

Macys: report to ceo research paper sample

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Report to CEO

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Background

The contemporary financial reporting regulatory environment has largely been influenced by the Sarbane Oxley Act 2002 (to be referred to as SOX). This act was enacted by the congress of the United States due to a series of financial scandals, the most notable of which were the Enron and WorldCom scandals that were brought primarily due to irregular and confusing accounting practices, which resulted in the misrepresentation of the actual financial positions of the above mentioned organizations, resulting in artificial values being allotted to share prices and subsequently causing the plummeting of stock prices when these irregularities and misrepresentations were exposed, causing employees and other shareholders to lose millions of dollars overnight. The intent behind SOX was to prevent any such instances from occurring again by mandating the requirement of accurate financial reporting, independent auditing, verification of financial statements by directors as well as stringent penalties to be placed on “white collar crimes”, these and many other provisions were designed to increase the transparency and accountability involved in the accounting reporting procedures of corporations (Rezaee, 2005). In recent years a series of regulations have been enforced by regulatory bodies such as the Securities and Exchange Commission, in a bid to ensure compliance to SOX. Macy's being a corporation that is bound by the legislation and regulations active in the United States has a corporate responsibility to comply with the provisions of the act and regulations designed to uphold it, as well as

performing any necessary duties and implementing any necessary controls as stated by the act. The corporation has been largely successful in avoiding legal action due mainly to its commitment to following stringent internal financial reporting standards. This report will attempt to analyze and evaluate the corporate governance structured and financial documents provided by the organization, in order to assess Macy's compliance to SOX as well as to identify any potential practices that may carry a risk in terms of a legal reprimand.

Corporate Governance

An essential function of any corporate governance structure in addition to ensuring the seamless operations of the organization is to provide systemic checks and balances that maintain accountability, integrity and transparency. In an attempt to further embed these principles within an organization's manifesto, SOX contains specific provisions referring to requirements that a company is required to fulfill related to external auditing practices. One of the most critical measures that require implementation according to the act refers to the independence of auditors and the requirement to implement measures in the structure of the corporate governance that enables this. According to SOX, auditors must be appointed by an independent auditing committee which is in turn appointed by the board of directors; the members of this committee are required to be independent of the managerial and operational functions of the organization and must have financial expertise (Kimmel et al., 2011).

Macy's has rigorous measures in place in order to comply to this stipulation. The degree of separation between the management and directorial levels of

the organization and auditor activities has been intensified due to the existence of specially designated corporate governance committee which is appointed by the board of directors, that is responsible for the appointment of the auditor committee that is charged with selecting suitable auditors (Macy's, 2013). Both the auditor and corporate governance committee is comprised of individuals that are not affiliated with the management and operational functions of the organization. The organization may benefit further by making publically available the names and backgrounds of each of the individuals that are part of both the auditor and corporate governance committees, in order to verify beyond any shadow of a doubt that the committees and hence the appointed auditors are free of any undue influence. The institution of several charters by Macy's that outline the principles through which effective corporate governance structures can be implemented also serves to demonstrate the company's willingness to prioritize issues outlined by SOX and subsequent regulations. However, the company needs to provide the public and regulatory bodies of concrete examples of charters being abided by members to display its determination to practically implement these lofty principles.

Section 3 of SOX, calls for a company's board of directors to take direct responsibility for financial statements and information officially released by the company. Financial statements must be attested to by the CEO and CFO of the organization on a quarterly basis, while annual reports including 10K filings must be signed off on by all directorial level employees (Kimmel et al., 2011). In accordance with this stipulation, all financial documents released by the company are verified by the CEO and CFO, while annual reports are

verified by directorial staff (Macy's, 2013). Furthermore, annual reports are also attested to by independent accountant which in Macy's case is the accounting firm KPMG (Macy's 2013).

Section 4 of SOX relates to enhanced financial disclosures and accurate and detailed reporting of financial aspects regarding Non-GAAP (Generally Accepted Accounting Principles), employee and executive stock options as well as the declaration of any and all special purpose entities (SPE's) (Kimmel et al., 2011). This is a particularly important section of the act as activities that it bars were the primary reason for the downfall of Enron, in particular the non reporting of special purpose entities which were used to reduce total liabilities. Macy's complies to all relevant standards outline by this section or title of the act by conforming to SEC regulation on the reporting of Non-GAAP based financial data such as pro-forma figures and other figures which are calculated using unorthodox methods that contain a certain degree of embellishment. Similarly, figures related to pension plans and employee stock options are also stated clearly within the financial statements. The identification of the awarding of stock to employees is stated as an expense which also adds to the credibility of the organization's governance structure and financial reporting practices (Macy's, 2013). A certain drawback of Macy's corporate governance structure that may cause the company's released information to be viewed in a negative light pertains to the management of the organization. The management of Macy's can be considered to be largely entrenched, the CEO has held his position since 2004 while the remainder of the directorial staff has also been in place for a period greater than 2 years. According to research by Banko et al.

(2012) it was found that companies with an entrenched management hierarchy are far more likely to manipulate figures, understate debts and show abnormal profits. This is due to the compensation through stock initiative implemented in many organizations including Macy's which rewards management with shares, giving management an incentive to influence financial reporting and to overstate profits in order to increase share prices. While there is no evidence to suggest that Macy's managerial staff is involved in similar activities the company would benefit by publically distancing itself from such activities and by clearly stating measures in place to prevent this practice. The organization may also assess alternative means of rewarding employees rather than stock options.

Forensic Financial Analysis

The history of Macy's has been largely devoid of financial scandals and allegations of financial impropriety particularly in terms of financial reporting an achievement which is due primarily to the organizations commitment to comply to stipulations set out by SOX. Therefore, a forensic analysis of the company's financial statement and attached notes is not likely to lead to any uncovering of a major fraud. In lieu of the intent of this section of the report is to highlight the positive aspects of Macy's financial reporting as well as certain steps that can be taken to prove to regulatory authorities beyond a shadow of a doubt that no fraudulent misrepresentation of figures and performance occurs within the organization.

Annual reports of the organization and 10K forms contained within are attested to by independent accountants as mandated by the SEC (Kimmel et al., 2011) which in the case of the most recent report and filed form

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containing data related to the fiscal year 2012 was KPMG. In offering its unofficial opinion and verdict of the company's internal control mechanisms and financial reporting practices, the accounting firm stated that controls were satisfactory and that all reports were an accurate representation of Macy's actual financial position, however the opinion indicated that internal controls may be insufficient in terms of meeting the needs of future regulations (Macy's 2013). In order, to rectify this it is possible for the company to allot additional responsibilities to its corporate governance committee which charges them with keeping abreast of future regulatory changes and to formulate pre-emptive responses that will institute or adjust existing controls based on these predicted regulations. The auditor's statement also alludes to the inability of the existing system in place to rectify accidental misstatements of figures (Macy's, 2013).

Macy's employs a last in first out method (Lifo) of inventory valuation that assumes that the most recent piece of inventory that is stocked will be sold first whereas earlier pieces of inventory will be sold last (Macy's, 2013).

While this is a valid and widely recognized method of stock valuation there is a possibility that the aggregate stock valuation may be prone to misjudgments in the form of an inaccurate cost being attributed to inventory (Macy's, 2013).

Macy's has also recently witnessed increasing profits coupled with a decrease in total liabilities over the past five years (Macy's, 2013), this can be considered to a sign of healthy financial performance, but there is also the danger that suspicions will linger in on in auditors and regulatory bodies such as the SEC's minds regarding the possibility of off-balance sheet

borrowing and a lack of disclosure with reference to these activities (CIMA, 2012). In order to dispel this impression, Macy's future financial statements must clearly indicate the sources of increased profitability as well reasons for decreased liabilities (CIMA, 2012).

Macy's will also need to prevent suspicion from arising regarding executive stock options. Under SEC regulations, organizations are required to inform the SEC of the trading of any employee held stock or the awarding of stock to employees within a period of two days. However, the practice of backdating whereby the date on which the stock was awarded is changed, in order to display a lower or higher value depending on the particular motive (Lattman, 2010). The organization is required to demonstrate the existence and effectiveness of controls that will prevent backdating.

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