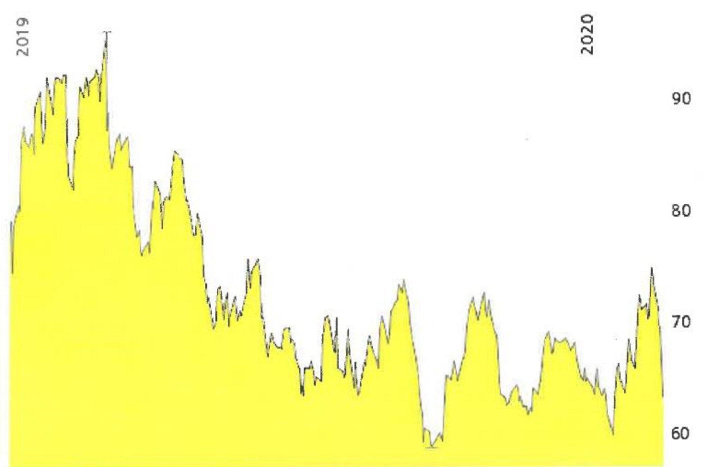
From 2014 to 2017 we have saved one third. From 2018 to 2021 we want to reduce manufacturing costs by more than 30 % again. One of the ways we are achieving this is through more automation in production. And we improve the processes.

**You have recently adjusted your estimates for yourpolysilicon business in 2020. What does that mean ?**

It means that after the price decline in 2019, we expect lower average prices this year as well. The improvement on the cost side will just make up for th:is. We therefore do not yet expect the operating result - Ebitda - in the polysilicon segment to improve in 2020. This is based on the assumption, that we will continue to operate at full capacity because the quality of our products means we always have sufficient sales.

**Wacker Chemie AG, 63,48 € Share Price as of February 28, 2020, German Stock Exchange Xetra**

Share Price Chart, January 2, 2019 to February 28, 2020, in€




**Do you have an explanation for the fact that your share price rose in December following the announcement of a high annual loss ? Were the shareholders expecting worse?**

I believe Wacker Chemie's current market capitalization does not imply a high value for the polysilicon business anyway. That's probably why the write-down is not so important for the capital market. The market looks more at cash flow, which is not affected by the impairment.

**And what does the net loss for the year mean for the dividend ?**

Our policy is to pay out around 50 % of net profit.

**Consequently, the loss means there will be no dividend.**

This does not necessarily have to be the case because we are still well financed. No decision has yet been made on the dividend proposal of the Executive Board and Supervisory Board to the Annual General Meeting.

**But you were surprised that the share price did not react negatively to the expected high loss - right?**

Frankly speaking, yes. Otherwise we would not have published an ad hoc release. However, we have often experienced that the share reacts little or not at all - even when we lowered our full-year forecast for sales and earnings in October.

**You intend to step up the efforts for savings and efficiency programs - not only in the polysilicon business, but throughout Group. How far have you progressed with this?**

We are feeling the pressure of competition in our chemical business as well and are preparing for a tougher competitive environment. Additionally, there are risks for the global economy. We need to look at how we can make the indirect functions in the Group faster, more flexible and leaner, because WACKER is a smaller company now, following the deconsolidation of our former subsidiary Siltronic.

**And what is the current project status ?**

We are still in the analysis phase. We first will define the objectives for the future organization and then communicate it, because we build on a good social partnership with our employees. We want to have the discussion at the right time.

**When will that be ?**

We expect to know this quarter how far we have to jump. Then we will set up the schedule. For 2020, the program will not yet bring much of a relief for the Group's earnings. It will be a mixture of initial reliefs, but also charges from one off effects.

**Wacker Chemie AG**

**Shareholder Structure,** as of December 31, 2018

| | |
|---|---|
| **Dr. Alexander Wacker Family Corporation**<br>around two dozen shareholders | over 50% |
| **Blue Elephant Holding**<br>Peter-Alexander Wacker and parts of family | over 10% |
| **Free Float**<br>thereof | below 40% |
| Germany | 37 % |
| USA | 22 % |
| UK | 21 % |
| Other Europe | 18 % |

| | |
|---|---|
| **Market Capitalisation,**<br>as of February 28, 2020 | **3.3 billion €** |

Source: Wacker Group, Refinitiv

**Jobs will be lost, right ?**

Yes, jobs will be lost. This is our clear message. This will go beyond normal staff turnover. Otherwise we won't get far enough with our jump. The question is how many intermediate steps we need on our way to the targeted organization.

**Will the cost and efficiency programs affect production sites as well?**

It is not a production site program, it is not aiming at the core of our production. However, it deals with all indirect functions. It is thus not just a classic program to optimize administration, but we are also scrutinizing our business divisions' organization as well as sales-related functions, research and development, and IT. And we are also looking at material costs, for instance in procurement.

**About the Person**

**Endurance Runner**

"We Have the Stamina to Go the Whole Distance " , says Tobias Ohler self-assured, referring to Wacker Chemie's long-term approach in competition. The CFO, who will be 49 in two weeks, needs to be in good shape also in his leisure time. Ohler is a marathon runner and is aiming at the 42 kilometer distance in London this year. He also shows perseverance in his assignment at the Munich Chemical Group: He works for Wacker since 2004. Born in Saarbrücken, Germany, the manager started his career at Wacker as Vice President Group Controlling, before taking over responsibility for raw material procurement . In 2010, he became CFO of Wacker's former subsidiary Siltronic. Since seven years he is in his current function at Wacker Chemie AG.

Ohler has studied macroeconomics and business engineering and holds a PhD in the former discipline. He started his professional career at the consulting company McKinsey. Ohler's motto on the Wacker Chemie website: "When it comes to finance at Wacker, we're conservative in the best sense of the word. A sound financial position is our top priority."

From Börsenzeitung, Frankfurt am Main, Germany, January 11, 2020.
Responsible for English translation: GEFIU, the Association of Chief Financial Officers Germany, the German IAFEI Member Association, translator: Helmut Schnabel

# CFO Talks Interview 41: From banking to working at the cutting edge of data analytics, Jodi Joseph is a CFO who has proven that versatility leads to a dynamic career

Interview with **Jodi Joseph**, Division Executive – CaseWare Africa
The interview was made **by Ciaran Ryan**

**CIARAN RYAN:** This is CFO Talks and today I'm very happy to have Jodi Joseph with us in the studio. Jodi is the divisional executive of CaseWare Africa, which is a division of Adapt IT and we're going to be getting into that in a minute. But before we do that let's talk a little bit about Jodi, she's a results-driven executive with extensive experience in both finance and operations, she's also a chartered accountant, and has many, many years of experience as a financial professional. Jodi completed her articles at Grant Thornton, which was previously Kessel Feinstein, and thereafter joined Investec in various roles, including chief operating officer and chief financial officer. In 2013 she was appointed chief operating officer of CQS Holdings, which was subsequently acquired by Adapt IT, where she is today. Welcome, Jodi.

**JODI JOSEPH:** Thank you very much for having me on to talk with you.

**CIARAN RYAN:** Great, let's start off with CaseWare, there's a lot of software out there in the market for companies, what is the unique offering about CaseWare and what brings a chartered accountant into that realm?

**JODI JOSEPH:** I think the most important thing about CaseWare in South Africa is we have really been involved with auditing and accounting professionals since the '90s. So we originally brought laptops to that community and we have walked every step of the way with them, as technology has improved and regulations have become more demanding. So today we have software, which would result in a financial professional achieving their goals in the quickest, most efficient and, we believe, the most compliant way.

**CIARAN RYAN:** I guess one of the things that software these days has to accommodate is the change in regulations and the change in law, CaseWare does that?

**JODI JOSEPH:** That's a key part of our value proposition, our technology has been developed over the years to do just that. In a very elegant way all client files, all financial statements can be updated annually to consume all new regulations. We take care of that. We have extensive content providers who are really taking the change in regulations and making it simple in a way to actually apply it to the audit or the set of financials that one has to prepare and then the technology takes care of updating the client file. So the user can consume the new changes and be compliant in the most efficient way possible.

**CIARAN RYAN:** Who would be your typical market, who are your clients?

**JODI JOSEPH:** We have various segments in South Africa, we have the auditing firms that focus predominantly on completing the audit, especially with Section 90 [of the Companies Act], a lot of them no longer have their financial statement production teams.

### "Healthy market share in South Africa"

**CIARAN RYAN:** Just explain Section 90.

**JODI JOSEPH:** Section 90 is the section of the Companies Act that required significant independence, so those that conducted the audit were no longer allowed to produce the financial statements. So historically many of our clients solved both those problems for their clients, now due to the demand of independence, many of the auditing firms are focusing on the audit side. So we service the auditing community, we service the advisory community that produce financial statements for clients. We then also service corporate South Africa, where those financials are produced internally by the financial teams and we have quite a significant client list and a high volume of our corporate South Africa clients are from large listed companies, to smaller owner-managed businesses that produce their financial statements. We also service public service South Africa quite significantly, from the municipality level, right up to provincial and national departments, and we have different solutions for all those regulatory environments.

**CIARAN RYAN:** So you have a different product suite or different products aimed at different segments of these markets?

**JODI JOSEPH:** Yes because the different user requirements are different, as well as the reporting frameworks are different, we have developed templates that work per segment and for the reporting frequency every segment has to adhere to. So that's been really in the last ten years because through our footprint originally in the audit and accounting market, we were exposed to financial South Africa and all the variety of reporting frameworks and we've managed to build quite a healthy market share in all of them in South Africa.

**CIARAN RYAN:** You probably read the Auditor-General report that came out in 2018, it wasn't very flattering for municipalities and the public sector, the number of qualified audits and bad marks against the public sector, and it hasn't really improved in recent years. One would imagine with the kind of product that you're offering is what you're trying to do is get these municipalities and public sector entities into compliance. In other words, to assist the Auditor-General in what he's doing.

**JODI JOSEPH:** Our focus is on financial reporting, which is very much the last mile of the process, we spend a lot of time internally going through the detail of the Auditor-General findings and reports to see where we can further enable our clients with our value proposition. We believe that our solutions make that last mile significantly simpler and quicker, allowing for more detailed analysis of the financial statements. But many of the findings are really around the financial processes and the procurement processes and the internal control environment. That's not particularly an area we focus on, but we believe in the standardisation of the reporting and creating a very transparent reporting environment for government. We enable the insight into where the problems are going wrong. So where we have dominant market share in some of the segments, it's very easy for the oversight bodies to compare financial statements and see where things don't look consistent or where there's a glaring omission or problem but we are the reporting mile and a lot of the findings are the internal controls and more the operational processes within those entities, where the challenges lie.

**CIARAN RYAN:** Tell us a little bit about yourself, you're from Joburg?

**JODI JOSEPH:** Joburg born and bred, spent six years in London though, but I do love Johannesburg, I have travelled the world extensively and I believe there is no climate like Joburg…

**CIARAN RYAN:** It is the best in the world and that's a bit of a secret.

**JODI JOSEPH:** It's the best in the world, there may be no mountain or any other of the good things but 350 days of sunshine and even if there's rain it goes away and it's wonderful. So I really love Johannesburg.

**CIARAN RYAN:** The winters can be a bit chilly.

**JODI JOSEPH:** The winters are chilly but if you're not outside you can sit in your car and it's nice and warm and toasty and you have a blue sky throughout winter, where in the world can you say that happened?

**“Exciting years at Investec London”**

**CIARAN RYAN:** What were you doing in London?

**JODI JOSEPH:** I went to London with Investec in 2000, I went across originally on implementing a credit risk management system and then fell in love with London, to be honest, and had the opportunity to move over there, where I spent my time in the capital markets division, firstly as CFO and then I moved into a COO role. It was an exciting time in the business because we really built that business from the ground up, brought in a lot of different businesses, foreign exchange, equity derivatives, commodities trading, project finance, structured finance, securitisation. So I think that period of my career certainly was where I learnt the most and had to dance on my toes and learn and research, and a lot of system implementation, I guess that's where my passion for technology also started when you saw what was really possible with the various systems.

**CIARAN RYAN:** Right, and you're a chartered accountant and you articled with Kessel Feinstein, which is now Grant Thornton…

**JODI JOSEPH:** And Grant Thornton has subsequently joined with SNG and it's now SNG Grant Thornton, so it's now one of the biggest firms in South Africa.

**CIARAN RYAN:** When did that happen?

**JODI JOSEPH:** It happened late last year or during the second half of 2019, I'm not sure of the exact date.

**CIARAN RYAN:** Let's talk about the role of the chief financial officer, just shifting gears here, and you've operated as a chief financial officer in a large banking group, now you've joined a technology company. One might think that's a step down for you but I'm sure you don't see it that way at all because it does seem that CaseWare is on a very fast growth track at the moment. Maybe explain your reason for taking that career step and the role of the chief financial officer as well, how has that evolved over the years that you've been in this game?

**JODI JOSEPH:** So my two CFO roles at Investec were at a divisional level, I wasn't ever the group CFO or the listed entity CFO. But I think in the early 2000s the CFO role started being exposed to the Rapidly increasing regulations in banking. So my early days were in London when it was still under the FSA and the regulations were coming thick and fast, they were dealing with a lot of the early market crises and that kind of thing. A lot of the CFO focus though was on partnering with the business, focusing on profitability, focusing on platform improvements and doing business better. I would say that through 2000 to 2010, both in South Africa and in the UK you just saw the regulations in banking increasing, increasing and increasing. Anti-money laundering came in, even KYC, all of those kinds of things, FICA, it all came in and business just became much more difficult. I'd say in my experience a lot of the CFO focus over that time shifted from business enablement to business compliance. To be honest, I would say that was probably one of the biggest drivers of leaving the banking industry…

**CIARAN RYAN**: It was just getting too regulated?

**JODI JOSEPH**: It wasn't fun anymore, to be honest, there were just more and more regulations. I did the Basel II project at Investec Bank globally, dealing with both the UK and South African regulators, and moving from business enablement in the early part when I got to London, really building a business, to business compliance focus, it was very demanding and not fun.
The cost of regulation in the banking industry

**“The cost of regulation in the banking industry”**

**CIARAN RYAN:** Did you ever do a calculation to see what the cost of regulation was in the banking industry? I tell you why I ask that because I was recently researching the subject in South Africa for small businesses on the stock exchange. You've probably noticed that there's not a lot of love going towards the small cap shares on the Johannesburg Stock Exchange because they're spending about 3% of turnover on compliance-related issues and one of the big costs for them is the audit. There's been a lot of discussion and there are softer listing requirements in other markets around the world, where a compulsory audit isn't necessary for a listing and the question is raised why should we have it here in South Africa. We'll come to that in a minute, perhaps the audit should be a voluntary thing. But did you ever do that calculation, what was the cost of compliance to the baking industry or to Investec?

**JODI JOSEPH:** We used to do it quite a few times because Stephen Koseff, the CEO at the time, worried about it tremendously, especially with Investec being dual listed, so the regulatory burden there was significant. I can't remember the numbers offhand but it was enormous.

**CIARAN RYAN:** Was it more than 3% of turnover?

**JODI JOSEPH:** It's difficult because in a bank what is your turnover because it's not a traditional turnover measure.

**CIARAN RYAN:** How were you measuring it?

**JODI JOSEPH:** We were measuring the actual rand cost and the number of staff involved, and also the time delay in doing business because the Investec brand was very much on responsiveness to clients, providing a superior service. I remember when FICA and the KYC started, it became a big thing in banking in South Africa, generally that everything now slowed down and it was harder to do business. So we looked at it a lot, in the early days it was very expensive because a lot of the systems hadn't been enabled to do it. Today I would say I have a lot of colleagues there and because the platforms are a lot more sophisticated, regulatory requirements are far easier to implement. But I think also the other thing with banking is that the banking competitive landscape has changed significantly, there's all the new banks, the new digital banks we are seeing coming along. So what really happened and to answer your question of why did I leave banking at that time and was it a step backwards or I'm not sure how you phrased it…

**CIARAN RYAN:** A step down.

**JODI JOSEPH:** But I really took stock at that time, I had had vast experience in Investec, working both in South Africa and London in capital markets and private bank, I had done a lot and I had really learnt a lot there. I was 40 and I thought am I going to retire a banker because at 40…

**CIARAN RYAN:** It's a horrible thought.

**JODI JOSEPH:** And I thought I have really done a lot, enjoyed it, learnt a fortune but have I got another 20 years of that left or do I want to try something new and learn something different.

**CIARAN RYAN:** Do you have children?

**JODI JOSEPH:** I have three and at that time…

**CIARAN RYAN:** Were they with you in London?

**JODI JOSEPH:** My son was born in London and then when I came back to South Africa my two daughters were born. Also, at that time at Investec they were all starting to get to school-going age and life was quite demanding for a senior professional woman and three young children, even with all the help that one can have in South Africa. So I think all of that really came together and I thought if I am going to change careers and industries and so on, it would be at that time or I am committed to banking for the rest of my life. I guess I thought I don't really want to get to the end of a career and I have only ever worked in one business. You also like to see if you can do different things and take some of those learnings elsewhere.

**CIARAN RYAN:** So you have kind of explained in a round about way why you moved to CaseWare, you decided you didn't want to be a banker, you had children, you had to create some time or some environment for them where they could grow up with an active mother, am I correct?

**JODI JOSEPH:** You are, and I think even at my time at Investec, Investec was very accommodating for me, I remember going to galas and that kind of thing. But what actually happened when I left Investec is I took six months off and time out, I think I was exhausted, being a mother, and private banking at that time had been through significant challenges, it was around 2012 when the property market had taken quite a dip in South Africa and may high net worth individuals were under pressure. So it was a difficult time and I really hadn't decided to leave Investec to go to CaseWare, I decided to take some time out. So I took some time out and it was probably within six weeks of taking time out, a good friend, who worked both for Investec and CaseWare, said you've got to meet these people. I said I actually don't want to meet anyone, I just want sleep late, go to gym, have a bit of time with my children. She said no, no, you have to meet these people. I think I have learnt throughout my career that the people you work with are everything and the culture where you work, that's always been critically important to me. So after a lot of nagging she convinced me to go and then when I met them I knew these were the next people. There's a great leadership team with the founders at CaseWare and we were all a similar age, we all had three children at school of a similar age. It was technology, which from banking I think I'd only go to technology really, I was at the time looking at technology or the telecoms industry or those kinds of things, things I was interested in really. In that first meeting I just knew. But I said to them I can't come until January, I need my time off, I'm not budging on that, they nagged quite a bit and I said no. On Monday last week it was my seventh-year anniversary at CaseWare and I haven't looked back.

**CIARAN RYAN:** Congratulations.

**JODI JOSEPH:** I think the other thing that was attractive is I wanted to join a smaller business, where you could know everyone's name again. At private bank there were over 1000 people, everyone knew my name, but I didn't know all of their names. I also wanted to join a business that had some international connection. I had enjoyed my time travelling with Investec and learning to really be global, and with CaseWare being a reseller of CaseWare International's products, which is based in Toronto, it ticked that box as well. So it almost was like a perfect match and I am a fatalist, so I believe things just happen for a reason and I really haven't looked back since.

**"CaseWare expansion in Africa"**

**CIARAN RYAN:** One of the questions I wanted to ask you was your expansion path, you are expanding into Africa and I guess that is happening out of the Johannesburg office here, just explain very briefly how that's going.

**JODI JOSEPH:** We're focusing on English-speaking Africa and we are following a lot of the Adapt IT expansion, which to date has subsidiaries in Botswana, Namibia, Mauritius and Kenya. We are currently looking at expansion into West Africa and we follow the same South African model, focusing on the professional accountants and auditors first and then rolling out into corporate and public sector across Africa. It's been going very well to date and as those areas mature from a regulatory standpoint we are the right provider to solve their problems, as we have in South Africa.

**CIARAN RYAN:** Talk about the role of the chief financial officer and has it changed over the years, since you have been in that seat yourself, and just observing it perhaps from your seat in a smaller company.

**JODI JOSEPH:** I think it has really changed a lot, I think CFOs are under more pressure than ever before and I think it's for a variety of reasons. One, as I mentioned earlier, the regulatory environment in any industry, so even at Adapt IT, being a listed business and having other regulatory challenges, it just increases all the time from what I can see. The other challenge I see through our client base and through the CFOs that I work with, and being a technologist, to be honest, I think we still sit in 2020 where CFOs have not enabled their platform enough. I still see finance teams where month end is a crisis, year end is a crisis. I still see Excel too much, everyone is in Excel…

CIARAN RYAN: It's a great programme.

**JODI JOSEPH:** It's a great programme but it means it's not a click of a button, it means a human, expensive humans, very skilled CAs are still sitting producing spreadsheets output, they're still looking at historical information, rather than real-time or forward-looking information and I think that, together with the increasing demands and more complex businesses, business gets increasingly complex every year, whichever business you are in and the CFOs have to keep a handle on all of that. So I think yes it's very much more demanding than it's ever been and I think it's only going to get more demanding because of the rate of change, the rate of increasing demands. So if the CFOs don't enable their platform, I think also particularly in the South African environment there's such systemic corruption that the risk from the top to the bottom and across industries that we operate in, that to have any responsibility in the financial domain in South Africa today is a very hard role to take up.

**CIARAN RYAN:** Final question, have you got any good books that you would recommend?

**JODI JOSEPH:** I have been recommending this to everyone, so to recommend it in this format would be ideal, last year I read the book Being Mortal by Atul Gawande, and I think perhaps it's particular to my life stage but I think it changed my outlook on how we care for our aging parents, how we care for ourselves and how we care for our friends and community. It provides a real perspective on getting old and the role of medicine in how we age, and how medicine maybe prolongs life but doesn't give you better quality of life. I can honestly say that book changed a lot of the way I think, a lot of the way I interact with my staff on a daily basis and my friends and my parents. So if you are going to read one book, I would say read Being Mortal, it might change the rest of your life.

**CIARAN RYAN:** That's a great recommendation, thank you very much Jodi and thanks for coming into the studio, it's been fascinating talking to you.


**Ciaran Ryan**
Journalist for CFO talks, an online publication of SAIBA, member of IAFEI

# Taxing the digital Economy: A realistic goal for 2020?

## By Piergiorgio Valente, Chairman of the IAFEI Technical Committee

An ambitious project

New year. New resolutions.

From an international taxation perspective, the resolution to reach in 2020 is a clear and an urgent one: worldwide consensus on how to tax the digital economy. It is all but a new project, considering that the discussion started 5 years ago. But 2020 has been set as the landmark-deadline year to find a common solution. Indeed, there is no more margin and no excuse for extensions.

The business world knows well why. Uncertainty in taxation can be costly and is certainly risky. Since the rise of the international debate, in the context of the Base Erosion and Profit Shifting (BEPS) Project, many countries introduced local digital taxes, others are in the process of doing so and others wait for the international response. The burden is then on business to find its way through this complex puzzle, with many pieces missing and with further changes lying ahead.

On the one hand, there is wide agreement on the urgent need to reach international consensus on the matter. On the other, this is not reflected in the actual stance of many highly influential countries. It is therefore questionable if a consensus solution on digital taxation is a realistic goal for 2020. Yet this is still the plan, negotiations are at a peak and for the first time a unified proposal is on the table for discussion at the end of January 2020.

In this light, the present article provides an overview of the unified proposal suggested by the OECD secretariat to set the basis for a consensus solution by the end of the year.

<u>OECD's Unified Approach: Background</u>

As mentioned above, it was five years ago, in 2015, in the context of Action 1 of the Base Erosion and Profit Shifting (BEPS) Project, that taxation of digital business was officially identified as problem. It was also recognized that this problem merited to be studied independently from the BEPS project, because its implications go much beyond base erosion.

The tax revenue at stake is quite high and therefore countries' intention to compromise low; as a result, progress in the debate has been rather slow. 2018 saw, thus, an interim report by the Task Force on Digital Economy and then a number of country-initiated proposed solutions.

The Unified Approach suggested by the OECD in autumn 2019 seeks a compromise of these proposals to the extent they deal with allocation of taxing rights on digital business. To this end it underlines the points where minds worldwide seem to meet:
- First, it is recognized that in digital economy, some taxing rights should be granted to the market or user/consumer jurisdictions.
- Second, digitalization renders unnecessary physical presence for a business to generate income in a jurisdiction. Hence, a new nexus should be identified, focusing on economic presence.
- Third, the fact that physical presence has become irrelevant necessitates the identification of new transfer pricing rules beyond the arm's length principle.

In forming its proposal, the OECD also sought to take into account the need for tax certainty.

OECD's proposal shall be discussed at the end of January 2020 with the purpose to reach consensus on the main principles of the common solution for digital taxation. The details of such solution should then be worked on and finalized by the end of 2020.

1 OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

2 OECD (2018), *Tax Challenges Arising from Digitalization – Interim Report 2018*, Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

The Unified Approach: Brief Overview

Considering that the Unified Approach shall be the base for the discussion on the taxation of the digital, it is worth summarizing its key features, keeping in mind that many practical issues (e.g. tax rates, remain open questions).

First, in terms of scope, the new tax rights are suggested to apply to consumer-facing businesses. This would include (i) business that exploits new technologies to remotely interact with users/consumers as well as (ii) any business that has a "consumer-facing element", i.e. markets its products or provides services to consumers. The rationale of the approach is that user engagement is important for value creation in all these cases. Where this is not the case, the business may be considered out of scope (extractive industries, e.g. oil and gas).

Second, the relevant factor for a business in scope to be taxable in a jurisdiction (nexus) should be related to the income such business is generating from that jurisdiction. In other words, economic presence would substitute physical presence for the business in scope. This recognizes that income can be generated remotely. But this does not imply that the jurisdiction of the (potential) user/consumer has not contributed to its generation. It is the jurisdiction that ensures the infrastructure for users/consumers to be users/consumers and should be fairly remunerated for that.

Third, transfer pricing rules should be adopted to the new context, i.e. to the potential absence of physical presence. This means that they should be maintained to the extent they can apply to routine transactions and new rules should be agreed for transactions not reasonably covered by the existing rules. These new rules should require:

(I) A certain part of the business profit that remains after calculation of the profit from routine transactions to be taxed in market jurisdictions;

(II) Market jurisdictions would also have taxing rights over the income generating activities of the business there.

To ensure tax certainty, targeted dispute resolution mechanisms should ensure smooth and effective resolution of any disputes between the taxpayer business and the market jurisdiction.

Recent developments and conclusion

To conclude, the Unified Approach is a remarkable work by the OECD, seeking to promote an acceptable response to the burning question of taxation of the digital. It is an important step and provides an opportunity that should not be missed.

In view of the upcoming discussion at the end of January, tensions have apparently risen worldwide. The harsh exchanges between the US, France and the OECD are telling in this respect.

Yet this should not lead to losing sight of the big picture. Missing the opportunity for a common solution would undoubtedly lead to a lose-lose situation for all parties to the debate. While a compromise cannot be ideal for no one, the lack of a compromise will harm everyone.

It is critical that political leaders around the world find the way to an agreement this time.

**Piergiorgio Valente**
Charmain, IAFEI International Tax Committee

3 OECD (2019), *Secretariat Proposal for a "Unified Approach" Under Pillar One*, Public Consultation Document, 9 October 2019 – 12 November 2019, OECD Publishing, Paris.

4 T. Franck, CNBC, *Treasury Secretary Mnuchin warns of new global taxes, opposes digital services duty*, 4 December 2019.

# IAFEI Partners

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