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Conference Call Transcript

HHGP - Hudson Highland Group Inc Conference Call

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PRESENTATION

Operator

Good morning. My name is like Lakeisha and I will be your conference operator today. At this time I would like to welcome everyone to the Hudson Highland Group conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. (OPERATOR INSTRUCTIONS). Mr. Kirby, you may begin your conference.

David Kirby *- Hudson Highland Group, Inc. - Director of IR*

Thank you, operator, and good morning everyone. Before we begin, I will read the Safe Harbor statement. Please be advised that except for historical information, the statements made during today's call constitute forward-looking statements under applicable securities law. Such forward-looking statements involve certain risks and uncertainties including statements regarding the Company's strategic direction, prospects and future results. Such factors including factors outside of our control may cause actual results to differ materially from those contained in the forward-looking statements including economic and other conditions in the markets in which we operate, risks associated with acquisitions, competition, seasonality, and the other risks discussed in our filings with a Securities and Exchange Commission. These forward-looking statements speak only as of today. The Company assumes no obligation and expressly disclaims any obligation to review or confirm analysts' expectations or estimates or to update any forward-looking statements whether as a result of new information, future events or otherwise. With that, I will now turn the call over to Jon Chait.

Jon Chait *- Hudson Highland Group, Inc. - Chairman, CEO, President*

Thank you very much, David, and thanks to all of you for joining us today. I wish it were under more pleasant circumstances. I would like to refer all of you to the press release that we issued earlier today and to a filing on Form 8-K which has been filed with the Securities and Exchange Commission earlier today as well.

In the press release we announced our preliminary results for the second quarter, and I just like to tell you that we will not be able to discuss those results in any more detail than is contained in our press release. We are planning to have a conference call next Tuesday August 8 to discuss our second quarter results in more detail, and we will release our results at the close in the market on Monday August 7, but we're not in a position today to comment upon the text of the release as to the preliminary results.

The principal purpose of the call today is to talk about the other actions are described within the release and the 8-K. There are two broad series of actions, one relates to the restatement of our earnings for the first quarter of 2006, and the other relates to charges that we are going to take in the second quarter of 2006 which total approximately $1.6 million on a net basis.

Before I turn it over to Mary Jane Raymond, our Chief Financial Officer, who I should say is here with me -- I'm sorry I didn't introduce you -- who is here with me today. Before I turn it over to Mary Jane to talk about this in more detail, I want to just make a couple of preliminary observations and draw your attention to the things that were in our press release as well.

The accounting errors that are the subject of the restatement occurred solely in Hudson North America. No other geography was affected. We have reviewed the financial records of other regions and did not find similar issues. So the issue is contained, so to speak, within the Hudson North America. Secondly, I would like to point out to you there is absolutely no evidence of fraud or misconduct by any employee of Hudson Highland Group. With those two broad comments, I'll turn it over now to Mary Jane Raymond to discuss in detail the broad actions described in our release.

Mary Jane Raymond *- Hudson Highland Group, Inc. - CFO & EVP*

Thanks, Jon. Thank you offer joining us today. With respect to our announced Q1 2006 restatement, I think the three most critical questions that are probably on all of your minds are the following. What happened? Number two, did we get it all? And number three, will this happen again? So we think those are three good questions too and let me address them in order.

So as to the question of what happened. You will recall that we have talked about our challenges with our installation of PeopleSoft in the Hudson North America business since it went live about a year ago. As a reminder, PeopleSoft is only used in the Hudson North America business. I talked to you during our first quarter conference call that I'd decided to bring in a third party resource to look at our installation because it was basically very difficult to use.

It was expensive to maintain. We talked a lot about the amount of money we spent on it in Q1 and it was also affecting our customer relationships. As an aside, we have actually hired Oracle who is now the parent of PeopleSoft to help us do that. We are happy about that and the concept of hiring them is that we're going to right to the source to help us get this more efficient.

I also mentioned to you during our Q1 called that we're going to look at our business processes as well, because they were probably compounding the difficulties in using the system. Well, in the process of looking at those accounting processes particularly, as I say in the accounting area, we are observed as a first indication that the accounts receivable reconciliation was possibly not being done correctly. So as many of you know, the accounts receivable record is the one that supports the revenue and for prospective our accounts receivable balance is over $200 million for our Company and for the North America market it is over $80 million.

So the basic problem appears to be the design of the installation. So I am no technologist, but let me tell you roughly how this normally goes. Typically the design is that one has a set of subledgers for each part of the accounting and that is where all the individual transactions are, for revenue, for example, all the individual customer events.

Typically what happens is they are subdivided into logical groups, and those logical groups go into the general ledger in a certain place, sort of an address, and that is typically called a control account. Then what happens is the accounting team reconciles of the detail to this address, to the control account. And if they all match, then logically the detail matches the general ledger. That is basically the process somebody goes through to close.

Well, the value of that design is that typically differences can be isolated. They can be found pretty quickly and they can be resolved quite easily. That, however, is not how our installation was designed. Our installation, it is very difficult to extract the detail, and there's actually only a small number of control accounts. So that makes it actually pretty hard to find differences. A large number of transactions are coming into these individual addresses or control accounts.

So what we have had to do since our installation was developed offline subledgers and quite a few manual processes for certain parts of our business operation that require complex reconciliation. Since our installation, people familiar with how it went in understood how to do them, but during Q1 we had some staff turnover and the transition of knowledge from those more familiar with our system didn't really happen as well as that should have. And as a result, certain items were not understood and recorded correctly.

So upon seeing this situation and informing our audit committee, we agreed with the audit committee a very comprehensive process design with our external auditors to look at all our reconciliations. We used a number of outside advisers to assist us in this, and the reason we did this, the reason we looked at all the reconciliations after finding this initial issue in accounts receivable is really simple. And that is when you find something in one area, the smart thing to do is to check the status of everything else.

In doing this we could see that the system was actually difficult to use in a few other areas in particular payroll. If you step back and think about that, payroll is the area that has the most transactions in terms of number and it also is just complex in its own right for a staffing company because contractors come on and off billing. You're not paying the same people every single time.

So here as well with the level of complexity and this changeover in staff during Q1, we did determine that there was some reconciliations in the area that were not done correctly.

Since these changes in staff were in Q1 and the quarterly period in general for a company has a shorter review time than we typically do at year-end, the largest amount of issues that we found were in Q1. We did find a few items affecting in 2005, as we noted in the press release, and we have reported them in Q2 because they were not material to the results of 2005.

So after we did all of this work, looking at our reconciliations of the North America operations, we actually still had about $900,000 sitting there as an adjustment to the revenue, what would be called by the accountants an unreconciled difference. After we focused on this specifically for a little while, in consultation with our external auditors and after discussion with our audit committee, we determined that we would not be able to determine the applicable period for that $900,000 which probably frankly is a series of items, not just one, in any practicable way.

We discussed what our options were with the audit committee and our external auditors and we determined that we would do better to turn our attention to our overall remediation and not continue to search for the periodicity of that. And as a result, decided, as is the right practice, to record that $900,000 in the second quarter.

Therefore, upon finishing this review we took the decision that, one, we would record what we found in -- what we found and because we had a larger number of items in Q1, we concluded that we would restate the first quarter. So that is the description of how this happened.

Let me turn to the question of whether we got all. First of all, we began the whole review of looking at our accounting systems installation to get a box around the issues we've had with this system since its installation because going forward our very clear objective was to be able to discuss the business progress of North America in a very clean and straightforward way.

So upon seeing the first indication of an issue, as I said, we designed a process to understand all the parts of our ledgers as thoroughly as possible. It was very broad in its design. We had relevant outside help to help us design the process of review and then to actually assist in doing the review.

We applied the resources not only to complete the work but to document what we did, the concept there being want to be sure we can repeated and we also insured that we involved the current staff of the operations so that everyone would have the same facts and knowledge and that the learning would be shared broadly. Sometimes when companies do this, they have the experts do it, and then the people left to repeat it don't understand it. We involved all of them.

We do believe that this process has identified the full extent of the differences existing in our account at the end of the second quarter of 2006 that could be material. And again, these matters only affect Hudson North America.

Of course, similar to the concept of if a company finds an issue in one part of its accounting ledgers, it checks all the other ledgers. There is a similar parallel that says, upon finding issues in one region, the right thing to do is to check all the other regions. We did do that. We did not find similar issues in our other business regions in our Company.

We did engage the staff accounts and internal auditors from some of those other regions both in doing that work outside the U.S. market and then some of them actually came to assist in this work in North America. And the reason we did that was because we wanted to be sure that those who going forward would be keeping books or auditing them could see the conditions that gave rise to this restatement. That knowledge will help them prevent these conditions elsewhere.

So let me turn then to our third question which is, could this happen again? While there is no guarantees in life, I will tell you that we're very focused on the fact that it is important that we prevent this. Preventing it and having a very good understanding to do so is the reason we did the review during the second quarter as thoroughly as we did.

Now we have better processes on both system design and installation and our teaming with Oracle has helped us to make them even stronger. From an accounting point of view, we have used what we have learned here in closing our second quarter which we are in the process of completing. We have recorded all the differences that we identified so we don't have hanging issues that we are still going to work on for even another quarter.

To further insure that we avoid this ever repeating, we have designed from a control point of view what is typically called manufacturing, where I spent a lot of time, rings of defense. We are of course certainly documenting our new key controls to maintain the clean slate that we have going forward. We have also stepped up our procedures on cash collection which is an interesting and important monitoring control for the revenue. We are improving our training with our staff so that the best procedures to tell them how to do things can not only begin right but can actually be kept current. And we have begun more carefully monitoring changes in personnel particularly in situations where doing things correctly is knowledge dependent.

As a final matter, the accounting team in the corporate group will use as a very important metric something that is actually simple. And that is each region's ability to close on time. That is an important metric. If someone isn't closing on time, to identify early possibly small problems so that we can monitor those going forward.

Before I turn this back to Jon, let me just make one other comment that I think may be on your mind, and that is, having done all this work of what probably sounds like a lot more of an accounting nature, have we also completed all the work on the system itself? Particularly, you may have a question which we, as in the past about, might we have other investments in this system.

I do think that we may have investments in this system going forward and I'm not prepared to quantify those for you right now. We have not taken all the work that we have done and put it already into a new system design. That will take a little bit more time than one quarter. However my comments as we've spoken above, do greatly improve our documentation, our discipline and our knowledge of how you use the system. This will certainly make our investment decisions in our systems in North America considerably better informed and more effective. Therefore, the work that we undertook during the second quarter and that I described above is a very good piece of work and very important to insure that additional investments are made well. With that said, I'll turn it back to Jon.

Jon Chait *- Hudson Highland Group, Inc. - Chairman, CEO, President*

Thank you very much, Mary Jane. With that, operator, would you open the lines for questions?

QUESTION AND ANSWER

Operator

(OPERATOR INSTRUCTIONS). Matt Litfin, William Blair & Company.

Matt Litfin *- William Blair & Company - Analyst*

At this time how long are you planning to have the outside Oracle consultants in-house?

Mary Jane Raymond *- Hudson Highland Group, Inc. - CFO & EVP*

Well, there is an initial assessment they are dealing with us which is about four weeks long and the purpose of that is to give us a recommendation on whether we should redesign anything. So the first instance with them for which we made a decision is four weeks and we will see what their recommendation is to see how much longer we think addressing their action plan will take.

Matt Litfin *- William Blair & Company - Analyst*

And I guess the follow-up to that is how expensive is it to have them in there, maybe not an exact number but just orders of magnitude, what are we looking at here?

Mary Jane Raymond *- Hudson Highland Group, Inc. - CFO & EVP*

Well, I would say suffice it to say that we have a reasonably good arrangement with Oracle. They have agreed to come in and help us.

Jon Chait *- Hudson Highland Group, Inc. - Chairman, CEO, President*

Hundreds of thousands of dollars, rather than millions.

Mary Jane Raymond *- Hudson Highland Group, Inc. - CFO & EVP*

Yes. That's a very good way to put it.

Matt Litfin *- William Blair & Company - Analyst*

At my final question is, is there any chance at this point that you guys simply decide to scrap this PeopleSoft system entirely or is that decision set in stone and if so why is that?

Jon Chait *- Hudson Highland Group, Inc. - Chairman, CEO, President*

Just take a look at -- as the ultimate in the non technologist, I'll turn it over to somebody who has more knowledge than I do. I would say it is not -- PeopleSoft, as you know Matt, PeopleSoft is used within our industry by a number of our competitors, and we have every reason to believe that this system will work. So I would be pretty surprised from where we are today if we were to turn around and say we're going to go in a different direction entirely.

Certainly one of the things on our mind is whether parts of it or all of it could end up being replaced. This is a system that is built in modules. It is entirely possible that we may decide that the shortest distance from Point A to Point B is to take out a module and simply start over.

You know we are in the process of -- as part of this process we are looking at the architecture of the entire system and according of each module. And there were a number of decisions made in terms of the architecture that in hindsight were decisions that we would not make again. So we are going to be making that, and that is the purpose of having Oracle come in and help us, and so we're going to be going through that process. I'll just ask Mary Jane whether amend or comment upon anything I said.

Mary Jane Raymond *- Hudson Highland Group, Inc. - CFO & EVP*

That's a perfect summary. As Jon said, I think it's unlikely we'll completely start over again, but we are looking at again whether the shortest point from A to B to unravel, kind of a little bit of a ball of string, might be to just reinstall some of them. That's what we are looking at. We do, though, as I said, I think at year-end we do think it is notable for us to have a system that works across the whole market so that the reporting is more consistent and so we're anxious to maintain the benefits of it.

Matt Litfin *- William Blair & Company - Analyst*

Thanks. And let me just comment that I, and I'm sure others, appreciate you guys being upfront about this disclosure.

Jon Chait *- Hudson Highland Group, Inc. - Chairman, CEO, President*

Thank you.

Mary Jane Raymond *- Hudson Highland Group, Inc. - CFO & EVP*

Thank you.

Operator

Mike Carney, Aperion.

Mike Carney *- Aperion - Analyst*

Two questions. First, when you decide to make some technology investments in the other regions of the world, are those -- what is the likelihood that there is going to be some of the same issues that surrounded the business in the U.S.? And then also will it also be the same type of system that you're going to implement?

Jon Chait *- Hudson Highland Group, Inc. - Chairman, CEO, President*

Let me, Mike, that's a great question and let me just use it as a segue to remind everybody. I know you know this. You have the history of our challenges in the North American market. I mean you recall immediately after this spin, we had enormous problems in terms of billing and collections and aging of accounts receivable within the North American market -- Hudson North American market. This is all related to Hudson North America.

And part of, I mean the driving reason for this change in PeopleSoft was that we did not inherit a historic system that really worked in our business. And so that led us to do an analysis, some alternatives, and we ended up making a decision with -- let's go to PeopleSoft.

In the other regions of the world we have systems that do work, so we are not under the pressure that we had from the very beginning in North America. We are not under the same degree of pressure to make changes. Certainly one of the things that we have learned through the experience in this whole area in Hudson North America is that certain parts of the process are extremely important, and we did not do a good job -- when I say we, the entire team working on this installation -- did not do a good job of testing the system before we went live and creating what I understand and I'm certainly not a technologist -- what I understand to be a test environment that allows you to test the system in a very complete way before we went live.

So we certainly learned a number of lessons, not so much about the system itself but about the need to have processes in place with respect to implementation, training, design and other things that you might say fall into the category of blocking -- good blocking and tackling that we would certainly not only would, but we will put to use when we consider what to do in other regions.

I would also say that my experience in this industry is that -- and I am not making any excuses at all, but I think just understanding the landscape, systems and information are extremely important in this business and in this industry. And yet we have a relatively low margin industry and business and so that is always a constraint on the amount of money they make and put in. And all of us, many of us that are international companies are covering huge geographies with huge ranges between our smallest areas and our largest areas. So it is a complex challenge in all places and you just have to understand kind of the shape of the horse it is that you are riding here.

So as we look at other places, I would summarize by saying there are lessons we have learned. They are not so much bits and bytes lessons as they are more how to do it lessons, and we are not under the same pressure in other places, so we can proceed much more -- I think you can be assured that we will proceed much more cautiously.

Mike Carney *- Aperion - Analyst*

And then, Jon, have you hired a Chief Technology Officer or Chief Information Officer and, if not, is Jon still in charge of that area?

Jon Chait *- Hudson Highland Group, Inc. - Chairman, CEO, President*

What we have done is we have just hired. We have not announced the person so I will not tell you the person's name, but he will be announced I think within really the next day or two by Hudson North America, a new Hudson North America CIO.

Now he is -- has experience in the industry and has experience with PeopleSoft, so we are very excited by his joining the Company. He started Monday and I think Tom Moran plans to announce him actually sometime within the next week or so. What we haven't done is we have not replaced our global CIO and our plan at the moment is not to do so and to have Don act as our, let say, a technology coordinator.

The reason is frankly expensive management and we have CIOs in each of our regions at this point, and our conclusion after looking at our whole expensive structure and we will talk about this more in our second quarter call and how expenses have been managed on the corporate level. What we have determined is with very strong regional CIOs if we didn't really have a full-time job to have a global CIO. And what we needed was really somebody who was we felt conversant with technology issues without being a technologist, but conversant with management of technologists and that could supply the global overlay and frankly could supply -- could managed lower-level resources that could help us with a minimum number of global things that are needed to pull things together from the various regions.

Mike Carney *- Aperion - Analyst*

Am I correct in assuming that you don't expect to report a material weakness in the third quarter?

Mary Jane Raymond *- Hudson Highland Group, Inc. - CFO & EVP*

We -- our remediation plan would have us remediate the material weakness by the end of the third quarter. We are very focused on doing that. We have put in place some -- quite a few actually of the remediation actions for the material weakness that we believe existed at the end of the first quarter and are diligently completing them, yes.

Mike Carney *- Aperion - Analyst*

Okay. And then also this is somewhat immaterial, it looks like, to the overall U.S. business but Jon, I am going to make an assumption that you can't confirm yet, but the fact that the U.S. business has not rebounded much in a very good market, and I don't think it really matters whether you confirm or deny that, but when is it time to, you know, make changes there and I guess maybe for you to take on a larger control piece?

Jon Chait *- Hudson Highland Group, Inc. - Chairman, CEO, President*

Well, Mike, as you said, this isn't the right time to confirm or deny it because we're going to talk about it in more detail. And I would just say that one of the things we will talk about on the conference call, well, both in our shareholder letter which will be published Monday night and in the conference call Tuesday morning, I will address the current situation in the North American market from an operational standpoint and I will address a number of changes that have been and will be made in the North American operation.

Mike Carney *- Aperion - Analyst*

Thank you.

Jon Chait *- Hudson Highland Group, Inc. - Chairman, CEO, President*

And please do ask me that question again because I would love to have a conversation with the shareholders about it. I think it's a very relevant conversation. I can absolutely understand why it is on your mind. It is on my mind, so let's leave that until Tuesday.

Operator

Jeff Mueller, R.W. Baird.

Jeff Meuler - R.W. Baird & Company - Analyst

Jeff Mueller for Mark Marcon. In terms of the Oracle four-week initial assessment, has that begun yet and if so where are you in that stage?

Mary Jane Raymond - Hudson Highland Group, Inc. - CFO & EVP

It has begun. It's about halfway through. It's a very good comprehensive process as well to go through with us how various parts of the business are running, from the front office through the back office. All of the operating leaders as well as their key operating lieutenants are involved, and we are expecting to have kind of a midpoint readout in the next few days, so yes it is well underway.

Jeff Meuler - R.W. Baird & Company - Analyst

And then in terms of the module that you would potentially replace, do you have a timetable for when you want to make any major changes by and then after that just fine-tuning, or is it too early to tell?

Mary Jane Raymond - Hudson Highland Group, Inc. - CFO & EVP

Well, I'd say really to be honest Jeff it is a little bit too early to tell. Obviously we would like to manage our capital spending well, managed cash flow and what we would like to do it is not make too many assumptions before we get what would be Oracle's recommendation on how best to optimize what we have and what helps us improve the efficiency and I think we will have it in about two or three weeks since we are about halfway through the process we are under right now.

Jeff Meuler - R.W. Baird & Company - Analyst

And then in Q1, were the expenses associated with review about in line with what you had expected?

Jon Chait - Hudson Highland Group, Inc. - Chairman, CEO, President

In Q1?

Mary Jane Raymond - Hudson Highland Group, Inc. - CFO & EVP

In Q1?

Jeff Meuler - R.W. Baird & Company - Analyst

During Q2. I'm sorry.

Mary Jane Raymond - Hudson Highland Group, Inc. - CFO & EVP

In Q2 obviously we had some expenses to manage this. Engagement of Oracle did not significantly change what we expected to spend on the system, though. I would say at this point we're still a little bit finalizing our review of the results for the quarter.

Operator

(OPERATOR INSTRUCTIONS). At this time there are no further questions.

Jon Chait *- Hudson Highland Group, Inc. - Chairman, CEO, President*

Thank you very much, operator. Before I turn it over to David Kirby to just close, I thank you once again for attending today. As I said, it is not the most pleasant circumstances we might be talking to you about.

And I just want to reiterate two general points I made at the beginning. These accounting changes that we have discussed in the press release and the 8-K affect only our Hudson North America business. They do not affect for example Highland Partners. That also operates in North America that uses a different accounting system and is the accounting system is administered at a different place.

And we have, as we said many times, taken a look because many of these things involved processes related to reconciliation, we have looked at the reconciliation processes in the other regions to see if there were similar problems and satisfied ourselves there were not at this time.

And again to reiterate, we have examined carefully and concluded that there is absolutely no evidence of fraud or misconduct on the part of any Hudson employee. All of these fall in the category of errors, admittedly errors, and we're not happy about errors, but they are errors of normal business venture. With that, David, I'll turn it over to you for closing instructions.

David Kirby *- Hudson Highland Group, Inc. - Director of IR*

Thanks, Jon. And thank you everyone for joining us today. This call has been recorded and will be available later today by calling 800-642-1687 followed by the passcode 400-1903. For calls outside the United States, please dial 1-700-645-9291, followed by the same passcode. This call will remain available for the next seven days at those numbers. Today's webcast will also be available on the investor section of our website hhgroup.com. Thank you again for joining us. Have a good day.

Operator

Thank you. This concludes today's conference call. You may now disconnect.