GEORGIA ENGLISH LANGUAGE ACCA PROGRAM
INSTRUCTOR'S NOTES FOR ACCA EXAM PAPERS 3.4 — 3.7

Submitted to:

USAID/Tbilisi, Georgia

Contract No. EEE-I-00-01-00011-00
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March 6 – June 29, 2002

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Georgia English Language ACCA Program
Tbilisi, Georgia
March 6 – June 29, 2002

Contract Number:	EEE-I-00-01-00011-00, Task Order No. 800
Program description:	This activity assisted the Georgian Federation of Professional Accountants and Auditors (GFPAA) in providing training to support and develop the sustainability of the English language Association of Certified Chartered Accountants (ACCA) training program. An accounting training specialist educated in the British ACCA system developed and tested training materials for upper level ACCA courses to prepare students for the June 2002 ACCA exams. He also provided upper level students and those who completed the ACCA curriculum with training in basic accounting teaching skills to help build a cadre of future accounting trainers. In addition, the trainer reviewed the organization and delivery of GFPAA training courses and recommended in a final report changes to improve the institution's sustainability as a training provider.
Attached documents:	The following documents submitted by the trainer provide instructor's notes for the ACCA Exam Papers 3.4 — 3.7
Type of training:	Instructor-led classroom training
Dates:	March 6 – June 29, 2002
Location:	Tbilisi, Georgia
Trainer:	Peter Welch
No. of training participants:	6
Counterpart:	Georgian Federation of Professional Accountants and Auditors (GFPAA)

General introduction / applicable to all Papers:

What makes a good 'Instructor'?

These personal characteristics and attributes listed here are clearly subjective but most should agree that these are pretty close to being on target and cover a wide range of ideas and thoughts. To every 'would be' Instructor, naturally some apply and others don't but the overall perspective here should be clear and hopefully agreed with! It would be difficult to perceive of any Instructor that would vehemently disagree with any of these 'observations'. Some are intuitively obvious, I hope.

- A love for education, studying and a high respect for students
- You know personally what can be gained from studying, examinations and obtaining qualifications
- You've been through it and want to share this to benefit others
- A very positive attitude towards life and basically are very comfortable in what you do for a living
- You have high energy and are very enthusiastic about all things (but you're entitled to be crabby, irritable and human occasionally)
- You are very flexible and willing to easily change direction 'on a dime'
- You're not afraid to apologize or admit you were wrong in front of others
- You are someone that would never 'professionally' allow yourself to get into an argument with a student
- You are very respectful of the ethnic diversity and differences in culture, politics and religious convictions amongst your students
- You enjoy being 'up there' and have fun doing it
- You're not afraid or insecure to say you 'don't know'
- You respect every student's abilities and contributions and know that many students may well have experiences and knowledge in areas greater than you
- As an Instructor, you are basically there to teach, guide, direct, co-ordinate, manage and adjudicate.
- And, you are perfectly comfortable having any student 'respectfully' disagree occasionally with you

Teaching/Supplementary material notes

These instructor/lecturing teaching notes (developed as supplementary material to the Foulks Lynch texts, final papers) were designed to provide any GFPAA instructor with some ideas about how to approach teaching some of this material. The approach was to develop supplementary material that attempts to put a 'working experience' perspective on the somewhat at times, very dry, text reading material. For students who are following a self-study approach, this material has been incorporated as part of the Supplementary notes to the final level, Part 3 papers. Additionally, as an instructor, your role, I believe, is also one of helping and guiding students through the studying period and trying to keep them on track. Certainly there are many ways to approach teaching any subject and so consider these as suggestions only that hopefully will provide a basis for development of perhaps more personal notes and/or the development of a different style that may work better or be more reflective of a very different level of experience and background. The natural rapport of (you, as) locally based Georgian instructors will also have a major impact on future success rates and program development.

Regardless of the approach used however, certain fundamentals exist with respect not only to these ACCA examinations but also to any exam preparation. A recent article, attached, from the Student Accountant, May 2002 issue, entitled, '<u>How to clean up in exams</u>' is an extremely important coverage of 'test taking techniques' that literally can result in students unnecessarily receiving a failing grade. As instructors, you should make major efforts to ensure your students read and learn to apply these techniques. This paragraph from the attached article is but one example:

"One candidate had apparently run out of time, as only a few words had been written in the final answer. This candidate had <u>wasted</u> a considerable amount of time underlining what the candidate considered to be key words and phrases in the answers. Mark (Assessor for Paper 2.1) found this <u>irritating</u> – all that underlining distracted him from judging for himself which points were relevant and important. Suppressing his irritation, he gave credit where credit was due, but arrived at a total mark for the script of a <u>marginal fail</u>. If the candidate had spent more time completing the questions, instead of underlining key words and phrases, the script would certainly have gained a pass mark."

There are many more illustrations in this excellent article that are, at times, almost unbelievable and only serve to highlight the criticalness of exam taking techniques.

Students, hopefully, will also be strongly encouraged by (you) the instructor to:

- <u>Develop a study plan</u> that covers the weeks (preferably months) before the exams and keep to it (instructors could even monitor progress if the student was willing). Any 'realistic' study plans developed (strongly recommend using Excel) must build-in a very high degree of 'free-float'; so to speak, such that 'actual' study time always (if you do this right) ends up greater than the original plan. That's exactly what you want!

Not using this approach risks three critical things:

- the study material fails to get completed by the deadline and the final week is not used for exam practice, as intended
- the student starts studying under stress and exam fears heighten
- the student starts short cutting (not reading articles and working examples) and fails to prepare adequately

The idea is simple, by being very realistic at least on the first draft; the student starts to appreciate more fully just how much 'work effort and time needed' is required to complete the syllabus on time. Such a plan helps the students pace themselves and stay focused.

<u>Developing a Study Plan:</u>

If you have never developed such a study plan previously and have no idea how much time to schedule, suggest you use the following approach. Take a beginning and short chapter and 'time' how long it takes to read it once at a reasonable pace so that you are following <u>and understanding</u> (very important) the material. Take that 'time' and at a minimum, triple (3 times) it and that becomes a 'standard' for estimating all remaining chapters.

Why three times, well you must at least read it twice and in addition you must schedule time to answer all questions and take whatever notes you need for revision, so three becomes a reasonable proxy. After you've actually studied three or four chapters thoroughly keep track of how long it really took and if necessary adjust the multiple factor. In other words, that 'time' becomes the hours needed per "xxx" # pages. That is why Excel is suggested for modeling this kind of study plan; it makes it very quick and easy to do. Next, take all seven days of the week and schedule the time you 'know' you must have for eating, sleeping, working, playing etc, etc, and what is left is theoretically your 'study time'. No question here, you have to be very, very honest with yourself because otherwise 'your' plan quickly becomes unworkable. Once you've ascertained what study time you think you have available, start allocating the chapters into the days and quickly you'll discover just how long you will need to work this plan. At the first draft you'll probably be shocked to find that you're still studying the material two months 'after' the exams were held, that's normal. Go back and reevaluate your available time but now you are going to have to start making choices or sacrifices on any so-called discretionary time available and then rework the plan. This could take two or three drafts before you feel it is comfortable and workable. After that you simply make sure you keep to schedule and should you start slipping then be honest and readjust the remaining plan weeks.

[Final comment before you argue this is all a 'waste of time'. The sheer volume of material, especially at the Final Part 3 level, to cover is huge (and, sometimes very difficult to read) and it is impossible to 'thoroughly' study all this material on an, 'as and when you feel able', basis and be sure (how could you know) that you'll complete it on time. In the beginning, definitely some material will be studied very well but towards the end some critically important chapters (and important readings) will receive very scant treatment because you simply run out of time. A major component of these ACCA Papers is the development and understanding of strategies and business plans. Well, please explain why a business needs a 'plan' to keep it on the right path but you don't. In many ways, fitting in studies into a hectic and busy work (and personal) life is probably far more difficult than a business planning an acquisition. The prospect of re-sitting and restudying is daunting and unpleasant to most every student.

Consider also how the Pass rate for Part 3 is much less than the earlier sections. This is probably attributable to a lack of planning and students not realizing what Part 3 entails. Final word (promise), in the exam you have to be extremely disciplined in allocating your time to the questions (in a 3 hr paper, take every question's marks, double it and deduct 10%, that's how much you can safely spend on any question, e.g., 100 marks, becomes 200 minutes less 10% equals 180 minutes or 3 hrs) so applying the same discipline to actual studying makes everything that much easier and you get accustomed to it, very important.]

- Plan to <u>study multiple Papers in parallel</u>; don't study them one at a time. The risk of the first Paper studied becoming stale by the exam date is far too high.
- <u>Only if possible</u>, if a student is athletically inclined, keeping up an exercise regime (either daily/weekly) during the weeks leading up to the examination can make a huge difference and provide the energy levels needed to maintain the enormous work load between working and studying.
- All ACCA <u>Student Accountant articles</u> (and ideally other current event "NYT" business articles) must be read and understood during this period.
- All 'original material' studying must be completed at least a week (or slightly more) before the exams (it is important not to finish studying too early).
- If possible, take off the week immediately before the examinations and do nothing but work exam questions and answers under strict examination conditions (and absolutely no original material during this week). Studying the 'answers' also provides an excellent final review of the material/subject matter and 'confirms' (hopefully) that you've grasped and understood the topic. Additionally, students start to gauge what is 'expected' of them pertaining to each question.

This perspective can be critical for exam success because it provides the student with a 'comfort-zone' (the student knows they provided the required answer) during the exam and this helps tremendously in effective time-management and moving efficiently (and comfortably) from one question to the next.

- The weekend (Saturday and Sunday) immediately before the exam week should be time off with ideally no studying etc planned (occasional peaking to look at notes is ok, no student can totally relax). Hopefully it is obvious and also commonsense that refraining from drinking and any excessive eating is the order of the day. There is, in a way, not a lot of difference between an athlete preparing for the Olympics and a student preparing to take a very tough set of examination's, both require a similar discipline and attitude. Trust me, you don't want to feel tired during an examination.
- Preferably (a <u>personal decision</u>) do not take to the exam hall any last-minute study notes etc. The reality is that 'if by then' you still don't know the material, it's far too late and reviewing (last-minute) any material/notes at that point will risk the pre-exam panic or nervousness setting-in. {<u>That prior weekend was the time to do any of those last minute reviews</u>.} The truth is that no matter what you do focus in on 'just before 'that' door opens' there will always be something you did not review, so what is the point.

  You cannot, it's impossible, review the entire syllabus and your notes in the last few minutes. It is very; very important to be calm when you sit down in the exam hall. In the ideal world, if you've done everything above diligently then the actual examination is 'just another test' and that attitude and realization can make all the difference in the world.
- Studying and exam techniques are obviously a personal matter derived from experience but if you follow a disciplined approach as suggested above it is very hard to go wrong.

As a final point, I believe it is very critical for 'you', the existing instructors here in Georgia to try and form some kind of 'informal' association. Several major advantages would arise from such an association:

- It is more likely that as existing instructors, you will remain 'onboard' if you feel part of something. (teaching is not easy)
- Until a critical mass has been obtained here, you are all critical in enabling the program to continue going forward, and within such an association you can work better together in support of the GFPAA's goals.
- Such an association will probably do much to attract other 'finalist' students into the fold with you especially if a certain prestige follows that of being a 'member'.
- Most important, new instructors will feel they have a support network and can tap into 'you', the existing instructors skill sets

to deal with teaching issues. As existing instructors, you could offer to co-teach the first one or two classes in support of a new instructor to help ‘getting them off the ground’, so to speak.

Anyway, seriously think about it!

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Paper 3.4

Section I

The syllabus for Paper 3.4, Business Information Management, encompasses a significant amount of reading material, no calculations naturally, and draws upon a number of notable authors in the field that have contributed in this area. The Foulks Lynch material (and also that of Financial Training Company and others) is basically forced by way of syllabus compliance to divide the material into chapters. As the above syllabus, courtesy of FTC, indicates there is, as with all these syllabuses, a considerable amount of theoretical and academic coverage. The problem again here is that unless the student has had considerable industry or work experience it can be very difficult trying to relate to the material, which can at times be very dry both for the student and the Instructor. This is the purpose behind this Supplementary material, to provide a sufficiently detailed look into the real world and thus, it is hoped, gain, for you the student, a much better perspective on the different aspects of the ACCA syllabus dealing with this subject matter. All this material is the accumulative result of nearly 25+ years of (accounting/finance) working experience in organizations that range from billion dollars to small startups and also direct experience in the Software implementation and Consulting field. Having specialized over several years in the area of Information Reporting and that of (Excel) Business (5-year Plans) modeling, especially using advanced ERP software systems; the 'appreciation' of the enormity of information is very solidly imbedded (along with 'how' to get it).

In the real world, many things happen that are both serious and hilarious at the same time but no 'serious' academic treatise would dare mention such things, despite the fact that they are nevertheless absolutely true and part of 'getting things done'. Let me share a real life example that few of my students can ever believe actually happened. Understand here, that Information Technology guys (the 'IT' guys) unfortunately, and often unfairly, get a bad reputation of being, on occasion, somewhat 'user unfriendly. A lot has to do with the onerous demands placed on these people and the, again unfortunately, lack of respect and appreciation of what they do. Unless you happen to be somewhat of a 'geek' yourself, it is very hard to realize how difficult it can be to resolve many of the reporting and database issues faced constantly by the IT Department. Sometimes, in smaller organizations, it is not uncommon that IT may literally be one person, not an envious position to be in. So with this backdrop, let me tell the story.

On a Friday, late afternoon, around 5:45pm when most human beings have rapidly departed for the weekend away, I had an urgent need for some IT help. Now, understand here, that I had already discovered (within the previous hour or so) that I could eliminate the need to run a 3,000-page report by extracting the information using an Excel spreadsheet. Up until then, the information needed was 'manually' extracted and entered (typed) into an Excel spreadsheet (not good). But, because the data was so huge, I was only able to use Excel for the smaller database and hence I needed IT to extract the data directly, bypassing Excel, and I knew it could be done and exactly what to ask for. Well, it was 5:45pm, as I said, IT was hanging around and about to 'go home' when I approached them for my 'request'. Usually, no one in his or her right mind would ever dare doing such a thing. I also understood this needed some 'very serious begging' (and diplomacy) on my part, and so, in my mind, there was only one approach to take. On both 'knees' I got down with hands clasped in a pray-like fashion (grinning from ear to ear) and said 'can you guys help me??'

Well, after we all finished cracking up laughing over my antics, they said 'ok, ok, you can get up now', they proceeded, within only a 20-minute time frame; to get me the information that no-one had previously ever bothered to 'specifically' ask for. So they (IT) had been running this 3,000-page report, month in and month out, just because no one had the insight into realizing what was needed and how to ask for it. It was not, I would say, the fault of IT (they do not usually know what you want the information for, they are not accountants), for always here the so-called blame must rest with the 'User-community' who need to take responsibility for what information they need and how to communicate it with IT to derive the most cost and time efficient means of getting it. This role is often that of the Business Analyst who usually possesses a combination of some basic IT skills and that of Accounting/finance. The Business Analyst basically forms the bridge between the User groups and IT. And, oh by the way, I was only a Consultant and not even an employee and they still did it for me. Bottom line, you do what you have to do (with humor if possible)!! Can you only imagine what would have been the outcome if I had 'demanded' this from them (at 5:45pm on a Friday afternoon) because after all, it was the job of IT to 'give me the information'? I believe my assignment (or do I mean retirement) would have ended long before I'd have actually got the information. This is reality and politics not theory.

Does all this mean that 'official' emails and/or requests for information do not work, definitely not. However, just because it is in official form doesn't mean that the 'pleasantries' of asking nicely no longer apply, they still do. Actually, the fact that it is in writing probably means even more likelihood that the words will be carefully chosen. Most people have a boss and that boss also has a boss and so on up the chain of command. The higher you go (or in either direction) there is a high probability that friendships/ relationships across departments have already been forged, so be careful how you ask regardless of the medium selected.

As a student, you study the discipline of accounting along with all the academic theories, tools and concepts that apply. You view various diagrammatic representations of concepts and principles along with somewhat 'odd' descriptions of processes but fundamentally every organization is simply comprised of 'people' or put another way, an organization comprises of multi-disciplines (people) all working and interacting together 'synergistically' towards the common objective (you hope). You get things and 'information' only and only by working with and through people not processes or departmental structures (do not make the mistake of thinking that ERP software solutions replaces the 'people' component, it does not, actually it increases the people element but significantly raises the threshold of information access and seamless interface/transfer of data across modules). Every person in every organization and in every department is just as complicated, as moody, as irritable, and as friendly as everyone you know, outside of work, on a personal as well as even a marital basis. Effectively, for things to really work in any organization, the trials and tribulations of a marriage equally apply. You don't believe me, try getting information from someone that 'thinks' you don't like them or you've done something or said something to upset them. Contrast that to your 'other half' after you accidentally make a comment about his or her Mother (truthful or otherwise), the same applies exactly.

Organizations comprise, it should be understood, not of products or services per se, but of massive information flows. The information (people controlled) is 'about' the products or services but what controls the organization is the information itself.

Think about it this way logically, the only way you 'stay in business' is to become and remain profitable (as measured by accounting information) and generate real economic returns to your shareholders (true), but you only become and remain profitable by control and unless you have 'business information' you cannot by definition be in control because without business information you don't know 'what to control' nor what is happening. Only good information gives you the ability to make good business decisions. A type of paradox, I believe. Can you imagine a CFO telling everybody that he or she 'thinks' everything is great but they don't know for sure because they don't have any information, not a career enhancing strategy.

Later we'll discuss in great details about what happens when an organization decides to either upgrade or invest in a totally new ERP software system such as Peoplesoft, SAP or Oracle. Additional we'll talk about the fit/gap analysis that takes place along with the RFP (Request for Proposal) that also comes under the heading of due diligence. More later.

As we discuss this whole area, the information flows and/or content of some department or key functions will be reviewed but more importantly, you should start to appreciate how each and every department's information flows becomes a critical input to another key area within the organization (the interaction of disciplines).

First, let us begin on a hypothetical Monday morning at 9am,under the following scenario, last week was month-end and the CFO and Head of Human Resources (HR) were both out of town at a business meeting all last week:

- The Chief Accountant (CFO) arrives in and on his/her desk 'could' be the following:

1. Company-wide or consolidated draft P&L for the month-end along with Budget to Actual top level variances (excluding monthly accruals)

2. An analysis (or possibly just a listing) of major variances, say over 10% or $500. The reasons will follow later.

3. Sales figures for last week and last month by major product.

4. Collections for last week and last month and DSO figures.

5. Cash and/or positions and bank ledger balances by each day last week and monthly daily trend.

6. Notification of short-term rollovers, maturities and any position close-outs (foreign currency contracts) etc.

7. Production figures for last week and for the month.

8. Key performance indicators last week and for the month (Balanced Scorecard type data).

9. Summary of any key economic data that was released.

- Head of Human Resources now arrives in, but on his/her desk 'could' be:

    1. Productivity statistics by Product-line and by certain groups of manufacturing employees on the assembly and/or production line for last week and last month's trend.

    2. Productivity/operating statistics of Employee hours by manufacturing and overhead department for last week/month (Variable cost labor).

    3. Overtime hours worked last week and last month.

    4. Any changes to Payroll including hires and fires.

    5. Summary of any firing actions and documented reasons.

    6. Summary of any disciplinary actions taken and why?

These two hypothetical situations serve to illustrate a major point, that is, both positions albeit at the senior level, require information from different parts of the organization that on the surface are unrelated to his/her function and yet at the same time are critically important to that employee performing his or her job function satisfactorily. As we said, organizations exist with multi-disciplines all interacting together (are co-dependent) and not independent. As we'll see, the use or interpretation of the same information but by different job functions/departments can have major ramifications across the entire organization. This also has a great deal to do with performance measurement and job functionality, the same information minor to one person can be significant to someone else.

Accounting, the language of Business

Though it should seem obvious to any accountant, certainly one studying at the final professional level; that in a real and 'business information sense' accounting is truly the common language of business. But, what is really meant by this statement and how far reaching is it.

Consider that regardless of how complex an organization is, regardless of whether it is a manufacturer or a provider of services, regardless of whether it is domestic or is a multi-national and regardless of whether it is a startup or a billion dollar corporation, all these entities end up producing a Balance Sheet, a Profit and Loss Statement and a Statement of Cash Flow.

These three critical statements, reflecting the financial representation of an organization, effectively become, the ultimate 'top of the pyramid' irrespective of the complexities beneath. By definition therefore, accounting information, and that includes both financial and non-financial combined, must permeate all aspects of an organization in order for these three critical statements to ever be generated. The syllabus, above, requires students, within this Paper, to:

- Identify the information requirements of different levels of management and understand how information is used to support the objectives of the organization.

Though we will certainly be both directly and indirectly referencing other 'syllabus requirements' (of this Paper) this one alone is very far reaching. The statement has about three components, namely:

  - information requirements (what are these??)
  - different levels of management (senior, mid-level, junior or employee empowerment??)
  - support objectives (what objectives??)

By examining some of the key operating departments, the answers to these questions should become intuitively obvious.

The following chapters will address some of these departments or key areas and raise discussion on other aspects of business information. It should become clear very quickly from reviewing the department's primary or major functions just how much cross over and business information exchange is required, business is 'information flow'.

- Accounting (CFO and Controller)
- Treasury (Finance and Cash Management), duties include:
    - Primarily Cash and/or Bank and Short-term Investment management
    - All short and long-term debt and equity financing structures
- Human Resources, duties include:
    - Company wide staffing and people resource procurement and training
    - Administration of Company wide Benefit Obligations
- Manufacturing Operations/Production
    - Responsible overall for Raw material Inventory levels, WIP and level of Finished Goods and the quality of Finished Goods 'sold' to customers.
    - Responsible for meeting all production targets with adequately trained employees and management/supervisory personnel.
- Materials Procurement/Inventory Management
    - Responsible for obtaining the above Raw Materials, needed by Production at the lowest cost available and meeting all timeliness requirements.
    - Responsible for ensuring the accuracy of all Inventory account positions and transfers to Production departments
- Accounts Payables/Vendor (Creditor) Management
    - Responsible for managing the processing of all Vendor invoices and payments in accordance with best terms available and managing Vendor (Creditor) relationships
- Costing and Budgeting
    - Overall responsible for all product related decision-making information and accurate reflection of product costs and revenues.
    - Responsible for development and preparation of Operating Budgets, Business Plans and for maintaining all cost data, standards costs and controlling all expense levels and coordinating company wide budget preparation in accordance with CFO Accounting office Executive level guidelines.

- Sales and Marketing
    - Responsible for development of pricing/competitive research and recommending/implementing a pricing strategy
    - Development of new products and identification of new markets and channels of distribution
    - Responsible for Credit collection and for managing Accounts Receivables (Debtors) in accordance with CFO/Executive directives.
    - Administration of Sales commission programs and hiring/training of new sales staff

Senior Executives (Chairman's Department and CEO)

Section II

- Sales and Marketing
    - Responsible for development of pricing/competitive research and recommending/implementing a pricing strategy
    - Development of new products and identification of new markets and channels of distribution
    - Responsible for Credit collection and for managing Accounts Receivables (Debtors) in accordance with CFO/Executive directives.
    - Administration of Sales commission programs and hiring/training of new sales staff

Lets examine the 'Sales and Marketing' department in greater detail but first lets review again the idea of 'business information'. This is one department that needs business information (especially non-financial) probably more from the outside than necessarily the inside. By the inside, we always mean the internal information system, assuming an ERP (Enterprise Resource Planning) type software solution, and the information always comprises financial and non –financial. By this time, to believe that information must mean 'financial' only is to fall short of appreciating the full dimension and complexities of today's organizations and the true concept of a performance measure system or what is sometimes referred to as the balanced scorecard approach. Hopefully you are now very familiar with this 'balanced scorecard' approach covered thoroughly in Paper 3.3. Even before such 'labeling' was introduced (the balanced scorecard) the concept and idea of tracking performance using non-financial measures is definitely not new.

As a revision, the Balanced Scorecard approach (courtesy ©Foulks Lynch) focuses on 'the idea that performance has to be measured from four different perspectives:

1. How do customers view the business? (the customer perspective)
2. What skills and processes must we excel at? (the internal perspective)
3. How can we improve and increase value? (the learning and growth perspective)
4. How do shareholders view the business? (financial perspective)

The answers to the above questions will form the basis of 'a coherent set of goals and performance measures'.

An important point to remember is that 'ultimately' all information regardless eventually does become financial in nature, so effectively it is a timing issue, albeit a very important one. The observation of the eventual translation of all actions and events within any organization into the accountant's set of financial statements (debits and credits) is a reality and truth to any business. (When I teach basic bookkeeping, the confusion of debits and credits are less of a problem if you simply view them as recording economically what you just did, e.g. 'purchased office supplies for cash' should automatically tell you to use 'office supplies' and 'cash' to record the transaction.)

Consider the example of tracking the number of 'customer complaint letters'. Without a doubt, this is a true non-financial measure but in time and without management action this eventually will 'financially' translate indirectly into lost sales and revenue but more importantly into lost customer goodwill thus damaging future sales even of new and totally different products and services.

Some businesses have very long time periods before the true economic profit ever finally emerges. In the 'Life Insurance" industry, theoretically, everyone has to 'die' before you truly know whether you under or over reserved for such an event. Meanwhile, year after year, you can only make educated guesses based upon Actuarial Morbidity Tables that attempt to predict such occurrences.

Following on from above therefore, the critical point here is that 'if you wait' for the accountant's sales and revenue data to tell you the reality of what is happening to your business, it is probably by then far too late and the damage has already been done. By using such non-financial business information (essentially an early warning system), management has the opportunity to rapidly take action and correct the problem, even actually improve customer goodwill (because management did something about the problem and it was noticed) thus potentially increasing sales and revenue all originating from some 'bad news'. As a Managing Director once said to me, 'if all you can do is tell me what I've done, you're useless but if you can help to show me where I am going, you're providing some real value?

No one person or any business is perfect and problems etc are always expected but the issue is not the problem itself but what you do or did not do about it! Customer relationships, which are today embodied in CRM (Customer Relationship Management) software solutions, that have become partnered with ERP software providers in recognition of just how important customers (and sustaining sales and revenue) naturally are to any business. Again, appreciate here that such CRM solutions have become an additional and major component of today's 'business information' with respect to sales and marketing departments.

To demonstrate then how the Sales and Marketing departments work in reality, let's use ABC, as a pseudonym for a very well known Company in the Express Distribution Industry, as an example here. The objective therefore is, how do you attract and maintain the highest level of customers in the business while still remaining profitable (a key limiting factor to selected business growth). For this type of business, as far as customers are concerned, price and speed of delivery (service) are the primary considerations. For customers, the 'cost' of using the service must be the lowest possible and there is no 'after-service' consideration and any quality differentials between the company's is irrelevant, it is just a matter of 'was the package delivered on time or not' and if so, end of story.

We'll add just a couple of riders, however, here, the 'reliability' of service is extremely critical and can override price consideration and no customers want their package arriving damaged. So assuming these 'other' factors are equalized between the major competitors, only price and speed of service remain. Also, the 'speed of service' includes factors such as 'pick-up' and 'drop-off' points and having the 'latest' possible times for pick-up and yet still be able to guarantee a 10:30am delivery time. It might not therefore surprise the astute student that bottom line highly competitive margins in this business can be razor thin.

The pricing considerations from the Company's standpoint must factor in such things as:

- Cost of transporting domestically and overseas and this of course includes such variables such as fuel costs, efficient (east-west) routings, equipment maintenance, purchasing of airline fleet/replacement, local available labor and wage rates, skill sets, condition of local roads and prohibitive local regulations pertaining to scheduling local driver/van stops and pick-up points (a major factor in servicing customers by being able to meet the guaranteed delivery times)
- Desired margins relative to the available 'volume' of local business and determination of airline load factors to maximize routing efficiencies and stops enroute.

Actually, ABC employs Industrial Engineers to calculate many of the above factors and to determine business feasibility. It should thus, go without saying, that the 'business information' requirements are enormous and highly detailed in order for any possible projection of sales/revenues to be derived. Sometimes, 'select' business (by weight range) may be deliberately (over) priced to avoid acquiring or attracting uneconomical business. To maximize profits therefore, only a combination of selected routing costs/efficiencies along with destination and desired weight/volume and acceptable margins will derive the optimum business mix to be aggressively sought after.

Only after all the above analysis etc has been performed can the other major elements of the sales/marketing department (in ABC) be pursued, namely:

- Responsible for Credit collection and for managing Accounts Receivables (Debtors) in accordance with CFO/Executive directives.

In a thin-margin business, as a student, consider the bottom-line costs of working-capital management when ABC billings to its customers are not getting paid fast enough relative to the overall cash flow of the organization and the company has to 'pay' for short-term borrowings and/or credit lines. This reflects a 'leverage issue' that can be very high in any business where margins are not sufficient, meaning that a small increase in finance (or any) costs can disproportionately shift a profit into a loss position or can cause a disproportionate percentage change in the projected profit figure itself.

- Administration of Sales commission programs and hiring/training of new sales staff

If you fully comprehended the above type of analysis/due diligence that a business like ABC is in and has to do, it will become very apparent that only a very well educated and trained sales force can fully support the business goals of the Company. Consider the financial ramifications that could arise if, after all the above analysis was completed, followed by the subsequent identification of the right 'economical' business that ABC should be targeting, the sales force then signed-up the wrong and uneconomical type of business customer and offered uneconomical volume discounts. Again, business information becomes a critical component to success.

This material, overall, has presented strongly how business is really the interaction of disciplines working together towards a common goal. Well, as we view other areas/departments we'll continue using this ABC type business (or for that matter any razor-thin margin business) as an excellent example of just how critical this concept is.

Section III

- Manufacturing Operations/Production
  - Responsible overall for (Working Capital Assets) Raw material Inventory levels, WIP and level of Finished Goods and the quality of Finished Goods 'sold' to customers.
  - Responsible for meeting all production targets with adequately trained employees and management/supervisory personnel.

When we looked at the sales and marketing function we used ABC (a pseudonym) as a form of case study to examine the criticalness of needing business information in order that the 'right' decision of only targeting certain customers that were 'economically sound'. In that kind of business, with such marginal profits given the very tight competitive position, no Company can afford to randomly select business and go after 'everybody'. Every customer incurs a (production) 'cost' and unless that cost is below the offered price, naturally a loss will arise. There is clearly such a thing as a bad customer (loss making business) and an excellent customer that offers the Company high rewards for high volume repeat business. In a sense there is here a 'synergy' between the customer and the company whereby both become winners, the customer receives a 'low cost' (discounted price) relatively for the service/product and the company achieves an acceptable rate of return on that business. But the question here is, what makes an ABC type of business so different that only highly accurate business information will enable the company to be profitable? Just because a 'manufacturing operations/production' normally is applicable to a traditional type of factory-belt environment, doesn't mean you cannot apply it to other types of businesses. The ABC type of Hub operations (spoke and wheel concept) is in many ways akin to a production-type environment.

In a more traditional type of business, whereby a business manufactures a product (single or multiple) or sells a service such as 'accounting or consulting' both the product and the service is relatively tightly defined such that each product sold 'will' derive a contribution/profit and all services (hours) performed for a client will generate an automatic profit relative to costs incurred. Ultimately, of course, whether either type of business becomes profitable overall depends on the volume or level of activity. This gets back to the concept of break-even analysis whereby each and every subsequent product sold contributes directly to profit. Here we are talking about manufacturing a product, such as an automobile, whereby all costs involved are detailed down to each nut and bolt, thus when you 'sell' that automobile you theoretically cover all costs and contribute to profit. A very important point here is that the 'costs' are 100% known and identified per 'product or automobile' before you determine the selling price. But, what if you have an ABC type business that offers a service (delivering packages overnight guaranteed by 10:30am) here you have a situation where 'critical mass' becomes a minimum to derive a profit. Arguably, you could suggest that the company simply prices accordingly and some customers may have to pay very high charges to receive that service and for other customers, the price is significantly lower due to economics. True, but totally unrealistic, nobody would pay for it. Add an additional complication, how do you derive any price using that concept when the cost/package is initially an unknown variable.

Why, well first, because until you have the airline fleet in place, the routing scheduled, the forward contracts in place to buy the fuel, the delivery trucks and drivers ready to pick-up and deliver and the 'Hub' fully operational, ready to service all incoming flights and distribute the packages (just like the US Postal Service), you cannot offer any service. Secondly, the 'per package' cost (averaging) is a function of volume and when you 'sign-up' a new customer, you have no idea whether they will come through with the volume they anticipated when they requested 'volume discounts'. It doesn't take much to appreciate that this type of business is in some ways in a 'catch 22' predicament. Again, it continues to come down to the critical importance of having excellent business information ready at hand. Unless you track a customer's volume, you do not know whether they misled you with anticipated volume in which case the discounts should be rescinded.

Such a business therefore requires in a sense taking a significant gamble or a leap of faith. The upfront investment is as already mentioned, getting all the 'operations' ready to receive and deliver the packages. Next, the sales force needs to sign-up the targeted and economically desirable type customers and after that, it is a gamble that the anticipated volumes will come through. In the case of more traditional type businesses (automobile production), increases in production can be phased-in or increased gradually as sales start to climb. So initially, the customers may experience back-orders until production catches up with demand, again the need for trustworthy and reliable business information to backup decisions to increase production. With an ABC type business, initially you commit everything (rather hard to fly half of a plane) and you trust and hope that generated sales (volume) activities will ultimately prove to have justified the investment. You cannot 'back-order' the delivery of a package, especially when you've guaranteed delivery. Additionally, the customer knows immediately if you've met the deadline especially in today's email and telecommunications mobile world. Today, using tracking technology, a customer using a hand-held Palm type device, knows within seconds exactly where a package is enroute.

Even if it were feasible to increase the price to cover uneconomical deliveries, the competition would, in all likelihood, be ready to step in and offer a much lower price. Obvious question, how could they afford what you cannot? High probability, they would also incur a loss but in many instances the opportunity to 'steal' business by offering deliberately low-ended prices for selected weights, products, and destinations would position them to later gain the more profitable and lucrative sector of the market and price accordingly. Customers want everything and do not necessarily accept the cost of meeting their demands. As we said in Chapter 2, all things being equal, 'for this type of business, as far as customers are concerned, price and speed of delivery (service) are the primary considerations.' Businesses know that and so effectively price wars are part of operating. A good business strategy is to offer selected and limited uneconomical prices in order to capture the more profitable routes/products. For the economically sound routes/products these 'loss-leaders' in a sense become part of doing business, or another type of 'cost of goods sold'. Again here, having good business information and tracking such strategies is critical to ensure that such an approach has not backfired. In a low or thin margin business, literally any additional costs can be the difference between profit or loss.

Another aspect to realize is that should a price-driven strategy be successful in stealing a significant portion of the competitors business then the remaining player has greater options to raise the prices to generate a more realistic return and cover these loss-leader costs. Though price and delivery are the primary customer considerations, it is not unusual for 'customer loyalty' to play a part once a Company has acquired the business and keep offering slightly higher discounts as volumes creep upwards. But, a driver that accidentally damages a package can create immense negative goodwill and possibly cause permanent customer defection to the competition. A good business information system should sound a warning were any package to become damaged and enable the management/sales executive to step in and appease the customer immediately. Time here and rapid responsiveness literally can be critical to salvaging the business.

Section IV

- Costing and Budgeting (Management Accounting)
    - Overall responsible for all product related decision-making information and accurate reflection of product costs and revenues.
    - Responsible for development and preparation of Operating Budgets, Business Plans and for maintaining all cost data, standards costs and controlling all expense levels and coordinating company wide budget preparation in accordance with CFO Accounting office Executive level guidelines.

So far we have, using the ABC (a pseudonym) form of case study, talked a great deal about the criticalness of the initial costs incurred relative to achieving economical volumes to justify the business. The average 'cost per package' is a major performance measurement criterion within this type of business. Not only is the load factor per flight extremely important, but also the actual positioning of the load itself can play a significant role in the calculated fuel efficiency and in the unloading/destination considerations. We've stated clearly already that the only successful long-term strategy is one of targeting those 'economically' sound customers meaning competitive pricing for selected weight/volume and certain destinations. Put very simply, you need to define exactly what business you want to go after because those anticipated volumes/weight and destination combinations offer the greatest return. Once you do that, then you price accordingly with volume discounts to aggressively get the business. If, on the other hand, there are only a few customers anticipated, and with low volumes, that want to ship to certain destinations, you strategically price to turn the business away or you simply do not offer those routes. The doubled edged sword here is being careful not to appear as a 'less than a full service' provider thus playing into the hands of your competitors. How do you come to know all this, business information again!

Within the Costing function, there is obviously a major need for business information both internal and external. It would be good here to <u>repeat what was written for Paper 3.3</u> pertaining to the description of how business plans are compiled within the framework of a so-called typical year, as it relates to the Accounts Payable function being one of the sources of information used to derive cost drivers.

[Lets address a critical issue here relating to the identification and recording of expenses/costs in any organization, namely the <u>Accounts Payable</u> function. There is an entire chapter or so that addresses the syllabus requirements (Paper 3.3) pertaining to the actual identification of costs as to whether they are variable or fixed in nature (by behavior) and what, if any, are the cost drivers. However, once a cost has been so identified, in accounting/costing terms, that also identifies (or should do) the general ledger account (chart of account) to which this will debited (Dr) within the accounting system. Any good management accounting system will have developed a chart of accounts that in great detail, along with account roll ups, records and tracks expenses by type and behavior. This is not simple nor is it easy to maintain but in theory in can be an excellent system. A major obstacle is the employees/staff behind the mass processing of invoices and the inherent inaccuracies of correct 'posting'.

It is never the system but rather the 'people' that fail the system constantly in tracking costs and expenses. Additionally, vendors (creditors) are frequently changed, managers will be hired and fired, clerical turnover can be very high and supervision/training can be very poor. None of these factors contributes positively to the desired outcome of an accurate system that identifies costs by type. Frequently, the managers themselves can be the systems worst enemy as they are often operationally focused and not naturally orientated towards the accounting mentality. They often control the G/L accounts to be charged especially as each Manager is probably responsible for a Cost-Center or department (depending upon the organization) along with all the G/L accounts (by product and department sub-code) under that Business Unit concept. They may have little interest in the preciseness of recording the expenses under their control as long as it is overall under-budget, a clear performance issue. They care greatly about 'what amount' is being charged to them but they may not be too concerned over finessing the accounting reflection of their actions.

Realize here that any 'errors' in correctly booking the expenses to the right accounts will have a major ripple effect of giving erroneous information to management accounting responsible for analyzing and ascertaining behavior patterns. Over time and with experience it is possible to visually identify incorrect account postings but in a huge organization with countless vendors (creditors) that is an extraordinarily difficult task. The ability to export and download G/L files and/or G/L account data to Excel (Peoplesoft have tools that will facilitate this called Query and Nvision) somewhat mitigates this problem. Many other data extract tools exist within or partnered with major software providers to enable the accounting areas to extract and analyze the data.

Identifying a cost as variable or fixed in nature is based upon a combination of behavioral observations and research plus experience. However, the overall source of 'those changes' per se (as clearly discussed above) is the Accounts Payable system that originally booked or recorded the expense in the first place. In other words, summarizing what we said above, a Vendor sends in an invoice for payment and the Manager, authorized to order the item, will approve the payment and identify the G/L account to be used. This process repeats itself many, many times and over the course of a few months or a year or two, a pattern of cost behavior will emerge. Often, the Cost or Management Accountant will develop massive spreadsheets that will attempt to track these G/L accounts and attempt to determine what relationships may exist, such as a cost-driver.]

All the above is ‘business information’ and in the case of the Costing/Management Accounting function it is the primary source of attempting to derive and analyze cost behavior. Again, using an ABC type business as an example, the true identification of variable and fixed costs can be the difference between accepting or rejecting very profitable business. ABC used to employ an approach with respect to approving below targeted gross margin business. Depending upon the ‘derived’ return that dictated the level of signature or approval that was required.

Now, considering that the return was a function of both price and costs, it takes little to appreciate the importance and just how significant (from a leverage perspective) therefore is the imputed accuracy of the cost ‘business information’. When you consider the problematic area of capturing cost data, you realize how quickly and what risks are borne by basing key decisions on data that is inherently flawed from the outset. The issue is that no matter how sophisticated you are, what software solutions you employ, the difficulties of totally and unequivocally identifying costs, as being either variable in nature or fixed still remains an uncertain science. When Vendors (suppliers) are contracted or approached to provide goods and/or services, they do not send in invoices for payment marked ‘variable’ or ‘fixed’, for obvious reasons, relative to what? Thus the determinant of this criterion or classification becomes an internal evaluative process only.

Certain costs/expenses are without question automatically pegged as fixed or variable in nature just by ‘what they are’, such as ‘office lease charges’ clearly are unlikely to be unrelated to production and the costs of specifically defined raw materials are obviously variable in nature. The problem is that many key suppliers send in voluminous invoices with literally ‘hundreds’ of items listed often with very poor descriptions provided. All these invoices have to be ‘keyed-in’ to the system and posted to a GL account, probably to a production department ‘cost’ account. In a perfect world and only if you knew ahead of time, you could probably request that your supplier sends in even more invoices but including only certain items that ‘you’ know were either fixed or variable and once received you accordingly and accurately recorded in a designated chart field account earmarked as either fixed or variable. My realistic answer to this request is probably ‘good luck trying’ but you’re not likely to get a favorable response, as bottom line, it’s your problem to handle the bookkeeping end and not to blame the supplier who after all just wants to be paid. If you want them to do your bookkeeping, be prepared to pay for it. As we discussed above, between the Managers who order and approve payment, to the Accounts Payable clerical staff, frequently overworked and understaffed, there is no easy and clear-cut solution. It is not that it is totally wrong but that no one can for certain know just how accurate it really is and even small margins of error can leverage into significant lost opportunities when decision-making presupposes a high degree of accuracy.

This, therefore, is one major area of ‘business information’ that can directly impact the bottom line (positively and negatively) as well as across multiple departments that use the GL account activity business information to perform analysis etc. The source of so much information is channeled through the AP function because it is the one area that is responsible for booking and paying (managing) all (vendors) creditors. Other than internal month-end type accrual and provision entries etc, the vast majority of all GL profit and loss, expense account activity is 'populated' through the AP function. The revenue accounts, fortunately I guess, and usually the most accurate are populated through the sales/marketing department responsible for billing customers and managing Accounts Receivable (Debtor) payments.

Section V

- Accounting (CFO and Controller)

- Human Resources, duties include:

Continuing to use ABC (a pseudonym), we'll now reference the accounting function to talk about another angle of business information. We are going to use this chapter to discuss an aspect of business information, both the use and creation of it, and relate it to the people side, and the major effects of politics and attitudes. Even though, in most organizations, HR is naturally very separate from Accounting, in the case of ABC, the accounting (or Financial Planning and Analysis function) was directly responsible and charged with making hiring decisions. Again, that is not dissimilar to most organizations but in ABC's case, HR very much was purely an administrative type function rather than having any real decision-making input into the hiring process. Essentially, HR performed the 'paperwork' end of the process. Why, because within this ABC type organization, any additions to staff, regardless of 'what they did' were considered, correctly, as an added cost that had to be cost-justified by business criterion before any approval could be given. Again, the suggestion is not that other organizations hire frivolously but that ABC maintained an unusually tight grip over all financially related decisions (effectively everything therefore), far more so than most organizations I have experienced. Usually, normal delegation of authority presupposes that hiring managers are acting responsibly and in the best interest of the company, but in this case, ABC reserved the right to reject the "Manpower Requisition" thus usurping the departmental and/or line manager authority even at the senior management level. What was an almost frightening offshoot from this situation was the highly aggressive and 'get-even' mentality that it fostered. Personally I had never witnessed such high level managers being so vehemently aggressive against each other; please don't suggest that this is 'healthy' in any organization, for it definitely was not. But read on and you'll see where this is heading.

It goes that saying that 'politically' speaking it created an unusually and aggressive hostile environment. Looking at all this from a business information perspective, FP&A, in ABC's case, thus used the manpower requisition (as well as for Capital Requisitions) request to build up either an analytical support or a basis for rejection. The acute focus on margins, relative to weight/volume and destination factors, was always used to justify the FP&A arguments. This however, again from a business information perspective, unfortunately also led to situations where the 'business information' used by the hiring managers was often construed as 'suspect' and so therefore was discounted in the arguments against the decision. Hierarchically speaking (and organizationally) this virtual confrontational type environment was contrary to the concept of multi-disciplines all working together towards the common objective.

From a business information perspective, this ABC company highlights the problem that information, the same exact information, can get used or interpreted totally differently across the organization depending upon the 'agendas' that are implicitly and subversively operating.

This chapter has raised, in a sense, the ugly side of business, politics and the use and/or misuse of business information. It is nevertheless a very important perspective to cover if only to provide some additional real worldliness to this material. We have given significant coverage to the 'people-side' of business and appreciating that businesses comprise of people first and products/services second. We have shown, the real but humorous side of getting business information where the 'relational' side can be and is extremely important. Regardless of your individual level of experience here, it is a facet of humans that creativeness and ingenuity prosper greatly in an open and healthy environment devoid of politics and personal agendas and can be totally stifled where ideas and risks are perceived as 'dangerous' unless the 'boss' thought of them first. These comments are made because having seen and experienced so many organizational types from extreme and ugly politics to completely free and open healthy environments; it is very clear that the use of and 'creation' of business information is not uniform across every company. Many very, very successful company's, the same company's highlighted for having highly and unusual innovative approaches to employee empowerment and management styles, have shown how 'people' really working together can achieve some extraordinary results.

You may have noticed that in this chapter we introduced the concept of 'creating' business information. This is very important because it is possible that as you read this material you might just ponder, what has politics and aggressive environments got to do with business information, the answer, everything. Business information doesn't just mean the standard type of data pertaining to financial results or data of a non-financial type (we've previously used 'complaint letters' as an example here) or external information such as competitor information, financial markets data (oil price futures) etc. Business information can equally be created from scratch and can encompass totally new and innovative ways of doing something be it in production or to suggesting a new product or service, to a new approach to customer servicing issues. I hope the objective or point is starting to sink home now, that within organizations and only ones that encourage creativeness and ingenuity will such quality or value-added ideas emerge. It is these ideas and new approaches that give very successful organizations the ability to be differentiated from the competition. Additionally, because of the voluminous amounts of even standard business information constantly flowing in any large organization, the use of and positive interpretation of such data requires a very positive and enthusiastic attitude from all employees and totally supported by managers from the top level downwards. Like any human being, if your focus is positively charged towards say the organization and finding ways to improve or ensuring that 'existing business information' is being duly acted upon, positive things will happen.

If on the other hand, the organization fosters 'negative' aggression and personal political agendas, you have the hallmarks of a standard 'goal incongruence' between the company and that of its employees. Only when you achieve employee goal congruence with those of the company, its objectives and goals, will you ever theoretically maximize future opportunities. Note, we said 'future opportunities' and not profit because first you need a creative and positive mindset to identify the opportunity and then to examine ways to determine if it could be profitable.

Section VI

We'll now discuss in greater detail what happens when an organization decides to either upgrade or invest in a totally new ERP software system such as Peoplesoft, SAP or Oracle. Additional we'll talk about the fit/gap analysis that takes place along with the RFP (Request for Proposal) that comes under the heading of due diligence.

In the life of many organizations, the reality of the shortfall in the adequacy of the existing business information system becomes very apparent after a while. Partly it can stem out of the frustrations expressed by the CFO/Chief Accountants office or it can emanate from many disgruntled managers wishing to have a better information system. However, it can also be very much driven by the software providers themselves whose sales force can be extremely effective in bringing the latest technological advances to the attention of key personnel in the targeted company.

As a Peoplesoft Professional Services Group (PSG) Senior Consultant, I was myself in a couple of instances asked to demonstrate to a potential client the Peoplesoft Treasury Management module. Often during these opportunities, especially if the consultant, as was in my own case, possesses an accounting/finance background with direct experience in the development of cash flow projection models, there is a great chance to build a rapport with the Treasury/financial guy and impress upon him or her what capabilities and functionality is imbedded within the software, that they currently are unable to do. Most financial professionals need very little time to appreciate the advantages that getting state-of-the-art technology will bring to the job function. The issue, internally, is usually more along the lines as to whether the company is committed to such an investment or is just curious. Sometimes the presentation may be just part of an RFP (Request for Proposal) and you are just one of several software vendors being considered. Prior to or part of any RFP is the fit/gap analysis, we'll discuss below. Also unfortunately, the investment in major software and/or upgrades runs in parallel to the business cycle thus business downturns do have a marked impact on getting new business or software implementation engagements. This is also logical because no matter which way you look at it, the company has been functioning 'ok' up until this point, so when cash crunches arise and business starts to downturn, naturally the so-called discretionary expenditure in IT upgrades takes a back seat.

As we look at this in more detail, we'll review the fit/gap analysis that needs to take place before any implementation and then we'll look at the post-implementation stage where accessing the system and extracting business information becomes a key focus. The issue of fit/gap is also very important not just for brand new implementations but also for major upgrades especially if the company is upgrading by more than one two product releases.

The idea of fit/gap analysis is to 'systematically' go through each and every part of the organization and to examine and document (using flow charts etc) very thoroughly every business informational flow of data. You effectively are putting on paper and documenting exactly how the organization business information actually flows and is processed. In other words, documenting effectively what everyone actually does in the day-to-day operations. Additionally you are documenting each and every shortfall and requirement for business information that you do not have today. Logically, this makes sense for if you already had your 'perfect system' you certainly would not be seeking to change and/or upgrade. The concept behind an RFP is therefore to request software vendors to present how their software solution functions, and what capabilities it brings to the table.

Many times also, the organization, given either the Legacy systems it has been using, or the manual/spreadsheet approaches it has employed, will sometimes have to totally re-engineer completely the existing business information flows to accommodate the proposed new software solution. This latter aspect can often be the most painstaking part of a major implementation in an 'older' and well established organization especially one where some staff have been employed for decades using extremely outdated systems.

In one particular organization, where I had been working for about five-years, a decision had been made to implement a state-of-the-art Investment Management software solution. I remember well how some employees wanted the software vendor to customize the 'input' window so that it resembled the older system and wouldn't confuse the older employees as much. Such is the mentality at times, when the prospective of any change is seen as instantly threatening. Rather than considering a simple adapting to a new 'window' approach, the attitude was, why not make it like the old system. Any time you consider 'customizations' you automatically head down a road of far greater cost and future upgrading headaches. There are many times when, for sound business reasons, why the path of customization is selected but simply to change the visual layout (because employees don't want to adapt) is not likely to be one of them.

Looking again at the fit/gap document, you would often see listed, business information requirements or needs that the client is seeking from any new system. The issue becomes one of deciding which ones can be eliminated in lieu of getting something else or compromised because of the potential costs of customizations. Most software vendors, all in the same field of course, all offer very similar software solutions and so often it ultimately plays into whose software is the user-friendliest and has imbedded functionality that is really liked by those making the decision. Sometimes, the CFO/IT head has prior relationships with certain software vendors that could be construed as biasing the decision or alternatively ensuring you don't 'get sold a bill of goods' as the expression goes. In truth, were I to be in such a position, Peoplesoft would in all probability get the order, I've seen first-hand what it can do.

Let's talk a little now about Sales demos that software vendors use to present their product(s) to the client. First however lets look at the software architecture behind the front-ended panels and windows you see when you first sign-on. Software, in its raw form, is nothing more than 'panels' (or groups of panels) that have been designed with 'field' input functionality that becomes a 'row' of 'data' in a Data Table or Transaction Table. Because certain data is constant and used across multiple departments or Business Units (BU's) such as 'Bank ID' or 'Vendor ID', these same panels use what are called 'Prompt Tables' (or 'drop-down' lists) to call up these unique Company or data qualifiers and once selected these also become attached to the transaction data entry.

Let's assume that you work in Accounts Payable and you've entered certain invoices that are just part of normal monthly data entry. As you entered those invoices you used the 'drop-down' lists to select the Vendor. The Vendor setup panel may have also included a predefined GL Account to which this Vendor automatically gets expensed or debited. Now let's assume someone else, but not you, that works in Cash Management needs to pay certain Vendor's using manual checks that are all being issued against the same bank. They will use a panel to select the invoices for payment and a 'drop-down' list to select the bank account. This 'cash management' employee may only have authority to access certain bank accounts and may also be restricted to only certain Vendors. The software security effectively 'hides' from view and/or access any data or information for which authority has not been granted. Now, think about this all from a Security perspective, you, the employee, 'must' only use one of the bank ID's on this list (for which you have authority) and so no cash or bank transactions can ever by-pass the approved and/or existing Company Bank Accounts. Only the Controller and/or Treasurer perhaps have the authority to set-up new Bank ID's. Equally, the Accounts Payable clerk may also only have had authority to enter invoices from certain vendors.

Multiple security levels or layers, like this, can be established that effectively means that any intended embezzlement would require total cooperation across several employees and departments. Within any system of internal controls any such forced collusion greatly reduces the likelihood of any dishonesty. Each and every transaction additionally is automatically imbedded with the employee's sign-on ID and password thus providing an excellent audit trail. Such software systems can also incorporate what are called 'workflows' that directs information to pre-designated employee's (usually management level only) automatically once certain 'triggers' have occurred such as manual checks exceeding a certain amount.

Now back to that Sales demo data. You have to remember that these software companies have, but one purpose in mind, and that is to 'sell' you the software along with the annual licensing, maintenance and upgrading fees etc, etc, and 'oh' don't forget about the Consulting fees for implementation and post-implementation training and developing customized reports and so on. Without a doubt, there's a lot at stake here, no matter who puts on the presentation, whether it be Oracle, SAP or Peoplesoft etc, etc.

Also, for obvious reasons, the demo needs to 'put the best face forward' in terms of the software's capability and functionality. There is no implied intent that the software companies mislead in any shape or form but nevertheless it is a 'sales' presentation and all the demonstrated functionality usually looks 'absolutely incredible' and the audience is 'wowed' at how impressive it is. That's the objective, plain and simple.

We've briefly described the software, in its raw form, but without actual data there would be nothing to demonstrate, so where does the data come from. That is the tough issue internally in any software company. Ideally, populating the Tables from an existing client's database (obviously with legal permission etc) and then entering additional transactions 'live' is the best way to go and it is much more realistic. Failing that solution, the software companies have to create the database from scratch, which requires a considerable work effort to develop a good-sized database for presentation purposes. Additionally, it is exceedingly difficult to 'make up' an imaginary database when you appreciate all the 'business information' sources that comprise a database in the real world.

It goes without saying, that every software product has its built-in 'glitches' and 'bugs' that periodically are so-called fixed by 'maintenance releases'. Those functionalities that do not 'work' quite as intended are also very unlikely to be included in any sales demo, hardly surprising. These problematic issues of any software often become part of voluminous daily email chat room conversations between Users that sign-up to specialized discussion and support groups that spring up everywhere, sometimes globally to just a small local network. The Internet is truly miraculous for its application or use in these very far-flung support groups. They just could not exist without it. At one point, I signed-on to a support group for Peoplesoft and found that anywhere from 60-80 emails a day was not unusual. Unfortunately there is a daily battle to find the time to keep-up with this level of volume because frequently scattered amongst these email was some extremely valuable information. It becomes almost a part-time job just keeping up with this level of business information flow, much of which could be 'stored' or archived for later use.

Going off at a tangent briefly, the same issues and problems of not having a 'rock solid database' also extend into the training arena. Having been a Senior Curriculum Developer with Peoplesoft and involved in train-the-trainer type classes this was always a major problem and not one that was probably ever fully appreciated by clients when external Client training sessions/classes were being offered. Actually, one of the major criticism's that was often leveled at classes was the inadequacy of a realistic database that could be used to practice on. This impacted both the instructor as well as the students equally. The actual compilation of such a database, however, was another matter and few attendees ever equally offered us a solution. Also, many Companies frequently setup 'Production Testing' databases, on a completely separate server, so that report compilation, scenario testing and testing certain functionalities could be performed totally without risk to the actual live Production database. Usually, the IT department will periodically copy the Production database to another server just for testing purposes. Be aware however that running such a job requires considerable IT resources and is not always too popular given the daily constant demands for limited resources and solving technical problems.

That same approach of copying an actual production database could also be the basis for developing a classroom environment for practicing. Any experienced consultant will never initially use a live production database when they are trying to solve a technical issue or create a new report. Usually such 'experimentation' is best done out of harms way as you try and locate the tables/fields that you need in order to develop the information. Developing such reports is never an automatic five-minute exercise, often involving hours of dedicated 'digging' until you locate and identify the best approach and source to use.

This transitions us naturally over to the area of post-implementation consulting that frequently involves developing customized reports. However, first lets address why the Company's own internal resources could not develop these 'business information' reports themselves, and at a considerable cost savings. At some point, before, during or after an implementation, the Company's (or client's) staff attends training sessions relating to certain modules or complete product suites. On occasion, these classes are conducted in-house but more frequently they are held at various major city locations. Realize that these classes, no matter how well conducted, are primarily designed only to familiarize the client's staff with the functionality of the software so as to enable them to become 'operational' as soon as possible. [Sometimes, rather than 'sending employees' out to expensive training classes (that include travel expenses etc) Company's will employ Consultants to come in and develop customized training material geared specifically to certain employees and/or groups of employees.] They are generally not intended to be technical classes. Also, appreciate that, with the exception of certain key employees, such as analysts and/or accounting personnel, most attendees are 'very' non-technical in nature and often struggle to grasp all the different aspects of the software. These key employees usually are also the same ones that are under very tight monthly financial reporting and closing schedules and deadlines. There are, 'technical' type, classes held that do address the different aspects of accessing information but they can do no more than 'introduce' the mechanics and cannot substitute for experience.

There is no doubt that, given time, the Company's internal resources will (and do) develop extremely sophisticated business information reports. Usually, the immediate priority is to get all the basic information needs addressed such as Profit and Loss reporting, Balance Sheet positions etc, etc. Internally, these are usually taken care of without employing outside consulting services. However, the Company has just invested, sometimes, 'millions' of dollars in this new software solution to the business information needs and requires access to significant amounts of information as soon as possible, if for no other reason than to politically justify the investment. Sarcasm aside, that is obviously not the business reason but do consider that within the RFP the business defined its needs, its business information needs, in great detail and is now justifiably looking for delivery. Most existing 'legacy' systems are quite capable of producing a complete set of financial statements and its what they 'cannot' generate which is why you invest in a full ERP seamlessly integrated solution. Developing financial statements is the last reason why you select an ERP software solution.

When the sales demos were being conducted, certainly the client's requirement for business information reporting was a major aspect of the presentation and the 'sell'. But, within the very limited confines of a sales demo (remember the database problem we discussed above), it is much easier to present 'how' to get all this information by demonstrating the imbedded reporting functionality than it is in the 'real world'. After the software is live and in production, the CFO (Chief Accountant) will gradually start naturally expecting more and more from this new software. Additionally, Managers will start becoming more and more demanding and frustrated when constant delays and extended delivery dates keep pushing the expected plethoria of 'never-before' had information they were promised during the sales demo. That is why, primarily, from experience that external consultants are brought in to develop these reports. It has also been my experience that once the 'tap' has been turned on, it is amazing how many new reporting needs suddenly start getting defined rapidly. Additionally (and finally), there is no substitute for experience and though there may be no 'direct' means of getting a particular business information report out of the system, there are frequently many ways to achieve a result but only if you're very creative (and refuse to accept 'cannot' as an answer).

Teaching/Supplementary material notes

These instructor/lecturing teaching notes (developed as supplementary material to the Foulks Lynch texts, final papers) were designed to provide any GFPAA instructor with some ideas about how to approach teaching some of this material. The approach was to develop supplementary material that attempts to put a 'working experience' perspective on the somewhat at times, very dry, text reading material. For students who are following a self-study approach, this material has been incorporated as part of the Supplementary notes to the final level, Part 3 papers.

Paper 3.5

Section I

"In Paper 3.4 Business Information Management there will be related material on information resource management and information systems and competition." So it thus, makes sense to start again with the 'people' side behind 'business information' management that we discussed in detail in Paper 3.4. "As a student, you study the discipline of accounting along with all the academic theories, tools and concepts that apply. You view various diagrammatic representations of concepts and principles along with somewhat 'odd' descriptions of processes but fundamentally every organization is simply comprised of 'people' or put another way, an organization comprises of multi-disciplines (people) all working and interacting together 'synergistically' towards the common objective (you hope). You get things and 'information' only and only by working with and through people not processes or departmental structures (do not make the mistake of thinking that ERP software solutions replaces the 'people' component, it does not, actually it increases the people element but significantly raises the threshold of information access and seamless interface/transfer of data across modules). Every person in every organization and in every department is just as complicated, as moody, as irritable, and as friendly as everyone you know, outside of work, on a personal as well as even a marital basis. Effectively, for things to really work in any organization, the trials and tribulations of a marriage equally apply. You don't believe me, try getting information from someone that 'thinks' you don't like them or you've done something or said something to upset them. Contrast that to your 'other half' after you accidentally make a comment about his or her Mother (truthful or otherwise), the same applies exactly. Organizations comprise, it should be understood, not of products or services per se, but of massive information flows. The information (people controlled) is 'about' the products or services but what controls the organization is the information itself. "

So, when you start considering the concept of 'culture' it brings together many of the personality traits that we just referenced above from the introductory comments to Paper 3.4. However, culture does one more thing and goes that much further than just 'people' working together. Culture evolves effectively into a form of cohesion, a combining, as it were, and creates standards or norms of acceptable behavior. For an organization to have an identified culture, the 'value' system that goes with culture must permeate very clearly down from top management. The interesting thing about 'culture' is that it can result in a very productive environment or it can, in a sense, become very destructive internally and stifle creativity in a major way. The culture, as such, can create a very pleasant working environment or it can be totally the opposite and be very unpleasant to deal with. Before, the obvious question gets asked, that of, why would anyone work in such an environment, you have to revisit the 'diversity' of people along with the unfortunate inability, at times, of people to have multiple work options. Additionally, the concept of 'unpleasantness' is clearly subjective. In reality, there are very few 'ideal' cultures in the workplace. Consider also that regardless of how well the '<u>hiring</u>' process attempts to match candidates with the corporate culture, a perfect match is virtually impossible.

During most interviews, no matter what the theory says, many times neither the hirer nor the 'employee' ever get a totally clear and 'unambiguous' perspective of each other. No one is being intentionally dishonest, but that's life and both sides of an interview have, in all probability, an agenda. Thus, many employees inadvertently join organizations that have corporate cultures contrary to the employee's personality traits; it can result in a major misfit. As in life of course, what can appear to someone subjectively, as an unpleasant and miserable place to work can be the ideal environment for another person. Those types you'd rather perhaps not have as 'best friends'!

Additionally, the extreme difficulties at times of finding suitable employment can often result in accepting positions in organizations not necessarily best-fitting the 'candidates' personality. Though 'money' is often a primary motive and driver, it can also result in very poor career choices. It is not the best situation to be in because such a person will in all likelihood be very miserable trying to fight the system and failing. As a possible workaround to this 'matching' problem, some organizations use questionnaires and personality profiling to try and ascertain whether a cultural fit per se is a high probability. However, like any questionnaire, no matter how carefully worded, an astute candidate can respond appropriately and avoid perceived undesirable responses considered negative to the application. Actually, when such questionnaires are compiled 'in privacy' they can become another valuable tool towards seeking the right job fit provided the profile was derived then from absolutely truthful and unbiased responses. No system is foolproof!

We are talking a lot here, obviously, about 'culture', <u>but really, is it that important</u>? Actually, it is more than just important, <u>it is critical because culture, as such, controls and dictates what the organizations is and stands for</u> and all strategies and subsequent (financial) business plans are a direct reflection or mirror of that corporate culture.
A corporation, as a legal entity, is nothing more or nothing less than a creation of statute and only the 'people' (management and employees, the 'culture') give it an identification and personality. When an organization develops its strategy, it looks to answer effectively:

- Who am I?
- What am I? And,
- Where am I going?

Academically, of course, these 'questions' would be phrased somewhat differently. Well, consider how any organization can truthfully answer these 'strategic' questions, separate from the culture (personality) that embraces, embodies, everything the entity stands for. It is true that many corporations have attempted, some successfully, to change their corporate culture or identification because it becomes recognized as an impediment to a desire or strategy to embrace change. As top-level management must be seen to embrace any cultural changes first, they ironically, even though being the drivers themselves of such a change, often have the hardest time letting go of the old! Before we discuss the 'sides' to culture, I should be open on my own views in this area thus letting bias be in the open.

To begin with, I generally detest 'heavy' political environments, very much like the founder of Peoplesoft, who so dislikes politics that he will even fire his senior officers if it was believed they were creating any derivative of a 'political' structure or hierarchy. That's a man I can respect! Over the last 30 odd years, I have experienced many, many different type of cultures. Now, the subjectiveness of liking and disliking a particular culture is very important (especially for job satisfaction) and in a sense it requires each 'person' to identify what environment fits well with their personality.

As to mine, I have found that fully participative and entrepreneurial type cultures work well for me. Being of an entrepreneurial mindset (I incorporated in the U.S. back in '96) the word 'politics' and 'entrepreneur' should not be in the same sentence. That being said, what does culture infer as far as being a 'manager'. We'll discuss the 'participative' approach later.

In order to be a 'manager' in any organization, you must by definition fully embrace and support the corporate culture (that's only reasonable). The concept of goal congruence between that of the organization and the employee can only coexist if the employee mutually agrees with and shares all values of the corporate culture. To do otherwise, would constantly involve working against the organization and career-wise that cannot last for too long. To survive a political environment, your personality must be one of a 'conformist', sometimes very mistakenly used in place of a 'team player'. An entrepreneurial mindset can also by definition infer a major non-conformist, one who aspires to individual creativity and thinking/decision-making and very much outside the 'box' and of any political hierarchies.

Many times, players (employees) within such 'heavy' political hierarchies will use the political 'structure' to hide or mask personal insecurities and adversity to risk. Playing the game and maintaining a low profile is corporately a very safe strategy to employ. Many major corporations, having thousands of employees, with strong political hierarchies are often those that reflect the most inefficient use of staffing. Politically, a very large staff reflects power, and so hiring decisions may reflect departmental political desires and not be based upon any 'efficiency' concepts of sharing staff across departmental and political boundaries. It all becomes embodied in the culture, once the norms have become established and accepted. As a student, contrast the political culture (and its cost ramifications) and all we've discussed with Activity-based costing (ABC) that effectively opens up exactly what everyone actual does from an 'activity' standpoint. Is there an inherent conflict between politics and ABC?

There are many sides to culture, some that we'll discuss below, can include:

- maintaining the 'old' ways of employer and employee relationships

In many corporations, even today, the employee is often seen and expected to be subservient to the managers. It is akin, at times, to the old 'be seen but not heard' adage. Basically, it is a fall back to the 1950's when employees and managers were viewed as 'inferior' and 'superior' roles. To say the least, such a culture severely discourages any creative ideas flowing from employees and very much becomes a '9-5' mentality with pay as the only real motivation. Managers effectively totally rule and to do 'anything' requires 'permission' of your manager. It is the complete opposite of anything reflecting an entrepreneurial/participative environment. Do not confuse this with 'respect' versus 'disrespect'; it has nothing to do with either. Such corporations, certainly back in the 1950's era, actually structured office layouts with 'rows and rows' of desks where employees were closely monitored by the supervisor sitting up front. Very much like a classroom setting. Today, despite so-called modern office layouts the underlying 'old-ways' can still be very strongly maintained.

- treating employees as equals or partners

Now, a participative environment, what is it? Very simply, it is when you recognize that both employees and managers equally have very significant contributions to make towards the success of an organization (or say the outcome of a meeting or project). No one is stifled, everyone is encouraged to think and be creative and everyone has potentially great ideas, it does not matter who it comes from. The role or position is totally irrelevant, only the idea matters. Now, this is where the respect and disrespect concept comes in. A manager needs to be respected for what he/she brings as clear value-added to the organization; they bring something to the table that no one else has. That's why they got the job! In any organization, someone has to be in charge and someone must be responsible for the ultimate decision, otherwise you would have the equivalent of organized chaos. In such a participative environment, employees feel totally free and comfortable to contribute ideas even if they are totally contradicting the 'managers' viewpoint. When you have total respect, very critical, towards each other then ideas can flow freely and unrestrained. The 'presenting' of the alternative approach must come across as a 'respectful' different idea and not in an argumentative or defensive posture. The final decision comes down to the manager; but only after 'all' ideas have been considered. Effectively the manager is conducting, controlling and guiding the meeting and eventually he/she will decide the outcome that ought, theoretically, to reflect a 'consensus' of opinion. It is actually a much tougher and demanding role than under the so-called, old-ways, discussed above because managers must be seen to clearly take into account and consider all contributing ideas 'before' determining an outcome. Under such a culture, any manager that is seen to be clearly ignoring other ideas will probably not survive too long and quickly lose all respect.

- the corporate 'uniform'

It is interesting that there is often a direct correlation between 'dress code' and the type of corporate culture. Under the old-ways, per se, in all likelihood a strict adherence to official 'proper-dress' will probably exist. Under, a very participative environment, it is more likely that 'casual-dress' will be acceptable. Under the latter, the focus is more on 'what you contribute' and not how you 'look'. However, notwithstanding these comments, the location and type of business also play major roles in determining dress codes and can override some cultural issues. Businesses that have major interaction with customers frequently opt for proper dress and organizations located in major downtown office complexes usually prefer proper dress to maintain a corporate image to others and the competitors. Today, a balance usually exists, and some employees dress 'smart-casual' and others more formally. It is also not unusual for certain 'days' like Friday to be designated as 'dress-down' days. When corporations move their offices to more rural locations, e.g. 'office-parks', outside of expensive downtown locations, it is often accompanied by a change in dress code and usually to more casual.

- the culture reflects perceived customer expectations
- opening the door to new ideas
- fostering an open and free exchange of ideas
- being technologically innovative
- rejecting the 'technological revolution'
- fearing change as threatening
- embracing all change as a prerequisite to continued growth
- allowing employees to fail
- encouraging the internal establishment of cliques and preferred members
- rejecting any concept or idea that leads to isolating any employees
- treating politics as a basis for dismissal

Section II

This is, in many ways, a natural continuation from the discussion on 'culture'. Actually, this introductory sentence could probably be used for every chapter in this Paper because culture permeates every facet of a business. Many times, customers can clearly see through the 'veil' of a corporation and decide whether they wish to do business or not, it is hard to hide! A corporation today cannot afford the 'arrogance' of thinking they can get or demand all the customers they want by simply having the products or services, it is far more complicated and emotionally driven than that. We live in a very aggressive and competitive world (with tight margins) in which, except for a few rare moments, we survive from point 'A' to point 'B' by understanding exactly who and what we really are and recognizing that, but for the good graces of our customers, we would not be in business at all. This '101' perspective, for example, is critical for any Consultant to survive and continue to get clients. Some businesses, it is true, can maintain certain complacency with respect to customers and markets but that is not the norm.

Who and what a corporation stands for, and what it can offer (price and service) to its customers is a direct reflection of its culture. There are those businesses that have constant personal interaction with its customers and there are those whose only communication is through the telephone and other non-personal mediums (the Internet). Either way, customers do get to really evaluate and judge a business in its true form. When consumers are given choices, it is the customer that has the leverage and not the corporation. The attitudes and body language that is conveyed to customers, through a corporation's employees, can either solidify a customer for life or guarantee that the customer will never to do business again with that corporation. The emotional level (of a very frustrated and disgruntled customer) can be so high that even receiving the benefits of a much lower offered price, are not perceived as worth the cost of having to deal with major service aggravation. Actually, if the opportunity cost of lost time and frustration were factored in, the savings per se would probably erode to below zero with the 'other' company suddenly being that much cheaper.

Take for example the Telephone companies. Within the U.S. today there are considerable and cost effective choices since the breakup of the earlier 'Ma Bell' monopolies. From a consumer's standpoint, what differentiates one telephone company say from another besides rates? Well, we probably all know that there are a myriad of reasons why we need to have personal interaction with the Telephone Company's representatives. The call did not go through, the line was bad but we were still charged, you do not know the access code or are having difficulties reaching your party etc, etc. Now that is only if say you're a residential customer, but what if you're a business that requires multiple business lines installed, toll-free calling setups and absolutely uninterrupted service and so on. As a Telephone company, the rates you charge are just a single aspect of the whole business but the ongoing and daily service to both your residential and business customers can either help grow the business or it can aid in systematically destroying it through poor and rude service. From the perspective of being a customer, an incredibly helpful and courteous telephone operator can do wonders when you're about to launch that telephone into 'outer space' for the sixth dropped call! Telephones probably account for 75% of all UFO sightings!

Ok, all very interesting, but what has all this got to do with 'strategic business planning and development', think about it? What business are you (say, the Telephone company) really in? Additionally, do you 'really' have a corporate culture that supports your 'identified' business? Strategically, say if you only believed you were in the telecommunications industry and provided you created a network that enabled your customers to telephone each other all over the world, you've done everything, correct. In addition however you also internally (and probably unknowingly) fostered a corporate culture that stifled creativity and employees were fearful for their jobs being a very political and hierarchical environment. But, now as a result of surveys and other customer-satisfaction feedbacks you determine and realize that rather than being a pure telecommunications company you are actually in a 'service' industry. Unfortunately, you have an employee base that culturally is not very service orientated. When customers do call, they reach an employee who does not convey enthusiasm, helpfulness or a positive attitude. Actually, this employee is more likely, being part of such a political hierarchy, to deny responsibility, say they cannot help the customer and will transfer the call to someone else regardless of whether they can help or not. This way, the employee has not accepted any blame nor risked any criticism of their managers being fearful for their jobs. Does all this sound too unrealistic, well actually it is probably more common than you'd think. The criticalness of really determining what kind of business you are actually in and ensuring that your corporate cultural supports this in both spirit and form is probably the difference between achieving real economic growth versus just treading water and eventually experiencing negative growth. The one area that will really kill you in any business is failing to identify with your customers and markets.

A real life example that really does a great job of highlighting all we've said was in a Peoplesoft consulting engagement. Peoplesoft, as a company, is primarily in the software ERP/EPM industry but it has also recognized very clearly that real success lies with achieving superb and extraordinary customer service, above and beyond the call of duty. Customer service here extends from the 'Help-desk' lines, to the post-implementation follow-up, to Consultants during implementation and on post-implementation assignments. Developing the software, testing it and implementing it, in some ways is the easy part. Developing and finding new customers, maintaining and keeping existing customers very happy at all times is really the hard part. It is a very competitive industry and word-of-mouth counts a great deal. A very satisfied customer is worth millions as a reference and for ongoing upgrades and consulting services. Additionally, existing customers can be invaluable as beta test sites for new releases and innovative functionality changes. That all being said, here is what happened.

A Peoplesoft Professional Services Group (PSG) consultant was working late at a client's site on a Friday evening and the following happened. The consultant knew that he/she had to start running a critical report before they left for the weekend. Some of these reports can take many hours to run and weekends are often the ideal time. Unfortunately, the client's computer staff had left and locked the Computer room up. The PSG consultant, refusing to accept failure, decided a little breaking and entering was in order. The consultant decided the only approach open was to use the air duct to access the Computer room. So, believe it or not, they climbed up into the air duct using a chair, crawled through the duct and then lowered themselves down into the Computer room onto a desk (or something). They accessed the computer and successfully ran the report over the weekend. Needless to say, the client (on Monday) was shocked at the level of service dedication and commitment displayed by the consultant. It was most definitely extraordinary. By the way, Peoplesoft has a very participative and creative culture where individual ideas and contributions (not titles and positions) are highly valued and rewarded. The resulting organization and the attitude of staff is self-evident. The culture and the business are in total congruence with each other.

Section III (this material is in Paper 3.4 also)

We'll now discuss in greater detail what happens when an organization decides to either upgrade or invest in a totally new ERP software system such as Peoplesoft, SAP or Oracle. Additional we'll talk about the fit/gap analysis that takes place along with the RFP (Request for Proposal) that comes under the heading of due diligence.

In the life of many organizations, the reality of the shortfall in the adequacy of the existing business information system becomes very apparent after a while. Partly it can stem out of the frustrations expressed by the CFO/Chief Accountants office or it can emanate from many disgruntled managers wishing to have a better information system. However, it can also be very much driven by the software providers themselves whose sales force can be extremely effective in bringing the latest technological advances to the attention of key personnel in the targeted company.

As a Peoplesoft Professional Services Group (PSG) Senior Consultant, I was myself in a couple of instances asked to demonstrate to a potential client the Peoplesoft Treasury Management module. Often during these opportunities, especially if the consultant, as was in my own case, possesses an accounting/finance background with direct experience in the development of cash flow projection models, there is a great chance to build a rapport with the Treasury/financial guy and impress upon him or her what capabilities and functionality is imbedded within the software, that they currently are unable to do. Most financial professionals need very little time to appreciate the advantages that getting state-of-the-art technology will bring to the job function. The issue, internally, is usually more along the lines as to whether the company is committed to such an investment or is just curious. Sometimes the presentation may be just part of an RFP (Request for Proposal) and you are just one of several software vendors being considered. Prior to or part of any RFP is the fit/gap analysis, we'll discuss below. Also unfortunately, the investment in major software and/or upgrades runs in parallel to the business cycle thus business downturns do have a marked impact on getting new business or software implementation engagements. This is also logical because no matter which way you look at it, the company has been functioning 'ok' up until this point, so when cash crunches arise and business starts to downturn, naturally the so-called discretionary expenditure in IT upgrades takes a back seat.

As we look at this in more detail, we'll review the fit/gap analysis that needs to take place before any implementation and then we'll look at the post-implementation stage where accessing the system and extracting business information becomes a key focus. The issue of fit/gap is also very important not just for brand new implementations but also for major upgrades especially if the company is upgrading by more than one two product releases.

The idea of fit/gap analysis is to 'systematically' go through each and every part of the organization and to examine and document (using flow charts etc) very thoroughly every business informational flow of data. You effectively are putting on paper and documenting exactly how the organization business information actually flows and is processed. In other words, documenting effectively what everyone actually does in the day-to-day operations. Additionally you are documenting each and every shortfall and requirement for business information that you do not have today.

Logically, this makes sense for if you already had your 'perfect system' you certainly would not be seeking to change and/or upgrade. The concept behind an RFP is therefore to request software vendors to present how their software solution functions, and what capabilities it brings to the table.

Many times also, the organization, given either the Legacy systems it has been using, or the manual/spreadsheet approaches it has employed, will sometimes have to totally re-engineer completely the existing business information flows to accommodate the proposed new software solution. This latter aspect can often be the most painstaking part of a major implementation in an 'older' and well established organization especially one where some staff have been employed for decades using extremely outdated systems.

In one particular organization, where I had been working for about five-years, a decision had been made to implement a state-of-the-art Investment Management software solution. I remember well how some employees wanted the software vendor to customize the 'input' window so that it resembled the older system and wouldn't confuse the older employees as much. Such is the mentality at times, when the prospective of any change is seen as instantly threatening. Rather than considering a simple adapting to a new 'window' approach, the attitude was, why not make it like the old system. Any time you consider 'customizations' you automatically head down a road of far greater cost and future upgrading headaches. There are many times when, for sound business reasons, why the path of customization is selected but simply to change the visual layout (because employees don't want to adapt) is not likely to be one of them.

Looking again at the fit/gap document, you would often see listed, business information requirements or needs that the client is seeking from any new system. The issue becomes one of deciding which ones can be eliminated in lieu of getting something else or compromised because of the potential costs of customizations. Most software vendors, all in the same field of course, all offer very similar software solutions and so often it ultimately plays into whose software is the user-friendliest and has imbedded functionality that is really liked by those making the decision. Sometimes, the CFO/IT head has prior relationships with certain software vendors that could be construed as biasing the decision or alternatively ensuring you don't 'get sold a bill of goods' as the expression goes. In truth, were I to be in such a position, Peoplesoft would in all probability get the order, I've seen first-hand what it can do.

Let's talk a little now about Sales demos that software vendors use to present their product(s) to the client. First however lets look at the software architecture behind the front-ended panels and windows you see when you first sign-on. Software, in its raw form, is nothing more than 'panels' (or groups of panels) that have been designed with 'field' input functionality that becomes a 'row' of 'data' in a Data Table or Transaction Table. Because certain data is constant and used across multiple departments or Business Units (BU's) such as 'Bank ID' or 'Vendor ID', these same panels use what are called 'Prompt Tables' (or 'drop-down' lists) to call up these unique Company or data qualifiers and once selected these also become attached to the transaction data entry.

Let's assume that you work in Accounts Payable and you've entered certain invoices that are just part of normal monthly data entry. As you entered those invoices you used the 'drop-down' lists to select the Vendor. The Vendor setup panel may have also included a predefined GL Account to which this Vendor automatically gets expensed or debited. Now let's assume someone else, but not you, that works in Cash Management needs to pay certain Vendor's using manual checks that are all being issued against the same bank. They will use a panel to select the invoices for payment and a 'drop-down' list to select the bank account. This 'cash management' employee may only have authority to access certain bank accounts and may also be restricted to only certain Vendors. The software security effectively 'hides' from view and/or access any data or information for which authority has not been granted. Now, think about this all from a Security perspective, you, the employee, 'must' only use one of the bank ID's on this list (for which you have authority) and so no cash or bank transactions can ever by-pass the approved and/or existing Company Bank Accounts. Only the Controller and/or Treasurer perhaps have the authority to set-up new Bank ID's. Equally, the Accounts Payable clerk may also only have had authority to enter invoices from certain vendors.

Multiple security levels or layers, like this, can be established that effectively means that any intended embezzlement would require total cooperation across several employees and departments. Within any system of internal controls any such forced collusion greatly reduces the likelihood of any dishonesty. Each and every transaction additionally is automatically imbedded with the employee's sign-on ID and password thus providing an excellent audit trail. Such software systems can also incorporate what are called 'workflows' that directs information to pre-designated employee's (usually management level only) automatically once certain 'triggers' have occurred such as manual checks exceeding a certain amount.

Now back to that Sales demo data. You have to remember that these software companies have, but one purpose in mind, and that is to 'sell' you the software along with the annual licensing, maintenance and upgrading fees etc, etc, and 'oh' don't forget about the Consulting fees for implementation and post-implementation training and developing customized reports and so on. Without a doubt, there's a lot at stake here, no matter who puts on the presentation, whether it be Oracle, SAP or Peoplesoft etc, etc.

Also, for obvious reasons, the demo needs to 'put the best face forward' in terms of the software's capability and functionality. There is no implied intent that the software companies mislead in any shape or form but nevertheless it is a 'sales' presentation and all the demonstrated functionality usually looks 'absolutely incredible' and the audience is 'wowed' at how impressive it is. That's the objective, plain and simple.

We've briefly described the software, in its raw form, but without actual data there would be nothing to demonstrate, so where does the data come from. That is the tough issue internally in any software company. Ideally, populating the Tables from an existing client's database (obviously with legal permission etc) and then entering additional transactions 'live' is the best way to go and it is much more realistic.

Failing that solution, the software companies have to create the database from scratch, which requires a considerable work effort to develop a good-sized database for presentation purposes. Additionally, it is exceedingly difficult to 'make up' an imaginary database when you appreciate all the 'business information' sources that comprise a database in the real world.

It goes without saying, that every software product has its built-in 'glitches' and 'bugs' that periodically are so-called fixed by 'maintenance releases'. Those functionalities that do not 'work' quite as intended are also very unlikely to be included in any sales demo, hardly surprising. These problematic issues of any software often become part of voluminous daily email chat room conversations between Users that sign-up to specialized discussion and support groups that spring up everywhere, sometimes globally to just a small local network. The Internet is truly miraculous for its application or use in these very far-flung support groups. They just could not exist without it. At one point, I signed-on to a support group for Peoplesoft and found that anywhere from 60-80 emails a day was not unusual. Unfortunately there is a daily battle to find the time to keep-up with this level of volume because frequently scattered amongst these email was some extremely valuable information. It becomes almost a part-time job just keeping up with this level of business information flow, much of which could be 'stored' or archived for later use.

Going off at a tangent briefly, the same issues and problems of not having a 'rock solid database' also extend into the training arena. Having been a Senior Curriculum Developer with Peoplesoft and involved in train-the-trainer type classes this was always a major problem and not one that was probably ever fully appreciated by clients when external Client training sessions/classes were being offered. Actually, one of the major criticism's that was often leveled at classes was the inadequacy of a realistic database that could be used to practice on. This impacted both the instructor as well as the students equally. The actual compilation of such a database, however, was another matter and few attendees ever equally offered us a solution. Also, many Companies frequently setup 'Production Testing' databases, on a completely separate server, so that report compilation, scenario testing and testing certain functionalities could be performed totally without risk to the actual live Production database. Usually, the IT department will periodically copy the Production database to another server just for testing purposes. Be aware however that running such a job requires considerable IT resources and is not always too popular given the daily constant demands for limited resources and solving technical problems.

That same approach of copying an actual production database could also be the basis for developing a classroom environment for practicing. Any experienced consultant will never initially use a live production database when they are trying to solve a technical issue or create a new report. Usually such 'experimentation' is best done out of harms way as you try and locate the tables/fields that you need in order to develop the information. Developing such reports is never an automatic five-minute exercise, often involving hours of dedicated 'digging' until you locate and identify the best approach and source to use.

This transitions us naturally over to the area of post-implementation consulting that frequently involved developing customized reports. However, first lets address why the Company's own internal resources could not develop these 'business information' reports themselves, and at a considerable cost savings. At some point, before, during or after an implementation, the Company's (or client's) staff attends training sessions relating to certain modules or complete product suites. On occasion, these classes are conducted in-house but more frequently they are held at various major city locations. Realize that these classes, no matter how well conducted, are primarily designed only to familiarize the client's staff with the functionality of the software so as to enable them to become 'operational' as soon as possible. [Sometimes, rather than 'sending employees' out to expensive training classes (that include travel expenses etc) Company's will employ Consultants to come in and develop customized training material geared specifically to certain employees and/or groups of employees.] They are generally not intended to be technical classes. Also, appreciate that, with the exception of certain key employees, such as analysts and/or accounting personnel, most attendees are 'very' non-technical in nature and often struggle to grasp all the different aspects of the software. These key employees usually are also the same ones that are under very tight monthly financial reporting and closing schedules and deadlines. There are, 'technical' type, classes held that do address the different aspects of accessing information but they can do no more than 'introduce' the mechanics and cannot substitute for experience.

There is no doubt that, given time, the Company's internal resources will (and do) develop extremely sophisticated business information reports. Usually, the immediate priority is to get all the basic information needs addressed such as Profit and Loss reporting, Balance Sheet positions etc, etc. Internally, these are usually taken care of without employing outside consulting services. However, the Company has just invested, sometimes, 'millions' of dollars in this new software solution to the business information needs and requires access to significant amounts of information as soon as possible, if for no other reason than to politically justify the investment. Sarcasm aside, that is obviously not the business reason but do consider that within the RFP the business defined its needs, its business information needs, in great detail and is now justifiably looking for delivery. Most existing 'legacy' systems are quite capable of producing a complete set of financial statements and its what they 'cannot' generate which is why you invest in a full ERP seamlessly integrated solution. Developing financial statements is the last reason why you select an ERP software solution.

When the sales demos were being conducted, certainly the client's requirement for business information reporting was a major aspect of the presentation and the 'sell'. But, within the very limited confines of a sales demo (remember the database problem we discussed above), it is much easier to present 'how' to get all this information by demonstrating the imbedded reporting functionality than it is in the 'real world'. After the software is live and in production, the CFO (Chief Accountant) will gradually start naturally expecting more and more from this new software.

Additionally, Managers will start becoming more and more demanding and frustrated when constant delays and extended delivery dates keep pushing the expected plethora of 'never-before' had information they were promised during the sales demo. That is why, primarily, from experience that external consultants are brought in to develop these reports. It has also been my experience that once the 'tap' has been turned on, it is amazing how many new reporting needs suddenly start getting defined rapidly. Additionally (and finally), there is no substitute for experience and though there may be no 'direct' means of getting a particular business information report out of the system, there are frequently many ways to achieve a result but only if you're very creative (and refuse to accept 'cannot' as an answer).

Section IV (This includes an interesting marketing piece from Al Ahram Beverages)

From a strategic perspective, marketing can be one of the most exciting and creative sides to analyze. Why, because effectively you write the rules, there is no one that can tell you how creative or innovative you can be (limited only by your boss and the corporate culture perhaps). Your history, as a corporation, is irrelevant because you are always starting at a fresh page, so to speak. The only thing that inhibits you is your imagination and of course, to some extent, the products/services you're trying to market and/or sell. To date, you are probably (and have to be) in some kind of existing market to be selling your products. Marketing doesn't simply mean that you take what exists and try to 'get more out of it', though certainly that is always an objective (you should be doing that anyway). No, marketing means you are seeking 'new' ways to present, package perhaps, and sell your products/services, to 'people' (consumers) that don't yet even know you exist. They may be unaware that they even want your product/service. It is easy to confuse marketing with advertising, but advertising is a tool, one tool, within the marketing arsenal.

Unless you happen to be in a monopolistic position, whatever market you are currently in, you are no doubt sharing that with your competitors. You are all trying fervently to get the highest possible share, which means of course; within any specific market segment any gains you make are a loss by definition to someone else, your competitor. One could argue that say you're trying to reach all 18-25 year olds, and that market has a mass total (population segment) of 25 million people, then unless 100% (of maximum market potential, not necessarily the 25 million) have already been reached, any increase in market share on your part is to 'new' and not replacement sales. Either way, every percent you gain, is business someone else has lost or isn't going to get. From a present value perspective, the discount factor is either 1.0 or less than 1.0 on a time line. Actually, if the market is such that you are all 'fighting' for pieces of the same pie, because in aggregate you have reached maximum saturation (very unlikely), then the strategy becomes in theory one of aggressive replacement or maintenance. The question becomes economic, that of evaluating the incremental cost of gaining ground relative to the present value of incremental revenue. It is important that cost/benefit analysis over weigh any possible 'ego' considerations. Strategically, many companies will, almost at any cost however, seek to increase market share because of the enormous Public Relations (PR) angle of being able to promote 'total control of the market' and thus control prices and profitability.

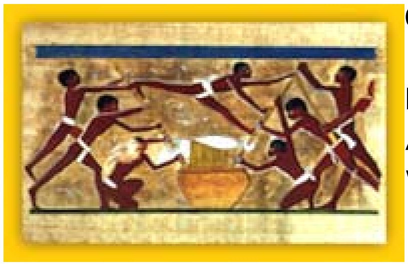
Let consider this last point in greater detail. When you are operating in a very competitive environment, reducing price (and thus lowering profitability) is a 'possible' strategy to gain market share but in an aggressive price war, so to speak, who really is the winner, probably not the companies. If the product has high price elasticity, then any marginal price change will create a disproportionate increase in demand, but how far down this road do you 'all' go? There are some products/services where low price is actually equated with lower quality and being the cheapest isn't necessarily being in the best position. Provided you have a product where 'market entry' costs are prohibitively high then you potentially have price leverage providing you're able to capture (or acquire) the majority of the market share.

In other words, while you're in competition you may be forced to compete using prices but should you buy-out or acquire your competition, you now have the leverage to albeit 'slowly' move the prices backup to realistic return levels and possibly recover any acquisition premiums. Your ability to control prices of course totally depends upon the nature of your products/services and the manner in which you adjust the prices.

Common sense dictates that no company would suddenly start increasing prices because in all probability they would risk seriously alienating the customers. However, there are more discrete and subtle means to achieve the same end result through the 'back-door' so to speak. One approach is to develop 'brand' identification such that consumers feel 'associated' with the product and price is almost a secondary consideration. The cost aspects of product differentiation may be relatively minor but such 'changes' can create justification of a price change but only for that 'unique product'. The profitability of that specific product can become very high or certainly 'higher' than very comparable products. Another possibility is to reintroduce the 'old' competitors products back into the market under a new label and again slightly changed so that it is perceived as 'new' and thus command a price change relative to the old competitor's brand. Introducing new 'sizes' and 'packaging' (plastic versus glass for example) can also command price changes.

The means by which products are distributed can also have very major ramifications for both price and profitability. If a company creates an entirely new way to distribute a product and the 'convenience' factor is received very favorably then again that product can command a price differential justified by the new distribution channel. If say, a particular area had poor access to certain products then, for example, by 'bringing' the product to the consumer, the company would be in a good position again to justify a higher price. In each and every instance we've referred the incremental costs are probably much lower than the price leverage achieved thus resulting in marked higher profitability.

The following material, cut and pasted, from the web site of 'The Al Ahram Beverages



Company', located in Cairo, Egypt, does a great job of reflecting the immense success that can flow from having brilliant marketing strategies. In the year 2000, The Al Ahram Beverages Company was in the Top 20 of Forbes World's Best 300 Company's, a most prestigious honor for the first privatized Company in Egypt as recently as 1997.

Bira Stella, One Hundred Years Of Gold

The fertile Nile was the cradle of civilization. What helped rock that cradle all those

thousands of years ago, was the birth of beer.

Carrying on a thousands year old tradition, Al Ahram Beverages Company S.A.E. (A.B.C.) has been pleasing beer drinkers and creating special memories in Egypt since 1897. Our celebrated beer, fondly known as Bira Stella, has been part of modern Egypt's past one hundred years of cultural, political and social change.

The Birth of Beer In Ancient Egypt

Throughout the world, Egypt is recognized as the cradle of civilization. One of the most celebrated children to come out of that cradle was beer, which was first brewed along the fertile banks of the Nile thousands of years ago.

Women soon found out that producing beer helped them get what they wanted from men, so it was customary for women to produce the beer - from soaking the grain to crushing it with yeast to filtering the fermented mash. Since hops were not available, they frequently flavored the brew with the likes of dates, mandrake, safflower and various spices. There are still papyri in existence that list as many as seventeen different kinds of beer. There are also papyri, and tomb paintings, which portray men, helping the women; making brewing a group effort. In the time of the ancient Egyptians, beer was enjoyed both socially and in religious contexts.

Some of the earliest references to the golden brew are from Egyptian mythology. In one myth the god Ra was compelled to intercede in the protection of mankind from the wrath of the goddess Hathor, who at the time was bent on annihilating all humans. Ra ordered the god Seket to grind dada (a mysterious fruit) and give it to the slaves for them to place in a mixing jar together with beer made out of barley. After adding the blood of men to the mixture, they prepared 7,000 jugs of beer.

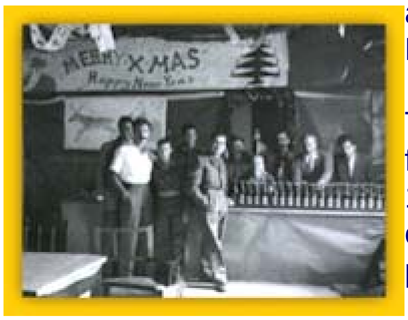
They then poured out the mixture in the area where Hathor had been obliterating the human race, flooding the fields with beer. When Hathor returned in the morning to complete her destruction, she found the fields inundated with beer and saw, mirrored in the golden brew, her beautiful face. She drank the beer and was satisfied. Following that, she went around drunk and no longer recognized mankind. Humanity thereby got a new lease on life, and beer has been brewed in Egypt ever since.

History of Stella

The Beginning

Modern Egyptian beer brewing officially began one hundred years ago. On May 15, 1897, the Crown Brewery Company (ABC's oldest ancestor) registered itself in the Kingdom of Belgium -–home of the well-known Stella Artois beer – to start operations in Alexandria.

Two years later, a different group of entrepreneurs from Brussels and Antwerp opened a brewery in Cairo, which came to be known as Pyramids Brewery.



The new Cairo brewed beer was a hit, but competition with foreign imports was fierce. Despite the competition, by 1906 Pyramids Brewery was in the black, showing a profit of 16,032 French francs with a 30% increase in overall production.

Back in Alexandria, there were now two breweries; the Crown Brewery Company of Alexandria (1897) and a family run brewery (Brasserie ET Rizerie Bomonti Freres)

After a series of mergers and acquisitions the Bomonti and Pyramids Beer Company was capitalized on Christmas day 1922 at 15,300 Egyptian pounds.

The Boom

Stella beer came to be the symbol of reliability, good times and a great brew in Egypt. Then, suddenly the lucrative Egyptian market found itself on the threshold of a virtual explosion of demand. As the Second World War raged through Europe, over one million thirsty Allied soldiers passed through Egypt, providing the greatest sales boost in the company's history. Without ever leaving Egyptian territory, by its fiftieth anniversary Egypt's Stella beer had become an international brand name.

In July 1953, the Cairo brewery became known as Al Ahram (pyramids) Beer Company.

The Fall – State Run Economy

Ten years later all companies traded on the Cairo and Alexandria stock exchanges were either nationalized or sequestered. Al Ahram Beer Company was first sequestered in 1961, and then nationalized in 1963 when it was forcibly merged with the Crown Brewery Company of Alexandria. After that, its chairmen were government appointees.

Thus was the beginning of state-run economy. Although contracts with the West slowed to a trickle and revenues were drying up under new public sector financial systems, Al

Ahram Beer Company kept brewing beer and introducing new products including Stella Export brand in 1967, created for foreign tastes.

Beginning in the 1970s, the population of Egypt began to explode and tourism became increasingly important. Demand for Stella beer grew with the crowds, foreigners and Egyptians alike, despite a rise of anti-secular sentiments throughout the Nile Valley.

In an attempt to counter these social trends and appease general sentiment Al Ahram Beverages (the company's new name as of May 1985) diversified its production line and launched several non-alcoholic drinks including the non-alcoholic beer Birell, and Fayrouz and malt-based apple/lemon flavored beverage. These new drinks complemented Stella Beer in an increasingly diverse competitive market. The introduction of two more soft drinks, Yusfino (mandarin) in 1993 and Citrino (lemon-lime) in 1994 further varied the company's innovative product line.

Modern Egypt – A New Beginning

Egypt entered the 1990s after three decades of revolutionary practices, which inhibited the development of the county's infrastructure and free-market economy. After a decade of false starts, the current government launched a much-anticipated economic reform program, including the privatization of state-owned industries. Al Ahram Beverages Company was one of the first public sector companies to privatize a majority stake.

The company was a pioneer in this novel process. In one year, ABC has quickly become "the model of privatization" in Egypt. By Modernizing production, improving quality control measures, and capitalizing on tremendous brand equity, ABC was able to unlock the potential of a long neglected company and restore to Egypt's beer its legendary style and prestige.

Consumption increased dramatically. And, to the delight of Egypt's beer connoisseurs and Stella devotees worldwide, the company introduced Stella Premium in September 1997. The rich darker beer rejuvenated the Stella name and raised Egyptian brewing to a new international standard.

The next step in Al Ahram Beverages Company's plan is the construction of a state-of the-art plant scheduled to begin production by 1999 and a canning subsidiary, which began operations in May 1998. The results are already visible. With vastly improved quality and availability, the consumer has reacted by putting Stella on the table. In conjunction with the visibly enhanced sales support, large-scale advertising and marketing campaigns are being undertaken on an ongoing basis to build brand equity. A fully-fledged export division has also been set-up to give consumers worldwide a taste of Al Ahrams' high quality beverages.

One hundred years after modern Egyptian beer making began – and thousands of years after the ancient Egyptians first introduced brewing to the world – with excitement and pride, we offer a toast to our long distinguished heritage in Egypt, the land where beer was invented. May the past challenge and the future inspire? Teaching/Supplementary material notes

These instructor/lecturing teaching notes (developed as supplementary material to the Foulks Lynch texts, final papers) were designed to provide any GFPAA instructor with some ideas about how to approach teaching some of this material. The approach was to develop supplementary material that attempts to put a 'working experience' perspective on the somewhat at times, very dry, text reading material. For students who are following a self-study approach, this material has been incorporated as part of the Supplementary notes to the final level, Part 3 papers.

Section I

International Accounting Standards (IAS) Harmonization Project (re-Section I b)

To obtain the data necessary to compile GAAP 2001, we (Appendix) asked partners in the large accountancy firms in more than 60 countries to benchmark their local written requirements against some 80 accounting measures, focusing on standards (both IAS and national) in force for the financial reporting period ending 31 December 2001.

GAAP 2001 provides summaries of areas in which national standards require different accounting and reporting treatments from IAS. It is designed to increase the awareness of users of financial statements that, although financial reports from different countries may appear to be similar, significant differences in national requirements and the resulting financial statements still exist. Users of financial statements are also alerted to the potential for differences between requirements by the reference in audit reports to the national set of requirements adopted in the financial statements under review.

Background:

Harmonization of the financial accounting and reporting standards on which financial statements are based is a necessity to respond to today's global capital markets. The world's economies are facing a future in which cash flows across borders will grow. Accounting and financial reporting is an important element of this evolving market and can support or undermine the efficiency of markets. Reporting financial information on the Internet is fast becoming common, giving investors from any country ready access to the financial information of companies, regardless of their country of domicile. This globalization of capital markets and the developments in telecommunications and the internet bring a new significance to the need for comparable and transparent financial reporting and require new thinking by companies, investors, creditors and auditors about what financial information companies should publish and how best to communicate it.

The present lack of common accounting requirements around the world serves as a significant impediment to the globalization of capital markets by restricting an investor's ability to make informed decisions about investment alternatives. For investors and other users to compare investment opportunities and, indeed, for a company to benchmark itself against its competitors, a common accounting and financial reporting framework is needed.

The work of the International Accounting Standards Committee (IASC) has had a significant impact on the development of accounting standards all over the globe. Countries increasingly look to International Accounting Standards (IAS) in the absence of domestic standards. Many others permit the use of IAS in cross-border filings, and some countries permit IAS in domestic filings. Importantly, the constitution of the IASC was modified in 2000 to provide for standard setting by an independent International Accounting Standards Board (IASB) of fourteen individuals, each chosen for his or her technical expertise. The fundamental objective of the IASC also has been refined - specifically, it seeks to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in financial statements.

The potential for IAS to provide the basis for comparable national and cross-border financial reporting is increasingly clear. Evidence includes the May 2000 recommendation by the International Organization of Securities Commissions that regulators should allow multi-national issuers to use IAS for cross-border offerings and listings, subject to the provision of supplemental data. In addition, in February 2001, the European Commission proposed a Regulation that will require Europe's listed companies to prepare their consolidated financial statements in accordance with IAS from 2005 onward. Across the world from Asia to Latin America, national governments, regulators and accountancy professionals are actively considering how their national accounting rules differ from IAS and how to reduce those differences. This process will, in many countries, lead to a significant improvement in financial reporting transparency and comparability

Accounting, the language of Business

Let's revisit all this again from a 'business information' perspective, because in many ways Paper 3.6 is literally the 'other side of the business information coin' that was Paper 3.4. "Though it should seem obvious to any accountant, certainly one studying at the final professional level; that in a real and 'business information sense' accounting is truly the common language of business. But, what is really meant by this statement and how far reaching is it. Consider that regardless of how complex an organization is, regardless of whether it is a manufacturer or a provider of services, regardless of whether it is domestic or is a multi-national and regardless of whether it is a startup or a billion dollar corporation, all these entities end up producing a Balance Sheet, a Profit and Loss Statement and a Statement of Cash Flow. These three critical statements, reflecting the financial representation of an organization, effectively become, the ultimate 'top of the pyramid' irrespective of the complexities beneath. By definition therefore, accounting information, and that includes both financial and non-financial combined, must permeate all aspects of an organization in order for these three critical statements to ever be generated. The syllabus, above, requires students, within this Paper (3.4), to:

- Identify the information requirements of different levels of management and understand how information is used to support the objectives of the organization."

Macro perspective:

As the above comparison between IAS and other countries accounting standards indicated, these so-called, 'faithfully representational financial reporting statements' all generated with the same 'objective intent' somehow all end up developing a slightly (sometimes major) different perspective and yet all based on the 'same' information. And yes, exactly the same 'business' information, because if you realize that were that particular entity existing in any one of those 'other' countries, the financial statements would conform to that countries standards and so on and the financial results would be different. The 'numbers' and/or derivation per se don't change but the way you report and present definitely does. There cannot be any fundamental difference other than language and currency (both of which can be universally translated) and, of course, local customs between a businesses operating in, say, Georgia versus Australia. Think about multi-national organizations with subsidiaries all over the world. Just because the 'numerical' revenues and costs are either above or below that of other countries where cost of living differentials change the absolute values, doesn't fundamentally change the 'properties' and/or composition of the numbers themselves. A ratio of 20% of net income to total sales is regardless of whether we're looking at a three-figure or six-figure revenue line; it is all relative. So, are there any real and justified differences that might explain these financial reporting differences?

In all probability, one of the most notable differences that may result in a higher or lower relative net income will be the local cost structure and the incurrence of particular types of costs/expenses that relate solely to local customs/practices. If, for an example, bribes/onerous taxes were a normal 'cost of doing business', and this is true in certain countries, the issue (it could be argued), for comparative purposes, is how do you recognize and/or report such charges. Fundamentally, what you have is a 'classification' issue only and whether you decide to separately identify it or simply merge it in, as part of the total cost of purchase doesn't basically change anything. It is a red herring! Something 'identical' that may cost 50 in one country but 70 (after currency conversion) elsewhere are just the facts of doing business in that particular locality regardless of whether it is attributable to VAT, local taxes, bribes or the weather, it doesn't really matter. If it is unacceptable then move on, that's the competitive nature of business! Equally, there are probably off-setting comparative savings on other line items. It can have no financial reporting ramifications (I didn't say results).

An expression that says, 'not seeing the wood for the trees', is very applicable here. From a cash flow perspective, trying to identify component pieces or drilling down to each 'dollar (or currency unit)' of outflow is meaningless because in the big picture 'that's what it cost', period. The intent here is to try and dilute any potential arguments that so-called legitimate reporting presentation differences do exist. When you ultimately get down to the real fundamentals of operating a business, and avoid any financial game playing, there can be none. Given the theoretical (not saying political) possibility of a single world currency (consider the Euro), and a common language, there should be no differences between States (New York vs. Connecticut in the USA) or between countries, say New

York and London, England. Normal differences in the costs of doing business locally as we've discussed, yes, and in the local prices you can charge, but that's it.

If for a second, you ignore accrual accounting, and analyze a business from a cash flow perspective only, the only major difference that can exist between 'countries' is in the recognition and the emergence of income and in the matching of expenses incurred relative to that same income. In other words philosophical and/or conceptual differences. From a Balance Sheet perspective, every unit of cash outflow is either Balance Sheet related (pay Creditors) or retained earnings (profit and loss statement). If you pay out cash (excluding inventory) but charge it or defer it to a Balance Sheet asset account then major reporting differences can arise if that practice is not universally accepted given the nature of that particular expense. Equally, if cash comes in (inflow) to the entity, other than from a debt arrangement, and you credit a deferred revenue account rather than retained earnings, again if not universally accepted then major reporting differences will arise. So what have we just concluded here?

What we have actually concluded (if you think about it) is that basically there are no real and justified business/economic reasons why any major differences should continue to exist between countries financial reporting standards. (Note, we're staying away from political here) Consider the major differences as highlighted in the Foulks Lynch material that do exist today. Each of these individually, along with others of course, are all capable of being harmonized towards a common set of standard.

- Goodwill

If you consider that (purchased) Goodwill by its nature is an accounting creation because the basis of the difference that creates goodwill in the first place, is derived from 'values' (fair market values relative to net assets) that are determined by accountants using management discretion in the first place. If the accounting 'basis' that created goodwill in the first place 'were to be the same' then only the amortization/future time period recognition becomes an issue.

- Deferred Tax

Usually deferred tax arises from temporary timing differences (depreciation) pertaining to financial recognition versus the local tax authorities/tax code. Obviously here national differences will exist given the different tax laws but the methodology could be the same.

- Valuation of Property

Determining fair market value has always been a subjective area and the tools/techniques used will in all probability vary across countries based upon local practice and sophistication. A simplified standard approach to valuation methodology could be adopted perhaps.

- Capitalization of Development Costs

This type of deferred expense is where accountants/management have the discretion to arbitrarily spread 'future investment' type costs over some future time period on a matching basis theoretically. By definition all assets must have some 'derived future economic value' to remain an asset and thus this could be the determining factor with management obliged to justify the remaining asset value.

- Accounting for dividends

This is more of an accounting difference arising from academics having 'differing opinions' as to when exactly does a transfer of value take place and is therefore totally reconcilable. All parties need to agree on a definition.

- Profit on Long-term contracts (construction contracts)

Again, accountants (and economists) can argue over the timing issue of when to recognize any profits (or losses) arising from such long-term projects. It's a conceptual issue and raises the question as to when something is 'economically' in service and therefore belongs or attributable to an accounting period and thus should be recognized. In order for profit, as such, to be recognized, the question becomes, "have the equity holders truly received a real increase in their economic wealth?" Contrast this to the concept of net present value.

The question as to what exactly is 'profit' is by no means a closed discussion. The accounting profession still continues to wrestle with defining revenue and true costs, in trying to determine how assets ought to be valued, how to measure the reduction in asset values and upon what basis should liabilities be measured. Debits and credits may be rock solid but the accompanying 'values' are still very much an open debate.

- Borrowing costs (capitalization)

If you view 'assets' as the 'employment' of the funds or capital provided to an entity a logical matching takes place and thus a conceptual argument arises over capitalizing finance charges (when borrowed money is used to acquire assets) versus writing them off immediately as a cost of doing business.

Contrast perhaps the treatment of 'dividends' paid to Equity. Are not 'some' dividend payments possibly another form of a finance charge? Some would strongly argue, no, that dividends are a return of capital as such and totally distinct from finance charges but I think many interesting conceptual arguments in either direction would justify the 'floor', so to speak. Because accounting is still evolving that's what makes the subject so interesting, provided you view it through the eyes of a business entity seeking to create and maximize 'economic wealth' and not just that of a bookkeeper.

Consider, again, the basic requirements of IAS 1, paragraph 20:

- Management should select and apply an enterprise's accounting policies so that the financial statements comply with all the requirements of each applicable International Accounting Standard and Interpretation of the Standing Interpretations Committee. Where there is no specific requirement, management should develop policies to ensure that the financial statements provide information that is:

(a) relevant to the decision-making needs of users; and
(b) reliable in that they:
(i) represent faithfully the results and financial position of the enterprise;
(ii) reflect the economic substance of events and transactions and not merely the legal form;
(iii) are neutral, that is free from bias;
(iv) are prudent; and
(v) are complete in all material respects.

Thus, as you start to analyze the international environment along with the development and problems pertaining to developing a set of international accounting standards, something interesting starts to emerge.

Accounting has always been an 'art' and not a 'science' and this statement does have very far reaching conceptual and practical ramifications. The investor community, including banks, financial institutions and analysts fully understand and expect that there will always be some differences even between the reported financial results of similar entities because of the discretion afforded to management. Businesses may be in the same industry and thus similar but they are never identical and accounting recognizes this fact. The alternative would not be desirable because it would effectively have a stifling impact on businesses (and creative management) and would run contrary to the normal market mechanisms of competitively allocating capital in a free economy.

Thus if 'normal' management discretionary differences are expected and in addition certain accounting adjustments for items like deferred taxes will always arise, then 'differences' per se are not the issue but rather the acknowledgment and expectation that all accounting issues are being handled in a similar fashion. If an investor, for example, notices a line item on the Balance Sheet called 'goodwill', regardless of where the company is domiciled and under which laws they fall, the investor has a 'right' to believe that the accountants are handling it in exactly the same way as another entity they viewed that was doing business in a totally different country and under a completely different set of laws.

If this is not the case then 'capital' as such will only naturally flow to (or be distributed across) those entities in whose financial results the investors are able to 'believe' all report under a common set of financial reporting rules. View it this way; all objective and rationale investor's have decisions to make about which entities have the greatest potential to increase their personal economic wealth. Primarily, the only business information available is the published financial statements (plus due diligent research etc, etc) and only, and only, if all are being equally prepared under the same set of accounting rules can investor's ever make the right (optimal and economic) decision. This cannot be argued!

As an analogy, contrast this to fuel or gasoline that is sold by octane ratings such as 87, 89 etc. Every car owner has the right to 'believe' that these ratings across Gas Stations are correct and thus only price, convenience and personal preferences (airline miles) to Shell versus Texaco are decision factors. Only imagine the total chaos if it were realized that these ratings are derived from standards that totally vary across State lines and between countries. Not only would 'consumers' be completely at a loss and have a feeling of betrayal but equity holders would suddenly no longer know which Energy stocks could be trusted (the product, gasoline, has credibility damage) and there would probably be a major sell-off. As automakers also specify 'required octane's' for efficient engine performance, we are not going to even approach the litigation that this would create based upon arguable damage done to automobiles. Oh, and, shareholders frequently sue company's for perceived misrepresentation pertaining to published financial information and press releases.

Section I (b) GAAP 2001 Project

Appendix I

The following remarks are important in understanding the material presented in GAAP 2001.

The questionnaire used to generate the information for the country summaries is included as Section 4 of this report. Our work did not aim to record all areas of difference that a more detailed study would disclose. It focused on some 80 accounting measures (including a few areas of disclosure), selected using our professional judgment, as key accounting areas for the majority of companies from the International Accounting Standards (IAS) in force for accounting periods ending on 31 December 2001. Other areas of accounting, which are not included within our scope, may be more significant for certain companies or in particular countries. Partners from the large accountancy firms across the world used these questions to benchmark their local written accounting rules and then reviewed the resulting country summaries presented here.

It should be noted that the country summaries:

- focus on the rules for preparation of consolidated financial statements and, where there is more than one set of rules, on those for listed companies. Different or additional requirements may apply for example to banks, insurance companies or the financial statements of individual companies and non-listed groups

- concentrate on the written word. The variation between national accounting rules and IAS may in practice be less or greater in any particular country from that reflected in these pages. In some countries, IAS often is looked to in the absence of local rules; in others, local accounting custom and practice have developed independently of the 'rule making' and may therefore diverge from the written word
- do not record a difference when IAS permits alternative treatments and the national rules follow one of those treatments or are more detailed or more restrictive than IAS. For example, there is no difference recorded here if a particular country does not permit an IAS benchmark treatment (such as that for accounting policy changes in IAS 8) or does not permit an IAS allowed alternative (such as LIFO in IAS 2)
- are based solely on standards in force for the financial reporting period ending 31 December 2001, except for India and Japan where March year-ends are most common and where we have therefore applied a 31 March 2002 cut-off. We have only included those standards published as of 31 October 2001; therefore careful attention should be paid to areas where requirements may have been issued after this date but prior to 31 December 2001. In addition, we have excluded published standards (both IAS and national) that do not have mandatory effect at the cut-off date
- use International Accounting Standards as the benchmark. Consequently, when national rules are more detailed, or cover more topics than IAS, the relevant differences are not recorded here
- do not, from the order of presentation of the differences, imply any particular emphasis or priority. The effect of differences between national rules and IAS could be very different for each reporting entity
- include differences, which range from the absence of an overall standard, for example "no requirement for segment reporting" to a detail of inconsistency, for example "no requirement for disclosure of segment liabilities". The length of a country summary is not therefore, of itself, indicative of the extent of variation between national rules and IAS

We should also emphasize that we have not generally included areas of difference between IAS and national rules, which fall outside the "80 key measures" of the questionnaire. For example:

- when local rules specify rates of depreciation or amortization of tangible and intangible assets, we have not made judgments as to whether or not these might be considered to depart from the IAS prescription of "estimated useful life"; or
- when local rules and IAS are in line as of 31 December 2001 (or 31 March 2002, for India and Japan) we have not enquired as to the impact of transitional provisions. Different dates of first application of the standards may cause differences in practical accounting (for example for fixed asset revaluation,

business combinations, goodwill, employee benefits and deferred taxation) for some years to come.

For those countries that were included in GAAP 2000, the summary of progress made in effecting convergence in the past year identifies differences noted in GAAP 2000 that were affected as a result of new national requirements that have come into force. In general, affected means that the differences have been removed, although in certain instances differences have not been completely removed, have changed in nature or additional differences have arisen due to the introduction of conflicting national requirements. Finally, the preparation of any survey like this requires considerable judgment to be exercised, primarily in each country and then in assembling material from across the world. Those who have compiled this survey have done their best to reflect a consistency of presentation across the 62 countries; nevertheless, it should be emphasized that the depth of explanation of differences for each country may not be comparable.

Appendix II

Background

Harmonization of the financial accounting and reporting standards on which financial statements are based is a necessity to respond to today's global capital markets. The world's economies are facing a future in which cash flows across borders will grow. Accounting and financial reporting is an important element of this evolving market and can support or undermine the efficiency of markets. Reporting financial information on the internet is fast becoming common, giving investors from any country ready access to the financial information of companies, regardless of their country of domicile. This globalization of capital markets and the developments in telecommunications and the internet bring a new significance to the need for comparable and transparent financial reporting and require new thinking by companies, investors, creditors and auditors about what financial information companies should publish and how best to communicate it.

The present lack of common accounting requirements around the world serves as a significant impediment to the globalization of capital markets by restricting an investor's ability to make informed decisions about investment alternatives. For investors and other users to compare investment opportunities and, indeed, for a company to benchmark itself against its competitors, a common accounting and financial reporting framework is needed.

The work of the International Accounting Standards Committee (IASC) has had a significant impact on the development of accounting standards all over the globe. Countries increasingly look to International Accounting Standards (IAS) in the absence of domestic standards. Many others permit the use of IAS in cross-border filings, and some countries permit IAS in domestic filings. Importantly, the constitution of the IASC was modified in 2000 to provide for standard setting by an independent International Accounting Standards Board (IASB) of fourteen individuals, each chosen for his or her technical expertise. The fundamental objective of the IASC also has been refined - specifically, it seeks to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in financial statements.

The potential for IAS to provide the basis for comparable national and cross-border financial reporting is increasingly clear. Evidence includes the May 2000 recommendation by the International Organization of Securities Commissions that regulators should allow multi-national issuers to use IAS for cross-border offerings and listings, subject to the provision of supplemental data. In addition, in February 2001, the European Commission proposed a Regulation that will require Europe's listed companies to prepare their consolidated financial statements in accordance with IAS from 2005 onward. Across the world from Asia to Latin America, national governments, regulators and accountancy professionals are actively considering how their national accounting rules differ from IAS and how to reduce those differences. This process will, in many countries, lead to a significant improvement in financial reporting transparency and comparability.

The process of reducing differences and improving financial statement transparency will take time, but the ultimate benefit will be worth the effort. Paul Volcker, Chairman of the Trustees of the IASC Foundation, voiced this view in June 2001, when he said, "the rapid development of global financial markets has greatly reinforced the desirability of - indeed now demands - international consistency in accounting standards and auditing approaches." Strong support for high quality international standards has come from a number of other sources, including the European Commission's Commissioner on Internal Markets, Frits Bolkestein, who, in commenting on the EC's proposal for a Regulation on the application of IAS said, "The adoption of a common financial reporting language for listed companies throughout Europe will greatly benefit both companies and investors in bringing about more transparency and a higher degree of comparability." And, one of the Commissioners of the United States Securities and Exchange Commission, Isaac Hunt, commented recently, "... I can think of no greater gift to the investing public than establishing a set of world wide accounting standards."

High-quality global accounting standards are needed to improve the ability of investors to make informed financial decisions, thereby leading to a reduction in risk for investors and, ultimately, to a reduction in the cost of capital. Equally important, global standards can improve access to capital markets and reduce costs and the complexity for international companies by reducing or eliminating some of the multiple reporting obligations. Companies will save both time and costs by being able to report all financial information under the same set of accounting and reporting rules, irrespective of location. Together, these benefits of improved access to capital markets, reduced cost of capital and reduced internal costs will reward companies that improve their financial reporting by implementing global, high-quality accounting standards and will reward economies in general, delivering greater investment opportunities.

This Year's Report

GAAP 2001 provides summaries of areas in which national standards require different accounting and reporting treatments from IAS. It is designed to increase the awareness of users of financial statements that, although financial reports from different countries may appear to be similar, significant differences in national requirements and the resulting financial statements still exist. Users of financial statements are also alerted to the potential for differences between requirements by the reference in audit reports to the national set of requirements adopted in the financial statements under review.

To obtain the data necessary to compile GAAP 2001, we asked partners in the large accountancy firms in more than 60 countries to benchmark their local written requirements against some 80 accounting measures, focusing on standards (both IAS and national) in force for the financial reporting period ending 31 December 2001. The resulting high level summaries were prepared by identifying, for the selected accounting measures, those instances in which a country would not allow (because of inconsistent requirements) or would not require (because of missing or permissive requirements) the IAS treatment. To highlight progress that has been made in achieving convergence during the past year, we also have identified differences noted in GAAP 2000 that were affected as a result of new national requirements that have come into force this year. Similarly, we have recorded changes in national requirements or proposals expected to come into force in the future, which will further reduce differences from IAS.

In carrying out the study and preparation of the country summaries, there necessarily were a number of limitations on scope and methodology. These limitations are discussed in more detail in Section 2 and should be referred to when reviewing any country summary.

Key Observations:

The availability of two years of information - with last year's GAAP 2000 as a point of comparison - allows some analysis of the current progress toward convergence. We summarize here some themes emerging from the data with respect to three issues: national efforts; overall increase in differences; and major topics of difference.

National Efforts:

Approximately twenty countries are responding to the challenge of convergence with an active agenda and proposed changes to national requirements. These countries can be identified by the number of entries at the end of its summary. Other countries have only a limited number of differences, and convergence for them is a less difficult process. However, a year ago when GAAP 2000 was published, a number of countries exhibited many and major differences from IAS, and these differences continue to exist. GAAP 2001 shows that there are approximately thirty countries with major differences but with no indication of proposed changes. Generally, more effort needs to be made in these countries to identify differences from international standards and to plan for their removal over a period of time. For many, the process has commenced, but it may take some years for actual results to materialize because the strategy for convergence varies widely. Of course, for a few other countries, convergence of their standards is not an issue because they simply require the use of IAS.

Increase in differences:

IAS 39 (Financial Instruments: Recognition and Measurement) and IAS 40 (Investment Property) came into force during 2001. As a result, most countries have added these to their list of differences from IAS. Also, in a few countries, new national requirements have increased divergence from IAS. Thus, convergence is a moving target. Changes in both international and national standards will require extra effort to achieve convergence.

Major topics of differences:

Lack of convergence is particularly obvious for certain accounting and financial reporting issues, such as:

the recognition and measurement of

- financial assets and derivative financial instruments
- impairment losses
- provisions
- employee benefit liabilities
- income taxes

accounting for business combinations; and
disclosure of

- related party transactions
- segment information.

The way forward:

As a result of the reorganization of the IASC/IASB, few new international accounting standards were issued in the last 12 months. This may mean that fewer new national differences from IAS will emerge in 2002 than in 2001. However, the IASB has given priority to certain improvements that will lead to the removal of options in a number of standards, and therefore, the differences between IAS and some sets of national requirements will increase significantly. Other major changes to IAS are also on their way. As a result, national standard setters will have to redouble their efforts in the coming years to keep pace with the changes in IAS and to ensure that the gap between national and international standards narrows rather than dramatically increases.

One national response to this potential for wider differences between national and IAS requirements would be to abandon domestic requirements and adopt IAS fully. This response might be effective if applied to a limited group of companies (for example, only to listed companies in a country with a manageable level of such companies) and in the context of a highly trained accounting profession. However, this "big bang" approach to convergence poses a much greater threat to short term quality of the application of new standards when compared with managing change over a period. Thus, when practical, staged implementation may be more appealing to national regulators. This "evolutionary approach" would enable proper development of educational, professional and regulatory infrastructures; necessary financial accounting and reporting information systems modification; translation from English into local language; and so on. An evolutionary approach involving gradual changes to national rules could perhaps start by focusing on those areas - or groups of related areas - of greatest difference from IAS.

Another version of an evolutionary approach is the European Commission's announcement of its proposed Regulation, which has provided several years of advance warning before IAS becomes compulsory for listed European Union companies. This will allow time for the management and finance functions of affected companies to develop a well-considered, orderly transition to IAS.

As a first step in achieving full convergence, we encourage companies to begin to identify and quantify differences between their current accounting practices and IAS requirements. Companies need to prepare early for change. Quantification of the impact should be an urgent priority, even if only for a company's internal management purposes. And, in time, a requirement to present a numerical reconciliation to IAS could help to prepare the users of financial statements for the forthcoming change and could help to satisfy market expectations.

The quantity and significance of the differences in the GAAP 2001 country summaries makes it clear that, for many countries, convergence with IAS is a major task and requires a joint effort in each country by the government, stock market regulators, financial statement preparers, users, standard setters and the accounting profession. Changing the requirements will be difficult enough, but it will be more difficult still to ensure a high quality of implementation. Accountants and auditors must be trained, enforcement mechanisms must be improved and users must be informed. Although some efforts may be initiated internationally, it is clear that the most significant actions must be undertaken at the country level, where plans for convergence of high quality accounting standards need to be developed and implemented.

As a final comment, users of any particular financial information should take great care to understand which accounting principles (national or international) have been applied in preparing the relevant financial statements. Not only do alternative treatments exist in accounting requirements, but also particular events and transactions in different companies can take on more or less significance. While GAAP 2001 is not meant to provide a comprehensive analysis to facilitate the in-depth interpretation of financial statements of specific companies, it will alert users to the care needed in interpreting financial information from across the world. We particularly hope that this report on current differences will encourage regulators, users and others to continue to press for further convergence and improvements in standards.

Section II

- Property, Plant and Equipment (IAS 16)

Accounting standards currently dictate that historical cost concepts are an acceptable basis for asset valuation less a provision for depreciation. Additionally, assets can be revalued (any increases charged to a surplus reserve account or expensed if devalued). Periodically, adjustments in either direction can offset this surplus account or be recognized as a quasi-income adjustment. Depreciation should be such that reflects the 'type' of asset and its 'use' in the business. Depreciation is a cost-spreading mechanism only that attempts theoretically to match product revenue against the costs of 'earning' that revenue, and that includes a portion of the costs (i.e. depreciation) pertaining to any capitalized assets used-up during this arbitrary 12-month accounting period. It is not a purpose of depreciation to fund replacement as is sometimes thought. Sinking-fund type vehicles are used for replacement purposes.

The historical precept is still the most controversial when it comes to arguments over defining an economist's version of real economic profit. Can it truly be said that from year-to-year, real economic wealth was decreased only by this 'accounting' mechanism for spreading the cost of an asset used to create the products that derive the income or revenue. Discussions and arguments continue today on alternative valuation methodologies along with determining the approaches needed to recognize declines or reductions in these values (charging it off and/or recognizing it against income).

- Impairment of Assets (IAS 36)

The basis of IAS 36 is to ensure that entities do not carry assets whose values exceed their 'recoverable' amount. The standard dictates that the recoverable amount is the 'higher' of

  - Net selling price, or
  - Estimated FV cash flows of assets use in business

The business should use a discount rate that (net of tax) incorporates an appropriate risk premium. (The higher the rate, the lower is the product of the discounted cash flows.)

There is a natural crossover here with revaluing assets, discussed above, and using the same accounting entries. However, given that no asset should theoretically exist anyway unless there is some derived 'future economic value', it almost seems redundant for IAS 36 to exist. The so-called discount rate, defined in IAS 36, is so open to interpretation that virtually any discounted rate (at management discretion) could be used. It is thus questionable as to the practicality of this standard in actually improving reported financial information. It would not be difficult in all probability to find (using IAS 36 rules) support for any valuation determined by management. As to the rate, what is the source (it needs an active underlying financial market), what point along the curve (time) do you select the rate and upon what basis is the risk premium determined?

- Capitalization of Borrowing Costs (IAS 23)

This topic, from an alternative viewpoint, was discussed in Chapter 1 of this supplementary material.

- Accounting for Government Grants (IAS 20)
- Investment Property (IAS 40)
- Intangible Assets (IAS 38)

Intangibles that are not covered by IAS 38 include:

1. business combination goodwill
2. deferred tax assets
3. IAS 17 leases
4. financial assets
5. employee benefits
6. mineral rights and costs of exploration

The accounting treatment relating to valuation adjustments are identical to that of fixed assets, discussed above. (IAS 16 and also IAS 36). The standard also references the information requirements that must be disclosed in the footnotes.

- Goodwill (IAS 22)

One very important point is that only 'purchased goodwill' is ever reported (calculated using consolidated work papers) on a consolidated financial statement. There is no inherent goodwill. In Chapter 1 of this supplementary material we made some additional comments relating to goodwill in terms of its (IAS) divergent handling from that of U.K. accounting standards. The alternative accounting treatment(s) also available for handling goodwill provides effectively total management discretion that ranges from 'zero' amortization to a total write-off. Hard to get much more flexible than this!

- Inventory (IAS 2)

Inventories should be valued at the lower of cost or net realizable value (nrv). Four methods are approved:

1. Actual
2. LIFO
3. FIFO
4. Weighted Average cost

A great deal of material, in various places, has been written on selecting which method best suites the entity and what the ramifications are. A consideration with respect to inventory valuations that frequently arises is the question of inflation and inventory turnover. In a zero inflationary environment, relatively minor valuation differences will exist between all methods but the contrary is true in countries where inflation is rampant. Also, again if inflation is high or fluctuating then inventory turns (increase or decrease) can have a major impact on short-term reported results. It is often common in examinations to ask students the effect on profits when there are proposed changes to the method currently being used and/or inflation (and/or inventory turns) is expected to increase or decrease significantly during the next fiscal year.

Remember, inventory, as an asset, is nothing more (and ideally, very temporarily) than a deferred expense account. It is a 'holding bay' for cost of goods sold. However, what determines year-end values is greatly influenced by inventory turns and during inflationary times this balance sheet amount may fluctuate considerably. Unfortunately these are also questions that 'in the heat' of examinations students can become confused, they require a very level headed and logical approach to determining the end result. Be warned and practice frequently. After practicing a few variations, it is possible to 'automatically' develop a short cut to the overall outcome.

Inventory – Finished Goods

Debit		Credit	
Opening Inventory	100	Cost of Goods Sold Transfer	400
Inventory Purchases	500		
		Closing Inventory (Balance)	200
Total	600		600

Remember, any time you 'increase' the Balance Sheet value (deferred expense) you automatically 'increase' profit because of the corresponding 'decrease' in cost of goods sold. By increasing the Balance Sheet valuation you shift recognition (defer) to the next accounting period. If you shift from LIFO to FIFO (inflation is high), what happens, the cost of goods sold, now being valued at FIFO shifts downwards to a lower value and the year-end Balance Sheet valuation must increase because the latest purchases (at higher prices) are still in inventory under a FIFO valuation methodology.

Section III

Financial Instruments: (IAS 39)

Financial instruments also include derivatives:

- Forward Contracts
- Forward Rate Agreements
- Futures Contracts
- Swaps
- Options

Initially these are measured at cost and subsequently are marked to market at fair value. Financial instruments are sub-classified into:

1. Loans and receivables originated by the entity
2. Held-to-maturity investments
3. "any" financial asset where a quoted price/fair value is not readily available

   Maintained at amortized cost

4. Financial Assets held for trading
5. Available-for-sale financial assets

   Marked-to-market at fair value

The primary concern behind all financial instruments, especially derivatives is that they potentially expose an entity to very high levels of risk (and losses) unless they are carefully (and professionally) managed and used strategically to hedge either an asset or a liability position. There have been numerous cases where Company's have very ignorantly invested in (one-sided) derivative positions, having no idea of what they were actually doing or buying, and have resulted even in complete financial collapses given the huge and totally unexpected losses that occurred, for example, Orange County in the USA. During a CNN (USA television news program) a professional trader was asked of the Orange County debacle, could he explain to 'viewers' what exactly did Orange County invest in? The answer, "he didn't have a clue", and that was after trying to read the documentation supposedly explaining the investment vehicle. Derivatives, when used professionally and used in hedging activities, can be extremely critical in financial risk-management to create locked-in positions and control an entity's exposure to 'potential future' losses.

For example, a financial manager knowing the entity needs to borrow a large amount in 6-months may be concerned over interest rates temporarily spiking. By using an offsetting derivatives position, the financial manager can effectively lock-in today's interest rates and not be worried; he or she thus hedged the exposure. A Company is expecting a huge payment (from a customer) in foreign currency in 6-months and is worried over exchange rates weakening relative to the dollar thus creating a conversion loss relative to today's rates.

By purchasing an offsetting derivatives position, the financial manager can effectively lock-in at today's exchange rate and thus guarantee the dollar-converted amount. The balancing act, so to speak, is that though the derivative position is not free, on the other hand, the cost relative to the exposure is considered acceptable. Primarily, it is a gamble but a calculated one. Were neither adverse event to happen, and actually both interest rates and exchange rates became favorable relative to today, the derivative position, in retrospect, was not a good idea. The financial manager is unable to benefit from the improving position having locked-in. Unfortunately, reality is such that the financial manager gets criticized were things to improve and yet highly praised for his or her judgment if those adverse events actually were worse than expected. Fundamentally, risk management involves taking positions based upon a perspective on future events but should you be wrong you get criticized. No professional manager today can truly (and totally accurately) predict future interest rates and yet daily all financial managers are required to do just that and make decisions based upon that analysis. Forward exchange rates are a function of the differential interest rates between the countries and yet financial managers daily are required to make judgments on such future events in terms of predicting exchange rate changes.

The full text of the following is from a monthly 'derivatives' newsletter that outlines various derivative strategies using options (one of the listed derivatives above). It makes for interest reading and provides a real life perspective on option strategies.

```
-- Option Plays for Stock Investors by OptionInvestor.com --

    Simple Option Strategies
    ------------------------

      Call Option Play - Select Biotech Strength

      Put Option Play  - Is The Housing Boom Over?


    Conservative Option Strategies to Reduce Risk
    ---------------------------------------------

      STRATEGY #1, PROFITING FROM MARKET MOVEMENT.
                   with example Straddle and details

      STRATEGY #2, WRITING CASH-SECURED PUTS FOR LOW RISK PROFITS.
                   with example put play and details

      STRATEGY #3, WRITING "COVERED" CALLS.
                   with example play and details

      STRATEGY #4, WRITING "UNCOVERED" CALLS - BUT WITH A HEDGE.
```

(using a credit spread to limit risk)
with example play and details

-- SIMPLE OPTION TRADING STRATEGIES --

A lot of new (and old) option investors like to stick with simple strategies. The easiest strategy to understand is a directional option play. Simply buying a put or a call based on the direction you expect the underlying security to move. What does that mean in English?

If you have reason to believe a stock or index is going to go up then you can capitalize on the move by purchasing a call option. This is only one strategy for bullish option traders to use but it is the easiest to execute. As the stock price rises so does the value of your call option assuming the time decay is not eroding the price of the option faster than the stock is rising.

Following the same reasoning, if you believe a stock or index is going to decline then option traders can profit from the move by purchasing a put option. Put options increase in value as the stock price falls.

These are commonly referred to as directional option plays. Below are two directional plays for current market conditions. We have listed a call play for a stock with a bullish outlook and a put play on a stock with a bearish outlook.

================
Call Option Play
================

-- Remember, you normally purchase a call option if you believe
-- the stock will go higher.

IDPH - IDEC Pharmaceuticals $69.31 +2.93 (+1.72 this week)

Company Description:
IDEC Pharmaceuticals focuses on the commercialization and development of targeted therapies for the treatment of cancer and autoimmune diseases. IDEC's antibody products act chiefly through immune system mechanisms, exerting their effect by binding to specific, readily targeted immune cells in the patient's blood or lymphatic system. The company's first commercial product, Rituxan, and its most advanced product candidate, ZEVALIN (ibritumomab tiuxetan), are for use or intended for use in the treatment of certain B-cell non-Hodgkin's lymphomas (B-cell NHLs). (source: company press releases)

Why We Like It:
Isolated negative news events continue to filter out in the biotech spaces. Conversely, some continue to shine. With the sector recently showing some signs of strength in the face of weakness in the broader market, the biotech leaders could be poised for another leg higher over the next several months.
Ever since receiving early approval for its cancer drug Zevalin, shares of IDEC Pharmaceuticals have been gaining strength. The company received FDA approval in late February for its drug intended for non-Hodgkin's lymphoma. Most analysts hadn't been expecting approval for the drug until May or June. The drug is

expected to significantly impact IDEC's bottom line for the better. That news continues to help the stock higher along with the strength in the Amex Biotechnology Sector Index (BTK.X). The relative out performance has been a growing trend and with a positive broader market, we'd expect the BTK.X to out pace the averages to the upside. That sector strength should only add to IDPH's price momentum. The stock is coming off of a short term pullback, which may have ended with its rebound from the $65 area. The stock has slight congestion above current levels, which would be cleared on a breakout above the $70 level. From there, IDPH faces only minor congestion between the $72 and $73 levels before its all-time high up around the $77 level. The fact that IDPH trades so close to its all-time high reinforces the relative strength on display in this stock.

Selected Options to Consider:
BUY CALL APR-65 IHD-DM OI=3485 at $ 7.70 SL=6.00
BUY CALL APR-70 IHD-DN OI=4388 at $ 4.60 SL=2.75
BUY CALL JUL-65 IHD-GM OI=2603 at $11.50 SL=9.75
BUY CALL JUL-70 IHD-GN OI=3014 at $ 8.50 SL=6.50

-What do the numbers and abbreviations mean?-

By reading down the line you can see the recommended option and its relevant information. APR-70 tells you that you want to look at the April option at the $70 strike price. The symbol for that option is IHD-DN. Currently the Ask price is $4.60. Now remember, an option contract symbolizes control of 100 shares. That means it will cost us $460.00 to purchase the option. Open interest is the current number of outstanding contracts held by investors today. We normally don't recommend trading options that have open interest below 100 contracts which would be considered low open interest. This one has open interest with over 4300 contracts currently open. SL is an abbreviation for our suggested stop loss on the option price. Options can be volatile based on the movement in the underlying stock. If you're not comfortable placing your own stop loss talk with your broker.

! We are not suggesting you purchase all the options listed. We merely provided a selection for you to choose from. Option traders have dozens of options they can choose from with many not listed in this article.

================
Put Option Play
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-- Remember, you normally purchase a put option if you believe
-- the stock will go lower.

CTX - Centex Corporation $59.88 -1.44 (+0.41 this week)

Company Description
Centex Construction Company, a leader in the commercial construction industry for 66 years, provides general contracting, construction management, design-build, program management, and

preconstruction services. Centex Construction Company is a division of Centex Construction Group, a subsidiary of Dallas-based Centex Corporation. (source: company press release)

Why We Like It:
There's no arguing with the incredible resilience of the housing market, especially after the market sell off in September. Measured by the DJUSHB index, the sector is up nearly 100% since the September lows, as one home builder after another has announced record profits. But it looks like the party is coming to an end. With all the good news factored into stock prices and money beginning to flow into riskier areas of the market, this looks like an area of potential weakness over the near term. CTX just recently traced a new all-time high near $63, and given that fact, this play carries more risk as we are attempting to pick a top. But following that high, the stock has been seeing a fair amount of selling (roughly 50% above the ADV), and that is never a healthy sign for a stock that is looking to move higher as it reveals an equity that is most likely under distribution. The daily Stochastics are just rolling down out of overbought territory, and despite UBS Warburg raising their estimates for the stock, it looks like the near-term direction is down. The one very big benefit of trying to enter bearish plays in stocks trading near all-time highs is that risk to the upside can be measured and managed easily with a stop just above the relative high. In the case of CTX, the stock's all-time high is at $63.09, or about $3 away from current levels. That's $3 of upside risk, while the stock has the potential to retest its recent lows down around the $52 level, which is about $8 away from current levels. With potential reward far outweighing risk, we like the set-up in CTX currently. A little bad news from the housing sector is all it would require to get CTX moving lower.

Selected Options to Consider:
BUY PUT APR-60 CTX-PL OI= 168 at $3.70 SL=2.50
BUY PUT APR-55 CTX-PK OI=1519 at $1.60 SL=1.00

-What do the numbers and abbreviations mean?-

By reading down the line you can see the recommended option and its relevant information. APR-55 tells you that you want to look at the April option at the $55 strike price. The symbol for that option is CTX-PK. Currently the Ask price is $1.60. Now remember, an option contract symbolizes control of 100 shares. That means it will cost us $160.00 to purchase the option. Open interest is the current number of outstanding contracts held by investors today. We normally don't recommend trading options that have open interest below 100 contracts which would be considered low open interest. Open interest for this option is over 1500 contracts. SL is our abbreviation for a suggested stop loss. This is a stop loss on the option price. If you are not comfortable in choosing your own stop loss for option trading we recommend you speak with your broker.

! We are not suggesting you purchase all the options listed. We merely provided a selection for you to choose from. Option traders have dozens of options they can choose from with many not listed in this article.

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- OPTION STRATEGIES WITH A MORE CONSERVATIVE APPROACH TO RISK -

Tuesday, March 12th, 2002

STRATEGY #1, PROFITING FROM MARKET MOVEMENT

This section introduces investors to the mechanics of a Straddle.

The debit straddle is an appropriate strategy for occasions in which one suspects that the price of an instrument will move substantially but does not know in which direction it will go. A call option and put option are purchased with the same strike price and expiration date on the and underlying market. The risk is limited to the premium paid for the options (plus commissions) however, the potential profit unlimited and the position benefits from movement in either direction.

This "delta-neutral" technique can work very well in situations where important events are about to occur and they are expected to be either very favorable or extremely detrimental. Corporate earnings announcements, new drug approvals, merger or takeover speculation, annual board meetings (stock splits/spin-offs) are some common examples of situations in which unknown information will be released on or near a specific date. The recent economic reports have created uncertainty among investors and the interest rate reduction is just one catalyst that could move the Market in the coming sessions. Option traders can profit from these situations when premiums are favorable and there is a reasonable possibility that share prices will be volatile.

To construct profitable straddle positions, it is important to pick an expiration month so that the price of the straddle will not be too high (too far from expiration). However, it must also provide enough time for the stock to perform as expected, before we have to exit the trade to preserve capital. One important fact to remember; the highest increase in time decay for at-the-money options occurs in the last 30 days before expiration. That means one should rarely hold a straddle position to expiration. Most experienced traders agree that two to three months should be the minimum time frame for straddles, unless you are speculating on short-term movement and purchasing little premium in the options. If you have a choice between two different series of expiration periods and the Implied Volatility for the longer-term options are lower, you should consider the position with the greater time value because those options are likely to be theoretically cheaper. When you understand that time decay is working against you, you can begin to choose trades in which other beneficial components will help your position profit, even as time passes.

This issue is a good candidate for a debit straddle:

NRG - NRG Energy $12.75 *** Low Risk Probability Play! ***

NRG Energy (NYSE:NRG) is a global energy company engaged in the acquisition, development, ownership and operation of power generation facilities, and the sale of energy, capacity and related products. As of 1/1/02, NRG Energy had interests in power generation facilities (including under construction) having a total design capacity of 25,000 megawatts. Most of NRG Energy's North American projects are grouped in regional holding companies corresponding to the domestic core markets. The company has established regional offices in Pittsburgh, Pennsylvania (Northeast region), Baton Rouge, Louisiana (South Central region) and San Diego, California (West Coast region). NRG Energy's North Central region (a recently added region, as of year-end 2000) is managed from its Minneapolis headquarters.

PLAY (conservative - neutral/debit straddle):

```
BUY  CALL  JUN-12.50  NRG-FV  OI=896  A=$1.15
BUY  PUT   JUN-12.50  NRG-RV  OI=233  A=$0.85
```

INITIAL TARGET COST=$1.80-$1.90 TARGET PROFIT=50%
UPSIDE BREAK-EVEN=$14.40 DOWNSIDE BREAK-EVEN=$10.60

-What do the abbreviations in the "PLAY" mean?-

JUN (June) is the month the options expire.
$12.50 is the strike price of the options you are buying.
NRG-FV & NRG-RV are the official ticker symbols for the options.
OI is the open interest (amount of liquidity) in the option.
ASK is the current price for the option - but you can often buy it for less if the underlying stock moves much during the day.
TARGET COST is the amount we want to pay per option contract.
TARGET PROFIT is our initial profit goal in the play (it can be modified later as the situation dictates).

This issue is a good candidate for the speculative, short-term approach to Straddle trading:

CRUS - Cirrus Logic $19.64 *** Tech Sector Volatility! ***

Cirrus Logic (NASDAQ:CRUS) is a supplier of high-performance analog and DSP chip solutions for consumer entertainment electronics that allow people to see, hear, connect and enjoy digital entertainment. Building on its leading position in audio integrated circuits and its rich mixed-signal patent portfolio, the company targets mainstream audio, video and Internet entertainment applications in the growing consumer entertainment market. Cirrus Logic operates from headquarters in Austin, Texas, and major sites located in Fremont and El Dorado Hills, California; Broomfield and Boulder, Colorado; as well as offices in Europe, Japan and Asia.

PLAY (speculative - neutral/debit straddle):

```
BUY  CALL  APR-20  CUQ-DD  OI=1867  A=$1.45
BUY  PUT   APR-20  CUQ-PD  OI=76    A=$2.15
```

INITIAL TARGET COST=$3.40-$3.50 TARGET PROFIT=15-20%
UPSIDE BREAK-EVEN=$23.50 DOWNSIDE BREAK-EVEN=$16.50

-- What do the abbreviations mean? --

APR is the month the options expire.
$20.00 is the strike price of the options you are buying.
CUQ-DD & CUQ-PD are the official ticker symbols for the options.
OI is the open interest (amount of liquidity) in the option.
ASK is the current price for the option - but you can often buy it for less if the underlying stock moves much during the day.
TARGET COST is the amount we want to pay per option contract.
TARGET PROFIT is our initial profit goal in the play (it can be modified later as the situation dictates).

How does the strategy work?

We start the play by purchasing an equal number of calls and puts (example; 5 or 10) and we try not to spend more than the target cost (listed in the play) for each pair of options that are purchased. Once the straddle is in place, you must decide if you will hold the options until expiration or cut your loss at some point prior to that date (April 20, 2001). If you are planning to cut your loss early, determine the maximum risk in the position (which is simply some percentage of the amount you paid to purchase the options). If that amount is reached or exceeded, the entire position should be closed. Of course, the position should also be closed when the profit target is achieved. If the underlying issue starts to move significantly, some traders will use trailing stops on the profitable options and raise these stops as profits rise. In addition, you might sell the losing options when they fall to half of their initial value. Another popular method called "Trading the Trend" with straddles can be a very profitable technique for traders but it involves additional risk and requires knowledge of technical analysis. This approach involves monitoring the underlying issue for a breakout or key reversal through a known support or resistance level. When the new trend has been positively identified, the lower-priced options (losing side) are sold along with one-half of the higher priced options (profitable side). The remaining position is held until a reasonable profit target is met and downside protection is maintained with a trailing stop. Advanced traders favor this follow-up technique because it is based on known technical trends and the action generally occurs near the position's "break-even" points. When one of these break-even points is reached, two simple trades lower the overall cost basis while retaining a high probability of eventual profit.

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STRATEGY #2 WRITING CASH-SECURED PUTS FOR LOW RISK PROFITS

This section introduces investors to the strategy of selling cash-secured Puts to earn consistent income or establish a discounted cost basis in a new portfolio stock.

This unique approach to conservative option trading is one of the most popular techniques among experienced investors. The strategy of selling puts is designed to complement a low-risk stock portfolio because it offers a great method for generating profits; collecting premium by writing "out-of-the-money" puts, and it also provides a way to acquire new portfolio stocks at reduced prices.

Selling Puts
Strategy Definition

The basic strategy involves selling a Put against cash or other collateral held in your brokerage account. The sole purpose of the collateral is to assure that money is available to purchase the stock should the Put be assigned to the account. Generally, the buyer of the Put will exercise the option if the underlying stock drops below the sold strike price at expiration. If the share value remains above the sold strike price at expiration, the Put will expire worthless and the option premium retained by the seller constitute a profit.

Put writing takes advantage of the concept of time decay; the time value premium of option declines as it approaches expiration. Unlike stock trading, where an investor can hold on to a stagnant issue indefinitely hoping it will rebound, the value of an option will decline if the underlying stock fails to move in the correct direction. This premium erosion allows a trader to profit without having to correctly predict the future movement of the underlying issue, as long as it remains above the sold strike price. Time value premium decays at a predictable rate and falls rapidly in the final month of option expiration.

Selling Puts
Strategy Objectives

The strategy of writing puts for monthly income involves selling "out-of-the-money" options on a stock that the investor expects to finish above the sold strike price. With careful selection of the underlying issue, most sold puts will expire worthless, allowing the investor to keep the premium and receive a reasonable profit, without ever having to buy the underlying stock. There is still the margin requirement but this commitment of collateral funds is almost always less than the outright purchase of an equivalent number of shares.

An investor who is interested in buying a stock may also consider selling a cash-secured put as another means of acquiring the issue. Generally, when a person wants to buy a stock at a specific price, he will use some type of "limit" order. The problem is, after the initial order is placed, the stock will not be purchased until it trades at or below the limit price. Instead of waiting for that movement to occur, he could simply write a cash-secured put. A premium (the bid price of the option) will be paid to his account for the obligation to buy the stock. He has determined that the cost basis (the sold strike price minus the option premium) is an acceptable price at which to own this new stock, that he wants to be a part of his portfolio. This strategy is also used by fund managers, as well as large corporations, because it pays them for assuming the obligation to buy a particular stock that they intend to eventually add to their portfolio.

Here is a great candidate for this technique:

ACF - Americredit $38.31 *** Entry Point! ***

AmeriCredit (NYSE:ACF) has been operating in the automobile finance business since September 1992. Through its branch network, AmeriCredit purchases auto finance contracts without recourse from franchised and select independent automobile dealerships and makes loans directly to consumers buying late model used and new vehicles. AmeriCredit targets consumers who are usually unable to obtain financing from traditional sources. Funding for the company's auto lending activities is obtained primarily with the sale of loans in securitization transactions. AmeriCredit services its automobile lending portfolio at various regional centers using automated loan servicing and collection systems. AmeriCredit's typical borrowers have experienced prior credit difficulties or have limited credit histories.

The long economic slowdown, combined with possibly poor borrower selection, has worried investors that ACF might experience a deterioration in credit quality. But signs of economic recovery and a recent pricing of a $1.6 billion offering of automobile receivables-backed securities has eased the near-term monetary worries. From a technical viewpoint, last week's high-volume rally through the resistance at $30 suggests there is potential for further upside activity. Traders who wouldn't mind owning this issue at a discounted cost basis can profit from continued bullish movement with this position.

PLAY (very conservative - sell cash-secured put):

SELL PUT APR-30 ACF PF BID=1.00 OI=1098 CB=29.00 TY=9.0%

-- Definitions of Abbreviations --

APR-30.00 is the option's expiration month and its strike price.
ACF-PF is the official option symbol of the option to sell.
BID is the last price (or what we receive when we sell it).
OI is the open interest (amount of liquidity) in the option.
CB is the cost basis in the issue (the break-even point).
TY is the position's yield or gain (on a monthly basis).

Supplemental Candidates

The following group of issues is a list of additional candidates to supplement your search for "put-selling" plays. As with any investment, you must decide if the selections meet your criteria for potential plays. Only you can know what strategies and positions are suitable for your experience level, risk-reward tolerance and portfolio outlook.

Stock Symbol	Month to sell	Strike Price	Option Symbol	Opt Bid Premium	Open Intrst	Cost Basis	Target Yield

IDNX	APR	10.00	IDX PB	0.95	3	9.05	15.5%
HOFF	APR	10.00	UHH PB	0.90	0	9.10	14.6%
NPRO	APR	10.00	NYQ PB	0.75	250	9.25	14.5%
AWA	APR	5.00	AWA PA	0.25	38	4.75	11.6%
IBIS	APR	10.00	UIB PB	0.45	200	9.55	11.1%
FFIV	APR	20.00	FLK PD	0.75	3925	19.25	10.1%
ACF	APR	30.00	ACF PF	1.00	1098	29.00	9.0%
TTWO	APR	17.50	TUO PW	0.60	61	16.90	9.0%
VRTY	APR	12.50	YQV PV	0.40	12	12.10	8.6%
PPD	APR	20.00	PPD PD	0.70	710	19.30	8.5%
VRC	APR	17.50	VRC PW	0.80	0	16.70	8.4%
FCEL	APR	15.00	FQG PC	0.60	2643	14.40	8.3%
DZTK	APR	15.00	QDZ PC	0.60	25	14.40	8.2%
HAL	APR	15.00	HAL PC	0.55	11043	14.45	8.1%

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STRATEGY #3 WRITING "COVERED" CALLS

This section introduces investors to a low risk stock-ownership strategy: Selling Covered-Calls on portfolio issues to reduce their overall cost basis and increase the potential for profit.

This conservative approach offers the novice investor a great opportunity to profit in a comfortable, low maintenance strategy. The technique is based on stock ownership and it is much easier to manage on a daily basis than directional option plays. It also offers a good balance of risk versus profit potential for those who attempt to predict stock movement and magnitude. The strategy is more conservative than just buying stock, due to the fact that a premium is collected, lowering the break-even price on the stock position and the concept is attractive to the investor who is willing to limit his upside potential in exchange for some downside protection. In addition, writing "covered" calls is approved for individual retirement accounts.

Selling Covered-Calls
Strategy Definition

Covered-call writing is either the simultaneous purchase of stock and the sale of a call option or the sale of a call option against a stock currently held by an investor. Generally, one call option is sold for every 100 shares of stock. The writer receives cash for selling the call but will be obligated to sell the stock at the strike price of the call if the call is assigned to his account. In other words, an investor is "paid" to agree to sell his holdings at a certain level (the strike price). In exchange for being paid, the investor gives up any increase in the stock above the strike price.

Selling Covered-Calls
Strategy Objectives

Investors usually write covered-calls to generate monthly income, collecting the premium for the sale of an option against a stock position in his or her portfolio. This conservative strategy can be used effectively on all type of stocks as long as the outlook, fundamental or technical, for the issue is favorable. One of the advantages to this approach is that it allows new investors to learn successful trend-trading techniques with a small margin of safety while managing the combined position for upside profit and downside risk. This underlying basis for this strategy is a high probability of limited profit. The major advantage to a novice trader is the technique is easy to use and the resultant position is more conservative than outright stock ownership. In writing an option on the stock, the investor has insured the issue against a future drop in value. Regrettably, the downside risk in ownership is not eliminated, only reduced. In addition, the actual cost of opportunity loss or potential upside movement can be substantial. There are other, more subtle benefits and disadvantages but these are the most common reasons that investors choose (or avoid) this strategy.

The approach we use in selecting these positions is a based on the popular "total return" concept. With this conservative strategy, an investor considers the covered write as a single entity and is not interested so much in stock ownership or bullish movement, but in obtaining a consistent (annual) return on investment. In other words, with an "in-the-money" covered write, the maximum profit potential is established when the position is opened. Some investors worry about the sold option being assigned early, but that's not a problem with our plays, as it simply means you will earn the maximum profit in a shorter amount of time. Although this strategy might not be suitable for everyone, most investors find this conservative technique fits their comfort level and lifestyle much better than other stock option strategies.

Here's a great candidate for this strategy:

NPRO - NaPro BioTherapeutics $11.20 *** Drug Speculation! ***

NaPro BioTherapeutics (NASDAQ:NPRO) is a unique biopharmaceutical company focused on the development, production and licensing of complex natural product pharmaceuticals, and the development and licensing of novel genetic technologies for applications in human therapeutics, diagnostics, pharmacogenomics and agribiotechnology. The company's lead product is paclitaxel, a naturally occurring chemotherapeutic anti-cancer agent found in certain species of yew, or Taxus, trees. In addition to its efforts with paclitaxel and genetics, the company is working on several compounds that have displayed activity as anti-cancer agents. The company is actively engaged in evaluating the in-licensing or purchase of potential new products and/or technologies, whether or not those products or technologies are derived from natural products.

NaPro BioTherapeutics has some unique products in the works and the relatively steady, long-term appreciation in its share value suggests the company has a bright future. Investors who want to establish a low-risk entry point in the issue should consider this position.

PLAY (conservative stock/covered-call position):

BUY STOCK NASDAQ:NPRO LAST PRICE=$11.20
SELL CALL APR-10.00 NYQ-DB OI=572 BID=$1.90
TARGET COST BASIS=$9.30 MONTHLY PROFIT=5.9%

-- Definitions of Abbreviations --

APR-10.00 is the expiration month and strike price of the option.
NYQ-DB is the official ticker symbol of the call option to sell.
BID is the option's bid price; the price you receive for its sale.
OI is the open interest (amount of liquidity) in that option.
TARGET COST BASIS is the target price or "break-even" point for the issue. It is a combination of the price paid for the stock and the premium received from the sale of the call.
MONTHLY PROFIT is the yield you will achieve (on a 30-day basis) if the stock is above $10.00 at expiration in April.

Supplemental candidates

The following group of issues is a list of additional candidates to supplement your search for "covered-call" plays. As with any investment, you must decide if the selections meet your criteria for potential plays. Only you can know what strategies and positions are suitable for your experience level, risk-reward tolerance and portfolio outlook.

Stock Symbol	Month to sell	Strike Price	Option Symbol	Opt Bid Premium	Open Intrst	Cost Basis	Target Yield
IDNX	APR	10.00	IDX DB	1.30	390	9.00	8.7%
HOFF	APR	10.00	UHH DB	1.10	44	9.05	8.2%
VRTY	APR	15.00	YQV DC	2.60	1804	13.61	8.0%
VSNX	APR	12.50	MQB DV	2.05	354	11.56	6.3%
ACF	APR	35.00	ACF DG	5.60	212	32.71	5.5%
FFIV	APR	22.50	FLK DX	4.20	873	21.05	5.4%
MANU	APR	17.50	ZUQ DM	4.20	941	16.43	5.1%
TTWO	APR	20.00	TUO DD	4.20	332	18.80	5.0%
AWA	APR	5.00	AWA DA	1.25	414	4.71	4.8%
DZTK	APR	15.00	QDZ DC	2.25	130	14.25	4.1%
PPD	APR	25.00	PPD DE	5.00	503	23.80	3.9%

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STRATEGY #4, WRITING "UNCOVERED" CALLS - BUT WITH A HEDGE

For traders with bearish outlook on a specific issue or index, the credit spread can also be used to establish a limited-risk position that profit from a decline in the stock price. This section introduces investors to the bearish credit spread; often called a "bear-call" spread.

Bear-Call Credit Spread

Strategy Definition

Bear-Call (call-credit) Spread: The bear-call spread involves the purchase of one call (higher strike) and the sale of a lower strike price call. This spread also produces a credit and the amount is the maximum profit gained in the play. The spread remains profitable if the underlying security closes below the sold option strike price and the objective is for both options to expire worthless. This position requires the same collateral as the bull-put spread.

Risk/Reward Calculations:

Maximum profit = the net credit received

Maximum risk (or collateral) = the difference between the strike prices minus the net credit received

Break-even point = the lower strike price plus the net credit

Return On Investment = premium received / position collateral

Bear-Call Credit Spread
Strategy Outlook

The most common way investors participate in this strategy is with "out-of-the-money" options. That approach produces a high probability/low profit position that must be managed correctly to avoid significant losses. One big loser can erase the gains of three or four winners and that is why it is so important to be diligent in position adjustments. Most of the credit spreads offered in the OIN are also high probability/low profit plays. This strategy is great for new traders because the majority of positions are winners and the need for an adjustment (or exit) occurs on a limited basis. In addition, the issues we target generally have well defined price resistance, trend-lines, or trading ranges to help identify significant changes in technical character. Using a conservative approach, we strive for capital preservation in any (potentially) losing position and attempt to minimize its impact on our overall portfolio balance. The ratio of winners to losers, while very favorable, is not as important as position management, which involves timely adjustments and when necessary, closing a play early for a small, but acceptable loss.

Here is a great candidate for this technique:

CCMP - Cabot Microelectronics $65.73 *** Rolling Over! ***

Cabot Microelectronics Corporation (NASDAQ:CCMP) is a supplier of high performance polishing slurries used in the manufacture of advanced integrated circuit (IC) devices, within a process called chemical mechanical planarization (CMP). CMP is a unique polishing process used by IC device manufacturers to planarize (or flatten) many of the multiple layers of material that are built upon silicon wafers and necessary in the production of advanced ICs. Planarization is a polishing process that levels and smoothes, and removes the excess material from the surfaces of these layers. CMP slurries are liquid formulations that facilitate and enhance this polishing process and generally contain engineered abrasives and proprietary chemicals. CMP enables IC device manufacturers to produce smaller, faster and more complex IC devices with fewer defects.

Shares of Cabot Micro were upended Tuesday amid concerns over a competitive threat from a foreign slurry maker. Rumors of potential declining sales were rampant after the company's annual stockholder's meeting and traders turned defensive ahead of Intel's (NASDAQ:INTC) supplier recognition awards on Wednesday. One item of interest was a press release issued Monday night by Intel listing Fujimi as one of 25 companies that will receive Intel's Preferred Quality Supplier award. Market speculation is that Fujimi's slurry has become the new standard in the CMP industry and there are concerns a major displacement is taking place. In fiscal 2001, Intel accounted for 14% of Cabot's revenues but investors are worried that number could be changing for the worse in the coming year.

Based on the high-volume selling pressure, it appears the issue will have to spend some time in a consolidation pattern before resuming its bullish trend. Those who agree with a neutral to bearish outlook for the stock in the near-term can speculate on the issue's future movement with this conservative position.

PLAY (conservative - bearish/credit spread):

```
BUY  CALL  APR-85  UKR-DQ  OI=1088  A=$0.55
SELL CALL  APR-80  UKR-DP  OI=561   B=$1.05

INITIAL NET-CREDIT TARGET=$0.60-$0.70  PROFIT(max)=14% B/E=$80.60
```

-- Definitions of Abbreviations --

APR (April) is the month the options expire and the dollar amount ($85 and $80) is the strike price of the options you are buying and selling.
UKR-DQ & UKR-DP are the ticker symbols for those options.
OI is the open interest (amount of liquidity) in the options.
ASK is the current price for the option you are buying and BID is the current price for the option you are selling - but you can often improve on those prices if you place the trade as a contingency or "net-credit" order.
INITIAL NET-CREDIT TARGET is the amount we want to pay to open the position (per option contract).
PROFIT (max) is the amount of potential gain in the position.
B/E is the price (of the underlying issue) at which we achieve a break-even exit at expiration.

Credit Spreads - Initiating New Positions

One of the first skills new market participants must learn is to identify and execute a favorable opening trade. A good technique for initiating a combination position is to place the order as a "spread." That's why we always list a suggested "net-credit" or "net-debit" target to help traders open the play. This is simply a recommended entry point; just an opinion of what a trader might use as an initial "limit" for the spread order, and it should be a reasonable price to initiate the play even with small changes in the stock and option quotes. The target is always less than the straight BID/ASK numbers (we don't pay "market" for spread orders) and generally, you can expect to shave a minimum of $0.10-$0.20 off the BID/ASK price when opening or closing even the smallest spread order. The margin can be more or less, depending on the price of the options, whether they are ITM or OTM, the time value remaining, the volatility of the stock, etc. We simply try to give the beginning trader an idea of the value of the position because the option prices are always different the next day. Of course, you may need to adjust this target based on the activity of the underlying issue, the trading volume of its options or the implied volatility (IV) of the series being traded. In closing the plays, we generally suggest a target return of 10-20% per month on most of the basic spread strategies and that is how the target profit or "return on investment" numbers are derived. We try to construct positions to reflect that goal, but not every play is a winner so the main objective is to limit losses and close losing positions before they become very costly, preserving trading capital for the next success.

Credit Spreads - Position Management

A spread trader has many different alternatives when the underlying issue moves beyond the sold strike price in a combination position but in most cases, the appropriate action should be taken prior to that event, when the underlying issue experiences a technical change in character (such as breaking-out of a trading range or closing above/below a moving average). Most methods for taking profits and preventing losses (as well as making adjustments or rolling to new positions) fit into one of two categories: a pre-arranged target profit or loss limit; or a technical exit based on the current chart indications of the issue. The first technique; using a mechanical or mental closing STOP to terminate a play or initiate a roll-out, is simple as long as you adhere to the initially established limits. The alternative method, a technicals-based exit, is more difficult. However, there are many different indicators available to establish an acceptable exit point; moving averages, trend-lines, previous highs/lows, etc. and with this type of loss-limiting system, you exit the play after a violation of a pre-determined level.

A common question concerns the most difficult decision traders face: when to exit or adjust a position. Of course, the action taken should be based on the existing market/sector/industry conditions as well as the current outlook for the underlying issue and the ratio of potential gain to additional risk. One outstanding principle that new investors fail to adhere to is the need to outline a basic exit strategy before initiating any position, to eliminate emotional decisions. This plan must be simple enough to implement while also monitoring a portfolio of plays in a volatile market. In addition, these exit/adjustment rules should apply across a wide range of situations and be designed to compensate for one's weaknesses and inadequacies. To be effective in the long term, they must be also formulated to help maintain discipline on a general basis and at the same time, offer an easy memory aid for difficult situations. Using this type of system addresses a number of problems, but the most significant obstacle it eliminates is the need for "judgment under fire." In short, a sound exit strategy will help you avoid exposing your portfolio to excessive losses and that's important because the science of profitable trading is far less dependent on making money, but rather on avoiding undue outflows.

Reporting the Substance of Transactions

This section also deals with 'off-balance' sheet transactions and is relatively self-explanatory with the notable exception of Special Purpose Entities (SPE's). The recent huge Enron (USA) situation and the accompanying collapse of Arthur Andersen's highlights the criticalness of this area that is today receiving enormous attention from both standard-setters as well as regulatory authorities. The nature of Enron and the unbelievable complexities involved certainly place it outside of examinable material but any final level student might be wise to at least have a general overview of some of the major issues involved. The ACCA have officially produced a response in this area that might be worth a review as a background overview though clearly it is orientated towards auditing.

This article, from the New York Times, provides an interesting overview of the 'numbers game' that was being played out at Enron:

The Distorted Numbers at Enron
To understand the strange world of Enron (news/quote) accounting, think of a carnival fun house. Small amounts seem huge, and big ones appear to be unimportant. Joseph F. Berardino, the chief executive of Arthur Andersen, painted an amazing picture in his Congressional testimony about how his auditing firm came to certify financial statements that showed Enron was a strong and rapidly growing company up until the time it collapsed.

The crucial transaction, he said, involved just $5.7 million. He suspects that fraud may have been committed by Enron employees who failed to tell the auditors that the company had put up that much cash in one deal.
A few minutes later, Mr. Berardino airily dismissed Andersen's failure to notice that Enron had inflated shareholders' equity by $172 million through bad accounting. Relative to the size of Enron, "it was a very small item," he explained. "Accordingly, the transaction fell below the scope of our audit."

How can $172 million be very small, while less than 4 percent of that amount is crucial? That's the fun-house effect. Had Andersen known about the $5.7 million, it would not have allowed Enron to keep a couple of strange partnerships off its financial statements. Doing so added $45 million to Enron's 1997 profits and removed $711 million from its reported debts.

It also came at a crucial time for Enron. After rising for six consecutive years, Enron's stock price had sagged in 1997. Wall Street analysts had cut profit forecasts and taken Enron off their recommended lists. Even Kenneth Lay, Enron's chief executive, suffered as the company's board cut his bonus by two-thirds, to $450,000. Without those instant profits,

Enron's mystique might never have developed.
But it did. Over the next three years, that one arrangement inflated Enron's profits by $351 million. Enron's stock price more than quadrupled, and Mr. Lay cleared $180 million from cashing in stock options.
The transaction that Mr. Berardino identified as a possible crime was amazingly simple. Under the ridiculous accounting now allowed, Enron could keep a "special-purpose entity" off its books if an unrelated company put up 3 percent of the equity, even if virtually all the risk remained with Enron. That seemed to happen. But a secret $5.7 million transaction cut the real equity investment in half.

That 3 percent figure, by the way, evolved from a very different entity that was involved in a leasing deal a decade ago and persuaded authorities to accept the accounting. Soon that number was being used for all kinds of transactions, and rule makers did not intervene. Now they may.
Enron used plenty of other special-purpose entities, and it appears that some of them were just as misleading as the one Andersen now cites. They apparently conformed to accounting rules, but they did not "present fairly," as the auditor's letter says, Enron's real financial situation.
In an interview yesterday, Mr. Berardino said Andersen had no power to force a company to disclose that it had hidden risks and losses in special-purpose entities. "A client says: `There is no requirement to disclose this. You can't hold me to a higher standard,' " he said.
There is, Mr. Berardino testified on Wednesday, "a crisis of confidence in my profession." His solution includes better accounting standards. But more is needed. A real profession must do more than mechanically apply rules. It should never certify statements that it knows mislead investors by offering a fun-house reflection of reality.

Leasing Contracts

As a brief background, years ago, many entities attempted to use 'lease' contracts to keep substantial assets off the Balance Sheet thus circumventing loan covenants and required maintenance of certain key ratios. Additionally, if it wasn't on the Balance Sheet, no depreciation was therefore required, thus creating a potentially major distortion of the true 'emerging' financial results, year-to-year, and the cost of doing business. Only the lease payments would appear as an expense. In many ways, these lease contracts were nothing more than a financing vehicle much as if a bank loan had been acquired to buy an asset. The accounting profession therefore created a standard that dictated that 'under a certain set of rules' if an asset met these criteria then it had to be recorded as a capitalized lease, or an asset, along with the financial obligation being set-up as a 'present-value' liability.

But note, once you've identified the effect on cost of goods sold that 'automatically' changed the Balance Sheet valuation in the 'opposite' direction. Regardless of how you derive the 'amount' there is an inverse relationship between inventory and cost of goods sold. If you consider that when you 'credit' cost of goods sold (decrease), what must you 'debit', inventory is your only option!

Section IV

Segment Reporting and Related Parties

Note that IAS 14 applies only to entity's whose equity or debt is (or is about) to be publicly quoted. The rationale behind segment reporting is to provide investors/analysts the opportunity to determine the risk exposure relative to what is now identified as that entity's 'dominant source of risk and return' from either a business or a geographical perspective. It's akin to that old expression, 'having all your eggs in one basket' and thus you may be doing fine but you may have a much higher risk profile than if you were more diversified. This actually is taking the theory of Portfolio Management, from a diversification standpoint, and overlaying it onto a business.

Accounting for Employee Benefit Costs

The most difficult part of this standard (IAS 19 revised) is in understanding the terminology and viewing both the asset and liability side very differently even though they are 'sides' of the same coin. The Balance Sheet will reflect the 'net' liability or asset position of the defined benefit plan. The asset side represents the funded plans assets (debt/equity investments) that exist for the beneficiaries that will increase or decrease in line with market prices, whereas the liability side represents the 'actuarially' computed present value of future service obligations. The charge (net) to the profit and loss represents a combination of both liability and asset changes attributable to current year recognition of services costs, interest charges, asset earnings, actuarial gains/losses, amortization of past-service costs etc.

Reporting Financial Performance

This section also addresses EPS or earnings per share calculations. The one really controversial area here is the treatment (or recognition) of share equivalents including 'in-the-money' option contracts that have been issued to management/employees. The resulting fully diluted eps computation does on occasion give rise to some heated discussion on the subject of executive compensation levels. This extract from a recent Enron N.Y. Times article highlights clearly the magnitude of such option arrangements. Unbelievable could be an appropriate response!

Even Kenneth Lay, Enron's chief executive, suffered as the company's board cut his bonus by two-thirds, to $450,000. Without those instant profits, Enron's mystique might never have developed. But it did. Over the next three years, that one arrangement inflated Enron's profits by $351 million. Enron's stock price more than quadrupled, and Mr. Lay cleared $180 million from cashing in stock options.

Section V

The major difference between the UK and the International stream:

There are inconsistencies between UK rules and IAS that could lead to differences for many enterprises in certain areas. Under UK rules:

- employee benefit costs can be accounted for on a fundamentally different basis	IAS 19
- there is more restriction on the setting up of provisions in the context of business combinations accounted for as acquisitions	IAS 22.31
- goodwill can be treated as having an indefinite life and therefore not be amortized	IAS 22.44/51
- proposed dividends are accrued as liabilities	IAS 10.11
- deferred tax is calculated on the basis of timing differences rather than temporary differences, and balances can be recognized only if they are expected to crystallize, or when the event giving rise to the asset or liability has occurred by the balance sheet date	IAS 12.5/15
- deferred tax assets and liabilities can be discounted	IAS 12.53
- the recognition of deferred tax assets can be more restrictive	IAS 12.34
- trading, available-for-sale and derivative financial assets are not recognized at fair value	IAS 39.69
- trading and derivative liabilities are not recognized at fair value	IAS 39.93
- hedge accounting is permitted more widely	IAS 39.142
- an issuer's financial instruments which are legally shares are presented in equity irrespective of their substance, and compound instruments are not split into equity and liability components	IAS 32.18/23
- disclosures relating to discontinuing operations may begin later	IAS 35.16
- segment reporting does not use the primary/secondary basis; and it reports net assets rather than assets and liabilities separately	IAS 14.26/55/56
- cash flow statements reconcile to a narrowly defined "cash" rather than to "cash and cash equivalents"	IAS 7.45
- on disposal of a foreign entity, the cumulative amount of deferred exchange differences in equity is not recognized in income.	IAS 21.37

In certain enterprises, these other issues could lead to differences from IAS:

- somewhat different criteria are used to determine whether a business combination is a uniting of interests	IAS 22.8
- the financial statements of a hyperinflationary subsidiary can be	IAS 21.36

remeasured using a stable currency as the measurement currency

- lessors recognize finance lease income on the basis of the net cash investment not the net investment	IAS 17.30
- segment reporting can be avoided if the directors consider that it would be seriously prejudicial	IAS 14.3
- own (treasury) shares are shown as assets; gains and losses are generally recognized as income	SIC 16
- revaluation gains and losses on investment properties are reported in the statement of changes in equity not in the income statement.	IAS 40.28

Teaching/Supplementary material notes

These instructor/lecturing teaching notes (developed as supplementary material to the Foulks Lynch texts, final papers) were designed to provide any GFPAA instructor with some ideas about how to approach teaching some of this material. The approach was to develop supplementary material that attempts to put a 'working experience' perspective on the somewhat at times, very dry, text reading material. For students who are following a self-study approach, this material has been incorporated as part of the Supplementary notes to the final level, Part 3 papers.

Paper 3.7

Section I

An interesting perspective is introduced in this beginning chapter that of 'whose' returns are we maximizing. This, in a sense, ought not to be open for discussion because in the purist world, it obviously should be that of the equity or common stock holders, correct! Being a supporter of that school of thought, see below, and echoed by Milton Friedman, 'that a business is an economic institution whose legitimate function is economic performance, not social activity'; these alternative views could give rise to some heated debates. The so-called interested parties identified here are:

- community

It is suggested here that the 'community' vis-à-vis members of the public have an interest in the company, but have they. Without risking the unthinkable of raising the political spectrum here, this is unquestionably controversial. This concept gets to the core of 'what is a business' and 'what gives rise to its existence'. If you view this from a financial perspective, that no business exists without capital be it that of the owners or provided though the issuance of share capital, then clearly 'one might ask' what rights does the 'public-at-large' have when they have contributed zero to the entity and have no 'legal' claims on its assets.

As individuals and/or entrepreneurs, it would be unthinkable to suggest that your 'neighbor' (the public) have any rights to your personal financial assets, for we legally exist in the singular form and can be sued individually. So, why should a corporation, a legal creation that is granted the same legal status as an individual (corporations can equally be sued) have fewer rights than that of an individual? Legally, corporations are either privately owned by individuals or groups of individuals (the public) in the case of shareholders.

In terms of the environment, pollution and being a 'good corporate citizen', contributing to charities etc, many Companies do strive publicly to reflect such a role and it makes for excellent Public Relations material but whether such a 'public face' is truly (and ought to be) embodied in the financial objectives is another matter. One could argue that it is good business to incur such 'tangential costs' simply because they enhance the business image and theoretically positively contribute towards sales. Public opinion may be such that Company's that reflect good citizenry are more likely to be supported with higher sales and loyal customers than those that don't. Thus, in this sense, there is no inherent conflict between 'maximizing shareholder returns' (this is a relative not an absolute concept) and having a stated 'mission' to be a good corporate partner with society and the environment. No business can exist without customers and by definition 'customers' are the public. There is a subtle but major difference between suggesting that the 'public' has a financial stake per se in the Company versus accepting that publicly orientated spending is a 'cost of doing business' in the same way that paying taxes is a requirement of all Companies, again like that of individuals. The development today, that even greater public imagery is required of companies, (even at the cost of lower profits, see below) is effectively equivalent to businesses being required to pay higher taxes.

- employees (including management)

Let's revisit some comments that were made pertaining to Paper 3.4 (Business Information Management). "As a student, you study the discipline of accounting along with all the academic theories, tools and concepts that apply. You view various diagrammatic representations of concepts and principles along with somewhat 'odd' descriptions of processes but fundamentally every organization is simply comprised of 'people' or put another way, an organization comprises of multi-disciplines (people) all working and interacting together 'synergistically' towards the common objective (you hope). You get things and 'information' only and only by working with and through people not processes or departmental structures (do not make the mistake of thinking that ERP software solutions replaces the 'people' component, it does not, actually it increases the people element but significantly raises the threshold of information access and seamless interface/transfer of data across modules).

Every person in every organization and in every department is just as complicated, as moody, as irritable, and as friendly as everyone you know, outside of work, on a personal as well as even a marital basis. Effectively, for things to really work in any organization, the trials and tribulations of a marriage equally apply. You don't believe me, try getting information from someone that 'thinks' you don't like them or you've done something or said something to upset them. Contrast that to your 'other half' after you accidentally make a comment about his or her Mother (truthful or otherwise), the same applies exactly."

It should thus be very clear (and a lot less controversial) that 'employees' do have a very major role to play in the financial objectives (but in what sense) of any organization. Additionally, the concept of 'goal congruence' between that of employees and the corporation can either lead to dysfunctional behavior or behavior that clearly reflects the wishes of shareholders. The concept of 'return maximization' (shareholders) is actually very consistent with that of 'employee' goal congruence because achieving true goal congruence per se indirectly will result in maximized profits/returns. Many organizations today include 'employee groups' (or sometimes all employees) as part owners of the company. It is not unusual also for some companies to be totally employee owned with no outside shareholders at all.

One way, that many organizations strive towards 'linking' employee/management objectives (goal congruence) with those of the owners or shareholders is through the issuance of stock options. Many option arrangements can be so-performance related that they are very much of a non-dilutive kind. Dilution occurs when the number of shares and share-equivalents increases with no proportional change to earnings, hence, earnings per share, is driven down (and in all probability, the share price). If the issuance of options is based totally on achieving overly ambitious and aggressive goals of increasing profits (over and above normal expected growth relative to industry and competition) then all that is being 'asked' of shareholders is reasonably to share some of those economic gains.

Section II

With respect to Business Plans (Long-range 3-5 year plans), why are they important? Any good business must, figuratively speaking, 'look into a mirror' and ask itself:

- Who am I?
- What am I? And,
- Where am I going?

These are extremely important 'self-evaluating' type questions because unless a Company is willing to subject itself to what it is in business to do, be it offering goods or services, it will always risk falling behind in innovation and required technical changes to meet the ever changing and adapting needs of the customer or consumer. All customers, regardless of the company, are open and sensitive, as well as vulnerable, to the ever-changing product offerings, services, and competitor preying that could directly and rapidly lead to a precipitous decline in sales of some major key products. For these reasons alone, the development and work efforts behind business plans are, in reality, a survival exercise.

In other words, think of it this way, a business operating without a thoroughly and well-prepared business plan is like a ship trying to sail the ocean without a rudder, very difficult. You have no real way of steering the vessel. Also, think of this, "If you do not know where you are going, how do you know when you get there?"

Whether you study the Foulks Lynch material or that of Financial Training (and others such as ATC) the approaches used are very much the same, after all they are all following the ACCA syllabus. The approaches vis-à-vis strategic planning, gap analysis and business planning are all albeit correct but they suggest an approach that is, I feel, more 'student/academically orientated' than exists in the real world. At the Paper 3.7 level, any student who has actually been involved in the strategic/business planning process will certainly have experienced something very different from that suggested in these texts and I believe this is a critical perspective to have. Failing real world experience, the examiners have referenced articles as being a good proxy for reflecting a broader knowledge base and one that is not artificially divided into chapters. The examiners more expect a student at this level to draw upon the 'entire syllabus contents' and apply accordingly as the case scenario provided in the question is presented. Further, I am a strong believer that all the theories in the world do not replace the value of common sense, intuition and experience in any business. Business, as such, is a continuous process, with all its parts working seamlessly together and each and every decision invariably draws upon multiple disciplines (people) all contributing 'something' towards the outcome. Many things are done in business very well, strategies are developed, plans are put together and some excellent success stories unfold. The reality is that virtually none of these things were ever 'conducted' under the official 'labels' and/or paragraph headings that you read in the texts but everything was done using seasoned and professional managers, all possessing excellent business acumen and years of experience that know 'how to bring things together', that's what you have to learn to be able to do (within the confines of the syllabus). Oh and one other thing, they 'know' the business very, very well and you can't put a price on that. Bottom line, this syllabus (despite its academic approach) requires you to step 'outside the box' and think very carefully about 'all' you've studied and what makes sense to be applied in a 'given situation', very much like the real world. Though some of these comments may seem 'aggressively critical' they are nevertheless based partially upon the examiners own comments to the recent Paper 3.7, December 2001 examination. These comments have been recently published in the April 2002 Student Accountant magazine. If you read carefully between the lines, the examiners are critical of students that are failing to 'join the dots' so to speak and answering questions somewhat in a vacuum and not relating to the material presented in the question per se.

Ironically, the examinations 'expect' the student to grasp the real world interrelationships of all the various parts that become intuitively imbedded in any decision despite a syllabus that is structured very much along the lines of 'little boxes' that are not at all times obviously connected.

When senior management approaches the business planning cycle annually, they initially start developing a Strategic Business Plan that eventually gets translated 'financially' into a 3-5 year Business Plan and finally the detailed Operating Budget is derived from the first year of that same Business Plan. Thus everything is tightly woven together, as it logically should be.

The strategic plan will comprise of both financial and non-financial goals and/or targets and these each must be 'tested' for synergistically fitting together. It would, to say the least, create dysfunctional behavior if achieving one target drove the organization in a different direction from another objective, and yet both were part of the same strategy.

Despite the theoretically perfect world, not all organizations have unlimited capital to invest in initiatives and/or projects. If internal funds are not available then it cannot be presumed that the organization simply goes out and raises capital and/or funding. There are a myriad of reasons why that could not happen. It would be a reasonable beginning point to assume that organizations have capital as a 'limited resource' and go from there.

One of the first budgets/plans likely to be developed (even before the 'current year' Strategic plan is developed) is the Capital Expenditure Budget (in draft form) that would usually cover a 3-5 year time span. The importance of this budget is that it puts into perspective what 'strategically' can or cannot be considered albeit without additional financial resources. Remember, this 'strategic' plan (and the business plan itself) is an annual process and as each year actually progresses, 'unexpected' events and financial issues do arise. As an example, say during last year, an unexpected (and financially attractive) opportunity arose that requires a major capital expenditure in the upcoming two years. A decision was made, late last year, to incur such expenditures.

By developing a draft of the Capital Expenditure budget first that takes into consideration this major and new initiative (and any others), senior management now has a better perspective on the feasibility of some strategic initiatives that it had planned. Lets say, a software company determines that one of its missions/objectives is to provide the best customer service in the business, another, to provide technologically advanced web-based ERP product offerings and another, to grow and develop by training the best sales force in the industry and finally, to develop a consulting/implementation group that was second to none and received the highest training in the industry.

Not one of those objectives is without a significant cost. By having a draft or an updated Capital Expenditure Budget, senior management has the starting point to begin allocating resources, to the extent they do exist, and determine the best approach to be used towards meeting these goals. It is of course equally possible, depending upon the particular goal, to phase-in the full implementation on an, 'as and when funds are available basis' and focus remaining resources on those expenditures that will yield immediate results. Actually, when viewed from a positive NPV perspective, certain capital expenditures could become the partial funding vehicles for other initiatives, along the lines of a fueling growth concept. All capital expenditures must derive a positive NPV, an economic return to the shareholders that will enhance the value of the company, but the timing or duration of these returns can vary significantly from months to many years.

- best customer service in the business

    Achieving this requires major coordination with Human Resources (hiring the 'right' person) and a significant upfront, as well as, maintenance (ongoing) investment in training. Existing customer service staff will require some immediate (catch-up) followed by scheduled product-specific training. Once you introduce a form of testing/certification program, in all probability there will be staff turnover. Some alternative approaches are to use/access the consulting services group as back-up resources or in certain cases to directly access the customer.

    This is definitely long-term and there are always considerable difficulties in ascertaining and measuring the true value (cash flow) derived from such an investment. The strongest argument for such a long-term investment program is usually the additional sales that can be made by 'pitching' the strength of the follow-on or post-sales support that can make or break any vendor/customer relationship. The 'honeymoon' is during the implementation and the 'marriage' is post-implementation as all the little bugs and reporting issues start to emerge. References are very important and word-of-mouth can kill many a sale from disgruntled employees and managers who voice that they were 'never supported' enough. [As you read this keep the 'strategy' perspective in mind because that's what's driving the investment decisions.]

- provide technologically advanced web-based ERP product offerings

Once the product has been developed (software programmers), this provides the most immediate and identifiable cash flow, simply measured by sales and consulting revenue. The release-window through to actual sales here is (roughly) in the 12-18 month time frame, depending upon the position of your competitors in offering a similar web-based product. Being the 'first out the door' is obviously the goal and can generate some major publicity. The risks are that being first means that you cannot afford to have prematurely released (all bugs not eliminated nor fully tested in every respect) and that can create major negative PR and plays right into your competitors hands.

- grow and develop by training the best sales force in the industry
- develop a consulting/implementation group that was second to none and received the highest training in the industry.

The comments and discussion pertaining to customer service, above, very much are similar to the sales force and consulting group. The right hires, upfront and maintenance training programs and the subsequent measuring difficulties vis-à-vis cash flow equally apply. Just remember to keep the strategic perspective in mind at all times in terms of what the company is trying to achieve. No company can afford today to invest millions/hundreds of thousands in strategic initiatives unless it is absolutely certain about the return (however derived or measured).

The key, is that once you 'as a organization' are very clear (and correct) about who and what you are, then investing towards strategically defined goals will not only flow naturally but also (if you did your homework correctly) then all those expenditures should result in a natural growth. If, on the other hand, you incorrectly self-evaluated, due diligence was very poor (for the "SWOT" type answers must by definition incorporate many, many variables and factors), then any so-called strategic expenditures, as such, will probably fall under 'good money chasing. Many years ago, a very well-known and major "Cunard" type travel/shipping Company had to decide whether it was in the 'shipping business' or the 'entertainment industry' and the answer would have major consequences for how it determined its ongoing strategies. It decided it was in the 'entertainment industry'.

Section III

Within all these individual chapters of the Foulks Lynch material, you will now be introduced to some very important and critical concepts that have absolutely nothing to do with accounting per se but everything to do with finance. This material is segregated into five but totally connected chapters:

- The Valuation of Securities (Chapter 6)
- Investment Decisions (Chapter 7)
- The Capital Asset Pricing Model (Chapter 9)
- The Cost of Capital (Chapter 10)
- Further Aspects of the Cost of Capital (Chapter 11)

Though finance is a distinctly different discipline, over the recent years there have been developments that are resulting in accounting and finance gradually moving closer together. The challenges to the precept of historical cost accounting along with present-value techniques being employed in valuing liabilities are all indicators of these changes. Economics, traditionally more aligned with finance, is also playing a greater role as the fundamentals of accounting vis-à-vis the emergence of profits are also being questioned. One major assumption underlying the application of modern financial tools and theories is the existence of a highly interactive and liquid financial market (for both fixed income and equities) such as the NYSE. Additionally, the active participation of government in borrowing and lending activities in the financial markets is also presumed. Without the existence of such a sophisticated market and without the government as a key player, tools such as the Capital Asset Pricing Model (CAPM) cease to have any real meaning. The concept of the 'yield curve' can only exist as a byproduct of such a market and without a true yield curve most financial tools as presented in these materials cannot be applied. Taking this entirely one step further, the whole area of derivatives is totally based upon the existence of such a 'cash' based financial market. Derivatives, such as options and futures, interest rates and currency swaps, forward contracts, and concepts such as short selling are all meaningless without this 'market'.

The 'Weighted Average Cost of Capital" (WACC) that we'll discuss and along with investment valuation techniques such as 'net present value' (NPV) again have no real application without these underlying markets. Net present value techniques or discounted cash flow in general require selecting a 'discount rate'. Often in Corporations, the WACC is used as a proxy for the discount rate but often this 'discount rate' with or without the addition of risk premiums is based upon a Treasury Yield Curve. In a macro economic sense, businesses as an aggregate represent the economy but micro-economic concepts apply to the individual business. However, you cannot separate the relationship between macro and microeconomics, they are just different perspectives on the same thing, the economy. Businesses cannot exist 'outside' the economy, they are the economy and thus as all parts of the economy are related or in equilibrium with each other, you cannot arbitrarily select a 'discount rate' that was 'pulled from thin air', else you violate the relationship of the business to the economy.

The major topics covered are:

- constant dividend growth model
- term structure of interest rates (yield curves) READ
- npv analysis

- efficient market hypothesis. READ
- risk and return of portfolios
- portfolio theory READ
- systematic and unsystematic risk
- beta
- cost of equity using CAPM and dividend valuation models

Constant Dividend Growth model is:

Share (Equity) price = Div/(Ke – g)

Div	= dividend	=15.12
Ke	= required return by Equity holders (Equity cost of capital)	=16%
g	= growth factor	=8%

15.12/(0.16-0.08)
15.12/0.08
189 = Share Price (theoretical)

BUT: Ke can be derived (and is) using CAPM (this will be clear later)
ke $R_f + \beta\,(R_m - R_f)$

As you work through this material you'll see how that when the actual share price is different from the model, and all CAPM factors are verifiable, the only 'contributing variable' is the growth factor or 'g' that will equate the theoretical and actual share price. This analysis when done using 'dot.com' stocks resulted in some interesting 'g' values that could only equate the different share prices. Question, how efficient really is the market and upon 'what' is the market truly basing its decisions. Additionally, all values for 'g' must relate to the fundamentals, historical norms and economic reality. For example, if 'g' were to equal 55%, what does this really mean? If it were true then all other equities would be sold and they would buy this unbelievably high growth stock until the market came into equilibrium and the 'g' value decreased to normal levels. Bottom line, 'g' or growth must in theory equal a long-run sustainable value and not a short-run aberration. If you study the 'life-cycle' of a stock, many stocks initially experience very high growth rates that eventually level out. Many Mutual Funds exist simply to capitalize on these high-growth stocks for short-term capital gains and not long-run sustainable income value.

- WACC
- theories of gearing
- capital structure and high gearing

Section IV

Why do company's choose to merge and then later to divest, what factors are in existence in both scenarios. Remember, this Paper is 'strategic financial management', and thus there is a 'strategy' to be considered here. The whole area of M&A is fraught with issues over 'management motives' for such a deal. You only have to read newspapers such as the Financial Times and other notable business reviews to gauge an appreciation that such M&A activity is at times the object of very aggressive opponents and in-house shareholder groups taking different positions vis-à-vis the vote to approve (or not). Take for example the Hewlett-Packard and Compaq Computer proposed merger that has been cited as 'one of the most costly and acrimonious proxy contests in corporate history'.

May 1, 2002

SUIT AGAINST HEWLETT DEAL IS DISMISSED

By STEVE LOHR

The fight over the future of Hewlett-Packard — one of the most costly and acrimonious proxy contests in corporate history — appeared to have all but ended yesterday, after a Delaware court dismissed a suit by Walter B. Hewlett.

With Mr. Hewlett's court challenge thrown out, the door now appears open to completing Hewlett-Packard's merger with Compaq Computer, the largest ever in the computer industry.

Mr. Hewlett, an heir who served on the Hewlett-Packard board for 15 years, led the opposition to the company's planned merger with Compaq. Hewlett-Packard won the shareholder vote on March 19 by less than 3 percent, according to a preliminary tally by inspectors.

In a statement issued last night, Mr. Hewlett said he would not appeal to the Delaware Supreme Court and would now back the merger.

"I have disagreed with the board over the merits of acquiring Compaq; however, I have always been dedicated to enhancing value for H.P. shareholders," he said in the statement. "I will therefore now do everything possible to support the successful implementation of H.P.'s acquisition of Compaq and encourage others who have shared my views in the past several months to do the same."

Mr. Hewlett also strongly suggested that even though he was nudged off the Hewlett-Packard board last Friday, he will continue to use his large shareholding and his personal stature to be a thorn in the side of the company's management, led by Carleton S. Fiorina, the chief executive.

"My involvement with H.P. will not end today," he said in the statement. "I will continue to monitor the company's performance to ensure that it acts in the best interests of all stockholders."

In a brief statement yesterday, Hewlett-Packard said the company was "gratified by the ruling and we look forward to the opportunity to move on."

The simple wish to move on, though, will not be easy in the wake of what has been a divisive, emotionally draining proxy battle. Mr. Hewlett's opposition to the Compaq merger was wholeheartedly supported by many Hewlett-Packard employees, though just how widespread the internal opposition might be is not clear. And the success of the Compaq merger will critically depend on the efforts of the Hewlett-Packard work force, as well as the Compaq employees. Hewlett-Packard's management said last week that May 7 was the target date for completing the deal.

Hewlett-Packard also has some fence-mending to do with its shareholders, since more than 48 percent of the proxies cast were against the deal. Eighteen percent of the Hewlett-Packard shares were voted in opposition by the Hewlett and Packard heirs and their foundations.

In his suit, and during a three-day trial in Wilmington last week, Mr. Hewlett contended that Hewlett-Packard's management had withheld from shareholders important information that contradicted its claims of benefits from the merger. His second claim was that the company's management improperly "coerced or enticed" a sizable institutional shareholder, Deutsche Bank Asset Management, to switch its vote in favor of the deal at the last minute.

In a 43-page decision, Chancellor William B. Chandler III found that the testimony of Hewlett executives was credible and that Mr. Hewlett's side simply did not prove its allegations. Nor was it a close call, in Judge Chandler's view. At one point, he called the management's testimony "compelling." At another point, writing of the plaintiff's inability to meet an evidentiary threshold, he said, "they completely fail to do so."

"He lays out the facts as he found them and says the plaintiffs did not meet the burden of proof," said Michael Hanrahan, a partner at Prickett, Jones & Elliott, a Delaware law firm not involved in the suit. "It is difficult to find a legal issue here for the Delaware Supreme Court."

Most of Judge Chandler's opinion dealt with the failure-to-disclose allegation. During the trial, Mr. Hewlett's lawyers introduced documents from the business groups from both companies who were planning the merger that showed the groups did not see how they would meet their financial targets. Some documents characterized the lack of progress as "ugly" or a "frightening reality check."

Hewlett and Compaq executives said these were preliminary planning exercises, and gave an incomplete picture of the overall design for the merger. The executives testified that they never wavered in their belief that they could reduce costs by $2.5 billion by 2004 and that revenue for the company would fall by no more than 4.9 percent after eliminating overlapping product lines.

Accordingly, Hewlett-Packard argued, management had no duty to disclose the incomplete, even misleading, information from the business groups' planning exercises.

Judge Chandler found management's arguments persuasive. "Nothing in the record indicates that H.P. lied to or deliberately misled" shareholders, he wrote.

The judge also found the vote-buying accusation unconvincing. Mr. Hewlett asserted that Deutsche Bank switched 17 million votes in favor of the deal because of improper conduct by Hewlett-Packard, threatening to deprive the bank of future banking business unless its asset managers voted for the merger.

Ms. Fiorina did close a conference call with the bank's asset managers with the comment that having the merger approved was "of great importance to our ongoing relationship." But Judge Chandler wrote, "That statement does not, in my opinion, demonstrate that Fiorina was attempting to coerce Deutsche Bank."

What the judge termed troubling, however, was Deutsche Bank's conduct in the matter. Its investment-banking arm arranged the last-minute conference call between senior Hewlett-Packard executives and the bank's asset managers. "This fact," Judge Chandler wrote, "raises clear questions about the integrity of the internal ethical wall that purportedly separates Deutsche Bank's asset management division from its commercial division."

The Securities and Exchange Commission and other regulators are investigating Deutsche Bank's conduct in the Hewlett-Packard proxy contest.

Looking at this purely theoretically, one could argue that it ‘ought’ to be intuitively obvious whether such M&A activity was right for the company (the acquirer) or not. So something else must be going on here that will explain why there is such a level of disagreement and infighting, that seems to surround most M&A activity. Any final level student also ought to be regularly reviewing or at least keeping abreast of major business news headlines. Sources such as the New York Times online version can be accessed either free or for a very minimal charge. These online news sources also provide extremely valuable links to full text versions of the articles and other related articles and topics.

Some of the primary and logical reasons (© Foulks Lynch) for M&A are the gains derived from operating economies:

- economies of scale
- economies of vertical integration
- complimentary resources
- elimination of inefficiencies
- surplus managerial talent
- surplus cash

On the surface these all make sense and yet (© Foulks Lynch) the conclusion of ‘synergy’ is:

- synergy is not automatic
- value or synergistic gains are in practice quite small
- when bid premiums are considered, the only consistent winners in mergers and take-overs are victim company shareholders

This latter point seems to suggest that ‘bid premiums’ are the equivalent of taking hard-earned economic gains from a successful company (acquirer) and giving it away to the shareholders of a less successful company’s (acquired). In theory, the present value of any synergistic returns over the sum of returns as separate company’s should exceed this bid premium and accrue to the acquirer shareholders. Thus, this runs contrary to the concept of competitive economics whereby successfully run company’s reward shareholders with economic gains and poorly run companies will fail, the risks of holding an equity position.

This factor alone might certainly explain why emotions run very high when managements make proposals to merge. Further supporting the arguments against M&A are the following reasons for the high failure rate of combinations (© Foulks Lynch):

- over-optimistic assessment of economies of scale.
- inadequate preliminary investigation (due diligence) and an inability to implement the amalgamation efficiently.
- insufficient appreciation of personnel problems (cultural, congruence issues and 'fit' problems).
- dominance of subjective factors such as status of boards of directors.
- difficulty in valuation.

The last point, re-difficulty in valuation, also comes up as a major reason why many leveraged buy-outs (junk bond financing) failed during the last 20+ years. In exactly the same way as year-to-year business plans, with the current-year operating budget rarely agreeing with last year's (year 2) so too have valuations/projections in M&A failed to meet the test of time. The Junk Bond model was not per se the problem, the issue was the inability to accurately predict (anything).

5-Year Business Plan	Fiscal Year 2000 (January to December) (Completed September 2000)		Fiscal Year 2001 (January to December) (Completed September 2001)
Year 1 Operating Budget	January to December 2001		
Year 2	January to December 2002	Year 1	January to December 2002
Year 3	January to December 2003	Year 2	January to December 2003
Year 4	January to December 2004	Year 3	January to December 2004
Year 5	January to December 2005	Year 4	January to December 2005
		Year 5	January to December 2006

You can be very certain that the Business Plan completed in September 2001, with the Operating Budget (Year 1) being the FY-ending December 2002 will not agree with the same FY-end Plan (Year 2) completed in September 2000. It is thus not surprising those valuations that by definition incorporate present value (future activities) techniques are seriously inaccurate with respect to projected cash flows.

Section V

Foreign Exchange Risk
Risk Management
Options and Swaps (derivatives)
Global Economic Environment

The primary concern behind all financial instruments, especially derivatives is that they potentially expose an entity to very high levels of risk (and losses) unless they are carefully (and professionally) managed and used strategically to hedge either an asset or a liability position. There have been numerous cases where Company's have very ignorantly invested in (one-sided) derivative positions, having no idea of what they were actually doing or buying, and have resulted even in complete financial collapses given the huge and totally unexpected losses that occurred, for example, Orange County in the USA. During a CNN (USA television news program) a professional trader was asked of the Orange County debacle, could he explain to 'viewers' what exactly did Orange County invest in? The answer, "he didn't have a clue", and that was after trying to read the documentation supposedly explaining the investment vehicle. Derivatives, when used professionally and used in hedging activities, can be extremely critical in financial risk-management to create locked-in positions and control an entity's exposure to 'potential future' losses.

For example, a financial manager knowing the entity needs to borrow a large amount in 6-months may be concerned over interest rates temporarily spiking. By using an offsetting derivatives position, the financial manager can effectively lock-in today's interest rates and not be worried; he or she thus hedged the exposure. A Company is expecting a huge payment (from a customer) in foreign currency in 6-months and is worried over exchange rates weakening relative to the dollar thus creating a conversion loss relative to today's rates.

By purchasing an offsetting derivatives position, the financial manager can effectively lock-in at today's exchange rate and thus guarantee the dollar-converted amount. The balancing act, so to speak, is that though the derivative position is not free, on the other hand, the cost relative to the exposure is considered acceptable. Primarily, it is a gamble but a calculated one. Were neither adverse event to happen, and actually both interest rates and exchange rates became favorable relative to today, the derivative position, in retrospect, was not a good idea. The financial manager is unable to benefit from the improving position having locked-in. Unfortunately, reality is such that the financial manager gets criticized were things to improve and yet highly praised for his or her judgment if those adverse events actually were worse than expected. Fundamentally, risk management involves taking positions based upon a perspective on future events but should you be wrong you get criticized. No professional manager today can truly (and totally accurately) predict future interest rates and yet daily all financial managers are required to do just that and make decisions based upon that analysis. Forward exchange rates are a function of the differential interest rates between the countries and yet financial managers daily are required to make judgments on such future events in terms of predicting exchange rate changes.

The full text of the following is from a monthly 'derivatives' newsletter that outlines various derivative strategies using options (one of the listed derivatives above). It makes for interest reading and provides a real life perspective on option strategies.

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-- Option Plays for Stock Investors by OptionInvestor.com --

    Simple Option Strategies
    ------------------------

      Call Option Play - Select Biotech Strength

      Put Option Play  - Is The Housing Boom Over?


    Conservative Option Strategies to Reduce Risk
    ---------------------------------------------

      STRATEGY #1, PROFITING FROM MARKET MOVEMENT.
                   with example Straddle and details

      STRATEGY #2, WRITING CASH-SECURED PUTS FOR LOW RISK PROFITS.
                   with example put play and details

      STRATEGY #3, WRITING "COVERED" CALLS.
                   with example play and details

      STRATEGY #4, WRITING "UNCOVERED" CALLS - BUT WITH A HEDGE.
                   (using a credit spread to limit risk)
                   with example play and details
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-- SIMPLE OPTION TRADING STRATEGIES --

A lot of new (and old) option investors like to stick with simple strategies. The easiest strategy to understand is a directional option play. Simply buying a put or a call based on the direction you expect the underlying security to move. What does that mean in English?

If you have reason to believe a stock or index is going to go up then you can capitalize on the move by purchasing a call option. This is only one strategy for bullish option traders to use but it is the easiest to execute. As the stock price rises so does the value of your call option assuming the time decay is not eroding the price of the option faster than the stock is rising.

Following the same reasoning, if you believe a stock or index is going to decline then option traders can profit from the move by purchasing a put option. Put options increase in value as the stock price falls.

These are commonly referred to as directional option plays. Below are two directional plays for current market conditions. We have listed a call play for a stock with a bullish outlook and a put play on a stock with a bearish outlook.

================
Call Option Play
================

-- Remember, you normally purchase a call option if you believe
-- the stock will go higher.

IDPH - IDEC Pharmaceuticals $69.31 +2.93 (+1.72 this week)

Company Description:
IDEC Pharmaceuticals focuses on the commercialization and development of targeted therapies for the treatment of cancer and autoimmune diseases. IDEC's antibody products act chiefly through immune system mechanisms, exerting their effect by binding to specific, readily targeted immune cells in the patient's blood or lymphatic system. The company's first commercial product, Rituxan, and its most advanced product candidate, ZEVALIN (ibritumomab tiuxetan), are for use or intended for use in the treatment of certain B-cell non-Hodgkin's lymphomas (B-cell NHLs). (source: company press releases)

Why We Like It:
Isolated negative news events continue to filter out in the biotech spaces. Conversely, some continue to shine. With the sector recently showing some signs of strength in the face of weakness in the broader market, the biotech leaders could be poised for another leg higher over the next several months.
Ever since receiving early approval for its cancer drug Zevalin, shares of IDEC Pharmaceuticals have been gaining strength. The company received FDA approval in late February for its drug intended for non-Hodgkin's lymphoma. Most analysts hadn't been expecting approval for the drug until May or June. The drug is expected to significantly impact IDEC's bottom line for the better. That news continues to help the stock higher along with the strength in the Amex Biotechnology Sector Index (BTK.X).
The relative out performance has been a growing trend and with a positive broader market, we'd expect the BTK.X to out pace the averages to the upside. That sector strength should only add to IDPH's price momentum. The stock is coming off of a short term pullback, which may have ended with its rebound from the $65 area.
The stock has slight congestion above current levels, which would be cleared on a breakout above the $70 level. From there, IDPH faces only minor congestion between the $72 and $73 levels before its all-time high up around the $77 level. The fact that IDPH trades so close to its all-time high reinforces the relative strength on display in this stock.

Selected Options to Consider:
BUY CALL APR-65 IHD-DM OI=3485 at $ 7.70 SL=6.00
BUY CALL APR-70 IHD-DN OI=4388 at $ 4.60 SL=2.75
BUY CALL JUL-65 IHD-GM OI=2603 at $11.50 SL=9.75
BUY CALL JUL-70 IHD-GN OI=3014 at $ 8.50 SL=6.50

-What do the numbers and abbreviations mean?-

By reading down the line you can see the recommended option and its relevant information. APR-70 tells you that you want to look at the April option at the $70 strike price. The symbol for that option is IHD-DN. Currently the Ask price is $4.60. Now remember, an option contract symbolizes control of 100 shares.
That means it will cost us $460.00 to purchase the option.
Open interest is the current number of outstanding contracts held by investors today. We normally don't recommend trading options that have open interest below 100 contracts which would

be considered low open interest. This one has open interest with over 4300 contracts currently open. SL is an abbreviation for our suggested stop loss on the option price. Options can be volatile based on the movement in the underlying stock. If you're not comfortable placing your own stop loss talk with your broker.

! We are not suggesting you purchase all the options listed. We merely provided a selection for you to choose from. Option traders have dozens of options they can choose from with many not listed in this article.

================
Put Option Play
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-- Remember, you normally purchase a put option if you believe
-- the stock will go lower.

CTX - Centex Corporation $59.88 -1.44 (+0.41 this week)

Company Description
Centex Construction Company, a leader in the commercial construction industry for 66 years, provides general contracting, construction management, design-build, program management, and preconstruction services. Centex Construction Company is a division of Centex Construction Group, a subsidiary of Dallas-based Centex Corporation. (source: company press release)

Why We Like It:
There's no arguing with the incredible resilience of the housing market, especially after the market sell off in September. Measured by the DJUSHB index, the sector is up nearly 100% since the September lows, as one home builder after another has announced record profits. But it looks like the party is coming to an end. With all the good news factored into stock prices and money beginning to flow into riskier areas of the market, this looks like an area of potential weakness over the near term. CTX just recently traced a new all-time high near $63, and given that fact, this play carries more risk as we are attempting to pick a top. But following that high, the stock has been seeing a fair amount of selling (roughly 50% above the ADV), and that is never a healthy sign for a stock that is looking to move higher as it reveals an equity that is most likely under distribution. The daily Stochastics are just rolling down out of overbought territory, and despite UBS Warburg raising their estimates for the stock, it looks like the near-term direction is down. The one very big benefit of trying to enter bearish plays in stocks trading near all-time highs is that risk to the upside can be measured and managed easily with a stop just above the relative high. In the case of CTX, the stock's all-time high is at $63.09, or about $3 away from current levels. That's $3 of upside risk, while the stock has the potential to retest its recent lows down around the $52 level, which is about $8 away from current levels. With potential reward far outweighing risk, we like the set-up in CTX currently. A little bad news from the housing sector is all it would require to get CTX moving lower.

Selected Options to Consider:
BUY PUT APR-60 CTX-PL OI= 168 at $3.70 SL=2.50

BUY PUT APR-55 CTX-PK OI=1519 at $1.60 SL=1.00

-What do the numbers and abbreviations mean?-

By reading down the line you can see the recommended option and its relevant information. APR-55 tells you that you want to look at the April option at the $55 strike price. The symbol for that option is CTX-PK. Currently the Ask price is $1.60. Now remember, an option contract symbolizes control of 100 shares. That means it will cost us $160.00 to purchase the option. Open interest is the current number of outstanding contracts held by investors today. We normally don't recommend trading options that have open interest below 100 contracts which would be considered low open interest. Open interest for this option is over 1500 contracts. SL is our abbreviation for a suggested stop loss. This is a stop loss on the option price. If you are not comfortable in choosing your own stop loss for option trading we recommend you speak with your broker.

! We are not suggesting you purchase all the options listed. We merely provided a selection for you to choose from. Option traders have dozens of options they can choose from with many not listed in this article.

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- OPTION STRATEGIES WITH A MORE CONSERVATIVE APPROACH TO RISK -

Tuesday, March 12th, 2002

STRATEGY #1, PROFITING FROM MARKET MOVEMENT

This section introduces investors to the mechanics of a Straddle.

The debit straddle is an appropriate strategy for occasions in which one suspects that the price of an instrument will move substantially but does not know in which direction it will go. A call option and put option are purchased with the same strike price and expiration date on the and underlying market. The risk is limited to the premium paid for the options (plus commissions) however, the potential profit unlimited and the position benefits from movement in either direction.

This "delta-neutral" technique can work very well in situations where important events are about to occur and they are expected to be either very favorable or extremely detrimental. Corporate earnings announcements, new drug approvals, merger or takeover speculation, annual board meetings (stock splits/spin-offs) are some common examples of situations in which unknown information will be released on or near a specific date. The recent economic reports have created uncertainty among investors and the interest rate reduction is just one catalyst that could move the Market in the coming sessions. Option traders can profit from these situations when premiums are favorable and there is a reasonable possibility that share prices will be volatile.

To construct profitable straddle positions, it is important to pick an expiration month so that the price of the straddle will not be too high (too far from expiration). However, it must also provide enough time for the stock to perform as expected, before we have to exit the trade to preserve capital. One important fact to remember; the highest increase in time decay for at-the-money options occurs in the last 30 days before expiration. That means one should rarely hold a straddle position to expiration. Most experienced traders agree that two to three months should be the minimum time frame for straddles, unless you are speculating on short-term movement and purchasing little premium in the options. If you have a choice between two different series of expiration periods and the Implied Volatility for the longer-term options are lower, you should consider the position with the greater time value because those options are likely to be theoretically cheaper. When you understand that time decay is working against you, you can begin to choose trades in which other beneficial components will help your position profit, even as time passes.

This issue is a good candidate for a debit straddle:

NRG - NRG Energy $12.75 *** Low Risk Probability Play! ***

NRG Energy (NYSE:NRG) is a global energy company engaged in the acquisition, development, ownership and operation of power generation facilities, and the sale of energy, capacity and related products. As of 1/1/02, NRG Energy had interests in power generation facilities (including under construction) having a total design capacity of 25,000 megawatts. Most of NRG Energy's North American projects are grouped in regional holding companies corresponding to the domestic core markets. The company has established regional offices in Pittsburgh, Pennsylvania (Northeast region), Baton Rouge, Louisiana (South Central region) and San Diego, California (West Coast region). NRG Energy's North Central region (a recently added region, as of year-end 2000) is managed from its Minneapolis headquarters.

PLAY (conservative - neutral/debit straddle):

```
BUY  CALL  JUN-12.50  NRG-FV  OI=896  A=$1.15
BUY  PUT   JUN-12.50  NRG-RV  OI=233  A=$0.85

INITIAL TARGET COST=$1.80-$1.90  TARGET PROFIT=50%
UPSIDE BREAK-EVEN=$14.40  DOWNSIDE BREAK-EVEN=$10.60
```

-What do the abbreviations in the "PLAY" mean?-

JUN (June) is the month the options expire.
$12.50 is the strike price of the options you are buying.
NRG-FV & NRG-RV are the official ticker symbols for the options.
OI is the open interest (amount of liquidity) in the option.
ASK is the current price for the option - but you can often buy it for less if the underlying stock moves much during the day.
TARGET COST is the amount we want to pay per option contract.
TARGET PROFIT is our initial profit goal in the play (it can be modified later as the situation dictates).

This issue is a good candidate for the speculative, short-term approach to Straddle trading:

CRUS - Cirrus Logic $19.64 *** Tech Sector Volatility! ***

Cirrus Logic (NASDAQ:CRUS) is a supplier of high-performance analog and DSP chip solutions for consumer entertainment electronics that allow people to see, hear, connect and enjoy digital entertainment. Building on its leading position in audio integrated circuits and its rich mixed-signal patent portfolio, the company targets mainstream audio, video and Internet entertainment applications in the growing consumer entertainment market. Cirrus Logic operates from headquarters in Austin, Texas, and major sites located in Fremont and El Dorado Hills, California; Broomfield and Boulder, Colorado; as well as offices in Europe, Japan and Asia.

PLAY (speculative - neutral/debit straddle):

```
BUY  CALL  APR-20  CUQ-DD  OI=1867  A=$1.45
BUY  PUT   APR-20  CUQ-PD  OI=76    A=$2.15
```

INITIAL TARGET COST=$3.40-$3.50 TARGET PROFIT=15-20%
UPSIDE BREAK-EVEN=$23.50 DOWNSIDE BREAK-EVEN=$16.50

-- What do the abbreviations mean? --

APR is the month the options expire.
$20.00 is the strike price of the options you are buying.
CUQ-DD & CUQ-PD are the official ticker symbols for the options.
OI is the open interest (amount of liquidity) in the option.
ASK is the current price for the option - but you can often buy it for less if the underlying stock moves much during the day.
TARGET COST is the amount we want to pay per option contract.
TARGET PROFIT is our initial profit goal in the play (it can be modified later as the situation dictates).

How does the strategy work?

We start the play by purchasing an equal number of calls and puts (example; 5 or 10) and we try not to spend more than the target cost (listed in the play) for each pair of options that are purchased. Once the straddle is in place, you must decide if you will hold the options until expiration or cut your loss at some point prior to that date (April 20, 2001). If you are planning to cut your loss early, determine the maximum risk in the position (which is simply some percentage of the amount you paid to purchase the options). If that amount is reached or exceeded, the entire position should be closed. Of course, the position should also be closed when the profit target is achieved. If the underlying issue starts to move significantly, some traders will use trailing stops on the profitable options and raise these stops as profits rise. In addition, you might sell the losing options when they fall to half of their initial value. Another popular method called "Trading the Trend" with straddles can be a very profitable technique for traders but it involves additional risk and requires knowledge of technical analysis. This approach involves monitoring the underlying issue for a breakout or key reversal through a known support or resistance level. When the new trend has been positively identified, the lower-priced options (losing side) are sold along with one-half of the higher priced options (profitable side). The remaining position is held until a reasonable profit target is met and downside protection is maintained with a trailing stop. Advanced traders favor this follow-up technique because it is based on known technical trends and the action generally occurs near the position's "break-even" points. When one of these break-even points is reached, two simple trades lower the overall cost basis while retaining a high probability of eventual profit.

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STRATEGY #2 WRITING CASH-SECURED PUTS FOR LOW RISK PROFITS

This section introduces investors to the strategy of selling cash-secured Puts to earn consistent income or establish a discounted cost basis in a new portfolio stock.

This unique approach to conservative option trading is one of the most popular techniques among experienced investors. The strategy of selling puts is designed to complement a low-risk stock portfolio because it offers a great method for generating profits; collecting premium by writing "out-of-the-money" puts, and it also provides a way to acquire new portfolio stocks at reduced prices.

Selling Puts
Strategy Definition

The basic strategy involves selling a Put against cash or other collateral held in your brokerage account. The sole purpose of the collateral is to assure that money is available to purchase the stock should the Put be assigned to the account. Generally, the buyer of the Put will exercise the option if the underlying stock drops below the sold strike price at expiration. If the share value remains above the sold strike price at expiration, the Put will expire worthless and the option premium retained by the seller constitute a profit.

Put writing takes advantage of the concept of time decay; the time value premium of option declines as it approaches expiration. Unlike stock trading, where an investor can hold on to a stagnant issue indefinitely hoping it will rebound, the value of an option will decline if the underlying stock fails to move in the correct direction. This premium erosion allows a trader to profit without having to correctly predict the future movement of the underlying issue, as long as it remains above the sold strike price. Time value premium decays at a predictable rate and falls rapidly in the final month of option expiration.

Selling Puts
Strategy Objectives

The strategy of writing puts for monthly income involves selling "out-of-the-money" options on a stock that the investor expects to finish above the sold strike price. With careful selection of the underlying issue, most sold puts will expire worthless, allowing the investor to keep the premium and receive a reasonable profit, without ever having to buy the underlying stock. There is still the margin requirement but this commitment of collateral funds is almost always less than the outright purchase of an equivalent number of shares.

An investor who is interested in buying a stock may also consider selling a cash-secured put as another means of acquiring the issue. Generally, when a person wants to buy a stock at a specific price, he will use some type of "limit" order. The problem is, after the initial order is placed, the stock will not be purchased until it trades at or below the limit price. Instead of waiting for that movement to occur, he could simply write a cash-secured put. A premium (the bid price of the option) will be paid to his account for the obligation to buy the stock. He has determined that the cost basis (the sold strike price minus the option premium) is an acceptable price at which to own this new stock, that he wants to be a part of his portfolio. This strategy is also used by fund managers, as well as large corporations, because it pays them for assuming the obligation to buy a particular stock that they intend to eventually add to their portfolio.

Here is a great candidate for this technique:

ACF - Americredit $38.31 *** Entry Point! ***

AmeriCredit (NYSE:ACF) has been operating in the automobile finance business since September 1992. Through its branch network, AmeriCredit purchases auto finance contracts without recourse from franchised and select independent automobile dealerships and makes loans directly to consumers buying late model used and new vehicles. AmeriCredit targets consumers who are usually unable to obtain financing from traditional sources. Funding for the company's auto lending activities is obtained primarily with the sale of loans in securitization transactions. AmeriCredit services its automobile lending portfolio at various regional centers using automated loan servicing and collection systems. AmeriCredit's typical borrowers have experienced prior credit difficulties or have limited credit histories.

The long economic slowdown, combined with possibly poor borrower selection, has worried investors that ACF might experience a deterioration in credit quality. But signs of economic recovery and a recent pricing of a $1.6 billion offering of automobile receivables-backed securities has eased the near-term monetary worries. From a technical viewpoint, last week's high-volume rally through the resistance at $30 suggests there is potential for further upside activity. Traders who wouldn't mind owning this issue at a discounted cost basis can profit from continued bullish movement with this position.

PLAY (very conservative - sell cash-secured put):

SELL PUT APR-30 ACF PF BID=1.00 OI=1098 CB=29.00 TY=9.0%

-- Definitions of Abbreviations --

APR-30.00 is the option's expiration month and its strike price.
ACF-PF is the official option symbol of the option to sell.
BID is the last price (or what we receive when we sell it).
OI is the open interest (amount of liquidity) in the option.

CB is the cost basis in the issue (the break-even point).
TY is the position's yield or gain (on a monthly basis).

Supplemental Candidates

The following group of issues is a list of additional candidates to supplement your search for "put-selling" plays. As with any investment, you must decide if the selections meet your criteria for potential plays. Only you can know what strategies and positions are suitable for your experience level, risk-reward tolerance and portfolio outlook.

Stock Symbol	Month to sell	Strike Price	Option Symbol	Opt Bid Premium	Open Intrst	Cost Basis	Target Yield
IDNX	APR	10.00	IDX PB	0.95	3	9.05	15.5%
HOFF	APR	10.00	UHH PB	0.90	0	9.10	14.6%
NPRO	APR	10.00	NYQ PB	0.75	250	9.25	14.5%
AWA	APR	5.00	AWA PA	0.25	38	4.75	11.6%
IBIS	APR	10.00	UIB PB	0.45	200	9.55	11.1%
FFIV	APR	20.00	FLK PD	0.75	3925	19.25	10.1%
ACF	APR	30.00	ACF PF	1.00	1098	29.00	9.0%
TTWO	APR	17.50	TUO PW	0.60	61	16.90	9.0%
VRTY	APR	12.50	YQV PV	0.40	12	12.10	8.6%
PPD	APR	20.00	PPD PD	0.70	710	19.30	8.5%
VRC	APR	17.50	VRC PW	0.80	0	16.70	8.4%
FCEL	APR	15.00	FQG PC	0.60	2643	14.40	8.3%
DZTK	APR	15.00	QDZ PC	0.60	25	14.40	8.2%
HAL	APR	15.00	HAL PC	0.55	11043	14.45	8.1%

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STRATEGY #3 WRITING "COVERED" CALLS

This section introduces investors to a low risk stock-ownership strategy: Selling Covered-Calls on portfolio issues to reduce their overall cost basis and increase the potential for profit.

This conservative approach offers the novice investor a great opportunity to profit in a comfortable, low maintenance strategy. The technique is based on stock ownership and it is much easier to manage on a daily basis than directional option plays. It also offers a good balance of risk versus profit potential for those who attempt to predict stock movement and magnitude. The strategy is more conservative than just buying stock, due to the fact that a premium is collected, lowering the break-even price on the stock position and the concept is attractive to the investor who is willing to limit his upside potential in exchange for some downside protection. In addition, writing "covered" calls is approved for individual retirement accounts.

Selling Covered-Calls
Strategy Definition

Covered-call writing is either the simultaneous purchase of stock and the sale of a call option or the sale of a call option against a stock currently held by an investor. Generally, one call option is sold for every 100 shares of stock. The writer receives cash for selling the call but will be obligated to sell the stock at the strike price of the call if the call is assigned to his account. In other words, an investor is "paid" to agree to sell his holdings at a certain level (the strike price). In exchange for being paid, the investor gives up any increase in the stock above the strike price.

Selling Covered-Calls
Strategy Objectives

Investors usually write covered-calls to generate monthly income, collecting the premium for the sale of an option against a stock position in his or her portfolio. This conservative strategy can be used effectively on all type of stocks as long as the outlook, fundamental or technical, for the issue is favorable. One of the advantages to this approach is that it allows new investors to learn successful trend-trading techniques with a small margin of safety while managing the combined position for upside profit and downside risk. This underlying basis for this strategy is a high probability of limited profit. The major advantage to a novice trader is the technique is easy to use and the resultant position is more conservative than outright stock ownership. In writing an option on the stock, the investor has insured the issue against a future drop in value. Regrettably, the downside risk in ownership is not eliminated, only reduced. In addition, the actual cost of opportunity loss or potential upside movement can be substantial. There are other, more subtle benefits and disadvantages but these are the most common reasons that investors choose (or avoid) this strategy.

The approach we use in selecting these positions is a based on the popular "total return" concept. With this conservative strategy, an investor considers the covered write as a single entity and is not interested so much in stock ownership or bullish movement, but in obtaining a consistent (annual) return on investment. In other words, with an "in-the-money" covered write, the maximum profit potential is established when the position is opened. Some investors worry about the sold option being assigned early, but that's not a problem with our plays, as it simply means you will earn the maximum profit in a shorter amount of time. Although this strategy might not be suitable for everyone, most investors find this conservative technique fits their comfort level and lifestyle much better than other stock option strategies.

Here's a great candidate for this strategy:

NPRO - NaPro BioTherapeutics $11.20 *** Drug Speculation! ***

NaPro BioTherapeutics (NASDAQ:NPRO) is a unique biopharmaceutical company focused on the development, production and licensing of complex natural product pharmaceuticals, and the development and licensing of novel genetic technologies for applications in human therapeutics, diagnostics, pharmacogenomics and agribiotechnology. The company's lead product is paclitaxel, a naturally occurring chemotherapeutic anti-cancer agent found in certain species of yew, or Taxus, trees. In addition to its efforts with paclitaxel and genetics, the company is working on several compounds that have displayed activity as anti-cancer agents. The company is actively engaged in evaluating the in-licensing or purchase of potential new products and/or technologies, whether or not those products or technologies are derived from natural products.

NaPro BioTherapeutics has some unique products in the works and the relatively steady, long-term appreciation in its share value suggests the company has a bright future. Investors who want to establish a low-risk entry point in the issue should consider this position.

PLAY (conservative stock/covered-call position):

BUY STOCK NASDAQ:NPRO LAST PRICE=$11.20
SELL CALL APR-10.00 NYQ-DB OI=572 BID=$1.90
TARGET COST BASIS=$9.30 MONTHLY PROFIT=5.9%

-- Definitions of Abbreviations --

APR-10.00 is the expiration month and strike price of the option.
NYQ-DB is the official ticker symbol of the call option to sell.
BID is the option's bid price; the price you receive for its sale.
OI is the open interest (amount of liquidity) in that option.
TARGET COST BASIS is the target price or "break-even" point for the issue. It is a combination of the price paid for the stock and the premium received from the sale of the call.
MONTHLY PROFIT is the yield you will achieve (on a 30-day basis) if the stock is above $10.00 at expiration in April.

Supplemental candidates

The following group of issues is a list of additional candidates to supplement your search for "covered-call" plays. As with any investment, you must decide if the selections meet your criteria for potential plays. Only you can know what strategies and positions are suitable for your experience level, risk-reward tolerance and portfolio outlook.

Stock Symbol	Month to sell	Strike Price	Option Symbol	Opt Bid Premium	Open Intrst	Cost Basis	Target Yield
IDNX	APR	10.00	IDX DB	1.30	390	9.00	8.7%
HOFF	APR	10.00	UHH DB	1.10	44	9.05	8.2%
VRTY	APR	15.00	YQV DC	2.60	1804	13.61	8.0%
VSNX	APR	12.50	MQB DV	2.05	354	11.56	6.3%
ACF	APR	35.00	ACF DG	5.60	212	32.71	5.5%
FFIV	APR	22.50	FLK DX	4.20	873	21.05	5.4%
MANU	APR	17.50	ZUQ DM	4.20	941	16.43	5.1%
TTWO	APR	20.00	TUO DD	4.20	332	18.80	5.0%
AWA	APR	5.00	AWA DA	1.25	414	4.71	4.8%
DZTK	APR	15.00	QDZ DC	2.25	130	14.25	4.1%
PPD	APR	25.00	PPD DE	5.00	503	23.80	3.9%

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STRATEGY #4, WRITING "UNCOVERED" CALLS - BUT WITH A HEDGE

For traders with bearish outlook on a specific issue or index, the credit spread can also be used to establish a limited-risk position that profit from a decline in the stock price. This section introduces investors to the bearish credit spread; often called a "bear-call" spread.

Bear-Call Credit Spread

Strategy Definition

Bear-Call (call-credit) Spread: The bear-call spread involves the purchase of one call (higher strike) and the sale of a lower strike price call. This spread also produces a credit and the amount is the maximum profit gained in the play. The spread remains profitable if the underlying security closes below the sold option strike price and the objective is for both options to expire worthless. This position requires the same collateral as the bull-put spread.

Risk/Reward Calculations:

Maximum profit = the net credit received

Maximum risk (or collateral) = the difference between the strike prices minus the net credit received

Break-even point = the lower strike price plus the net credit

Return On Investment = premium received / position collateral

Bear-Call Credit Spread
Strategy Outlook

The most common way investors participate in this strategy is with "out-of-the-money" options. That approach produces a high probability/low profit position that must be managed correctly to avoid significant losses. One big loser can erase the gains of three or four winners and that is why it is so important to be diligent in position adjustments. Most of the credit spreads offered in the OIN are also high probability/low profit plays. This strategy is great for new traders because the majority of positions are winners and the need for an adjustment (or exit) occurs on a limited basis. In addition, the issues we target generally have well defined price resistance, trend-lines, or trading ranges to help identify significant changes in technical character. Using a conservative approach, we strive for capital preservation in any (potentially) losing position and attempt to minimize its impact on our overall portfolio balance. The ratio of winners to losers, while very favorable, is not as important as position management, which involves timely adjustments and when necessary, closing a play early for a small, but acceptable loss.

Here is a great candidate for this technique:

CCMP - Cabot Microelectronics $65.73 *** Rolling Over! ***

Cabot Microelectronics Corporation (NASDAQ:CCMP) is a supplier of high performance polishing slurries used in the manufacture of advanced integrated circuit (IC) devices, within a process called chemical mechanical planarization (CMP). CMP is a unique polishing process used by IC device manufacturers to planarize (or flatten) many of the multiple layers of material that are built upon silicon wafers and necessary in the production of advanced ICs. Planarization is a polishing process that levels and smoothes, and removes the excess material from the surfaces of these layers. CMP slurries are liquid formulations that facilitate and enhance this polishing process and generally contain engineered abrasives and proprietary chemicals. CMP enables IC device manufacturers to produce smaller, faster and more complex IC devices with fewer defects.

Shares of Cabot Micro were upended Tuesday amid concerns over a competitive threat from a foreign slurry maker. Rumors of potential declining sales were rampant after the company's annual stockholder's meeting and traders turned defensive ahead of Intel's (NASDAQ:INTC) supplier recognition awards on Wednesday. One item of interest was a press release issued Monday night by Intel listing Fujimi as one of 25 companies that will receive Intel's Preferred Quality Supplier award. Market speculation is that Fujimi's slurry has become the new standard in the CMP industry and there are concerns a major displacement is taking place. In fiscal 2001, Intel accounted for 14% of Cabot's revenues but investors are worried that number could be changing for the worse in the coming year.

Based on the high-volume selling pressure, it appears the issue will have to spend some time in a consolidation pattern before resuming its bullish trend. Those who agree with a neutral to bearish outlook for the stock in the near-term can speculate on the issue's future movement with this conservative position.

PLAY (conservative - bearish/credit spread):

```
BUY  CALL  APR-85  UKR-DQ  OI=1088  A=$0.55
SELL CALL  APR-80  UKR-DP  OI=561   B=$1.05

INITIAL NET-CREDIT TARGET=$0.60-$0.70  PROFIT(max)=14% B/E=$80.60
```

-- Definitions of Abbreviations --

APR (April) is the month the options expire and the dollar amount ($85 and $80) is the strike price of the options you are buying and selling.
UKR-DQ & UKR-DP are the ticker symbols for those options.
OI is the open interest (amount of liquidity) in the options.
ASK is the current price for the option you are buying and BID is the current price for the option you are selling - but you

can often improve on those prices if you place the trade as a contingency or "net-credit" order.

INITIAL NET-CREDIT TARGET is the amount we want to pay to open the position (per option contract).
PROFIT (max) is the amount of potential gain in the position.
B/E is the price (of the underlying issue) at which we achieve a break-even exit at expiration.

Credit Spreads - Initiating New Positions

One of the first skills new market participants must learn is to identify and execute a favorable opening trade. A good technique for initiating a combination position is to place the order as a "spread." That's why we always list a suggested "net-credit" or "net-debit" target to help traders open the play. This is simply a recommended entry point; just an opinion of what a trader might use as an initial "limit" for the spread order, and it should be a reasonable price to initiate the play even with small changes in the stock and option quotes. The target is always less than the straight BID/ASK numbers (we don't pay "market" for spread orders) and generally, you can expect to shave a minimum of $0.10-$0.20 off the BID/ASK price when opening or closing even the smallest spread order. The margin can be more or less, depending on the price of the options, whether they are ITM or OTM, the time value remaining, the volatility of the stock, etc. We simply try to give the beginning trader an idea of the value of the position because the option prices are always different the next day. Of course, you may need to adjust this target based on the activity of the underlying issue, the trading volume of its options or the implied volatility (IV) of the series being traded. In closing the plays, we generally suggest a target return of 10-20% per month on most of the basic spread strategies and that is how the target profit or "return on investment" numbers are derived. We try to construct positions to reflect that goal, but not every play is a winner so the main objective is to limit losses and close losing positions before they become very costly, preserving trading capital for the next success.

Credit Spreads - Position Management

A spread trader has many different alternatives when the underlying issue moves beyond the sold strike price in a combination position but in most cases, the appropriate action should be taken prior to that event, when the underlying issue experiences a technical change in character (such as breaking-out of a trading range or closing above/below a moving average). Most methods for taking profits and preventing losses (as well as making adjustments or rolling to new positions) fit into one of two categories: a pre-arranged target profit or loss limit; or a technical exit based on the current chart indications of the issue. The first technique; using a mechanical or mental closing STOP to terminate a play or initiate a roll-out, is simple as long as you adhere to the initially established limits. The alternative method, a technicals-based exit, is more difficult. However, there are many different indicators available to establish an acceptable exit point; moving averages, trend-lines, previous highs/lows, etc. and with this type of loss-limiting system, you exit the play after a violation of a pre-determined level.

A common question concerns the most difficult decision traders face: when to exit or adjust a position. Of course, the action taken should be based on the existing market/sector/industry conditions as well as the current outlook for the underlying issue and the ratio of potential gain to additional risk. One outstanding principle that new investors fail to adhere to is the need to outline a basic exit strategy before initiating any position, to eliminate emotional decisions. This plan must be simple enough to implement while also monitoring a portfolio of plays in a volatile market. In addition, these exit/adjustment rules should apply across a wide range of situations and be designed to compensate for one's weaknesses and inadequacies. To be effective in the long term, they must be also formulated to help maintain discipline on a general basis and at the same time, offer an easy memory aid for difficult situations. Using this type of system addresses a number of problems, but the most significant obstacle it eliminates is the need for "judgment under fire." In short, a sound exit strategy will help you avoid exposing your portfolio to excessive losses and that's important because the science of profitable trading is far less dependent on making money, but rather on avoiding undue outflows.

Concept of Swaps

In an <u>interest rate</u> swap, the theory is that both parties have advantages vis-à-vis certain segments of the market (fixed vs. floating rates) and 'only' by entering into such a private and independent arrangement (through Investment bankers) can both obtain the 'lowest' cost in the respective segment of the market they both desire. What swaps do effectively is to 'circumvent' the normal market mechanism for 'efficiently' allocating funds. Swaps, in essence, reflect inefficiency in the marketplace. The one critical aspect to swaps is that both sides continue to honour the arrangement.

A further look at Options:

Options are a form of derivative and are based upon the underlying 'cash' market. Most, if not all derivatives provide the holder with tremendous leverage. For a relatively small investment, the holder can derive significant gain, but can equally derive tremendous losses, goes in both directions. The concept of 'direction' equally applies to derivatives and 'how' a gain or loss is calculated, buy low and sell high. That is why option-trading strategies (mechanics of a Straddle) were developed to eliminate the one-sided risk position.

To take the simplest example:

Buy IBM at $20 and sell at $100 = gain of $80 ($100 - $20)

But, what if you 'shorted' the IBM stock, in other words, you sell a stock (you don't own yet) because you are convinced the <u>price will fall</u> and when you're required to deliver, you buy the stock (future date) at a price lower than you sold it for or shorted.

Short IBM for $100 and buy it for $20 = gain of $80 ($100 - $20)

Now, should you be wrong and IBM increases in price to $200 (not a decrease)
Short IBM for $100 and buy it for $200 = loss of ($100) ($100 - $200)
It is possible your losses could be unlimited!

1.2 The terminology of options

The option holder or buyer is an investor, or more likely a speculator, who *pays* the option money as consideration for the right to deal at a fixed price over a limited period.
The holder of an option, be it call or put (see below) is described as being *long*.

Call options and put options

A *call* option is one, which allows the holder the right (but not the obligation) to *buy* the underlying asset at the agreed price (strike price) in question.

A *put* option allows the holder the right (but not the obligation) to *sell* the shares at the agreed price (strike price). You hope the price 'FALLS'.

If you read this carefully, very carefully, derivatives act identically to the cash market but you have to be familiar with the terminology and know what direction of change results in a gain or loss. May not help, but think of a 'put' as 'putting' something (or selling something) to someone. A synonym for put is 'leave' as in selling something is to 'leave' it with someone. Well, just how important is this to the examination?

[The Paper 3.7 examiner (December 2001 review) made the following comment (student accountant April 2002 page 99) about one particular question. 'Answers to part b (iii) 1 were disappointing. Most candidates suggested that the manager should be offered 'put' options, despite the fact that if these were to be of value to the manager, the company's share price had to 'fall', and that put options might give the manager an incentive to make decisions that reduce the share price.'] Oops, not a recommended strategy!! This is the equivalent of a CFO being charged with maximizing losses!

Humour aside, the area of options and derivatives generally are very difficult and require several passes to try and understand it. Do allow plenty of study time to re-read several times and go through all the practice questions. It is, as the last exam demonstrated, easy to get things backwards. However, no student at the final level should ever be suggesting that a 'falling' share price is the goal of a manager irrespective of whether call vs. put options are confused.

Section VI

Treasury management and cash forecasting is actually one of the most interesting sides of both business and accounting. Accounting per se does not keep a business 'in business' only cash flow and sources of finances can do that. That was one of the reasons why the Statement of Cash flow became such an important financial statement, in recognition that unless investors had a clear picture of all cash flow movement, they were lacking a critical evaluative tool. A business could show a positive cash flow position and yet were incurring major operating losses. Accessing bank financing, drawing down lines of credit, issuing stock, selling assets could all contribute to a 'misleading' position about the true health of the company. Unless a business has a 'long-run' positive cash flow from operations, eventually it will start heading towards a going-concern problem. All businesses, from time to time, will fluctuate but as long as it is only temporary.

Strategic plans, as you know, are followed by Business Operating plans and Annual operating budgets. Developed in parallel, will be the cash flow forecast that translates all projected financial activity into cash flow timings. Generally, for most healthy businesses, that start off with a solid cash/short-term investment position, the actually 'timing' of cash flows is not so absolutely critical. A well-run business will have flexibility vis-à-vis credit lines and established access to any required short-term borrowings, ranging from 30 days to 90 and beyond. Additionally, if the company has any short-term investments, with maturities that range typically again in the 30, 60 to 90 days, a well-run business will have options either to rollover the investment or gain access to the funds. What becomes of far more concern, is when a business has Receivables (Debtors) with balances due in the million-dollar range and at the same time have weekly outgoing Payables (Creditors) due to vendors plus payroll and taxes etc that must be paid. There are exceptionally successful businesses that generate revenues in the hundreds of million dollars range and yet can experience short-term cash flow crunches because of natural mismatching between receivables and payables.

Unfortunately, in business as in life, once a 'service' has been performed/delivered and customers are billed, the leverage disappears and the customer has all the control. Only if ongoing relationships are critical to that customer will any leverage be maintained. However, the facts may be that the customers' 'business' to you is also critical, so effectively you have a stand-off so to speak (you both need each other) and only goodwill and trust can be relied upon to negotiate a cash flow that pays-off the balance in a reasonable timeframe. The 'anxiety level' of course is that the customer's own business continues successfully so that 'scheduled' payments will actually be made on time. If they simply do not have the money, there's not a lot you can do. Unless things become dire, no business willingly seeks to have to litigate a key client through the courts just to get paid. It is questionable whether you eventually do get paid and a certainty that you've lost a customer and all related goodwill. In certain types of business, litigation action can also seriously damage a businesses reputation and gaining new customers could be in jeopardy. Bottom line, it all depends on what type of business you're in. In many businesses (e.g. credit cards and/or retail) where customers are so plentiful, sending an overdue account to collection can be an automatic procedure.

In the text, there are references to a Cash budget (that is conceptually correct) but then they continue to imply an actual to budgeted 'cash' variance analysis, here I disagree!

Within the financial GL system, the annual operating budgeted data, including non-cash budgeted depreciation, is entered (input or imported) and each monthly financial reporting cycle, a variance of actual to budgeted gets run and (corrective) action 'does' get taken. The cash budget however, from my experience, is better termed, a cash flow projection model that is continuously (even daily) updated with current data and revised projections. For one major client, the assignment was to develop a working 5-year business plan that was used for recapitalization analysis along with developing a 30, 60 and 90-day forward projection of cash flow needs.

Each day (using daily bank fax transmissions) the prior-day closing bank ledger position was reconciled and became the current day's opening bank balance. Each week, the Sales department was responsible for creating updated projections of debtor (receivables) cash flow payments and these were daily adjusted to actual based upon the bank data received. If the sales department, say projected a $30k payment on the 12th but only $18k was received then 'last weeks-ending' projection going forward is automatically adjusted to actual. The sales department was notified and was responsible for deciding where (which day) to position the $12k shortfall ($30-$18). Most times it was incorporated into the next weeks-ending projections. Usually customers that shortfall, do not pay the difference within a few days. Often times, the customer had already notified the sales department as to the reasons involved, so it generally became an automatic re-projection. In this particular business, there could be a close relationship between the sales department and its customers (clients). All scheduled and anticipated Creditor (payables) check-runs were incorporated on a weekly basis, along with all payroll and tax payments due. Any non-repetitive and unusual cash flows (both incoming and outgoing) were also of course incorporated. The cash flow projection model was also, to some extent, more confidential than the financials because all cash flows relating even to Senior Executives had to be incorporated at a detailed level (specific payment) whereas within the financials, they could be grouped together. It was not unusual, however, for such items to be presented on the forecast under various nondescriptive names such as 'administrative' payments and no names mentioned of course.
Once you had a net daily position established between the opening ledger bank balances, any anticipated deposits along with any payments, check runs etc you could take the next step. Depending upon the bank and/or arrangement, any overdrafts would be either automatically covered by the bank or the 'cash manager' would notify the bank by around 3pm to execute a credit line draw-down. One of the difficulties of developing cash flow projection models is to predict when checks issued would be presented and cleared through the bank account. Obviously, depending upon the checks issued that could have a major impact on projected daily positions. A cash/finance manager is charged naturally with obtaining funding at the lowest cost, but determining whether to use 'more-expensive' credit lines versus borrowing say for 30 days at LIBOR was totally dependent on the accuracy of the cash projection models.

The model was effectively a 90 day forward projection but because both borrowings and short-term money market (surplus funds) investments were frequently for 30 days you viewed the model as a series of 30 days or 30, 60 and 90 days in total. It was quite possible to borrow at LIBOR for 30 days, repay it and immediately have sufficient funds to turn around and invest for 30 days. Cash flow projection models can reflect in the short-run very major swings in either direction. What you didn't want to have happen, is a major projection error that leaves you with insufficient funds because you've locked-up funds in a 30 days investment vehicle or to borrow for 30 days at LIBOR but then 'unexpectedly' have a major deposit occur. Unless one of your customers had a sudden change of heart and without notifying sales, that should not generally happen, but it could. Over lunch or the golf course can produce amazing results at senior levels! Mind you, no one usually complains too much over large deposits, just would have been good to know ahead of time.