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CFGINSIGHTS

INDUSTRY TRENDS AND DEVELOPMENTS FROM CFGI

Welcome to the spring edition of *CFGInsights.* Our goal is to provide you with an overview of the most up-to-date accounting and reporting trends that companies face today.

IN THIS ISSUE

DEBUGGING SYSTEM IMPLEMENTATIONS

Don't be the statistics - beat them!

Accounting and finance systems are essential to a Company's ability to make key decisions and run the business on a day-to-day basis. If you have been involved in sorting through the remnants of a system implementation gone wrong, you probably already know that failed IT projects are not only demoralizing and a major distraction to employees, but also come with a high price tag of lost time, money and opportunity cost. It is critical that all of the risks surrounding a system implementation, and the mitigating strategies that can be employed to minimize those risks, are carefully reviewed.

The statistics behind unsuccessful system implementations are daunting and without understanding the key success factors, any project is destined to fail. Research shows a staggering 18% of projects will be canceled before being completed. Further results indicate that an overwhelming 61% of system implementation projects are completed with significant delays and cost overruns; 59% of projects had cost overruns, 74% of projects had time overruns and 69% of projects had missed business requirements.[1]

The costs of project failures are just the tip of the proverbial iceberg. The lost opportunity costs cannot be measured, but could easily surpass the cost of the project itself. Outlined below are three of the most important ingredients of a successful system implementation: (1) Executive Sponsorship; (2) Project Management; (3) Sound Methodology.

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SEC COMMENT LETTERS

WHAT ARE THE CURRENT HOT TOPICS?

Over the past two years we analyzed over a thousand SEC comment letters issued through Staff's review of a registrant's periodic filings. This analysis allows us to identify the SEC's focus areas in order to assist our clients in addressing their financial reporting in a way to mitigate SEC comments during its periodic review.

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TRENDS IN MATERIAL WEAKNESS DISCLOSURE

Over the past two years, we have analyzed Management's Annual Report on Internal Control Over Financial Reporting and the Report of the Independent Registered Public Accounting Firm for instances where a material weakness in a company's internal controls over financial reporting is identified. Our research indicates certain trends in the nature of identified material weaknesses and allows us to work with our clients to ensure risk is addressed when designing and testing their control environments.

Material weaknesses identified in our research indicates companies continue to struggle with controls around financial reporting, tax provisions and entity level controls as these areas are the most frequently identified material weaknesses. These areas are consistently noted in our continuous research that stretches back to the beginning

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[1] Standish Group, Chaos Manifesto 2013, Think Big, Act Small. http://versionone.com/assets/img/files/ChaosManifesto2013.pdf

DEBUGGING SYSTEM IMPLEMENTATIONS (CONTINUED)

EXECUTIVE SPONSORSHIP. The success of any project depends on the level of support provided within its organization, especially at the executive level. When an executive sponsors a project, they can champion the project during its most challenging moments. Moreover, executives have the ability to arbitrate differences in a timely manner and reinforce expectations during conversion. Enthusiasm for the project at the executive level can also spread energy and excitement to stake-holders of the project counteracting any organizational resistance.

PROJECT MANAGEMENT. When the timeline for a project is approached by only planning backwards from a fixed project completion date, experience has demonstrated that this leads to an increased failure rate. Often, project leaders will make decisions about when a new or re-engineered system will be most useful to have in production without the necessary technical knowledge to determine whether or not it is possible to accomplish successfully in the given time period. Moreover, the success of any system implementation project rests on the proper management of four interdependent dimensions: cost, quality, speed and risk.[2] It is not possible to have the best of all four factors; a system cannot be built quickly and inexpensively, be of high quality and have little or no risk of failure.

Additionally, key finance personnel involved in system implementations have daily responsibilities that need to be prioritized along with project tasks. To help ensure a successful system implementation, adding external resources with the requisite subject matter expertise and experience in implementations is often a critical part of the process.

SOUND METHODOLOGY. Many projects are started with little thought to process and activities are performed without having defined objectives. It is not unusual for coding to begin as soon as there is enough information, which is typically premature and lacks clear definition to the finished product. Even if the project does succeed without the proper planning, it will typically only do so with substantial rewrites and cost overruns.

This vicious cycle can be avoided through employing a sound methodology for documenting detailed business requirements by individuals with the necessary technical accounting skills to ensure that the new system will meet the needs of accounting and finance users.

KEY TAKEAWAYS. The focus of a successful system implementation should be about more than just the system itself; it should also be focused on the communication among the people involved and the project team's ability to remain dynamic over the life of the project. Additional highlights to a successful implementation include:

- *Having project support at the executive level;*
- *Managing the four key dimensions: cost, quality, speed and risk;*
- *Creating a project plan and empowering team members with the tools needed to actively track against the plan;*
- *Increasing project bandwidth by hiring consultants with subject matter expertise and project management experience.* ■

We support our clients with key finance and accounting considerations at every stage of the system implementation process including business requirements, data transformation and validation, user acceptance testing and go-live activities.

[2] Dorsey, Paul, "Top 10 Reasons Why Projects Fail" http://dulcian.com/articles/dorsey_top10reasonssystemsprojectsfail.pdf

SEC COMMENT LETTERS:
WHAT ARE THE CURRENT HOT TOPICS? (CONTINUED)

During the October 1, 2013 to December 31, 2013 review period, we analyzed over five hundred SEC comment letters related to Form 10-K and Form 10-Q issued to companies with a market capitalization between $100 million and $1 billion. The result of our review generated consistent results with our previous analysis as MD&A, Revenue Recognition, Taxes and Compensation continue to be areas of focus.

Our analysis included 20 SEC comment letters related to Form S-1, which has been a particular area of focus during the fourth quarter of 2013 as result of the surge in initial public offerings (IPOs). There were 178 IPOs during 2013, which is the highest number of IPOs since 2004, and Emerging Growth Company (EGC) status offerings accounted for 82% of all filings.[1]

EMERGING GROWTH COMPANIES. EGC status was created in the Jumpstart Our Business Act (the "JOBS Act"), enacted on April 5, 2012, to provide a streamlined path to access capital for companies with less than $1 billion in total revenue during its most recently completed fiscal year. The scaled down IPO disclosure requirements include:

- Two years of audited financial statements and selected financial data;
- Management attestation on internal control over financial reporting starting with the second Form 10-K, without a requirement for an auditor attestation report;
- Compensation disclosure reductions to include executive compensation disclosures on three named executive officers instead of five and no compensation discussion and analysis section, to name a few;
- New accounting standards to be adopted concurrent with private company effective dates;
- Confidential nonpublic reviews of draft IPO registration statements by the SEC staff, provided that the initial confidential submission and all amendments are publicly filed with the SEC no later than 21 days before the IPO "road show".

CFGI's analysis included 20 S-1 filings during the fourth quarter of 2013. SEC staff comments on filings under EGC status have asked for additional disclosures on the prospectus cover page to identify the Company as an EGC filer, a summary of the various exemptions and elections available to an EGC and a description of the circumstances and timing that a company may lose EGC status. Additional findings are detailed below.

RESULTS OF ANALYSIS. Through our review of S-1 filings, we identified the following key accounting and reporting considerations for companies expecting to file for the first time with the SEC:

S-1 Forms Top SEC Comment Letter Topics	S-1 Forms % of Total Topics
Management's Discussion and Analysis	19%
Capitalization Changes	13%
Revenue Recognition	4%

MANAGEMENT'S DISCUSSION AND ANALYSIS. Similar to other filings, SEC staff comments on IPO registration statements are focused on MD&A. The SEC staff frequently requests additional clarifying language to help investors understand the registrant's business since the facts and circumstances surrounding these company profiles are being introduced to investors for the first time. For instance, in the executive overview section, registrants may receive a SEC staff comment for details on how the size of a market was calculated and additional details on the customer segmentation and competitors within that market. Another continued focus is to ensure your company's relevant reporting and disclosures within MD&A are adequate and thorough by describing the underlying factors that drive the business.

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[1] Wilmer Hale 2013 Year-End IPO Market Review, January 29, 2014

SEC COMMENT LETTERS:
WHAT ARE THE CURRENT HOT TOPICS? (CONTINUED)

REVENUE RECOGNITION. SEC staff comments on IPO registration statements focus on revenue recognition due to the importance and complexity of revenue recognition models. Areas of focus continue to include multiple-element arrangements, software revenue recognition, milestone arrangements, proportional performance models, collaboration arrangements and sales incentive programs. SEC staff comments are aimed at providing investors with disclosures on the substance and fact pattern of the rights and obligations within revenue arrangements and on the significant assumptions used and judgments made in the timing and amounts of recognition.
It is important that your company includes in its S-1 filing a clear and concise description of its revenue transactions as well as a complete description of the significant conclusions reached in the accounting model used to recognize those transactions

CAPITALIZATION CHANGES. Changes in capitalization that occur simultaneously with the closing of an IPO is a common area subject to SEC staff comments due to the significant complexities involved with capitalization transactions. Typically, a pro forma balance sheet that reflects capital activity must be included in the filing to show the impact of the adjusted capital structure resulting from the IPO. Such capitalization changes may include the automatic conversion or redemption of preferred stock into common stock, the conversion of convertible debt into common stock or the reclassification of warrants to purchase convertible preferred stock from debt to equity. An example of a SEC staff comment follows:

"Please revise your pro forma balance sheet and earnings per share to give effect to this change in capital structure and revise the notes to the pro forma financial information to explain the nature and terms of this change in capital structure. The notes to your pro forma financial statements should also explain how any changes in weighted average shares outstanding were calculated or determined."

This example illustrates the depth of knowledge required to prepare a pro forma balance sheet for an IPO transaction as well as the necessity for your company to perform a holistic review of its capital structure to ensure the pro forma balance sheet is appropriately adjusted.

KEY CONSIDERATIONS. EGC filing status provides streamlined regulations when entering public capital markets. Preparing an IPO registration statement offers unique challenges in comparison to other filings as it marks the company's public introduction to investors. Preparing an IPO registration statement also offers some similar challenges, for instance, MD&A and revenue recognition are also top SEC comment letter topics for all filings and; therefore, require particular emphasis from all companies. Knowing the SEC focus areas and observing best practices in the preparation of your S-1 filing will reduce the likelihood of receiving SEC comment letters. ■

TRENDS IN MATERIAL WEAKNESS DISCLOSURE (CONTINUED)

of 2013. In the current period reviewed, weaknesses in companies' controls over accounting estimates are an area of increasing occurrence. We examined filings from July 1, 2013 to February 28, 2014, and, combined with our prior research, have identified the following trends in material weaknesses disclosed since the beginning of 2013.

INADEQUATE CONTROLS AROUND FINANCIAL REPORTING. Financial reporting controls continue to be the vast majority of identified material weaknesses, which is consistent with findings over the past year. Disclosures not prepared by employees with the requisite knowledge, companies lacking formalized controls around the review of financial statement disclosures, or companies unaware of the impact of new promulgated regulatory requirements and the impact on financial reporting are the most common control weaknesses.

ENTITY LEVEL CONTROLS. The number of material weaknesses associated with entity level controls, or the control environment, continues to be one of the top areas identified by company management and their auditors. On May 14, 2013, The Committee of Sponsoring Organizations of the Treadway Commission ("COSO") released an updated version of its Internal Control – Integrated Framework. While the core definition of internal control and the five components remain largely unchanged, the revised framework reflects considerations of many changes in the business and operating environments including:

- *Expectations for governance oversight,*
- *Globalization of markets and operations,*
- *Changes and greater complexities of business,*
- *Demands and complexities in laws, rules, regulations, and standards,*
- *Expectations for competencies and accountabilities,*
- *Use of, and reliance on, evolving technologies, and*
- *Expectations relating to preventing and detecting fraud.*

The newly revised Integrated Framework refocuses companies and their auditors to evaluate the robustness of the entity level controls. The application of the revised Integrated Framework to non-financial reporting aspects of an organization led to many newly identified material weaknesses in a company's entity level controls. Companies should revisit their risk assessment and consider control improvements.

ACCOUNTING ESTIMATES. Material weaknesses relating to accounting estimates are an area of increasing occurrence, most notably due to the expertise and professional judgment required to support certain accounting estimates. We note the most common types of accounting estimates receiving material weaknesses pertained to allowances (doubtful accounts, loan losses), valuation of financial instruments and valuation of postretirement benefit obligations. The PCAOB and SEC have continued to focus on the reasonableness of companies' estimates. Auditors are challenging companies' estimates and it's become increasingly important to ensure adequate and competent resources are in place to develop and support the various estimates within the financial reporting process.

TAX PROVISION. Material weaknesses with the design and operation of controls covering the completeness and accuracy of the tax provision are common. Companies recognize they have a deficiency of technical expertise in place to ensure that the process was properly controlled and misstatements would be identified. Companies found they needed more people involved in the process, as well as people with technical expertise in the area. ■

Our significant experience assisting companies in addressing control deficiencies through process remediation and process improvement allows us to support companies with the development of a robust, yet cost-effective approach in order to enhance their control environments. Streamlined, efficient control structures generate savings as control environments operate and are tested for compliance. Additionally, companies are better prepared to address risk and prevent the occurrence of a material weakness.

WHY CFGI?

At CFGI, we define our success by the quality of our work and the satisfaction of our clients. Through our deep knowledge base, industry expertise and passion for client service, we provide value add solutions to address client needs. We have built a reputation as the go-to solution for all – critical finance and accounting projects and continue to build our business by attracting the industry's best professionals and supporting them with the cumulative expertise of our firm. When you partner with CFGI, you gain access to a full-service financial consulting and corporate finance team. Through our well-rounded operational and technical expertise, our team is ready to deliver the services and support needed to achieve your goals quickly, efficiently and effectively.

Whether it is assistance evaluating and documenting complex technical accounting issues, or assistance with your financial close process, financial reporting and tax process, or assistance with your SOX process and documentation, we are uniquely positioned to help you with those needs.