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It's Spring, Why Do I find So Much to Worry About?

How Should I think About Risk Management?

This is my favorite time of year. Year-end is over, W-2 and 1099's are in at \$4.50 to \$5.50 a copy, and public companies are sending out their Annual Reports and Proxy Statements. Year-end is always fun with politicians playing chicken with each other and passing tax measures so late that they can't be reprogrammed in time, tested, trained, and explained; customers leaving but wanting year-end reports; new customers coming in with incomplete data, and more and more links to third party operating systems; employees working overtime, and did I mention competitors undermining your company and over promising for their company? I love the free enterprise system!

I like the Annual Reports and Proxy Statements the best. I have sat on public company boards and boards for large not for profit companies. I have been a "financial expert" and Chair of several audit committees. We were told that we would never be singled out for incomplete or inaccurate disclosures, but let's just say that the people I want on my audit committee are people who worry a lot, want lots of verification of facts, and suffer from a severe case of skepticism.

I have sat on the boards of insurance companies, financial service companies, healthcare companies, and bio-tech companies. They had two things in common with you, my friends in the payroll/HR/work force management world. The debits had to equal the credits on the books, every day. And, they all use customer/patient data which is subject to more and more regulation, litigation, and security problems.

The Annual Reports and Proxy Statements are my way of keeping up with what these people worry about, not so that I can worry too, but so that I can see what smart people are trying to do to worry less and help their customer more.

Operational risk runs across all these companies. Today these risks include – fraud by employees or hackers, unauthorized access to computer systems, unauthorized transactions, breaches of internal controls and in data security, compliance, disaster recovery, and customer attrition due to negative publicity. They also include vendor programmers and personnel who have the ability to change software and workflows, use their own security practices, or not, and authorize access to your data with or without your knowledge.

What large companies say they do about these risks is have a Risk Management Committee of the Board oversee the policies and practices of the Company. They have management leaders like the Chief Risk Management Officer, the Chief Information Officer, the Head of the Internal Audit Team, and line managers, report to them on risk elements and levels at the Company. In addition they have a group within their external audit company conducting random focused audits. If they are regulated, the Companies can count on state and federal regulators coming in and reviewing for compliance with laws and regulations as well as best business practices.

Technology and new business practices compound the need to manage risk. Customers want online access, remote access to multiple users on multiple devices, to cloud servers, with vendors they

Spring Worries (cont.)

may not even know. They currently stress speed and access and convenience which may be the antithesis of sound business practices.

I read these reports to see what serious people are trying to do to manage risk, and not just cope, but flourish in the new environment. I take away several points for you to think about in your risk management strategy:

- You are the financial and risk management expert in your company, like it or not.
- Risk management is your job, not the job of your service providers, your bank, or your cloud.
- As you branch out from payroll to insurance and benefits administration and health insurance and HR services you are taking on compliance, data security, and execution risk which you need to manage.
- To help you manage your risk, you should hire audit resources with experience in reviewing risk in the businesses you are in.

That's all easy for me to say! I do know where risk management starts. It starts with the business owners who set the tone at the top of their company which requires that customer data security is a top priority and business risks are identified and managed with care and professionalism.

Why even think about Cyprus?

Cyprus may be important to think about if you hold money market funds which hold US or corporate bills, notes, or bonds of European banks and some US banks. Chances are your money market funds do not hold a whole lot of direct paper, but they may hold infected paper indirectly. Who knows what Chase might be doing to make a buck when it's not whale hunting or funding creative hedge fund managers?

The EU is a mess. It's barely a confederation of states that generally have a low opinion of each other. They have no central government, no central bank with real zone wide authority or an enforceable monetary policy. They have a difficult time coming together in a time of extreme adversity to solve their political and economic problems. The US has not been in much of a position recently to "guide them and set an example", even if they were in a mood to listen.

Cyprus was a side story, another weak Euro State which used their Euro credit rating to go on a spending spree with a twist. They thought they could be the Switzerland of the Middle East. They could act as a depository for funds from people for whom it would be impolite to ask the source of the deposits, and if taxes had been paid on them. Where they were different from the Swiss is in the interest they paid on the deposits. Depending upon how many bullet holes are in your jet when you land in Geneva, the Swiss banks set the interest they will pay on the funds. The more bullet holes, the lower the rate. Often the rate is negative. The Cypriots not only forgot to count the bullet holes, they paid a premium for the funds! The depositors were getting higher rates and basically euro-guarantees on their deposits! How great is that!?! The Germans, who are being asked to finance most of their erstwhile Euro-brothers, said 'enough'. If Cyprus was going to ask them for loans to keep their economy afloat, they had better show that they could pay them back. Since the Euro States were providing guarantees to the hot money depositors, those depositors should be charged a fee or given negative interest for being allowed to hide their money in Cypriot banks. It seems reasonable to me.

One problem though, even though the Swiss and some Germans are bullet hole counters, most of the rest of us aren't. We see the central bankers of the biggest market in the world with a monetary policy that pre-emptively grabs bank deposits to secure loans. We see that practice triggering bank runs

Cyprus (Cont.)

and capital flight which can bring banks and banking systems down. We see central bankers and monetary officials whose actions we can't predict, and we can't trust. And since banks loan deposits to each other, if one bank gets its deposits withdrawn it calls back its deposits from bankers around the world. A move to tax a bunch of depositors who spirited wealth out of Russia could turn into a test of the Cypriot banking system, which will fail, and a test of the EU banking system which could fail, and a test of the international banking system which will be drawn into the mess.

This is why you need to look at the statement from your money market fund. It will tell you if you have paper from direct lenders and close indirect lenders (that may be why you are getting such a great rate!) to EU banks. If your fund is full of US government and investment grade domestic paper, you ought to be OK. Put away your atlas. Set Cyprus aside and get back to serving your payroll and HR customers. And, I promise to have a happier message for you in the next Payroll Tribune. In the meantime, remember that Henshaw/Vierra is on your side looking at best business practices and helping you think strategically about payroll, work force management, and the future of your business.

Henshaw/Vierra Management Counsel

Henshaw / Vierra Management Counsel LLC has helped the owners of payroll service companies maintain, grow, and sell their companies for over 16 years. We have owned and managed payroll service companies and software providers ourselves.

We work with our clients to help them consider their strategic alternatives. We help them prepare their companies for success in the strategy they select, and to prepare them for what's next. We can help you to prepare your company and your team to be ready. Buyers or sellers need experience on their side. We can help you 'even up the sides' with our longterm experience in helping companies and their owners prepare for the future.

Call Guy R. Henshaw at 510-749-3225, or e-mail guy@henshawvierra.com

