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IAFEI QUARTERLY

42nd Issue | 2018 October

Augmented Finance
Are You Building a Data-Driven Advantage?

CFO Global Survey

WITH HIRING THEIR TOP CONCERN, FIRMS INCREASE SALARIES

Vietnam, COSO Literacy: A Must for Today's CFO

Germany, The CFO of Siemens: "We create entrepreneurial freedom"

INTERNATIONAL ASSOCIATION OF FINANCIAL EXECUTIVES INSTITUTES

LETTER OF THE CHAIRMAN

Dear colleagues,

we are approaching the 48th IAFEI World Congress. This important Event, will be held this year in Ho Chi Minh City on the 15th and16th of November. I take this occasion to sincerely thank the Institutes of Vietnam and Japan that jointly organized the most important annual event of the association for the 2018.

The theme of the Congress "Transforming Finance in the Digital Age" will offer the occasion for a comparison and an exchange of experiences on topics of great actuality such as, Cyber-security, Block-chain Technology, Artificial Intelligence, that are today at the first places in the agenda of the CFO's of all companies around the world.

The IAFEI World Congress , that returns in Asia after four years and for the first time in Vietnam, during the celebration for the 10th Anniversary of CFO Vietnam, will give the opportunity to the attendees, to analyze the growth of the Asian economy, that continuously leads the growth at the worldwide level, with higher rates of the ones of Europe and America. It will also focus the attention on the state of the global economy, unfortunately influenced, in this historical phase as well, by events and unfavorable political decisions for the international trade.

On the preceding day of the Congress, the customary annual Board Meeting of IAFEI will take place, and among other items, will handle the nomination of the IAFEI's Executive Committee for 2019.

After a three year old fascinating experience, I will leave the Presidency of IAFEI and pass the leadership to the present Vice Chairman and colleague Eduardo Francisco from the Philippines.

I take the opportunity, offered by this editorial, to thank all the Institutes members of IAFEI, for the cooperation and the trust given to me, and the colleagues of the Executive Committee, for the support they have granted to me in these three years.

Rest assured that, I have undertaken a lot, I have done my best to bring my contribution of knowledge and experiences for the improvement IAFEI, your association, that next year will celebrate its first 50th anniversary.

I have certainly not succeeded in reaching all the objectives that you and I were looking for, but rest assured, I have tried my best.

Long life to IAFEI!!!

Fausto Cosi
IAFEI Chairman

LETTER OF THE CHIEF EDITOR

Dear Financial Executive,

You receive the IAFEI Quarterly XLII nd Issue.

This is another issue of the IAFEI Quarterly, the electronic professional journal of IAFEI, the International Association of Financial Executives Institutes.

This journal, other than the IAFEI website, is the internal ongoing professional information tool of our association, destined to reach the desk of each financial executive, or reach him, her otherwise, at the discretion of the IAFEI member associations.

This issue is the twelfths one under the regime of the New Start for the IAFEI Quarterly. This new start has been backed up by the IAFEI Board of Directors decision of October 13, 2015, to establish an Editorial Board consisting of now ten IAFEI representatives from all continents.

This issue includes the "Survey of CFOs across the World, for the 3 rd Quarter 2018" , and articles from three continents on a very broad range of finance and economic subjects.

More IAFEI member associations should contribute articles to the IAFEI Quarterly.

Therefore I repeat our ongoing invitation, to all IAFEI member associations, and to each of their individual members, to send us articles for inclusion in future IAFEI Quarterlies,

With best personal regards

Helmut Schnabel
Chief Editor

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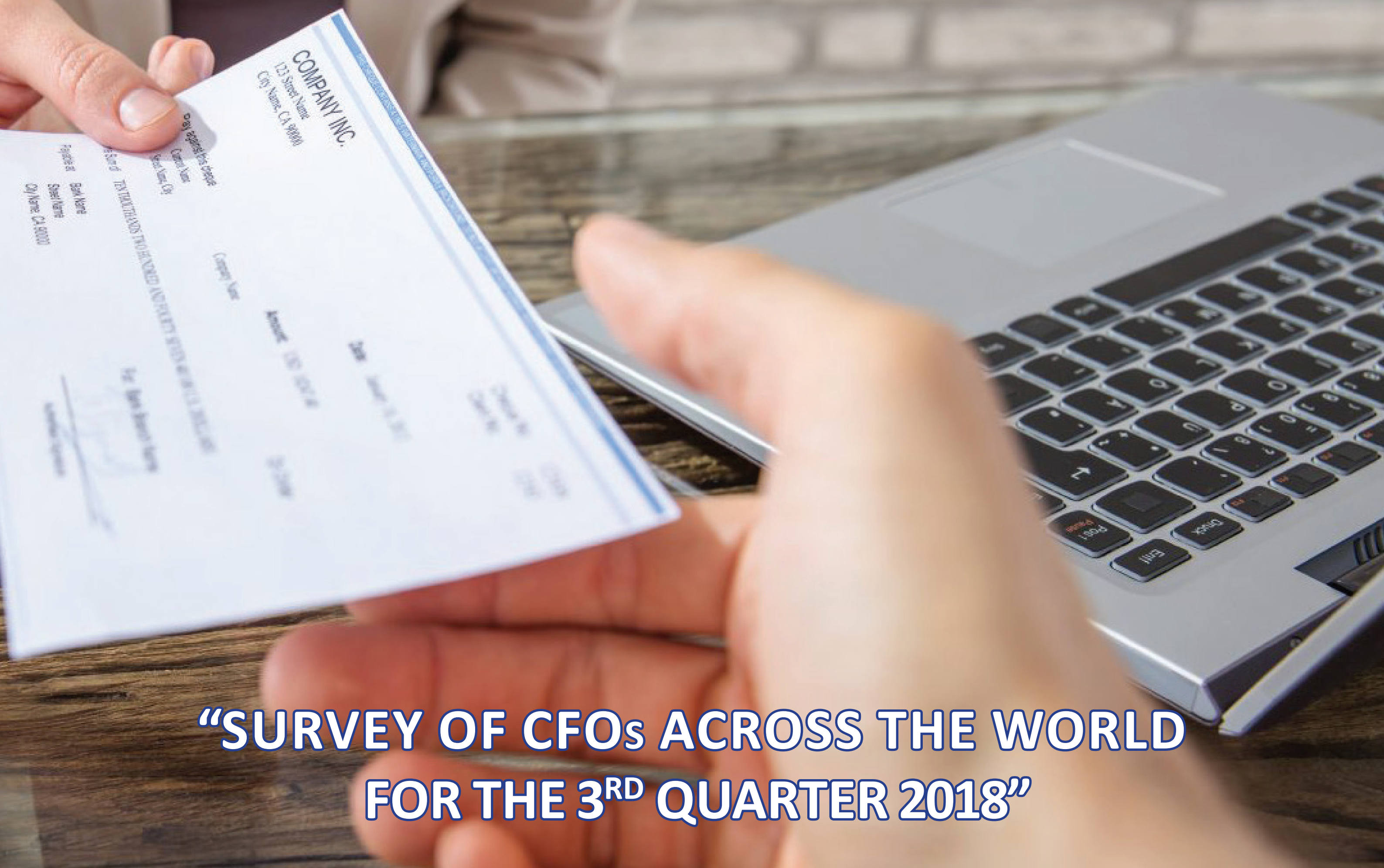


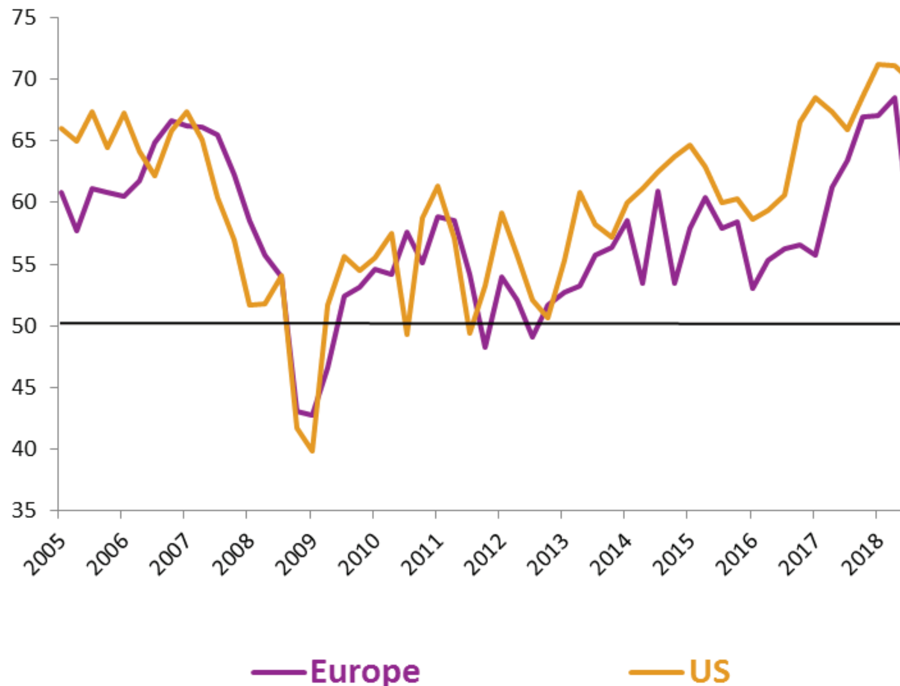
"SURVEY OF CFOs ACROSS THE WORLD FOR THE 3RD QUARTER 2018"

WITH HIRING THEIR TOP CONCERN, FIRMS INCREASE SALARIES

By **IAFEI** and a Group of Partners, among which **Duke University**, Durham, N.C., USA, **Duke The Fuqua School of Business**, and **Grenoble Ecole de Management**, France. The Survey was running from 22nd August to 6th September, 2018

Optimism Remains High in the US but fell in Africa, Europe, and Latin America and held steady in Asia.

With hiring their top concern, many firms increase salaries to improve their chances of hiring and retaining workers.



THE INDEX INDICATES STRONG GROWTH IN THE US BUT A SLOWDOWN IN EUROPE.

The Optimism Index about **the U.S.** economy declined to 70 this quarter, compared to an all-time high of 71 last quarter, on a 100-point scale. CFO optimism about their own firms' financial prospects increased to 71.4, the highest level since 2007. The survey's CFO Optimism Index is an accurate predictor of future hiring and overall GDP growth.

Optimism in **Europe** plummeted to 58 this quarter, down from 68 last quarter. Optimism is about 50 in the **U.K.**, **Italy**, and **Spain,** while optimism remains 60 or higher in **France**, **Germany**, and the **Netherlands**. Capital spending and employment are both expected to grow about 2 percent over the next year. The top concern among European CFOs remains attracting and retaining qualified employees, edging out economic uncertainty and regulatory and government policies. Among firms that list hiring challenges as a concern, 52 percent of European companies indicate they have increased wages to attract and retain workers, 34 percent have increased HR budgets, and 17 percent have increased vacation and flex hours. In contrast, 42 percent of companies say they have not made any changes to attract and retain employees. European firms adversely affected by the trade situation expect to reduce employment and capital spending by 4 percent.

Optimism in **Asia** held steady at 60 this quarter. More than half of Asian CFOs listed economic uncertainty as a top concern. Other concerns include employee productivity, difficulty attracting qualified employees, and rising wages. Capital spending is expected to grow about 5 percent, and employment 3 percent, over the next 12 months. Among Asian firms that list difficulty hiring as a top four concern, 65 percent indicate that they have increased wages to attract and retain workers, 45 percent are targeting new groups of workers (such as retirees), 39 percent have increased HR budgets, and 34 percent have increased vacation and flex hours. Asian companies adversely affected by trade wars will grow capital spending more slowly and reduce their number of employees.

Overall **Latin American** optimism is 56 this quarter, on a scale of 0 to 100. The Optimism Index is 70 in **Mexico**, 64 in **Chile**, 62 in **Peru**, 52 in **Brazil**, and only 37 in **Ecuador**. Economic uncertainty is the top concern among Latin American CFOs, with 65 percent of firms listing it as a top-four concern. Other concerns include government policies, currency risk, and weak demand. Capital spending is expected to grow 1.4 percent and employment 2.6 percent over the next year. Among Latin American firms that have been adversely affected by trade wars with the U.S., employment is expected to increase 0.8 percent over the next year.

Compared to other regions, few Latin American companies indicate that they are taking specific steps to attract and retain workers, with 43 percent saying

they have not adopted any new strategies. Twenty-nine percent indicate that they have increased wages to attract employees. Nearly two-thirds of firms in Peru say that recent judicial corruption cases will lead their firms to slow down and/or reduce investment.

Business optimism in **South Africa** fell to 38 this quarter, down from 51 last quarter. **Nigerian** optimism fell to 48 from 54. Employment should fall about one percent in South Africa and increase about one percent in Nigeria over the next 12 months. Median capital spending will remain flat in South Africa, and increase nearly 10 percent in Nigeria. African CFOs are most concerned about governmental policies, economic uncertainty, weak demand, currency risk, and access to capital. Among African firms adversely affected by trade wars, employment is expected to fall by 5 percent. Forty-one percent of African firms have increased wages to attract and retain workers.

TIGHT LABOR MARKET IS TOP CONCERN

In the US, the proportion of firms indicating they are having difficulty hiring and retaining qualified employees remains near a two-decade high, with 41 percent of CFOs calling it a top concern. The typical U.S. firm says it plans to increase employment by a median 3 percent in 2018 and expects wages to increase 4 percent on average. The tight labor market continues to put upward pressure on wages and wage inflation is now a top five concern of U.S. CFOs.

Employees are willing to leave their jobs for greener pastures. Over the past 12 months, U.S. CFOs report they had to replace 14 percent of their workforces, compared to 13 percent turnover in 2016.

Among companies that list hiring as a top concern, 56 percent say they have increased salaries to improve their chances of hiring and retaining workers; 31 percent say they have increased HR budgets to better advertise positions; 29 percent have increased vacation or flex hours; and 21 percent improved health care benefits.

Wage growth should be strongest in the tech, transportation, and service/consulting industries. U.S. companies expect the prices of their products to increase by more than 3 percent over the next year.

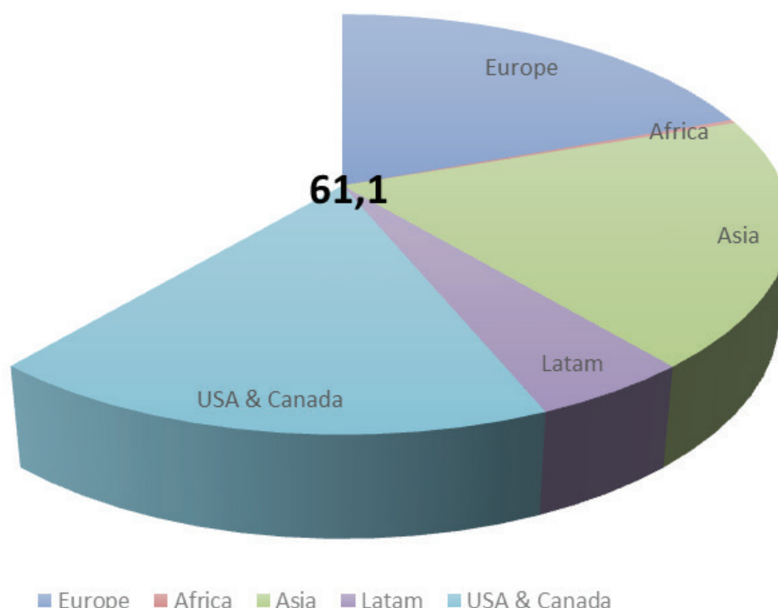
FAST PACE OF CHANGE SHORTENS PLANNING HORIZON

The fast pace of technological change and the economic environment is hampering the ability of companies to plan for the future.

U.S. firms indicate that five years ago they could effectively plan 3.5 years into the future. In the current environment, they say they can only plan 2.3 years out. Coincident with this shorter planning horizon, CFOs indicate the projects they adopt now have an expected life of 4.6 years, compared to a 6.2-year life for projects they initiated five years ago. Some CFOs said they would hesitate to buy a machine that will likely be obsolete within a few years. If companies hold off on investing because of the fast pace of change, with new investment becoming obsolete quickly, this may damage long-run growth prospects for the overall economy.

This accelerated obsolescence is on top of widespread concern that pressure to hit quarterly earnings targets leads to short-termism among public companies. The survey found the shortening of planning horizons is even more severe among private firms than public companies.

Other regions of the world have experienced similar or greater reductions in the planning horizon compared to the 1.2 year reduction in the U.S. Over the past five years, the planning horizon has fallen by 3 years in Africa, by 1.3 years in Europe and Latin America, and by 1.2 years in Asia.



TRADE WARS

U.S. companies are evenly split about the effects of ongoing tariffs and trade wars. Firms that say they have been negatively affected plan to reduce their capital spending by 6 percent due to tariffs and trade wars, compared to a 5.7 percent increase averaged across all firms.

The trade situation is also negatively affecting companies elsewhere in the world. African, Asian, and European firms adversely affected by the trade situation say they expect to lay off employees in response.

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

	Europe	Latin America	Asie	Etats-Unis
Economic uncertainty	**35.4**	**64.5**	**52.3**	**21.2**
Currency risk	18.9	38.7	27.0	5.0
Weak demand	18.9	35.5	16.9	10.8
Government policies	29.9	39.8	16.2	31.5
Access to capital	13.4	19.4	14.6	11.2
Regulatory Requirements	33.9	18.3	12.3	27.4
Difficulty attracting / retaining qualified employees	**36.2**	**16.1**	**33.5**	**53.1**
Employee productivity	18.1	26.9	34.7	19.1
Rising wages and salaries	7.9	1.1	27.1	28.2
Employee morale	**22.8**	**7.5**	**11.8**	**11.6**
Cost of borrowing	3.1	20.4	14.9	11.2
Data security	21.3	14.0	11.4	27.0
Geopolitical / health crises	15.0	6.5	8.6	5.4
Deflation	1.6	1.1	0.0	0.0
Rising input or commodity costs	10.2	14.0	13.6	22.0
Cost of benefits	4.7	12.9	2.8	27.4
Corporate tax code	5.5	19.4	3.5	9.1
Inflation	2.4	11.8	10.0	10.0
Other	8.7	3.2	13.9	7.9

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	Latin America	Asie	Etats-Unis
Revenue	**3.8**	**8.9**	**6.7**	**7.5**
Inflation (Change in prices of own-firm products)	1.2	3.8	3.6	3.0
Capital spending	**1.5**	**1.4**	**4.6**	**5.7**
Technology spending	**4.8**	**4.8**	**4.1**	**6.3**
R&D spending	2.9	3.7	3.8	2.7
Advertising and marketing spending	1.0	3.9	2.5	3.6
Employment – full-time	1.6	2.6	3.5	3.9
Wages and Salaries	2.2	4.4	4.3	4.8
Health Care Costs	0.7	7.7	2.4	7.8
Earnings growth	3.3	4.9	14.2	11.0

About the survey:

About the survey: This is the 90th consecutive quarter the Duke University/CFO Global Business Outlook survey has been conducted. The survey concluded September 7, and generated responses from more than 800 CFOs, including nearly 260 from North America, 65 from Asia, 128 from Europe, 352 from Latin America and 41 from Africa.

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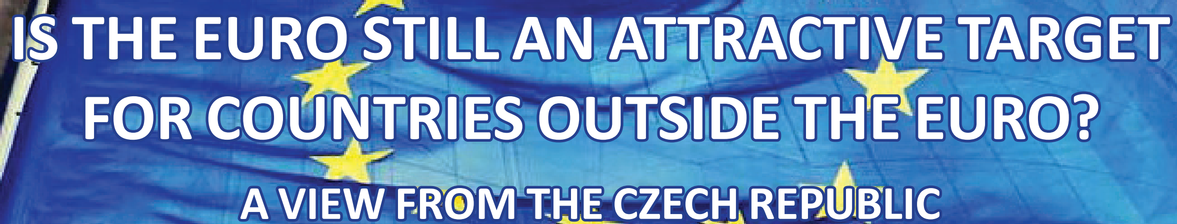
DUKE CFO GLOBAL BUSINESS OUTLOOK



IS THE EURO STILL AN ATTRACTIVE TARGET FOR COUNTRIES OUTSIDE THE EURO?

A VIEW FROM THE CZECH REPUBLIC

SPEAKING POINTS BY **MR. MOJMÍR HAMPL,** VICE GOVERNOR OF THE CZECH NATIONAL BANK, AT THE CONFERENCE "ARE WE ON THE VERGE OF A NEW EURO CRISIS?", COPENHAGEN, DANMARK, 4 SEPTEMBER 2018

Ladies and gentlemen,

Good afternoon. First of all, let me thank Lars Christensen for his kind invitation to speak here today in front of such a distinguished audience. It is really an honour for me and I am also glad to be in Copenhagen again.

In this talk I will try to shed some light on what appears to be a puzzling attitude of some new EU member countries towards the common currency.

I will use the example of my home country, the Czech Republic. It entered the EU in 2004 and has no opt-out from euro adoption, so legally we are obliged to join and to make every effort to enter the Eurozone as soon as possible.

Yet no major political force in our country pushes for euro adoption at the moment. Talks about joining the Eurozone are simply not part of the political agenda, and we now have a fourth or so government in a row declaring that this issue will be left "for the next government after the next elections" - so it is being postponed to political infinity. The antechamber for euro adoption, the ERM II, is not being considered either. And this approach has the full backing of the central bank.

Ten years ago, supporting euro adoption in our country was a sign of "good social morals among the better classes", whereas today only the brave confess to ardently supporting it. That's how much the mood of the elite and the electorate has changed over the last decade. Why is that so? Here my seven personal comments come into play.

The euro and political union

A stateless monetary union is inherently unstable. A currency is usually a consequence, not a cause, of the establishment of a state. In Europe, however, we began to build the "currency house" from the roof down, and then in 2008 everyone was very surprised at how the tiles flew off when the first wind appeared. Is there a prospect of a political union - a single European state - in the pipeline? Even if there is, do we want to be part of it? If the question is no, which would seem to be the case, thoughts of introducing the euro in the Czech Republic should, for that reason alone, be left on the back burner.

Autonomous monetary policy

Autonomous monetary policy is a kind of "absorber" of economic shocks. It is meant to reduce their impact and smooth the economic cycle. It prevents an economic contraction being borne by the unemployed and those on low incomes more than is necessary. Certainly, the more flexible is your economy (in terms of public finances, the labour market, and so on), the easier it is to cope with shocks and the less monetary policy is needed. However, the case of the Eurozone shows how tricky it is when the absorber in the form of monetary policy is switched off and nothing replaces it. The shocks are bigger and hurt

more. Listeners themselves can answer the question of whether the labour market and labour law are likely be made more or less flexible (and dismissals made easier) in the future. In doing so, they will answer the question of whether there will be a need in the future for more or less domestic monetary policy in the Czech Republic, a country whose conservative population is so averse to upswings and downswings.

The "convergence trilemma"

The standard "monetary trilemma", which you know very well (a country cannot simultaneously have a fixed exchange rate, an open capital account and autonomous monetary policy), is accompanied in a converging economy of our kind with something I call the "convergence trilemma". No country can simultaneously have high convergence growth, a fixed exchange rate, and low macroeconomic imbalances, be they internal or external. In our case, catching up with our wealthier, low-inflation Western peers means a long-term tendency for our currency to appreciate. This is hardly consistent with a permanently fixed exchange rate.

The paradox of the Eurozone

The Eurozone paradox is that the best possible members of the club are the countries that are so stable themselves in monetary and economic terms that they don't need "to buy in stability and credibility". Such countries have fewer and fewer reasons to adopt the euro. Conversely, the more a country begs to have the euro, the bigger the problem it will represent. This explains why almost no one is conducting a euro debate in Sweden, even though it does not have a derogation and many would like to see it in the Eurozone. Canonically, the same goes for us: either we can continue to stabilise ourselves, in which case we don't need the euro, or we will destabilise ourselves, but in that case we will potentially harm others in the euro club and Eurozone membership will be a hindrance in bad times.

There's no story in our case

The Baltic states took the euro as a geopolitical and security safeguard and paid an economic price for permanently fixing their currencies to it. Slovenia wanted to cut itself off from the Western Balkans. Slovakia wanted to seal the reforms of former Prime Minister Mikuláš Dzurinda. Germany gained unification in exchange for the euro. The southern countries (Italy, France, and Spain) gained the stability of the German mark because they were unable to create such a currency at home. And those who were tied to the German mark long before the euro was created (Austria and the Netherlands and Denmark for that matter) simply remained bound to Frankfurt after the Eurozone was established, only the Bundesbank building was replaced all of a sudden by the ECB building. There's no basic euro story like this in the Czech Republic. Why should we try to create one artificially? Our story is one of maintaining monetary stability across regimes and governments and of keeping the koruna as the name of our currency continuously since the time of Emperor Franz Joseph (his monetary reform established a new currency - the crown, or koruna - throughout the Austro-Hungarian Monarchy in 1892) regardless of totalitarianism and the horrors of the 20th century. Neither the Nazis, nor the Communists had any tendency to rename the currency and kept this old monarchist name despite otherwise changing basically everything, and for the worse. Our country - unlike the rest of Central Europe - has never experienced hyperinflation in its modern history, and this monetary stability has always served the entrenched mentality of small Czech savers well. Domestic scepticism about the euro: that's our authentic Czech story.

The Prague-Copenhagen connection

I have to add with some bitterness that many in the Czech Republic like having their own currency but not necessarily their own monetary policy or their autonomous central bank. This magical contradiction can be seen in the pleiad of ostensibly conservative political opponents of the euro in the revitalised euro debate. In one breath they say that we should not adopt the euro - so that we can keep our own currency and hence retain the ability "to weaken the koruna in bad times" - and then criticise the Czech National Bank for doing exactly that in the bad times of 2013. They then happily add that Greece would have benefited from having its own currency and that Germany is profiting from the euro being weaker than the Deutschmark would have been. The same, however, doesn't go for the Czech Republic after 2013. These endearing inconsistencies are present throughout the population. Here again, however, the Eurozone and its satellites offer parallels. You in Copenhagen have a fixed exchange rate against the euro (and previously had a fixed rate against the mark) and thus in effect "buy in" monetary policy from Frankfurt. You have your own notes and coins but not your own monetary policy. Note this fine "Scandinavian paradox": you have an opt-out from the euro following the 2000 referendum, yet you do not make your own monetary policy, nor did you before the euro was created, whereas the Swedes do not have an opt-out (although they have been trying not to fulfil the criteria and not to join ever since rejecting the euro in their 2003 referendum), yet they pursue autonomous monetary policy. I sometimes wonder whether the Czech sitting-on-the-fence approach is heading towards the Danish model. It wouldn't be my choice, but it's good to be prepared.

The price of entering goes up, or the Bulgarian thorny road to the euro

Yes, some new EU members are still keen to join the Eurozone. Especially in Bulgaria, the desire is understandable: the country has held a fixed exchange rate visa-à-vis the euro since the common currency's inception. Just like Denmark, Bulgaria has outsourced its

monetary policy to Frankfurt, but unlike Denmark, it would also like to become an official member of the club to enjoy all the benefits of using one of the most prestigious world currencies. On paper, at least, Bulgaria appears to be an ideal candidate: unlike many of the current members of the Eurozone, it actually fulfils the key Maastricht criteria. But the idea of Bulgarian membership is not an appetizing one to many technocrats at the ECB and to the representatives of some Eurozone member states. So, for many years, Bulgarians have been tacitly discouraged from applying to ERM II, the antechamber of the euro. This year, however, they tried their luck: perhaps they felt that the conditions would never get any better than under Bulgarian presidency of the EU and Jean-Claude Juncker's vocal emphasis on how the euro should become the currency of the entire Union. Complicated negotiations followed, and their result is of key importance to all EU member countries outside the Eurozone. It's not enough that Bulgaria fulfils the important Maastricht criteria: new criteria were thought up specifically to make the Bulgarian path to the euro as difficult and humiliating as possible. Prior to entering ERM II, Bulgaria has to join the Banking Union, pay its share in the ESM, and let the ECB conduct a deep audit of its financial sector. In other words, it has to pay all the costs of Eurozone membership many years before it becomes a member - and without any assurance that it will be accepted to the club at all. Crucially, in line with the principle of "equal treatment", in the future all countries wishing to enter ERM II are expected to follow these humiliating conditions. Well, in my eyes, that provision practically closes the door to euro membership for countries such as the Czech Republic: it is difficult to imagine how any government with a trace of honour left would choose for the country to go through such an ordeal.

In sum, I would say that the pragmatic Anglo-Saxon approach of "if it ain't broke, don't fix it" suits the Czech Republic and other Central European countries well on the point of independent monetary policy. In the case of the euro, it holds true here more than anywhere else that we are not rich enough to afford to repeat the potential mistakes of others. We make enough of our own.

Thank you for your attention.

"WE CREATE MORE ENTREPRENEURIAL FREEDOM"

THE CFO OF SIEMENS, **DR. RALF THOMAS**, ABOUT THE "VISION 2020+", THE REACTION OF THE CAPITAL MARKETS AND THE TRADE CONFLICT OF THE USA WITH CHINA

FROM BÖRSEN-ZEITUNG, FRANKFURT AM MAIN, GERMANY,
AUGUST 4, 2018, ARTICLE PROVIDED BY GEFIU, ASSOCIATION OF CHIEF FINANCIAL OFFICERS GERMANY, THE GERMAN IAFEI MEMBER ASSOCIATION

Dr. Thomas, does an exacerbating trade-conflict between the USA and China threaten the business objectives of Siemens?

A trade-conflict between these two countries would be damaging the entire world economy. Especially in the area of capital goods such global political uncertainty with potential tariffs are an inpediment for the investment climate.

How big is the danger of an escalation?

Experience is telling us that not everything will be executed exactly as announced. It is sometimes not even so easy to implement things which can be written relative quickly by way of the famous 280 twitter characters. Therefore, it is my hope that politics will well evaluate the significance of such great decisions. In spite of this and because hope is not a strategy: Siemens has to be prepared – and we are as best as possible.

What are the possibilities of the group?

Companies like Siemens have the advantage that they have not concentrated their value added chains at only one location. By way of our world wide production network, we have alternatives for the supply chains and for taking back or intensifying the focal points of our value creation.

For instance?

Take Siemens Healthineers for example, they have the possibility to supply a computer tomograph either from Forchheim in Bavaria to the USA, instead from China. This is a relatively simple solution. Therefore, we can steer capacities accordingly, in order to react to a specific demand situation. But one must not view this naively. There are developments in such conflicts which are outside our own sphere of action.

Which effect has Siemens already felt?

So far, there have not been negative material influences. Also through such steps, which the two countries have announced so far, we presently see no material threats for Siemens. The worry for our group is rather that important customers might be impacted in qualitatively high value industries like the automobile industry. There tariffs would interfere with the established logistic chains which go along with fine tuned quality securing processes. Which effects beyond the economy are you seeing? Tariffs would naturally increase the cost basis, and this leads to lower demand. The question then is: Who can afford a consumer product and who will not any longer? This would lead to futher political polarization which we, here in Germany, know best, unfortunately.

For the entire German economy, China is a growth motor. How strongly would Siemens suffer if the Chinese economy were to be dampened?

Indeed, the country is playing an important role for the export nation Germany. On the other hand, China has launched several projects with its Silkroad-Initiative which the country perhaps might intensify, should the trade conflict escalate. However, my worry is less related to the large industries which must eventually adapt themselves in a painful way, but rather especially related to the medium sized enterprises. These are sometimes extremely depending on a single customer which is located in one of the economic areas.

After its presentation on Thursday, August 4, 2018, the Vision 2020+ has failed at the stock exchange. Are you disappointed?

First of all, one must state that our share price had already developed quite well before that. Therefore, the notion “disappointment” would be an overdimensional notion for my emotional situation. Naturally, it is always like that: one does wish for a euphoric acceptance of good ideas that have been worked upon for a long time. However, me being a rather pragmatic person, I did not expect this.

Why?

Three brief news being totally unmistakable and even positive, can easily generate euphoric reactions. However, we cannot offer this simplicity at this point in time because we are a group with a widespread global value-chain which is active in many interesting markets. It would have been an illusion to believe, that there is a very simple way to do things even better. Because the easy things, we have already ticked off.

Why at all is Siemens trying just now to change itself with Vision 2020+?

We are acting out of a position of strength. Because we have achieved much with the Vision 2020+. A while longer, we could have applied the advantages which the concept is bringing along with itself. In spite of this, it is right to say that one takes care of the roof of the house at best when the weather is good, and not only when waiting for the rain. This is also important for the reason that some things need that time for preparation, before they be implemented. In so far, I am also not disappointed by the reaction of the capital market, but I feel myself motivated to find out where problems of understanding can be found eventually. At the end, it is an extensive program which one can hardly present completely in two hours.

What is the core, then?

We create even more entrepreneurial freedom for our businesses which these then have to utilize, however. On the other hand, this freedom makes it impossible to communicate a central message across the divisions in a uniform way. Therefore, we want to allow our operating companies to present their specific approaches to strategy and market with an extensive capital market day in the first half year of 2019.

Can the reaction of the investors be fed by the way, that the Vision “2020+” is welding the status quo into a structure, but otherwise is only creating options?

From my point of view, it is a quality as such to open up for oneself manouvering rooms, or “optionality”. Another step is how to utilize them, then. But to create the prerequisites for them is a real luxury for someone like me who has been in the business for so long. Often, I have already seen that due to a lack of ex ante opened manouvering rooms, in the situation the clear recognition what has to be done, is not any longer sufficient, because one cannot turn around the helm quickly enough. Also the Siemens history in the telecommunication business has shown this clearly.

However, the public would rather like to know which future the management is imagining for the group.

Sometimes it is good not to decide too early, because then one can include developments which cannot be anticipated, into the decision. Because one must always evaluate well how the framework conditions are changing before one is applying an option. In spite of all and at the end, it is about decisions which we have made against the backround of special uncertaincies. However, the expectation has been that we say more than what we can really say. But this doesn't make me nervous because the optionality has been created.

Everywhere in the strategic and operating companies, new group functions have to be built for the "Vision 2020+". Isn't the concept not too expensive?

This is no law of nature. The management of the operating enterprises receives a certain advance credit of trust. We are expecting that the teams do the right things for their respective business.

In spite of this, it can become expensive.

With the "Vision 2020+" we move the switches towards growth. Synergies do not create growth, focus does it, however. And this also relates to the "administration": Many procedures which one had bundled in the past because of their scalability, can be organized with modern technologies and without additional cost today, in such a way, that they can be worked off in a decentralized way adapted to specific businesses. Not any longer, the question is now: How do we make it as favourably as possible? But especially: How we are doing it right?

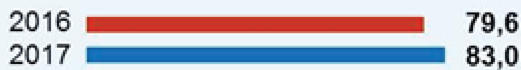
The Healthineers sub-group has already declared that more jobs have been created in Germany for the reason that group functions had to be established. Therefore once more: Will the Siemens overhead be decomposed in many smaller overheads, which – as a sum – are even larger than the corporate headquarter so far?

Because of its legal independence, Siemens Healthineers must build up certain group managing functions. This is clear. I am convinced that the management team will not erect a "Mini-Siemens". They will create the right structures for their business necessities.

Siemens at a glance

Group Numbers
Business Year ending September 30, 2017

Sales in billion €

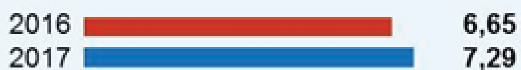


2016 79,6
2017 83,0

Profit Margin in %

2016 10,8
2017 11,2

Earnings per Share* in €



2016 6,65
2017 7,29

Net Debt in billion Euro

2016 19,0
2017 22,6

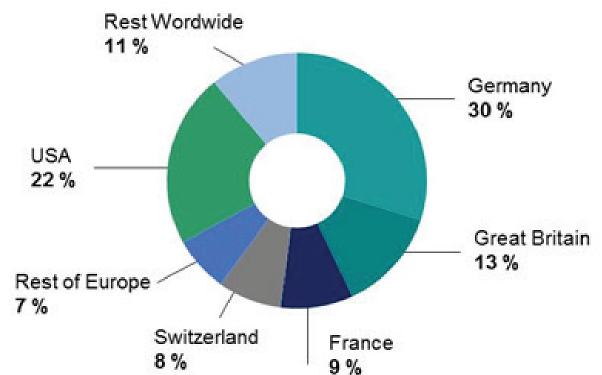
Rating

Standard & Poor's	**A+/stabil**
Moody's	**A1/stabil**

* diluted

SIEMENS

Shareholders by Regions, Countries



Market capitalization
Status October 24, 2018
85.0 billion Euro

Source: Corporation, Thomson Reuters

In future, the Siemens divisions are responsible for taking care of the business in the countries. Thereby, will a substantial new sales administration be created?

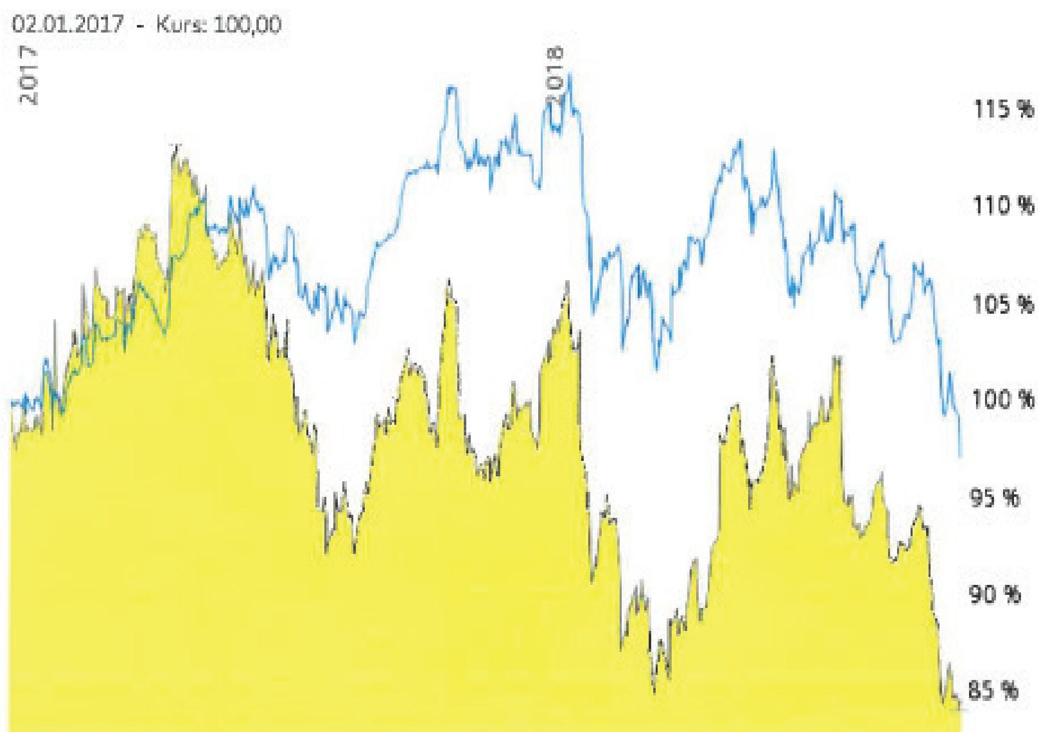
No. It is exactly the other way round. We have looked into the countries and have identified which of the operating companies have already established the strongest representation. This division is then also responsible for developing the access to the market. Most of the time this one of the operating companies, Digital Industries and Smart Infrastructure. Over the medium term, the country-CEOs will drive the most important business locally, but nevertheless, they will represent the entire Siemens-Group. This is also important because of cost considerations.

Siemens AG, 100,00 Euro Share Price as of October 24, 2018, German Stock Exchange Xetra

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

-Black line: Siemens AG Share

-Blue line: DAX German 30 Companies Large Cap Stock Index



Siemens wants to open new business areas with the "Vision 2020+". How much money is available for this?

One has to start the other way around. Everywhere, where a strong growth potential with an edequate profit pool or even a paradigm shift is to be seen – which Siemens can utilize better than other corporations – we are looking at investment possibilities. Also enterprises belong to this. Here, the hurdle is high as the existing value creation has to be pushed to a higher level. This is difficult for the reason that in many businesses also beyond the digilization and automization we are already very well on our way. As an example: The businesses railway or building technology are especially profitable.

Including the depreciation from aquisitions of corporations (PPA-effects) to the operating margin of Siemens, then the margin is stagnating since years. Is the result that good as it is always stated?

The earnings are strong. Taking out the PPA-effects which are created by purchasing corporations, is not a camouflage but a service-contribution to the capital-market in order to give a clear view at the operating performance capacity. By the way, it is not so that after the PPA-effects we do not have a better result. Because the earnings per share, which reflects the total earnings, has increased significantly in the past years.

Does Siemens purchase the software-corporations too expensively?

We are paying the customary multiples. For us, the advantage is to quickly scale up such corporations which are technologically brilliant but have a moderate size. At every single acquisition we do screen the proposal before. Then, you naturally only see what has been approved.

The objective for the return on the employed capital remains valid, but attaining it is being deferred endlessly. Doesn't feel it as an oath of manifestation for a CFO?

I do not see that in that way at all. We only make transparent that a ROCE of 10 to 15 % is not possible over the short-term because of our present portfolio activities. All target numbers of the "Vision 2020+" are related to the entire business cycle. So, there will always be situations in which one cannot attain individual objectives….

…. the cycle is not so bad presently.

The cycle is good, but yes, we have attained our target margin for the capital return in the first two quarters of the business year, naturally with special effects. Secondly, we do not want to block our long term perspectives. It would be illusory to believe that transactions like the planned combination of Siemens Mobility and Alstom would increase the capital return at the beginning. But after three or four year, they will do. We also make this transparent at each announcement. So it is important that the perspective is right. The strongest value driver is always growth. In addition, we now emphasise even stronger the free cash flow.

Are you satisfied with your share-price over the medium-term?

In the last five years, Siemens has moved on a sustainable direction of value-generation for our shareholders. We have steadily driven up the dividend. We have combined this with share-buybacks, even though not everybody in Europe likes that. I am asking investors at every location what we can improve in order that they would invest more money into Siemens. From most of them I am hearing: Continue on that unagitated and consequent way. An analyst got to the heart of it: "Be successfully boring for another ten quarters" – So, we are continuing to define for ourselves challenging objectives and we pursue them consequentially and in a sustained manner.

The interview was conducted by Michael Flämig.

<u>About the person</u>

Clear Perspective

Praise is a beautiful thing. The one who will get it on open stage and even by the boss, can be particularly happy. For Ralf Thomas this is quite routine. Because the Siemens-CEO Joe Kaeser utilizes many occasions to express his appreciation for his CFO on the side.
Presenting the "Vision 2020+" on the past Thursday, this happened again. Kaeser was wittily attesting Thomas – sitting on stage with an eye-cover after a medical intervention – that he has a sharper view with one eye than most other humans with two ones.
Thomas (57) has a clear view, no doubt. The special charges of failed projects are not a large theme anymore for Siemens, since he has taken care of it. The manager, who has a clear Siemens-career and who became member of the managing-board in 2013, has worked off excellently the chain of spin-offs, mergers and IPO of medicine technology Healthineers including balance sheet upheavels. The industry manager and administrator knows how to structure working processes efficiently, he sees himself as a "process-junky". Now it is all about executing the "Vision 2020+".

AUGMENTED FINANCE ARE YOU BUILDING A DATA-DRIVEN ADVANTAGE?

BY **MAURO MARCHIARO**, SENIOR MANAGING DIRECTOR ACCENTURE, ITALY, AND
BY **RICCARDO VOLPATI**, MANAGING DIRECTOR ACCENTURE, ITALY, SEPTEMBER 2018,
ARTICLE PROVIDED BY ANDAF, THE ITALIAN IAFEI MEMBER ASSOCIATION

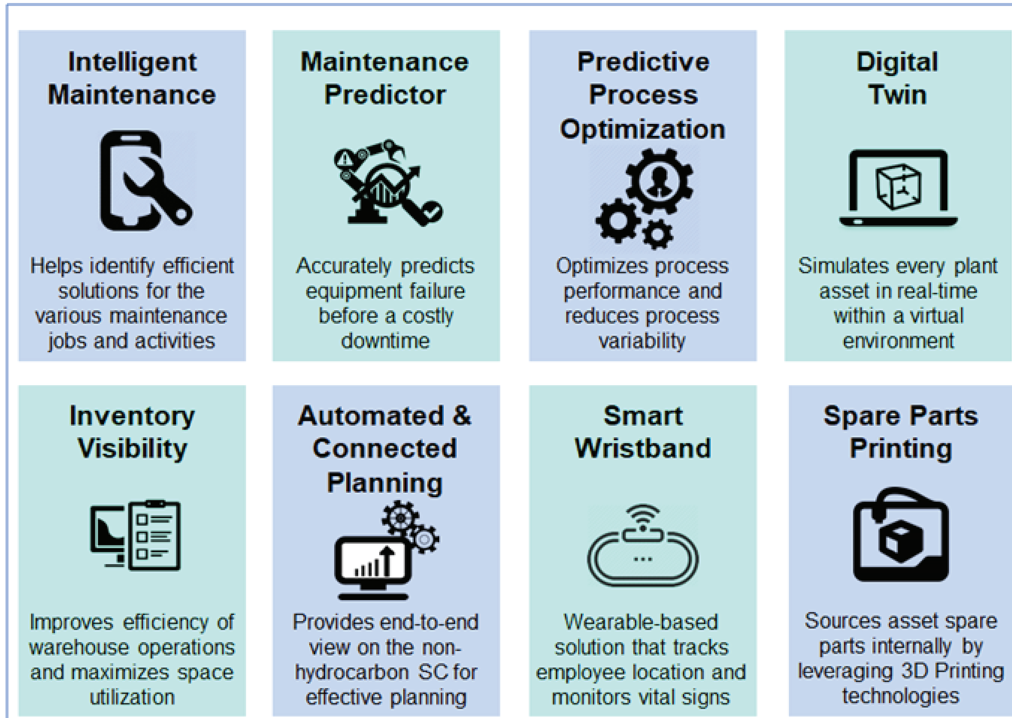
Through the pervasive use of big data, business operations are being re invented in the digital space. More and more businesses are pursuing data-centricity as a strategy that will deeply transform the way business decisions are made and, ultimately, the overall enterprise operating model. As part of this transformation, physical assets and their functionalities (machines, manufacturing plants, large capital projects, vehicle fleets, etc.) are being enveloped in a comprehensive digital environment that, through API gateways, "allows for seamless flow and intelligent filtering and presentation of data throughout all relevant operations"(1). Running digital twins for core operating asset can enable shorter decision lead times, improved OPEX and CAPEX management, higher throughput and asset utilization and ultimately higher profitability through real-time advanced and predictive analytics. Among other things, analytics applied to industrial sectors are a source of optimized operational efficiency, by pursuing better equipment tuning in order to improve energy consumption, cycle times, maintenance scheduling and risk of breakdown [1].

Clearly none of the above value-driving advantages can be ignored by the CFO. But how does the "digital reinvention of industry," impact the Finance department? How can the CFO capitalize on this increasing data-driven advantage? What the best approach could be to reap such benefits, as well as implications on the Finance organization, are often still up for discussion. Not all digital strategies are created equal, both in terms of digitalization roadmap, priority scope and roles being played across the enterprise. And in most cases, digitalization is happening with a modular and incremental approach, at different pace across the enterprise, with specific use cases being implemented within different businesses.

1. Source: "Industry X.0 – Realizing Digital Value in Industrial Sectors", Eric Schaeffer 2017

Some examples of digitalization use cases

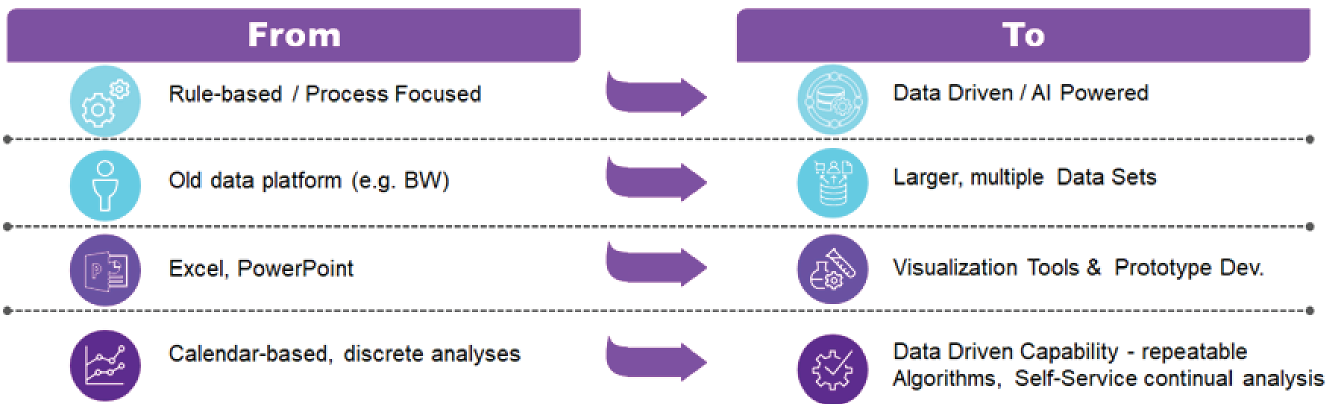
Although big data analytics use cases can range broadly in terms of operational areas being addressed, from predictive maintenance to connected field workers to



smarter inventory management, there is one common, Finance-related trait that applies to most of them. That is: as business data increases and becomes more accessible, Finance can capture the opportunity to leverage analytics to better read business performance thus driving better business outcomes. Non-financial data linked with financial data, if processed through appropriate analytic algorithms, can provide a new lens for the CFOs to read business performance, with a new "Augmented Finance" logic. The same digital applications (and related algorithms) that are used by the Operations departments to enhance business performance can offer information that is extremely relevant for the CFO as well. Think about operational maintenance forecasts based on real-time equipment information from the field, for example. These could offer much more valuable input to the cost and capital spending budgeting process than traditional cost baseline information from prior periods. Effectively exploiting data for such purpose will likely require ad-hoc analytic developments (as financial use cases will differ to a large extent from pure operational), but surely starting from a strong base.

In our view, provided current degree of maturity we observe across industrial sectors, one of the key challenges is to ensure that analytics developments are

effectively combined in an exhaustive manner, in order to benefit decision making not only within business sectors, but also at broader enterprise level. Let us get back to previous example (i.e. predictive maintenance). While gaining financial insights from single analytics use cases could add value to specific modules of the planning and budgeting cycle, much less immediate would be to broaden the concept to the overall planning process to make it truly data-driven. Think about an integrated Oil & Gas business as an example. Digital applications can be deployed in all segments of the integrated value chain, to cover exploration projects, production operations, supply and logistics, refineries, petrochemical plants, distribution and marketing operations. These will allow for AI-powered simulation and optimization of business-relevant operational parameters, in order to maximize performance with a predictive approach. Financial impacts of actions being simulated and implemented will be monitored in a predictive and real-time way. But still the CFO, when having to run scenario analyses at enterprise level (potentially for commodity/ currency scenario sensitivity but even for other purposes such as capital or operating expense optimization, asset integrity and risk analyses) might have to manage multiple modules and data sets separately, with multi-step processes involving separate organizations resulting in a cumbersome exercise, to the disadvantage of frequency and accuracy of outcomes. Nowadays, financial forecasting is often still a rule-based and small-data statistical exercise. But applying artificial intelligence to large data sets (including internal and external data), and establishing relationships of such data with financial performance, could allow for a truly data-driven predictive approach, with much faster, detailed and frequent iterations. And adding transparency on potentially relevant but under-recognized drivers of business outcomes (e.g. how will weather conditions affect future periods cash flow?). But while we are convinced that this is going to be the end game scenario, the challenges are still substantial, especially due to the exhaustiveness that is required

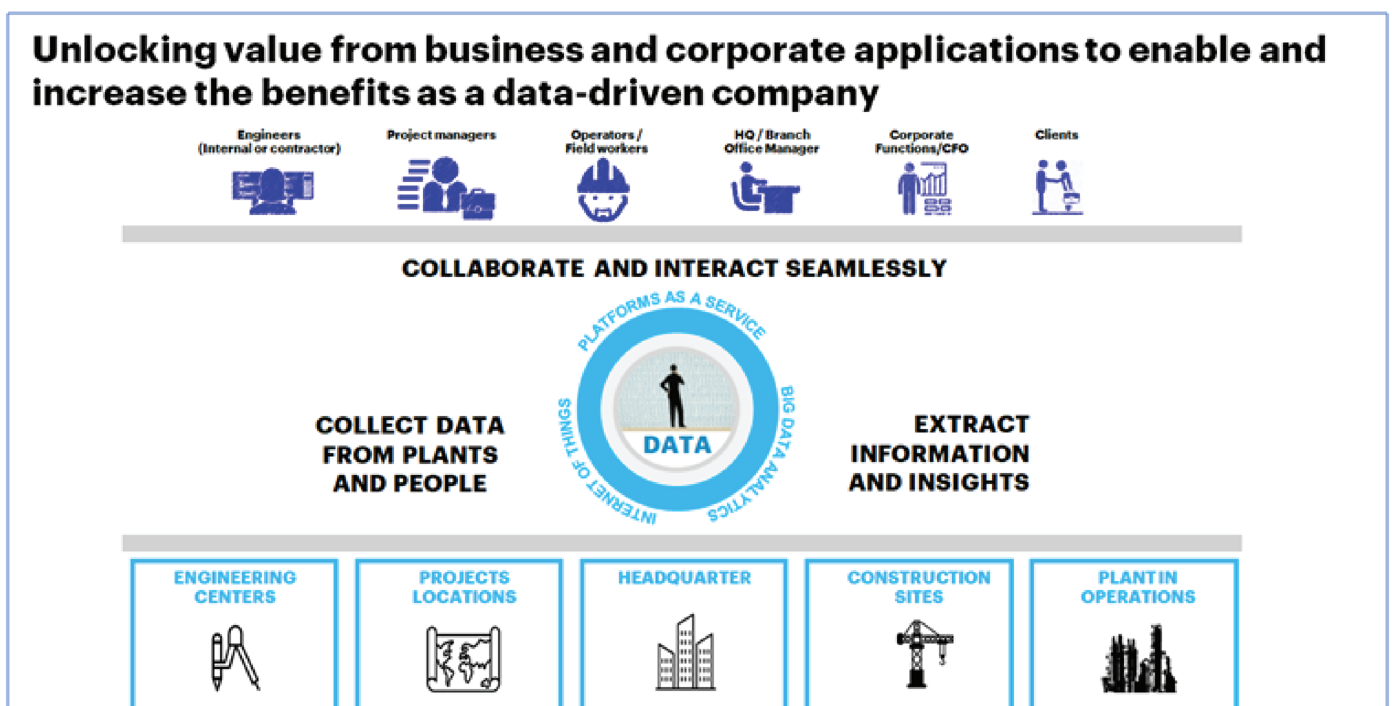


for financial forecasting to be meaningful. Although it might still take some efforts for integrated scenario analyses and financial planning to be largely backed by artificial intelligence-powered analytics, we believe that the journey has already begun in that direction. The key point is hence about "how" to most effectively start building the data-driven advantage, as opposed to "if".

From traditional to data-driven financial planning
Contemplating big data analytics within Enterprise Performance Management processes, although not in a fully pervasive way, can already lead to substantial advantages, and will increasingly do so in the near future. In actual facts, some of the most relevant performance drivers in most businesses are the same that already look most mature from a predictive analytics perspective, offering relatively better data abundance, quality and accessibility. Sales volumes, for example are already subject to advanced forecasting techniques in a large share of consumer goods and industrial goods companies. Pricing forecast in commodity volatility exposed business is a science. And maintenance operations (and related costs) are increasingly managed through predictive models in capital-intensive sectors. These observations suggest that the conditions are there to start transforming substantial modules of Enterprise Performance Management from traditional rule-based to data-driven. In this context, here are some considerations that should be contemplated to manage this transition successfully.

Think big, start small, scale fast: although having a compelling and bold vision will surely provide a clear direction, addressing implementation in an agile way is required, provided how vast and pervasive the transformation could be; for example, although the vision could be to reach full data-driven rolling financial forecasting to the operating income level, focusing first on the top line for a selected sub-set of business units might be a pragmatic and well-suited way to start, especially in environments where closer integration between Finance and S&OP could make sense.

Focus on critical dimensions of the business and strongly manage complexity[2]: it is far more valuable to leverage analytics to maximize frequency and accuracy of a limited set of highly relevant insights than just increasing reach to cover more areas, as this would result in unneeded over-complexity; in other words, for non-critical, highly stable financial items it could be just fine to stick to the traditional EPM logic, while focusing data-driven efforts on key business drivers (e.g. maintenance



2. Source: "CFOs Becoming Data Doctors", Accenture 2017

spending for Transmission System Operators).
Frame the journey as part of the enterprise-wide digital transformation to the extent possible: avoid doubling-up of efforts, and maximize synergies; as outlined above, the enterprise data-driven journey can be pursued in a variety of ways, and contemplating different priorities; but most of such developments can present advantages for the CFO in his increasingly digitally-enabled role; in this respect, working alongside a digital plant application development to make sure that it enables data-driven financial performance analysis and predictions could be a better choice than trying to build a separate application.

Bringing it all together: we believe that the CFO will play a key role in maximizing the benefits of the data-driven transformation of business, at least for two good reasons:
- The Finance function has always been the gate keeper of a single version of truth, and the only corporate function with an exhaustive view on business performance;
- Finance could be a natural fit as the hub for enterprise analytics.
- CFO's remit is expanding to include stewardship of the digitalization of the entire enterprise[3].

We recognize that, while transforming the way business decisions are made through big data analytics is an ongoing process, escalating such logic at overall enterprise level to support major C-level decisions such as capital allocation, major investments or divestitures will require reinvention of the traditional Enterprise Performance Management approaches. We see this as one of the most relevant and irreversible future evolutions in the Finance domain, and although the journey is still in its early phase, the time for mobilization has already started.

Mauro Marchiaro - Senior Managing Director Accenture, Italy

3. Source "The CFO Reimagined: from driving value to building the digital enterprise", Accenture 2018

FISCAL STATE AID
THE MCDONALD´S CASE

BY **PIERGIORGIO VALENTE**, CHAIRMAN OF THE INTERNATIONAL TAX COMMITTEE IAFEI, OCTOBER 2018

Introduction

McDonald's Europe has not received fiscal state aid from Luxembourg through the 2009 tax rulings investigated by the European Commission. On 19 September 2018, the Commission concluded its investigation[1], clearing the fast food company and re-evaluating its positions expressed in the 2015 decision opening the formal investigation[2].

The McDonald's decision seems to come to appease the heated international debate on the fiscal state aid front, while waiting for the Court of Justice of the EU to provide clarifications. A series of appeals against the Commission's state aid decisions have been filed, putting forward several question-marks on the application of the relevant EU norms, with a first hearing of the Fiat-Luxembourg case having taken place already[3]. In the meantime, various Commission's decisions have received harsh criticism from relevant Advocate Generals, especially as regards identification of the reference system and taxpayers' comparability[4].

To complete the scenery, the proposals of the European Commission regarding the taxation of digital business models in the Single Market have given new spark on the debate regarding potential unilateralism of the EU in an international arena.

In the context of what seems unprecedented uncertainty, it is critical for enterprises to follow the state aid developments. Even if not involved in a specific state aid case, an enterprise might have strong interest to intervene in a given case or at least to keep informed, e.g. if it has benefited from measures similar to the ones under examination or if its competitors have done so.

The Facts

The case focused on two tax rulings granted by the Luxembourg tax authorities to McDonald's Europe in 2009. According to the second tax ruling, which corrected the first, the royalties received by McDonald's Europe – tax resident in Luxembourg – were exempted from taxation in Luxembourg by application of the bilateral tax treaty between

1. European Commission, Press release, State aid: Commission investigation did not find that Luxembourg gave selective tax treatment to McDonald's, Brussels, 19 September 2018.

2. European Commission, Press release, State aid: Commission opens formal investigation into Luxembourg's tax treatment of McDonald's, Brussels, 3 December 2015.

3. S. Bodoni, Fiat's EU Court Showdown Gives a Taste of Fight Over Apple Taxes, Bloomberg Economics, 21 June 2018.

4. Hornbach-Baumarkt AG v Finanzamt Landau, C-382/16, Opinion of Advocate General Bobek, 14 December 2017; Dirk Andres (administrator of Heitkamp BauHolding GmbH), previously Heitkamp BauHolding GmbH v European Commission, C-203/16, Opinion of Advocate General Wahl, 20 December 2017.

Luxembourg and the U.S (the "Bilateral Treaty"). More specifically, the Luxembourg tax authorities acknowledged that the provisions of the Bilateral Treaty, interpreted in the light of the domestic law, implied that McDonald's Europe:
(i) had a permanent establishment in the U.S.;
(ii) the royalties received by McDonald's Europe should be allocated to such U.S. permanent establishment (which had the relevant franchise rights);
(iii) since the U.S. had the taxing right over the above royalties according to the Bilateral Treaty, Luxembourg could not tax them, regardless of whether or not the U.S. was effectively exercising its own right[5].
The difference between the first and the revised tax ruling was on the above point (iii): while the first required evidence of effective taxation of the royalties in the U.S., the second negated such requirement. This change of viewpoint is probably what raised the Commission's suspicions in relation to the tax ruling to McDonald's[6].
In the heart of the problem lies article 25 para. 2 of the Bilateral Treaty regarding relief from Double taxation in Luxembourg. This provision corresponds to that of article 23A para. 1 of the OECD Model Tax Convention (the "OECD Model").

The Commission's Initial Argumentation (Opening Decision)

In the 2015 decision opening a formal investigation of the aforementioned tax rulings, the Commission disagreed with the interpretation of the Bilateral Treaty embraced by the Luxembourg tax authorities. In particular, the Commission argued that the tax authorities should take into account the following:
(i) the U.S. branch to which the royalties were allocated, did not exist for U.S. tax purposes;
(ii) hence the U.S. could not exercise its rights to tax the royalties under the Bilateral Treaty.
In other words, the Commission endorsed the view that effective taxation of the income in question by U.S. was not relevant to determine the taxing right of Luxembourg on such income. Nevertheless, since U.S. law did not enable the U.S. to tax the income, by not recognizing the existence of an essential pre-condition to the exercise of the taxing right allocated by the Bilateral Treaty (i.e. the existence of a U.S. permanent establishment), correct interpretation of the Bilateral Treaty would not preclude Luxembourg's taxing right.
Hence, from the Opening Decision it arises that the Commission was inclined to conclude that Luxembourg derogated from the correct interpretation of the Bilateral Treaty. It considered that the royalties were to be exempted from Luxembourg tax while – according to the Commission – it did have a right to tax the royalties.

The Question-marks Arising from the Opening Decision

The interpretation proposed by the Commission in the Opening Decision seems to imply that Luxembourg tax authorities should take into account the domestic legislation of the U.S. in order to provide an interpretation of the Bilateral Treaty. Such a view seems to be in conflict with established case law of the Court of Justice of the EU, according to which Member States' national legislation does not have to take into account the legislation of other Member States, and equally third countries[7].
In practice, such a requirement would also be rather too demanding, taking into account the number of tax treaties and the international tax framework.
Furthermore, in the Opening Decision, the Commission attempts an interpretation of the Bilateral Treaty on the basis of the OECD Commentary. However, the OECD commentary invoked for this purpose is much younger than the Bilateral Treaty, signed in 1996. In addition, the commentary in question in this case is of substantial nature, i.e. it is not limited to providing clarifications but it actually modifies the effects of the rule. In Luxembourg, this type of commentary cannot be invoked to interpret pre-existing bilateral tax treaties[8].

The Concluding Decision

The arguments of the Commission in the Opening Decision seem to have been overturned during the formal investigation. In September 2018, the Commission closed the case with a positive decision, recognizing that no selective tax advantage has been granted to McDonald's under the circumstances examined.
In detail, according to the relevant press release[9], the Commission finally endorsed Luxembourg's interpretation of the Bilateral Treaty. It was thus acknowledged that for the correct interpretation and application of the treaty, relevant was Luxembourg law alone. Luxembourg tax authorities did not have to consider the U.S. domestic law instead.
There is no question that the royalties allocated to the U.S. permanent establishment of McDonald's Europe were subject to effective taxation neither in the U.S. nor in Luxembourg or anywhere else. Nevertheless, Luxembourg exempted such royalties from taxation correctly applying its internal legislation and hence without discriminating in favor of McDonald's. The double non-taxation of the royalties is clearly the result of a mismatch of Luxembourg and U.S. national legislation; it is not selective but equally available to all taxpayers under similar circumstances.

5. European Commission, SA.38945 Alleged aid to Mc Donald's – Luxembourg, available at: http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38945
6. W. Haslehner, The McDonald's State Aid Case – The EU Commission Interprets a Tax Treaty, Kluwer International Tax Blog, June 2016.
7. Columbus Container Services BVBA & Co. v Finanzamt Bielefeld-Innenstadt, C-298/05; P. Watterl, Stateless Income, State Aid and the (Which?) Arm's Length Principle, 44 Intertax 11, 2016.
8. W. Haslehner, supra n. 6.
9. European Commission, supra n. 1.

Concluding Remarks

The concluding decision for the McDonald’s case has not been published yet and therefore important information is still to be revealed on the reasoning of the Commission behind its change of point of view.
From the currently available information, it seems that the concluding decision is in the right direction. What is still highly problematic though is the length of the procedure and the subsequent uncertainty in taxation in the Single Market and in the state aid area in particular. The formal investigation into the McDonald’s case was opened in December 2015 and was only closed in September 2018, i.e. following almost 3 years.
Even if McDonald’s was eventually cleared, the reputational damage and the tax risk at stake during these years should not be underestimated.
Legal and tax uncertainty risk to severely harm the competitiveness of the Single Market. Until adequate remedies are put in place, enterprises with activities in the EU shall need to account and provide for the still fluid framework.

WESTERN GOVERNMENTS HAVE AMASSED UNPRECEDENTED DEBT MOUNTAINS AND A DAY OF RECKONING MUST BE ON ITS WAY. THE ONLY QUESTION IS WHEN

BY **ROLAND HINTERKOERNER**, A FORMER BANKER AND FOUNDER OF EXPERTISE ASIA. EXPERTISE-ASIA.COM.
FROM WWW.TREASURERS.ORG, OCTOBER 2018, **ACT**, UK

James Carville, the legendary adviser to Bill Clinton, once quipped that if there was reincarnation, he wanted to come back as the bond market, as he could intimidate everybody.

This was in 1990, when bond markets actually still worked efficiently and governments had to be mindful of what fiscal policies they would adopt. Otherwise, the market would punish them with higher interest rates and quickly curtail politicians who thought they could thrive on ambitious spending.

Those days are long gone. When the financial crisis hit in 2007 and raging economic and financial fires had to be extinguished, the world set a historic precedent of quantitative easing and – by flooding the system with excessive liquidity – made the primary function of the bond market obsolete for the better part of a decade. Artificially low interest rates were an invitation for political leaders to fight the burst credit bubble with more government debt.

As a result, the US national debt has more than doubled in the past 10 years. It currently stands at an incredible $21.6 trillion. However, despite economic improvements during the first half of Donald Trump's presidency, Washington has not reined in that mountain of debt.

On the contrary, Trump's spending will produce budget deficits of around $1 trillion annually for at least two to three years running. The national debt might even hit $25 trillion before he stands for re-election.

The cost of carrying debt

They say it ain't over until the fat lady sings. She might just start to breathe in hard. At the time of this unprecedented deficit-spending cycle, the Federal Reserve is raising rates and has significantly forced up yields across the curve. In other words, the cost of carrying the debt is rising.
Federal Reserve chairman Jay Powell's rigorous normalisation of the monetary system is bringing

the bond market back to life. He has not only raised rates and will do so again, but he has also started to taper the $2.4 trillion Treasury position on the Fed's balance sheet, albeit in small doses.

Once the market is re-empowered to play its regulating role, even one Donald Trump will have to concede to it. If he doesn't, a massive depreciation of the dollar and possibly an ensuing destabilisation of the global financial system would likely be the consequence.

Survival test

Europe is in a similar position. Politically, the Old Continent has been in clear trouble recently with regards to Brexit and immigration issues.

Worse still, the Eurozone is edging closer to its next survival test after the crisis around Greece in 2012. Italy's new populist government doesn't seem to have any interest in complying with EU rules and laws, and is breaking away from the European framework on key issues such as migration and fiscal policy.

Reneging on previous cabinet commitments as to whether refugees will be admitted at Italy's borders and using threats by questioning Italy's membership in both EU and the currency union to enforce a spending pattern that is far from conducive to bringing stability back to the debt situation have quickly become common in European politics.

The most recent spat between Brussels and Rome about the -2.4% budget deficit shows an acceleration in brinkmanship. And, the fronts are continually hardening.

Italy, as the case in point, sports government debt of almost €2.35 trillion, which constitutes approaching 135% of GDP. It is the largest nominal debt on the Old Continent, higher than France's and certainly higher than Germany's, even though Italy's economy represents only 75% and 50% of the other economies, respectively. With regards to the debt-to-GDP ratio, only Greece surpasses Italy at a 180% ratio, but Greece's GDP is 1% of the EU total, whereas Italy's is 10%.

Target2 mechanism

It doesn't end there. In order to keep the common currency in place despite current account and payment imbalances among Eurozone members, the Eurosystem relies on the so-called Target2 mechanism, which balances fund flows via the European Central Bank (ECB).

If, for example, a country is plagued by fund outflows – and in the case of Italy, the phenomenon of capital flight has accelerated – they have to be channeled back through the Target2 system in order to keep the Eurozone together.

In the process, receivables and liabilities vis-à-vis the ECB (but, implicitly, the affected jurisdictions) are being built up on the balance sheets of the respective national central banks. And so, Germany's positive Target2 balance of close to €1 trillion mostly reflects the same amount of liabilities on Europe's periphery part. Italy's negative Target2 balance means that Germany effectively lends Italians some €475bn.

These almost half a trillion euros are essentially unsecured liabilities implicitly underwritten by the Italian government that comes on top of the country's sovereign debt. So, Rome's outstanding debt is pushing an unmanageable €3 trillion.

Some pundits will tell you that Target2 imbalances won't matter, as long as the Eurozone remains as one, but that is rather a theoretical and naive way of looking at it.

The problem is that the Eurosystem has entirely run out of control, and Italian politicians understand their power in negotiating with the creditor side. A Euro break-up now isn't desirable on either side, as creditor and debtors would both suffer existential damage to their financial state.

Rather, Italy requires a reset – or the mother of all debt restructurings. To be sure, a massive haircut in periphery debt would come at the expense of the EU's surplus champion, Germany.

A natural rebalancing of the accounts, i.e. sustainable trade surpluses in Italy and investments in the country, is illusory and not to be expected. Nor can politicians fall back on the tried-and-tested dilution of debt by way of inflation or currency depreciation, as the Eurozone no longer allows for such options. Technically speaking, a write-down remains the only way forward. Politically, however, one wonders how the German taxpayer base will react to such prospect.

In summary, the Western societies' mountains of debt will eventually crash down on us. When this will happen, no one can tell. US governments may manage to kick the proverbial can down the road for decades to come. We are past the point of return, however. The day of reckoning cannot be avoided.

MOVING TOWARD "NORMAL" US MONETARY POLICY

REMARKS BY **MR. JOHN C. WILLIAMS**, PRESIDENT AND CHIEF EXECUTIVE OFFICER OF THE FEDERAL RESERVE BANK OF NEW YORK, AT THE JOINT BANK INDONESIA – FEDERAL RESERVE BANK OF NEW YORK CENTRAL BANKING FORUM, NUSA DUA, INDONESIA, 10 OCTOBER 2018

Thank you and good morning. It's a pleasure to speak at the Central Banking Forum co-organized by Bank Indonesia and the Federal Reserve Bank of New York. This is our second joint conference, and I am very much looking forward to the exchange of ideas and views on important economic issues affecting our regions. At the outset, I would like to thank Governor Perry and Bank Indonesia for their leadership and support in sponsoring this conference, amid what I am sure has been a very busy time with the IMF/World Bank meetings. Let me also say that our thoughts and hearts go out to everyone affected by the recent devastating earthquake and tsunami.

In my remarks, I will focus on the outlook for U.S. monetary policy. The good news is that on the 10th anniversary of the worst days of the global financial crisis, the U.S. economy is doing very well. From the perspective of the Fed's dual mandate of maximum employment and price stability, quite honestly, this is about as good as it gets. As a result, the Fed has naturally been moving toward more "normal" monetary policy.

And that brings me to a theme of my remarks today: What does "normal" monetary policy look like going forward? Before I say even one more word, I should stress that what I have to say represents my own views and not necessarily those of the Federal Open Market Committee (FOMC) or anyone else in the Federal Reserve System.

Strong, Strong, Strong

My view on the U.S. economy is well summarized by the most recent FOMC statement, in which variations on the word "strong" appeared five times in describing the U.S. economy[1]. Central bank communication can be difficult at times, but, at least in this case, our message is very clear. Indeed, the Federal Reserve has attained its dual mandate objectives of maximum employment and price stability about as well as it ever has. Most indicators point to a very strong labor market-including an unemployment rate of 3.7 percent-and inflation is right on target.

1. See FOMC Statement and Implementation Note, September 26, 2018.

With fiscal stimulus and favorable financial conditions providing tailwinds to the U.S. economy, the outlook is for more strong growth. Let me put some hard numbers to that: I expect real GDP to increase by around 3 percent this year and by 2.5 percent in 2019. Assuming this forecast comes to fruition, this will be the longest expansion in U.S. history based on data going back over 150 years. This above-trend pace of growth should lead to continued solid job gains and further declines in the unemployment rate. I expect the unemployment rate to edge down to slightly below 3.5 percent next year, the lowest level in nearly 50 years.

In keeping with this strong economic outlook, I expect price inflation to move up a bit above 2 percent. Importantly, I don't see any signs of greater inflationary pressures on the horizon. This is all very good news, especially in the context of the slow recovery and low inflation that has persisted in the years since the financial crisis.

In light of the progress we've made on our monetary policy goals, the FOMC has been in the process of gradually normalizing monetary policy for the past few years. Looking forward, I continue to expect that further gradual increases in interest rates will best foster a sustained economic expansion and achievement of our dual mandate goals.

Since first raising rates from near-zero back in December 2015, the FOMC has continued to raise the target range for the federal funds rate as the economy has improved and moved toward our maximum employment and 2 percent longer-run inflation objective. Our most recent rate increase came in late September, when the FOMC set the target range between 2 and 2.25 percent[2].

Throughout, we've repeatedly stressed that we foresaw this to be a process of gradual normalization, reflecting the balancing of risks to reaching our goals. In particular, downside risks to the achievement of our employment and inflation goals amid very low interest rates were compelling arguments for a relatively cautious and predictable approach to policy. This proved its worth: The U.S. economy continued to expand at a healthy pace even as the Fed raised rates numerous times.

For those who follow the Fed closely, you've noticed that the FOMC has been slimming down its statements of late and using less forward guidance about the future path of policy. In this vein, the FOMC in its recent statement removed language indicating that monetary policy remains accommodative[3]. Let me make clear, these more concise statements do not signify a shift in our monetary policy approach. Instead, they represent the natural evolution of the language describing the factors influencing our policy decisions in the context of the strength of the economic outlook and inflation being near our 2 percent longer-run goal.

These changes in our communication of policy views are a sign that we are nearing the end of the process of normalizing monetary policy and are inching closer to conducting normal monetary policy. Arguably, it's been a long time since monetary policy was normal, so it's worth describing what "normal" looks like in some detail.

At its most basic level, monetary policy-making will remain the same: The path of interest rates will continue to be guided strategically by our dual mandate objectives and shaped tactically by the data and their implications for the economic outlook. We'll continue to be transparent about our thinking about the economy and monetary policy.

But, changing circumstances call for some changes in how the FOMC communicates its policy views. Now that interest rates are well away from zero and the economy is humming along, the case for strong forward guidance about future policy actions is becoming less compelling. For one, the future direction of policy will no longer be as clear as it was during the past few years. When interest rates were extremely low, it was obvious that the direction for rates was upward, toward more normal levels, and our forward guidance reinforced that point. At some point in the future, it will no longer be clear whether interest rates need to go up or down, and explicit forward guidance about the future path of policy will no longer be appropriate.

In addition, as we have moved far away from near-zero interest rates, it makes sense to shift away from a focus on normalizing the stance of monetary policy relative to some benchmark "neutral" interest rate, often referred to as "r-star." Now, I have spent a good deal of my career studying r-star and I find it to be a useful concept for describing the economy's longer-run behavior.

Having said that, at times r-star has actually gotten too much attention in commentary about Fed policy. Back when interest rates were well below neutral, r-star appropriately acted as a pole star for navigation. But, as we have gotten closer to the range of estimates of neutral, what appeared to be a bright point of light is really a fuzzy blur, reflecting the inherent uncertainty in measuring r-star[4]. More than that, r-star is just one factor affecting our decisions, alongside economic and labor market indicators, wage and price inflation, global developments, financial conditions, the risks to the outlook...... the list goes on and on.

I've talked a lot about normalizing our policy around interest rates. In addition, about a year ago we started the process of gradually reducing the Fed's balance sheet as we work to unwind the asset purchase policies put in place during the crisis. In

2. See FOMC Statement and Implementation Note, September 26, 2018.
3. See FOMC Statement and Implementation Note, September 26, 2018.
4. See Jerome H. Powell, Monetary Policy in a Changing Economy, August 24, 2018.

the now-standard Fed practice of communicate, communicate, and communicate, we published detailed plans well in advance on how we would gradually and predictably reduce the balance sheet[5]. This process has proceeded smoothly without creating undue market disruption or volatility[6].

With balance sheet normalization well underway, the Fed is studying the question of what exactly the new normal looks like. We have indicated that we plan to shrink the balance sheet to the smallest size consistent with the efficient and effective conduct of monetary policy-and that, in the long run, the asset side of the balance sheet will consist primarily of Treasury securities[7]. That's our strategy, but its execution will depend on the operating framework of monetary policy, among other factors.

Here, the Fed basically has two choices. We could return to a system similar in spirit to that used before the financial crisis, in which the supply of reserves in the banking system was kept relatively scarce, and the interest rate was set by adjusting reserves on a frequent basis through open market operations. Alternatively, we could continue with the system that we've been using since the crisis, in which bank reserves are abundant and the federal funds rate target is achieved through adjustments to administered rates. This approach is working very well at controlling interest rates and has proven to be easy to communicate and adaptable to changing market conditions[8]. The Fed will be looking closely at these options in the coming months and will subsequently make a decision on the future operating framework. And, as is our standard practice, we will be sure to communicate our thinking and decisions on this issue as soon and as thoroughly as practicable.

Global Dimensions of U.S. Monetary Policy

So far, I have described the economic and monetary policy outlook from the perspective of the U.S. economy and policy. This should not be surprising given that the Fed's mandate-as defined by the U.S. Congress-concerns domestic economic conditions. Of course, that does not imply that one can view the U.S. economy and our policy actions in isolation from global economic and financial developments. Far from it.

In today's highly interconnected global economy and financial system, international developments affect the U.S. economy, and our policy actions in turn impact the rest of the world. Therefore, we devote considerable effort to monitoring and analysis of developments around the world to understand how our actions affect the global economy and indirectly feed back to our own economy. These considerations play an important role in my thinking about the economic outlook and the appropriate path for monetary policy, as well as how we best communicate our perspectives and plans.

Moreover, we actively engage with international counterparts in a range of forums, such as today's. These exchanges help us understand economic and financial conditions affecting our respective regions and provide opportunities to share perspectives and insights. A key lesson about policy-making in an interconnected world is that transparency and open lines of communication are critical to minimizing misunderstanding, market disruption, and volatility that can interfere with our common goals of having strong and stable economies. As I have mentioned a number of times already, effective communication that provides clarity and predictability to our policy actions is a critical component of successful policy-making.

Conclusion

Monetary policy-making has perhaps never been more challenging than it was following the financial crisis. But, as we move toward more "normal" conduct of monetary policy, we must not rest easy. We will confront our own fair share of future challenges. The most important monetary policy challenge in the United States today is sustaining the long economic expansion without allowing risks to grow that ultimately undermine economic prosperity. Whatever the future may bring, I will be guided by our dual mandate, a heavy dependence on data, and a steadfast commitment to transparency. Such an approach, in my view, will help support prosperity both in the United States and abroad.

Thank you.

5. See FOMC issues addendum to the Policy Normalization Principles and Plans, June 14, 2017.
6. See Simon Potter, Confidence in the Implementation of U.S. Monetary Policy Normalization, August 4, 2018.
7. See Policy Normalization Principles and Plans, as adopted effective September 16, 2014.
8. See Simon Potter, Confidence in the Implementation of U.S. Monetary Policy Normalization, August 4, 2018.

DON´T WORRY, BBB HAPPY: GIVING CORPORATE LEVERAGE THE SNIFF TEST

BY **PAYDEN & RYGEL**, INVESTMENT MANAGEMENT, POINT OF VIEW, FALL 2018, OUR PERSPECTIVE ON ISSUES AFFECTING GLOBAL FINANCIAL MARKETS, LOS ANGELES, USA, FALL 2018

They didn't know it at the time, but when bond issuers and investors emerged from the year 1900, their world would be irrevocably changed. The fast and loose, often local bank-driven, corporate financing markets of the post-Civil War era gave way to the first ever fearsome and stalwart corporate bond rating agency (it was Moody's; see Did You Know? box)[1].

Today, bond rating agencies dominate investment policy statements, supplier contracts, and real estate leases. According to U.S. Securities and Exchange Commission (SEC) data, in 2016, Nationally Recognized Statistical Rating Organizations collectively maintained 2,334,600 outstanding credit ratings. The big three—Moody's, S&P, and Fitch—alone accounted for 97% of those[2].

Given bond ratings' remarkable importance in securities markets today, we sat down to look at important changes in one segment of

the U.S. investment grade corporate bond market: BBBs. The BBB ("triple B," or Baa in the case of Moody's, and BBB again for Fitch) designation rings familiar in the ear of bond investors as the last rating category which qualifies an issuer as "investment grade."

To understand the importance and dynamics of the BBB segment of the investment grade corporate bond market, we review recent changes, discuss the evolution of corporate fundamentals within the BBB rating category, evaluate the consequences of downgrades from investment grade to high yield, and suggest what investors can do in the face of these elements to earn satisfactory, risk-adjusted returns.

BBBs NOW REPRESENT ALMOST HALF OF THE U.S. INVESTMENT GRADE CORPORATE BOND MARKET

«BBBs NOW MAKE UP 48% OF THE INVESTMENT GRADE CORPORATE MARKET, UP FROM 42% FIVE YEARS AGO AND 35% TEN YEARS AGO. »

The reason we mention BBBs now is because much ink has been spilled lately on the topic. And rightly so: BBBs now make up 48% of the investment grade corporate market, up from 42% five years ago and 35% ten years ago (see Figure 1 on next page). On their own as an "asset class" BBBs are bigger than

1. Friedman, Walter A. (2014). Fortune Tellers: the story of America's first economic forecasters. Princeton: Princeton University Press

2. U.S. Securities and Exchange Commission (2016). Annual Report on Nationally Recognized Statistical Rating Organizations

the entire high yield and municipal bond market. This increase over time has generally been viewed as a harbinger of defaults and downgrades by the sophisticated and the layperson alike. Indeed, given the $6 trillion size of the investment grade corporate market, downgrades precipitated by a downturn would likely be weighty. While on its face, a higher percentage of BBBs implies more "risk", we want to take a moment to explore both the upsides and downsides of the morphing corporate landscape.

DOWNGRADES AND INCREASED LEVERAGE HAVE SHIFTED UNIVERSE COMPOSITION

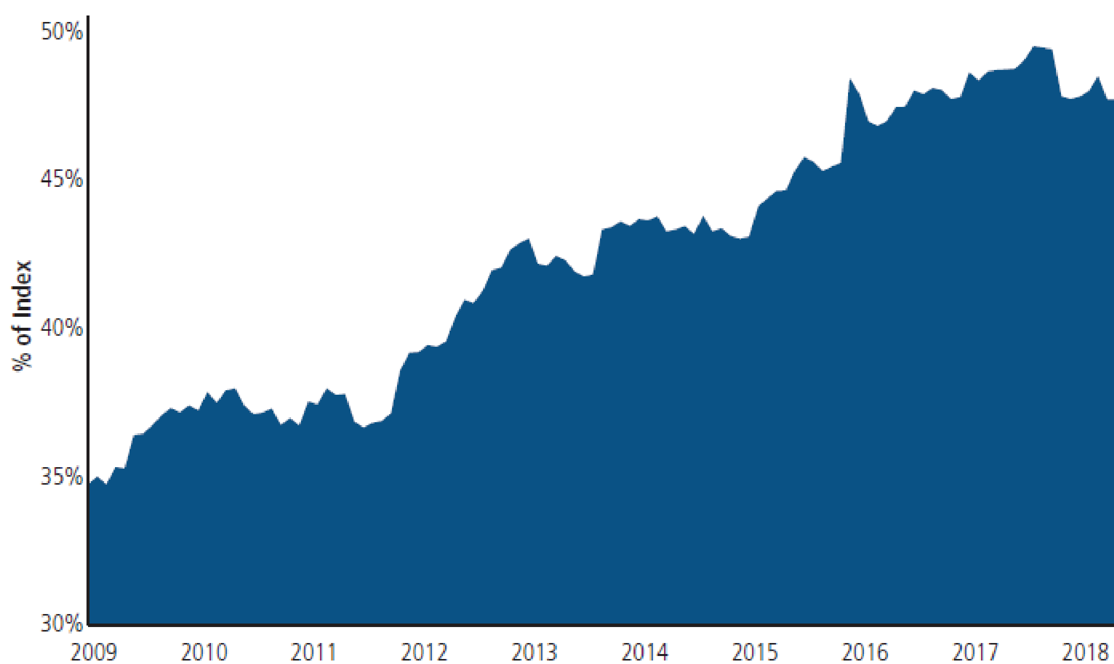
The proliferation of lower rated credits has more to it than just "more risk". For one, it has come from a more stringent view of credits.

In these later days of the ever-lengthening credit cycle, corporate gross leverage (excluding cash that could be used to reduce debt) stands at 2.8x, up from current cycle lows of 2.0x. Leverage among BBBs has risen even more, now at 3.3x, 1.2x higher in the same period. This is reason for pause as the cycle heads into its tenth year (see Figure 2 on next page).

CAPITAL STRUCTURE OPTIMIZATION MAY ALSO DEMAND ADDITIONAL LEVERAGE

Are the negative headlines overblown? There are oft-forgotten benefits of an expanded BBB universe. Every company has an ideal corporate structure that likely includes debt and which could reflect a BBB rating. After all, BBBs only pay about 1.5x what single-As pay above Treasuries (a yield premium of about 0.5% cur- rently).

fig. 1 BBBs GOING UP? BBBs AS A PERCENTAGE OF THE INVESTMENT GRADE CORPORATE BOND MARKET



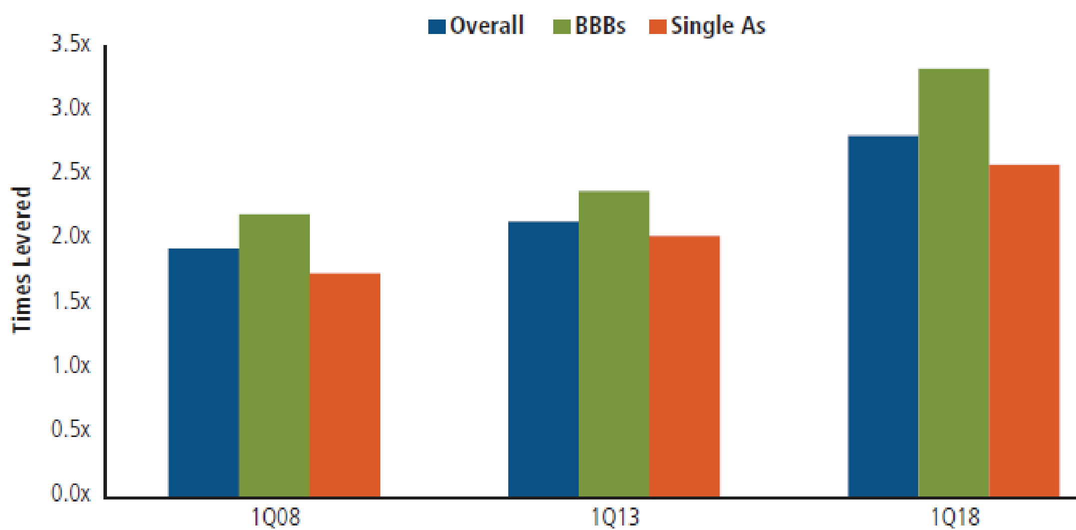
Source: Bloomberg Barclays Corporate Index

In the wake of the crisis, spooked rating agencies tightened standards and downgraded banks en masse. By 2010 over half of banks had been downgraded; nearly a quarter had been moved down by at least three notches (the pesky "+" and "-" represent a notch within the category rating). The trend is not just happening post-crisis: In the last 25 years, 20% of single -A or better rated names have been downgraded annually to BBB or below. Only 15% of names have moved in the op- posite direction.

BBB issuance has simultaneously picked up meaningfully, making up about half of issuance during the last five years.

This is especially true in a world of increased private equity and shareholder activism. Activist are looking to squeeze value and boost growth wherever possible and have proven time and again that their opinion carries weight even with behe- moth companies.

In the same vein, many corporations now engaging in M&A are expanding their debt purposely, as the growth opportunities afforded by debt are ostensibly more valuable than their current single-A rating. In a twist of irony, this has made event-prone single-A rated names riskier than BBB names focused on maintaining their capital structures.



Source: JP Morgan Non-Financial Corporate Fundamentals Data

COMPANIES ARE AWARE OF THE VALUE OF INVESTMENT GRADE RATINGS

Moreover, the cost of the drop from investment grade to high yield is steep. This is not lost on cor porate treasurers. For one, it changes how their business is operated. Bank relations shift as unsecured lines of credit become more tenuous. Similarly, terms of trade change as customers and suppliers negotiate with high yield counterparties.

Access to capital markets declines for recently-fallen high yield issuers, too. Investor guidelines play a key role here, as many institutional investors restrict their high yield exposure to a certain percent of their portfolio. The smaller buyer base and much higher premium required by the high yield market looms large, keeping debt levels at bay once they near the BBB- precipice.

Looking at 25 years of downgrade data, 9% of BBB- names annually migrated up a notch to BBB while only 5% fell to high yield, show- ing at least a modest force of will in practice. (In fact, the upgrade/ downgrade difference for BBB- companies is greater than for other A and BBB ratings categories.) This was also exemplified after the 2015-16 commodity crisis when energy companies (well, those that survived!) actively paid down debt to remain investment grade. In a time of crisis, their focus was on bondholders and their creditworthiness (see Figure 3).

RISK IS RISK: SOME DOWNGRADES TO HIGH YIELD ARE INEVITABLE

Positive sentiment and a Treasurer's will alone cannot overcome an overburdened balance sheet. Teva Pharmaceutical is a perfect example of an issuer that failed in its attempt to stay investment grade. Teva acquired competitor Allergan's generic drug business for over $40 billion in 2016, heavily leveraging their balance sheet just as generic pharmaceuticals started to falter. With such headwinds, Teva ulti- mately was downgraded to high yield. As its ratings slipped over the last two years, the value of its bonds has fallen meaningfully. It is sto- ries like this that make investors wary.

IT COMES DOWN TO CREDIT SELECTION

Rating agencies aside, it is ultimately careful analysis that remains crucial to bond investing. From an investor's perspective, there is now a disparate menu of BBB options from which to construct a portfolio. But not all BBBs are created equal: leverage can span from less than 1x to more than 5x for BBB names. This wide array of securities allows portfolios to be carefully crafted with desired risk metrics that align with the investor's objective and outlook.

As demonstrated in the review conducted above, understanding credit's topography and avoiding landmines requires a broad knowledge of the corporate market, expertise in industry trends, and in-depth company specific credit analysis. For example, in recent years leverage has in- creased, but aggregate corporate metrics lack nuance. In the entire investment grade corporate universe in 2016, J.P. Morgan calculated overall debt at ~3.1x EBITDA, but only ~2.8x EBITDA for the universe excluding commodity, metals, and mining companies.

More important are the idiosyncrasies underlying every credit story. We continue to believe wisely selected BBB corporate bonds provide opportunities for growth and strong risk-adjusted yield without adding the burden of a compromised capital structure. And we think the ghost of John Moody would agree.

COSO LITERACY: A MUST FOR TODAY'S CFO

CASE OF PETRO VIETNAM CAMAU FERTILIZER JOINT STOCK COMPANY (PVCFC)
CFO LEADING COSO FRAMEWORK IMPLEMENTATION.

BY OLIVIER HUBERT, ALTER CFO PARTNERS, WWW.ALTERCFO.COM.
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Today's CFO responsibilities' go far beyond finance. According to a Mac Kinsey report[1], 64% of risk management bosses report to their organization's CFO; CFOs subsequently play a critical role in relation to risks management strategy.
Risk management, so often considered as a way to prevent threats from various risks faced by an organization can also be used as a tool to create value. Nowadays, organizations are coping with surging demands from a wide range of stakeholders, such as boards, shareholders, regulators, legislators, ratings agencies, employees, etc., and have to manage a variety of risks. We believe that is crucial to have a proper framework to manage these risks, and such framework must be aligned to the organisation corporate strategy.

This whitepaper deals with one of the available framework, the COSO's Internal Control – Integrated Framework, "ICIF". We first present the recent COSO's ICIF evolution and its current environment. Then in a second part we highlight the importance COSO's ICIF literacy for today's CFO, and the role a CFO can play to build awareness and initiate COSO's ICIF adoption and implementation. Finally, we describe a real COSO's ICIF implementation case study. With governance improvement at the center of the discussion within the business community in Vietnam, the recent incorporation of the Vietnamese Institute of Directors, (VIOD) and the worldwide Financial Executives Congress (IAFEI) to be hosted in Vietnam early November 2018, we thought pertinent to meet up and discuss the challenges encountered by a Vietnamese organisation in the process to implement COSO's ICIF. We met with the CFO and the management of PetroVietnam Camau Fertilizer Joint Stock Company (PVCFC) accordingly.

COSO history and current context

The Committee of Sponsoring Organizations (COSO) is a co-initiative of 5 US organizations[2] that were asked in 1985 to develop a framework in order to improve organizational performance and governance, purposed on reducing the extent of fraud and providing thought leadership in the domain of internal control, enterprise risk management and fraud identification. The original COSO model was released in 1992 and played a key role in establishing a scalable framework for internal controls.
It became very popular from 2004 in the United States when the Sarbanes-Oxley Act (SOX) was passed by the US congress to protect investors from the possibility

1. McKinsey-Special-Collections_RoleoftheCFO.ashx

2. (AAA) American Accounting Association; (AICPA) American Institute of Certified Public Accountants; FEI (Financial Executives International); (IIA) Institute of Internal Auditors; (IMA) Institute of Management Accountant

of fraudulent corporate accounting activities. Under section 404 of SOX, the management of public listed company must file to the SEC, among several documents:
(1) A statement identifying the framework used by management to evaluate the effectiveness of internal control and,
(2) The management's assessment of the effectiveness of internal control as of the end of the company's most recent fiscal year end.

From there, although a few frameworks were available, the majority of public listed companies have adopted

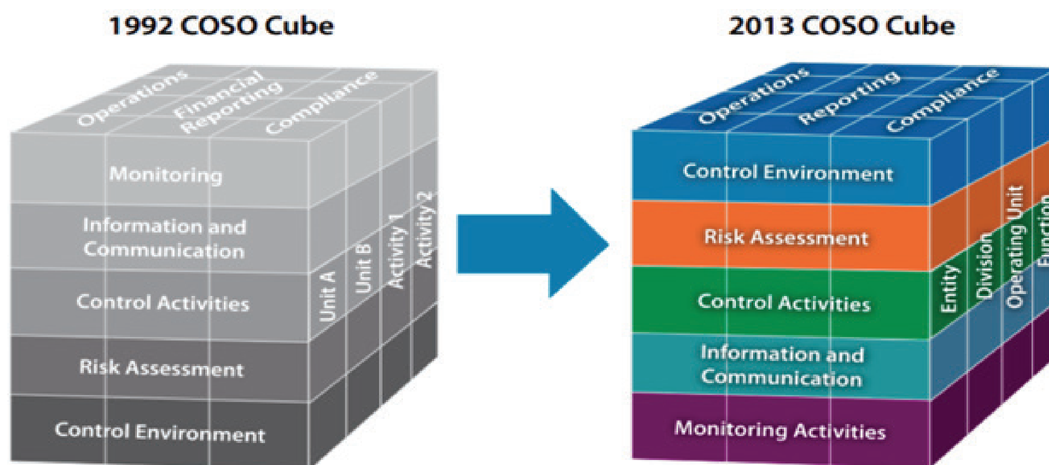


Table 1 – Comparison 1992Coso Cube and 2013 Coso Cube

the COSO's framework. Since then, and following the recent 2008 global financial crisis, many countries around the world have adopted similar regulations to the SOX 404 internal control framework requirements, and the COSO framework has been used globally.
A number of changes in business occurred over the last 20 years: the globalization of business, the expectations around fraud and accountabilities, the use of outsourcing by company all around the world and the significant change in the use of technology lead to adapt the existing approach to conduct internal audits. All this changes have been considered by the COSO to move from the COSO developed in 1992 to an update COSO framework, or COSO's ICIF released in 2013.

The COSO's ICIF 2013 is not regarded as a *new framework*, but instead, as updates to the existing framework. These updates consider the changes in business and operating environments aiming to ameliorate governance beyond financial reporting, to strengthen quality of the risk assessment and to boost anti-fraud efforts. The updated framework is also aiming to improving dialogues between management, boards and external parties.
Table 1 upon reflects the main change. Much of the structure of the 1992 framework is kept or barely modified in the 2013 framework. The definition of internal control remains identical. An organization's internal controls structure is still based on its identification of objectives and need to structure an efficient system to achieve those objectives. The COSO cube remains with a few particular changes. On the front face of the cube, *monitoring* becomes *monitoring activities*. This change aims to widen the way we perceive *monitoring* as a series of activities undertaken individually and as a part of each of the other four components, rather than as one sole process. On the top face of the cube, *financial reporting* has been changed to *reporting*. This change aims to widen the application of the framework, not only to external reporting, but also to include internal reporting as well as external reporting of nonfinancial measures.

Along the right side of the cube, the organization structure evolved to align with COSO's *Enterprise Risk Management Integrated Framework* (ERM Framework)[3] and also to better emphasize that an effective internal control structure develops through the entire organization at all functional levels, both independently and interdependently. The COSO's ICIF and the ERM Framework are distinct but interrelated. Internal control is fully part of enterprise risk management; however, enterprise risk management embraces a larger role than internal control in supporting an entity's governance structure. The COSO's ICIF 2013 establishes 17 principles that are needed for effective internal control, unless they are not applicable to the entity. Although the framework presumes that all 17 principles are relevant for each entity, management may determine that a principle is not relevant, based on its unique circumstances. If a relevant principle is not present and operating , a major deficiency exists in the system of internal control.

The CFO Role in the Implementation process

Risk management cannot be distinguished from performance, since there is a strong correlation between the two that needs to be managed jointly. In most organizations CFOs are key managers who understand the need for such holistic approach of an integrated risk management scheme. Proper internal control framework and overall assessment of economic and financial impact of risks allows CFOs to better predict result, allocate resources, ensure company assets safeguarding and allow organizations to reach their objectives. Today's CFOs must be aware of the framework concept and especially the COSO one that is used globally.
The first step for those CFOs who do not have previous

3. Ref : https://www.coso.org/Pages/default.aspx

COSO exposure is to go through the Executive Summary of the 2 COSO[4], to understand the concepts, updates and recent development. CFOs must think about the concept, ask themselves whether the company they are managing wouldn't be better than today, if the company would consider at least, some of the COSO items, or the whole framework, provided that it can be used irrespective to an organization size, industry, or whether such organization operates from 1 location or all around the world: the COSO framework is always a workable model. In addition, CFOs must send those links to their C-suite/Board and audit committee to bring COSO awareness and initiate discussion at board level to consider partial and full framework adoption, and the benefit for the organisation.

Besides its educator/coach roles, CFOs play a key role in COSO implementation process. The table 2 below presents the various stage of the COSO's ICIF implementation.

Component	Principles
Control Environment	1. Demonstrates commitment to integrity and ethical values 2. Exercises oversight responsibility 3. Establishes structure, authority, and responsibility 4. Demonstrates commitment to competence 5. Enforces accountability
Risk Assessment	6. Specify suitable objectives 7. Identifies and analyzes risk 8. Assesses fraud risk 9. Identifies and analyzes significant change
Control Activities	10. Selects and develops control activities 11. Selects and develops general controls over technology 12. Deploys through policies and
Information Communication	13. Uses relevant information 14. Communicates internally 15. Communicates externally
Monitoring Activities	16. Conducts ongoing and/or separate evaluations 17. Evaluates and communicates deficiencies

Table 2 – COSO's ICIF implementation

As organization plan their way through the implementation process, some decided to adopt only a minimum checklist approach just to comply with the framework. We believe that it is not sufficient and that organisation must take a 360 view of their business and assess how they are managing existing risks in light of their magnitude, complexity, global presence and risk profile. Those who adopt the right approach will unlock their organisation value, decrease fraud risk, circumvent financial reporting surprises and reinforce sustained business performance over the long term. Within such circumstances, CFOs are better placed to step back, explain the overall business and match it with the 17 principles. They also have the authority, the relation to and support from the board to manage the implementation.

Case PetroVietnam Camau Fertilizer Joint Stock Company (PVCFC)

PVCFC is one of the first companies to implement COSO frameworks in Vietnam. We had a discussion session with the company's CEO and its Finance Deputy CEO, Mr. Le Ngoc Minh Tri, who answered to our questions in relation to the achievement and difficulties of implementing COSO frameworks.

Q: Why did PVCFC decide to implement the COSO framework?

A: As a State Owned Enterprise and a Public Listed Company, our management always stresses the important of good governance, risk management and controls. PVCFC's management is continuously looking for ways to improve the company's operation, risk management, and internal controls… following the international best practices. COSO frameworks have been adopted in major economies like United States, Japan, and China. In South East Asia, we have also noted that Indonesia Government has adopted COSO for its Ministries and Departments while Singapore Accountancy Commission is encouraging Singapore companies to adopt COSO. The COSO Internal Control (COSO ICIF) framework and COSO Enterprise Risk Management (COSO ERM) are the international frameworks that provide guidance to enhance the control environment within our organization, stress the importance of governance, risk management, and information security and also provide an opportunity for us to better align our organizational strategy with good governance, risk appetite and effective internal control.

Q: Can you tell us the main driver to adopt COSO?

A: We wanted to enhance our internal control practices following the international standards and change our risk management habits moving from a silo-based traditional risk management to a big picture type risk management approach. The silo approach had some weaknesses since risks were monitored at department level with each department understanding about risks and controls on their own terms. We used to think "in a container way", where some departments of the company did not share information with others. COSO frameworks provide an integrated approach to risk management and controls so that our staff can follow in a consistent way when dealing with risks and controls to enhance the achievement of company's objectives.

Q: Did you seek assistance from a third party?

A: No framework, no matter how expensive or extensive, can provide absolute assurance on achievement of an organization's objectives or alleviate all risks. However, an effective framework can undoubtedly affect our company's culture, hamper wrongdoing and reduce risks exposure. We knew that COSO frameworks will benefit for the company but we lacked of technical known-how to apply and implement the frameworks. We have talked with few consultants and after several meetings with Mr. Ivan Pham, Partner – Risk Advisory & Internal Audit at Deloitte Vietnam, we have

4- Internal Control — Integrated Framework- Executive Summary ; https://na.theiia.org/standards-guidance/topics/documents/executive_summary.pdf

Enterprise Risk Management - Integrating with Strategy and Performance - Executive Summary: https://www.coso.org/Documents/2017-COSO-ERM-Integrating-with-Strategy-and-Performance-Executive-Summary.pdf

selected Deloitte Vietnam as the advisor to assist us to adopt the COSO frameworks.

Q: Are you aware of recent development of COSO?

A: Yes, we are aware of the revised frameworks. We are currently working with Deloitte and therefore, get constant update on COSO IC and COSO ERM development. We are currently implementing COSO IC – 2013 and COSO ERM – 2017. The frameworks allow us to build our internal controls and risk management in a structural way that support s our business growth and sustainability.

Q: Is the COSO implementation completed and what is the result?

A: Not yet, we completed part of COSO IC framework and are in the progress to do the rest in coming years. We have also kicked off risk management project using COSO ERM as guidance and have completed phase 1 of the project.
During the process, we have standardized over 18 key business processes with enhance internal controls in place; developed company wide's risk profile, risk appetite, structure, process, policies and procedures. We have conducted numerous trainings for staff, department heads and senior management and board.
At the moment, only partial COSO IC and COSO ERM have been implemented, which helps our staff to understand and to follow our established business processes uniformly, and helps our management to control and oversight the work more effectively, reduce errors, and limit risks exposure. This also creates a great impact on the company, especially in term of branding and reputation.

Q: What recommendations would you give to any Vietnamese company willing to implement COSO?

A: First, there must be buy-in and commitment from the top management and the board.
Second, there must be a lot of trainings and communication between senior management, department heads, and project team.
Third, there must be clear roles and responsibilities of all parties involved.
Also one must not think that it can be done in a fortnight. COSO framework implementation is a multiyear project. Do not hesitate to seek assistance from third parties to implement the frameworks. We have now a solid and enthusiastic team that can carry out risk management work as well as checking on compliance of new standardized processes to enhance overall internal controls and risk management for the company with the regular support from Deloitte Vietnam team.

About the Author

Olivier Hubert is finance professional with global experience gained in start-ups, private and public blue chip companies and fund management organizations. He initiated a public accounting career with Mazars, took few global and Asia based CFO roles prior to set up his own consulting firm altercfo that provides finance and CFO advisory. He is an Independent Non Executive Director and Audit Committee Member of several companies, a qualified CPA and a fellow member of CPA Australia. He is also a member of Vietnam and Cambodia CFO clubs.

Press, Journal Article

CHART OF THE WEEK

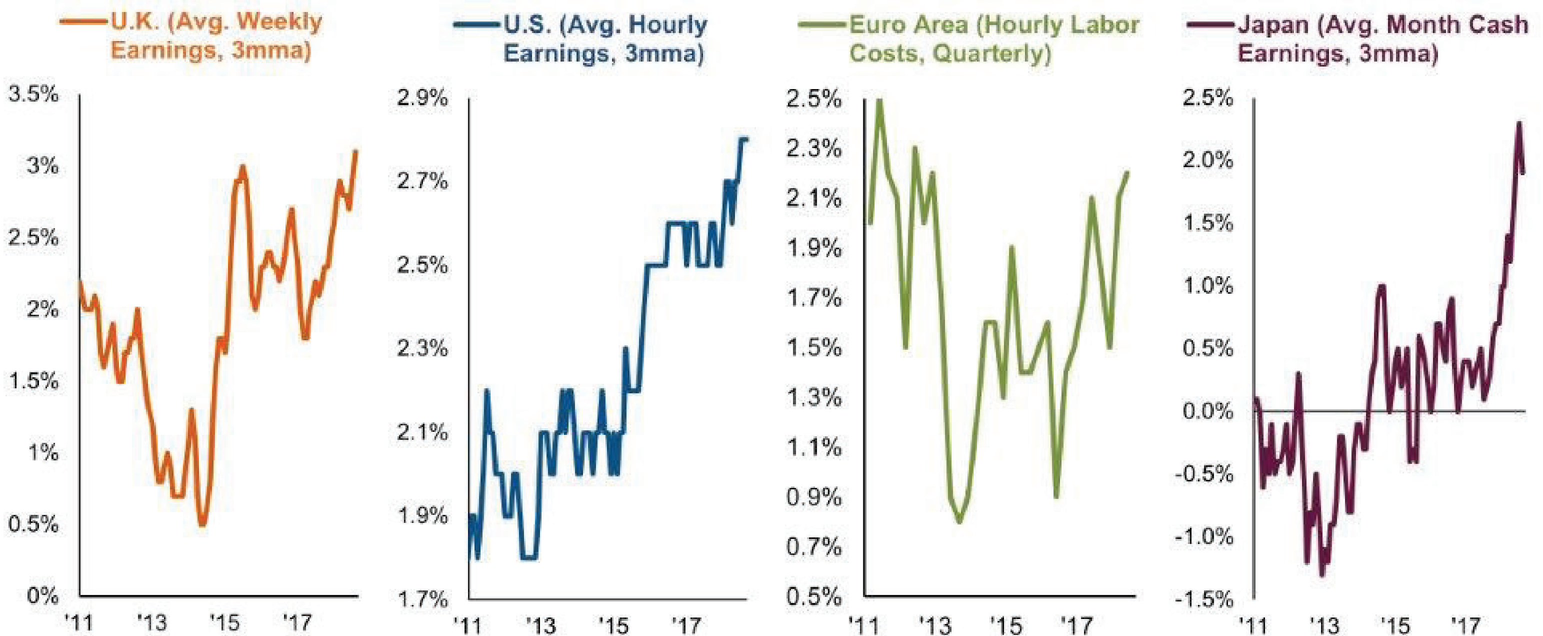
Payden&Rygel
Investment Management

Wage Growth Awakens

Wage Growth in the U.K., U.S., Euro Area, and Japan

For The Week Ending 10/19/18

% Change Year-Over-Year



Source: U.K. Office for National Statistics, Bureau of Labor Statistics, Eurostat, Japan Ministry of Health, Labour and Welfare, Payden Calculations

While unemployment rates have declined around the world, wage growth has remained elusive. That's changing. This week, the United Kingdom's Office for National Statistics released data on average weekly earnings that registered at 3.1% year-over-year in the three months to August, a cycle high. However, the U.K. is not the only developed economy seeing wage growth accelerate. In the U.S., the 3-month moving average of average hourly earnings rose to a cycle high of 2.8% year-over-year in September. The euro area, which recently saw its unemployment rate hit a fresh cycle low, also saw a gauge of hourly labor costs accelerate to 2.2% year-over-year in Q2 2018, the highest level in almost six years. Even in Japan, where wage growth has been notoriously low for decades, average monthly cash earnings have accelerated to their highest levels since 1997! Watch out world. Wage growth is here. Are investors and central banks paying attention?

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CHART OF THE WEEK

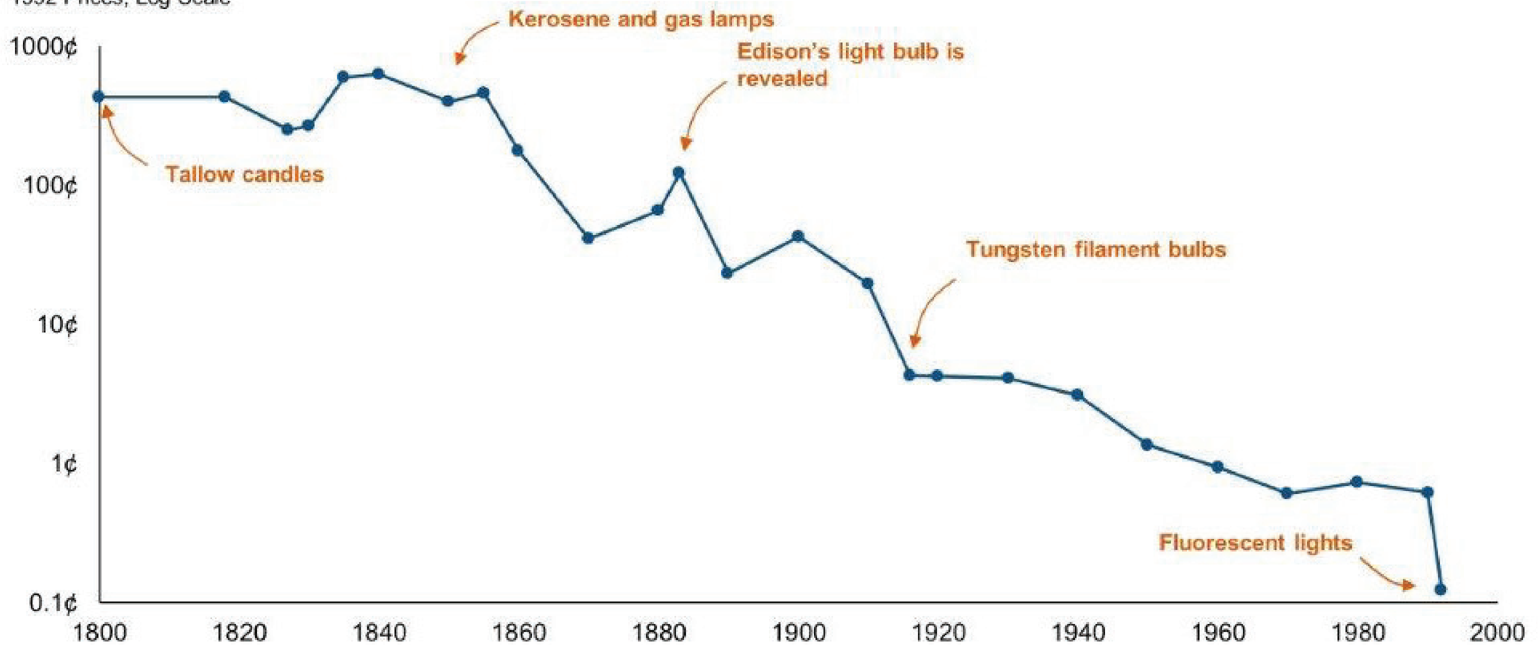
Payden&Rygel
Investment Management

Let There Be Light

Price of 1,000 Lumens* of Light

For The Week Ending 10/12/18

1992 Prices, Log Scale



Source: Nordhaus, W. D. (1997). "Do Real Output and Real Wage Measures Capture Reality? The History of Light Suggests Not" in R. J. Gordon & T. F. Bresnahan (Ed.), The Economics of New Goods (pp. 29-66). NBER.

**A unit of measuring brightness*

In a week full of market volatility and the release of the Consumer Price Index (CPI), we decided to take a step back and look at the bigger picture. Lost in the noise? The awarding of the 2018 Nobel Memorial Prize in Economic Sciences to Paul Romer and William D. Nordhaus. Buried in Dr. Nordhaus's extensive body of work, we came across data collected on one of the most useful commodities of our time: light. Nordhaus's data show that two centuries ago, the light that we take for granted in our offices was an expensive commodity. In two centuries, the price of generating 1,000 lumens of light (think the brightness of your standard light bulb) has dropped ~3,500x. From candles made of beef fat, to Thomas Edison's light bulb, to fluorescent lights, we have seen the price fall from above 400 cents down to a fraction of a penny. Our conclusion: don't spend too much time obsessing over core CPI falling from 2.19% to 2.17% in the course of one month!

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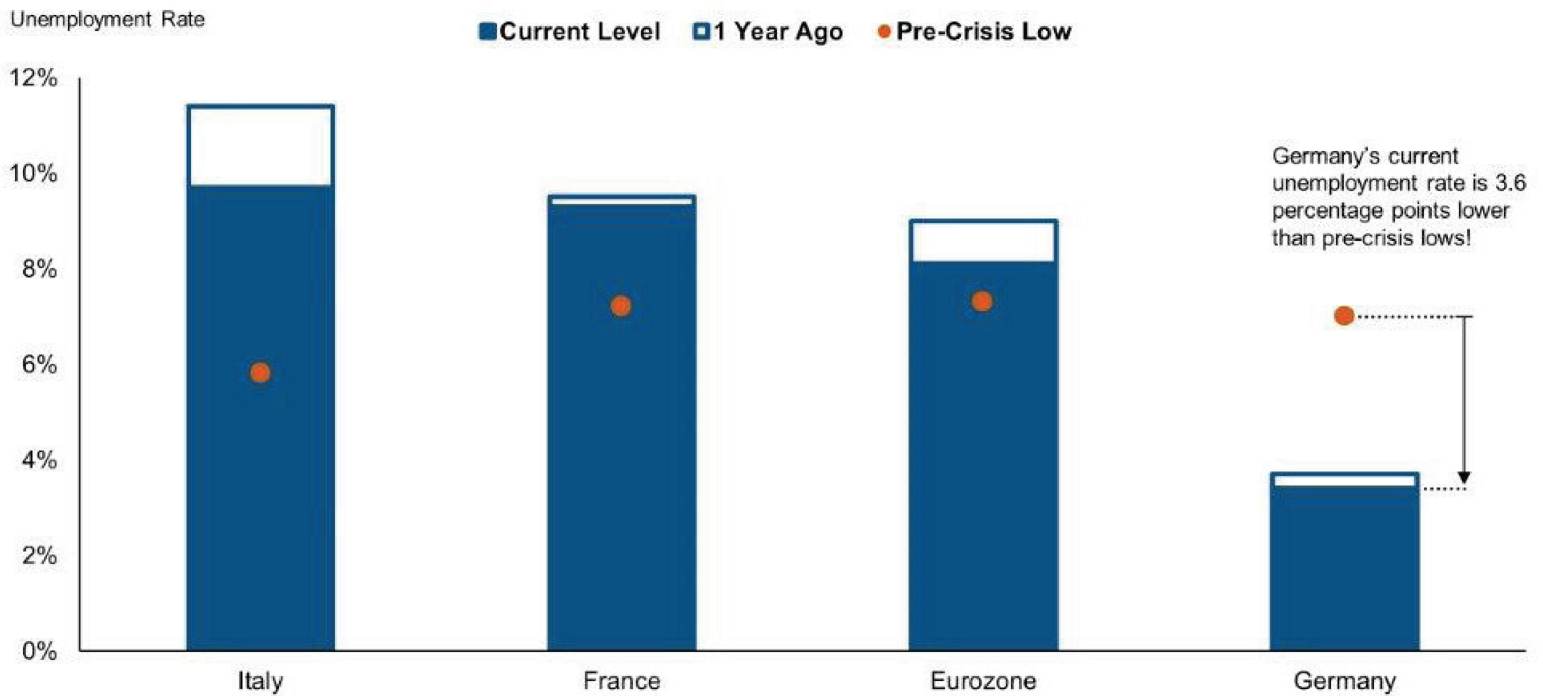
CHART OF THE WEEK

Payden&Rygel
Investment Management

The Euro Area Gets Back To Work

Unemployment Rates Across the Eurozone

For The Week Ending 10/05/18



Source: Eurostat

The unemployment rate in the eurozone fell to 8.1% in August 2018, the lowest reading of the cycle. The unemployment rate in the eurozone has now fallen or remained steady for 49 consecutive months, the longest stretch since the Eurostat series began in 1998. Across the continent, labor market stories vary. The three largest economies in the eurozone have lower unemployment rates than a year ago. Moreover, Germany's unemployment rate is now at 3.4%, well below 7%, its lowest level prior to the 2008 financial crisis. Italy and France saw unemployment rates as low as 5.8% and 7.2% prior to the 2008 financial crisis, but face unemployment rates of 9.7% and 9.3% today, respectively. Despite the lowest unemployment rate of the cycle, the labor market still has room to run before the European Central Bank considers a rate hike.

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