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Have You Got It Right? The Times Call For An Immediate Review Of Oversight and Control - November 25, 2001

H. Stephen Grace, Jr., Ph.D., et al

Have You Got It Right? The Times Call For An Immediate Review Of Oversight and Control

By H. Stephen Grace, Jr., Ph.D., John E. Hauptert, Peter Howell and Ronald H. Wilcomes

Telecoms, e-businesses and other tech industries were, for all intents and purposes, being blown onto the shores of bankruptcy eight months ago. In our February article "Sailing In Troubled Waters," the Advisors of Grace & Co. Consultancy, Inc. outlined points which we felt needed to be addressed when encountering such an economic slowdown. We wanted to provide early warning to companies – and indicate some actions that could be taken to stay afloat – and, even better – run against the wind.

A gargantuan storm has now surfaced in the form of the terrorist attacks of September 11th. General consensus is that the evolving recession is now upon us and getting deeper. After September 11th, Standard & Poor's downgraded 45 companies' \$162 billion in debt, while upgrading only \$44 billion issued by 9 companies during a three week period. The cut of almost 200,000 jobs in September does not bode well for increased levels of consumer spending to aid an ailing economy.

Every company, even those that know their industry, know where their market position is, and have a relatively stable long-term capital position, given the events of September 11th and the ensuing recessionary pressures, must at least begin an immediate and thorough review of corporate oversight and control factors.

The reality is that things will never be the same again. The terrorist attacks have permanently altered our way of life. Certainly, our government's military response, our heightened need to be on the lookout for new acts of terrorism, and federal, state and local governments' review of security procedures are influencing and will change just about every aspect of our business life. America is on guard, as should be every member of management.

What does this mean for the company that now finds itself facing weakening markets or even a crisis of existence? Events with crisis potential must, of course, be managed in real time. Maturing debt must be renewed or paid-down; SEC filings (if applicable) must be done in a timely fashion; the production of goods or services must be scheduled as committed. But at the same time, intermediate term factors need to be taken into

consideration. New business risks, credit availability, operational procedures, personnel policies, insurance coverages and physical plant protection are critical reviews that need to be done immediately – all with a fresh outlook given the impact of the events of September 11th and the acknowledged recession at hand.

You may be able to use some of the same techniques used by outside consultants to assess crisis management – as long as the project is spearheaded by individuals with an open mind and is given a senior level mandate to produce findings that relate to the appraisal outlined herein, not just “what management (owners) want to hear.”

Your review should begin with the collection of data, and an analysis of the company’s financial situation. Tools used by professional analysts include 3-5 years of original balance sheets, income statements and sources/uses of funds statements. Audit management letters, footnotes to financial statements, consolidated and consolidating financials (if applicable), historic cash-flow summaries vs. actuals and miscellaneous segment data are all used by consulting professionals in this review.

Next, current revenue/expense forecasts, cash flow estimates and capital budgeting requests must be re-examined and factored into the analysis to get a month-by-month picture for the current direction of business. This must include the latest input and judgments by line managers of production costs, raw material availability and pricing estimates based on realistic assumptions which must be tested and questioned under this new operating scenario.

With this information in hand, financial trends and business operating characteristics are known and the future has been assessed by line managers and senior management. The audit team, an important component of any corporation’s oversight and control structure, should be brought in to take a look at this data. Audit should insure that the data is valid, that internal controls and risk management techniques are adequate, and that their previous recommendations have been considered. This is the point where the captain assumes the helm, because the facts are on the table and objective business decisions need to be made reflecting the changed environment we find ourselves in today. We are not talking strategic issues, such as: Do we have the right business objectives? or, Is our business plan consistent with our resources?. What is needed at this point is a fresh look at decisions regarding purchasing, production techniques, continuation of partnership agreements, financing/debt structuring, staffing needs, risk control policies, asset dispositions, etc. In other words, does the way we have done business in the past justify business as usual, or should operations be tightened – based on a focused need to improve revenue and cash flow?

In the final analysis, decisions that increase revenues and conserve cash must be at the heart of this review. Often, these are not easy or popular decisions! But the course has been charted by the events of September 11th to come up with fresh ideas. You will only “get it right” if you use this opportunity to quickly look at a changed world. Everything is suddenly “on the table” for review.

The capabilities to carry out this process are within most organizations; however, a professional consultant can help guide and add valuable time, experience and discipline. So, seize the moment, and make the most of these times.

H. Stephen Grace, Jr., Ph.D. is President of Grace & Co. Consultancy, Inc., and John E. Hauptert, Peter Howell and Ronald H. Wilcomes are members of the Board of Advisors of Grace & Co. Consultancy, Inc. A consultant on corporate organization and financing, Mr. Hauptert was Treasurer of The Port Authority of New York and New Jersey prior to retirement. Mr. Howell, a consultant on banking, bankruptcy and reorganization, is the retired Direktor of Credit Risk Management for Deutsche Bank. Mr. Wilcomes, a consultant on finance and investments, was Vice President and Investment Counsel of Metropolitan Life Insurance Company before retirement.

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