Meeting today's financial challenges

Ernst & Young

Quality In Everything We Do

Global trends

Global trends are transforming the financial and accounting environment

- *Economic pressures* – Companies and specific sectors are continuing to experience challenges such as securing debt financing, managing cash flow and liquidity, valuing assets, etc. Many companies have been forced to recognize asset impairments, restructure their operations and recognize declining fair values, especially for illiquid or complex financial instruments.
- *Geopolitical development* – The increased emphasis on emerging markets, the influence of emerging market multinationals and the emergence of new power brokers – sovereign wealth funds (SWFs), private equity (PE), etc. – is significantly changing the global financial and economic landscape.
- *Regulatory convergence* – Regulatory pressure is increasing in response to the financial crisis, and is expanding beyond the banking and asset management sectors. Challenges exist for the consistent implementation of International Financial Reporting Standards (IFRS) across jurisdictions. While convergence across accounting standards (such as IFRS and US GAAP) is further off, regulators are moving toward greater mutual recognition and alignment. As development of new accounting standards continues, lessons learned from the financial crisis will need to be considered.
- *Risk management and internal controls* – As a result of the current business environment, the growing importance of emerging markets and regulatory developments, there is a renewed and intensified corporate focus on risk management. Boards, audit committees and management are looking beyond internal controls around financial reporting to broader, enterprise risks facing the business. In fact, some regulators and practices already go beyond financial reporting controls. In the future, it is possible that regulation around internal controls will expand from financial reporting controls to cover the controls surrounding key business processes linked to significant business drivers and strategic enterprise risks.
- *Company reporting information and technology* – Investors have an increasingly large appetite for more useful and more detailed financial and nonfinancial information on which to base investment decisions. Stakeholders, regulators and other observers are seeking more information and increased comparability of financial information through tools such as XBRL (eXtensible Business Reporting Language). Data collection, analysis, communication and reporting technology may transform the global audit environment.

Introduction

The global business and financial landscapes are being reshaped today by a number of transformational events and trends. As part of this transformation, the financial and accounting environment is also being reshaped, resulting in a number of significant challenges for management, boards, audit committees and external auditors. Success in today's markets requires organizations to effectively assess their most critical business issues and work to identify the best way to respond to those challenges.

In *Meeting today's financial challenges*, we review five key areas that have emerged for management, boards and audit committees in the financial and accounting environment:

1. **Enhancing corporate governance** — Improving the role of boards and audit committees in corporate governance, broader risk management activities, financial communications processes and the management of stakeholder expectations is critical to advancement in today's economic climate.
2. **Effectively managing today's business risks** — Evaluating the overall risk management infrastructure and investments necessary to look beyond financial statement risk to enterprise and external risks should not be undervalued and cannot be underscored enough.
3. **Evaluating the funding and liquidity strategy** — Assessing funding needs and proactively communicating with lenders, analysts and rating agencies is pivotal in an environment that demands financial flexibility.
4. **Assessing the impact of regulatory and accounting rules** — Determining the impact of regulatory and accounting rules, not only on the financial statements but also on the business, is a key factor in determining a response strategy.
5. **Protecting financial reputation** — Responding to the changing content of financial and nonfinancial reporting — including stakeholders wanting more information, transparency and certainty — could impact the financial reputation of the organization.

Enhancing corporate governance

The media and general public have placed at least a portion of the blame for the financial crisis on poor corporate governance. For example, the International Corporate Governance Network, a group of institutional investors with US$9.5 trillion in assets under management, stated, "It is now widely agreed that corporate governance failings were not the only cause of the crisis, but they were highly significant, above all because boards failed to understand and manage risk and tolerated perverse incentives."

As a result, corporate governance reform is at the top of investor, regulator and board agendas. Financial and nonfinancial institutions alike face the prospect of new governance rules and higher expectations. In the midst of the drive to reform, boards are reflecting on how to improve their performance by being proactive and more involved with governance and providing greater audit committee oversight of the risk management processes.

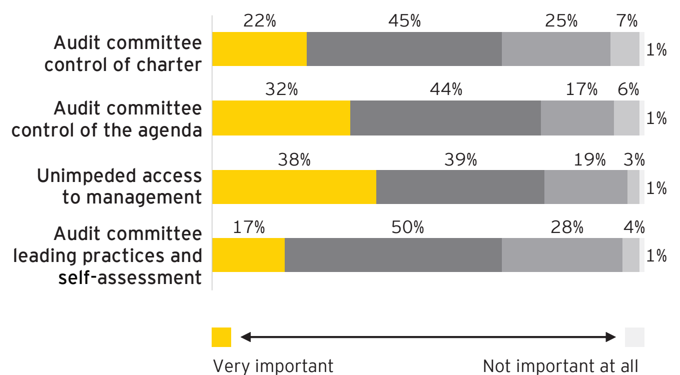
Boards are aware that governance reform cannot be delayed and may result in significant challenges for many organizations. Some have commented that the current enthusiasm for reform will produce more rules without making changes that will truly improve governance. Still others believe that there is no "magic bullet" that will make boards more effective by regulatory fiat, and that different approaches are required for different organizations in different sectors. This is especially true considering the view by many that corporate governance is only one of the many causes of the financial crisis, and that the approach going forward to be taken by the financial services sector will need to be different than for other industries.

Ernst & Young (along with Tapestry Networks) recently met with seven audit committee networks around the world to better understand the issues, opportunities and concerns related to governance and risk management oversight. One of the key themes that emerged from the discussions is that audit committees and boards are realizing that they must be much more involved in understanding and reviewing the corporate response to the key risks and financial issues their organizations face. Many organizations are realizing that their existing risk management oversight is inadequate for identifying new risks and the interplay between a wide range of factors in current market conditions. Risk has moved back to being a board-level focus, and investors are significantly increasing their scrutiny on risk assessment and response.

Boards and audit committees are increasingly being asked to look beyond the more traditional areas of emphasis — such as the internal controls concerning financial reporting — to other risk areas inside and outside the enterprise that could impact organizational performance. Put simply, the scope of work for boards and audit committees is increasing and risk at all levels is at the forefront.

As part of our recent *Global Audit Committee Survey*, conducted by the Economist Intelligence Unit, we asked participants to evaluate the importance of several aspects of governance in carrying out their duties, such as unimpeded access to management, control of the agenda, leading practices and control of charter. Although 67% of respondents considered audit committee leading practices and self-assessment to be important, only 17% felt they were "very important".

In your role as an audit committee member, how important are the following aspects of governance enabling you to carry out your duties?



Shown: percentage of respondents.

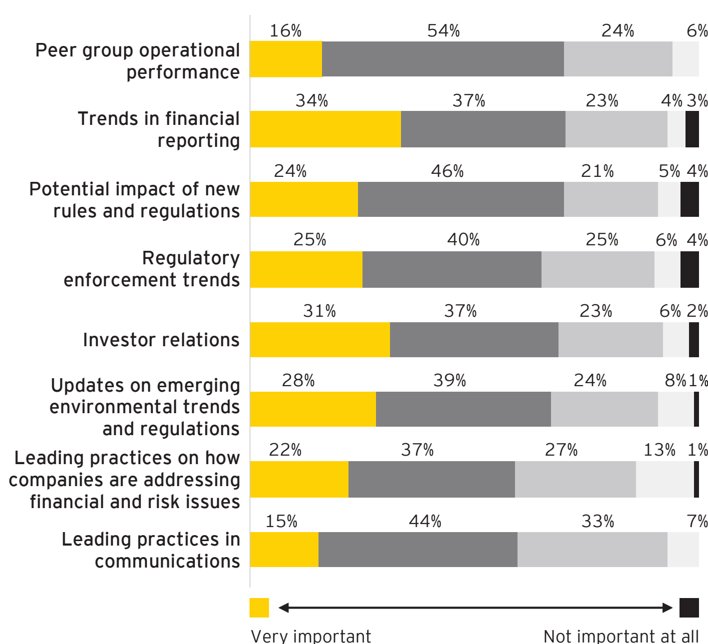
We also looked at the type of information that audit committee members need to receive to carry out their duties effectively. The top three responses from the panel included:

- Trends in financial reporting (34% very important)
- Investor relations (31%)
- Updates on environmental trends and regulations (28%)

What we viewed as interesting from an overall audit committee effectiveness perspective is that the bottom three in terms of being viewed as "very important" included:

- Leading practices in communications (15% very important)
- Peer group operational performance (16%)
- Leading practices on how companies are addressing financial and risk issues (22%)

How important is it that you receive information about the following to carry out your duties effectively?



Shown: percentage of respondents.

From this survey, we find it interesting that while 59% of respondents considered "leading practices on how companies are addressing financial and risk issues" and "leading practices in communications" to be important, only 22% and 15%, respectively, felt they were "very important". We believe boards and audit committees need to take a broader view of the risk landscape and closely examine audit committee effectiveness on a company-specific basis. Audit committees can significantly increase the effectiveness of their oversight responsibilities by identifying leading practices in areas such as communications and risk assessment, and then tailoring those practices to their respective organizations.

Many boards and audit committees are turning to the external auditor for more information. Audit chairs recognize that the external auditor remains the main source of external advice on the company's risks and processes. The external auditor may need to become more proactive in providing comparative or benchmark information and advice to the audit committee, other committees, such as risk and remuneration, or the board as appropriate. Some of the key areas where audit committees are seeking advice from the external auditor include: funding and liquidity; risk management; asset valuation and accounting changes; financial communications; and the wider topic of corporate governance.

Following a similar track of questions to our *Global Audit Committee Survey*, Ernst & Young and Tapestry Networks conducted interviews with a range of corporate governance professionals to determine how boards are addressing performance questions and the new governance challenges being presented to them by investors and regulators. Some of the key themes and comments that emerged from the study on how directors can improve board performance were:

- **Challenge management to simplify and explain the business** – One director (a retired bank executive) said that one of the best directors he worked with had little business or financial experience but was willing to keep pushing management to simplify their explanations until they were understood. The director commented that "he was prepared to look stupid, but he wasn't prepared to make a stupid decision."
- **Carefully evaluate remuneration schemes** – Misaligned incentives in financial institutions received some of the blame for the financial crisis, and scrutiny concerning executive remuneration is quickly spreading to all listed companies. Some leading company boards have changed their committee schedules so that audit committee members can attend – and in some cases, also be members of – compensation committees.
- **Improve oversight of risk management** – Directors must help ensure risk management approaches highlight key business risks and that the board fully understands those risks. Many directors have suggested that risk oversight be coordinated across the appropriate committees and management executives, but that the full board remains engaged, as appropriate. As an example, one audit chair insists that the Chief Executive Officer (CEO), Chief Financial Officer (CFO) and general counsel meet quarterly with the audit committee to discuss the current risks facing the company and how these executives are adapting their day-to-day activities in light of these risks.

Effectively managing today's business risks

In an unstable economic environment, protecting the company from excessive risk is a top priority for management and the audit committee. The board and audit committee need to understand the extent to which the company is exposed to financial, operational or strategic risks. They are also ultimately responsible for overseeing the company's plan to address the identified risk exposures.

In previous years, the focus of risk management discussions at the audit committee or board level tended to concentrate on financial statement risk. With recent economic events and increased investor scrutiny, however, the areas of risk management focus are evolving and expanding to cover more enterprise and external risks. Two specific areas of increasing risk management concern for audit committees to discuss with management and auditors are (1) the overall risk management infrastructure and (2) ethics and the potential for fraud.

Overall risk management infrastructure

As audit committees and management begin to look beyond the internal controls over financial reporting and into controls over other business risks, the overall company risk management infrastructure and level of investment needs to be considered and addressed. Audit committees and boards are realizing that they must be much more involved in the review and corporate response to the key issues their organizations face. And that need for increased board oversight has elevated the dialog around governance frameworks, risk assessment and mitigation approaches.

Ernst & Young's recent *Global Audit Committee Survey* also uncovered this trend. While 69% of the respondents already have a risk committee, an additional 17% are planning to establish one in the near future.

For those companies that currently have a risk committee, the structure varies widely. Fifty-five percent of respondents stated that their risk committees exist separately from the audit committee, 34% stated that the group includes both members from the audit committee and other groups, and 11% have established the risk committee as a subset of the audit committee.

In our *Opportunities in adversity* study (June 2009), we discussed how risk management is under intense review, both because of its perceived lack of performance in predicting problems and as a result of the fast pace of marketplace change. In this study, we found that 56% of respondents stated that they have made permanent changes to risk management operations, with an additional 33% making temporary changes. This is supported by significant increases in investment in both risk management (38%) and internal audit (22%) — all at a time when cost reduction is a major priority.

But what changes are the right changes? What investments will be most beneficial in mitigating key risk areas?

Key risk areas

Financial risks

- Accounting and reporting (e.g., accounting, reporting, internal controls)
- Market (e.g., interest rate, currency)
- Liquidity and credit (e.g., cash management, hedging)
- Tax (e.g., tax strategy and planning, indirect taxes, transfer pricing)
- Capital structure (e.g., debt, equity, options)

Strategic risks

- Planning and resource allocation (e.g., organization structure, strategy, budgeting)
- Communications and investor relations (e.g., media, investor and employee communications)
- Major initiatives and capital programs (e.g., vision, planning, execution, monitoring)
- Competitive market dynamics (e.g., competitive pricing)
- Mergers, acquisitions and divestitures (e.g., valuation, due diligence, integration)
- Macro-market dynamics (e.g., economic, social, political)

Compliance risks

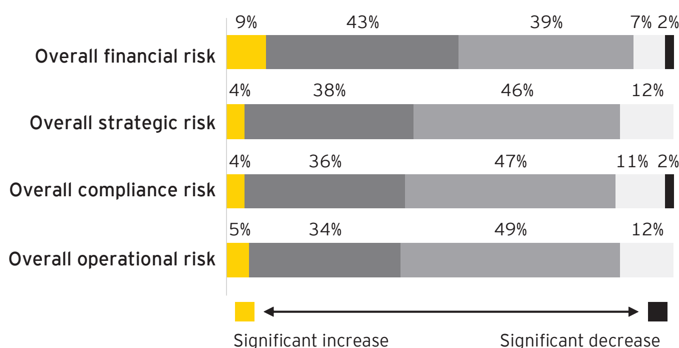
- Governance (e.g., board, tone at the top)
- Regulatory (e.g., labor, safety, trade/customs)
- Legal (e.g., contracts, intellectual property)
- Code of conduct (e.g., ethics, fraud)

Operational risks

- Information technology (e.g., IT management, security, availability)
- Physical assets (e.g., real estate; property, plant and equipment)
- Sales and marketing (e.g., advertising, pricing, customer support)
- People (e.g., recruiting, retention, development)
- Research and development (e.g., market research, product design and development, product testing)
- Supply chain (e.g., planning, inventory, distribution)
- Hazards (e.g., natural events, terrorist acts)

In our study, *The future of risk* (July 2009), we looked at how the risk landscape is changing. We asked our panel of executives to indicate the degree to which the risk to their organization has increased or decreased over the past 12 months in four key risk areas: financial, strategic, compliance and operational. Not surprisingly, all four risk categories showed an increase (see table on previous page). Over half of respondents indicated that their financial risk has increased, while approximately 40% indicated that strategic, compliance and operational risk has increased. In fact, very few organizations indicated a decrease in any of the risk areas.

Over the past 12 months how has risk increased or decreased for your organization in the following risk areas?



Shown: percentage of respondents.

In general, responses in *The future of risk* study suggest that there has been an advance of risk management efforts over the past several years. A majority indicated that their organizations have:

- Aligned their risk management efforts with business strategy and objectives (80%)
- Leveraged information technology to support the company's risk management (67%)
- Aligned their risk management efforts with performance management (67%)
- Embedded risk and control activities throughout the organization (65%)

Recent events have forced a quicker and more aggressive maturing and advancement of risk management infrastructure efforts within many companies. The sense of confidence that "we've come a long way," however, should not prevent organizations from recognizing how much work is left to do to improve risk management efforts.

More than ever, organizations need a comprehensive and coordinated risk management approach with strong executive oversight and board-level governance. Many organizations have multiple risk management groups that often exist in silos and operate in an uncoordinated fashion. In some cases, the silos are disconnected from the wider business strategy. The results often include separate groups performing disparate activities and using different approaches to manage risk, resulting in duplication of effort and potential gaps in risk coverage. Companies can and must improve risk management. One way to help ensure risk management has appropriate executive oversight and prioritization is to create a better link between risk management and executive compensation. Both our *Global Audit Committee Survey* and *The future of risk* study illustrated the opportunities to improve the coordination of risk management activities:

- 63% of respondents indicated they have seven or more risk functions
- 67% had overlapping coverage with two or more risk functions
- 50% reported gaps in coverage between risk functions
- 60% of audit committee members rated the degree of integration between risk management, internal audit and external audit as "very effective" or "effective"

How would you rate the degree of integration between the following risk functions?

Shown: percentage of respondents.

In addition to looking at integration efforts, we also asked audit committee members to rate the overall performance of the risk functions in their companies. In looking at the different risk management groups, the enterprise risk function scored the lowest, with only 13% rating their performance as "very effective" and only 63% rating it as "effective" or "very effective." The other groups scored only slightly better in performance effectiveness: internal audit (65%); legal (73%); treasury (73%); and compliance (75%).

Despite the economic downturn, nearly 4 out of 10 respondents in two different Ernst & Young surveys said they intend to increase their resources — people, management attention or financial resources — to strengthen their risk management capabilities. When asked where they plan to commit more resources, the top responses from our survey of over 500 executives (*The future of risk*) around the world included: improving the alignment of the risk management approach with business strategy and objectives (85%); improving the risk assessment process (84%); redefining risk ownership roles, processes and structure (72%); and improving coordination among multiple risk management functions (70%).

If you plan to commit more resources to strengthen your risk management capabilities, what will be your area of focus?

Shown: percentage of respondents.

Risk management has grown increasingly complex over the years, prompting organizations to increase the size, magnitude and reach of their risk management functions. But the result of that increased size and scale does not always correlate to more effective risk management. Designing a comprehensive and coordinated risk management infrastructure and making the right investments is no simple task in today's business environment.

Ethics and the potential for fraud

Another area of risk on the rise is the potential for fraud. As a result of the downturn, boards and management executives are under increased pressure to stabilize their businesses and to meet financial targets — both at the personal and organizational levels. In addition, cost reduction efforts which typically include streamlining "back-office" functions and controls could increase the overall risk of fraud. Not only does a downturn expose more fraud as the masking effect of economic growth is withdrawn, but as the pressure intensifies on management to maintain income and earnings, the incentive to commit fraud increases.

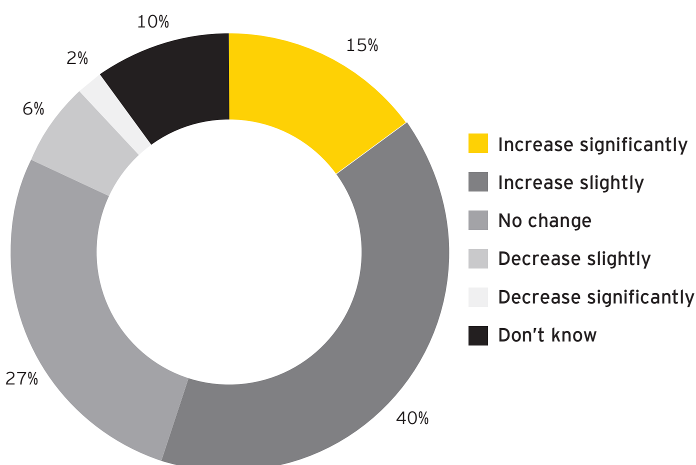
Schemes to perpetrate financial reporting fraud include improper accounting for transactions with related parties and special purpose entities, manipulation of management estimates of fair value relating to real estate assets and financial instruments. More traditional schemes, such as management of "cookie jar" reserves, and improper revenue accounting, such as from undisclosed side letter agreements and bill and hold arrangements, are also on the rise.

Ernst & Young's *European fraud survey* 2009, which included over 2,200 interviews with executives and employees in 22 European countries, revealed some interesting and troubling findings:

- 55% of the respondents expect corporate fraud to increase over the next few years.
- Two out of five respondents believe that their company's anti-fraud efforts had not increased in the last few years.
- Employees severely doubt management's integrity and perceive that their leaders pose significant risks: 29% of respondents believe management to be untrustworthy, and 42% of respondents believe that the senior ranks in an organization pose the biggest threat of fraud.

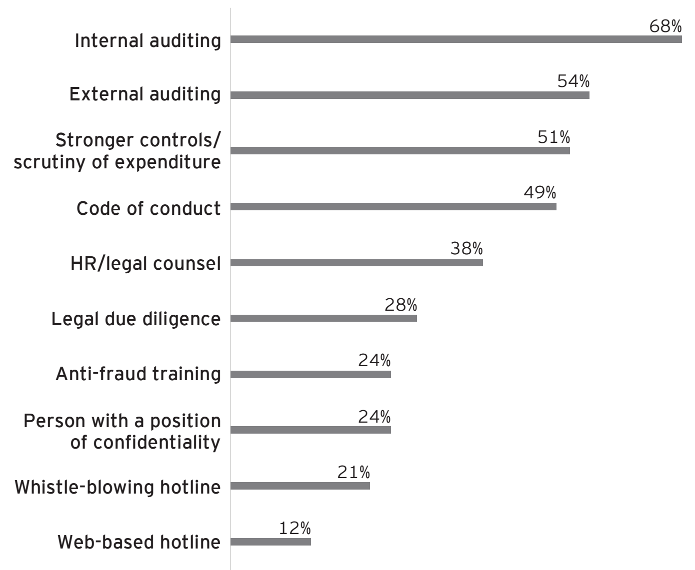
- Almost half of the executives (47%) stated that one or more types of unethical behavior was acceptable, including 25% who thought it was acceptable to give a cash bribe to win work. There was even a significant minority — 13% of senior managers and board members — who felt that distorting their company's financial performance was justifiable to survive in today's turbulent economic environment.

Do you expect corporate fraud to increase or decrease in the next few years?



In general, there was a fairly consistent view that survey respondents view preventing fraud as someone else's responsibility. When asked whether their company had certain anti-fraud measures in place, most suggested continued reliance on audit, either internal or external, as the primary response. Since the role of the external auditor is not to act on behalf of management in detecting fraud, it was surprising to have 54% of the respondents indicate external auditing as one of their anti-fraud measures.

Does your company have any of the following anti-fraud measures in place?



Shown: percentage of respondents.

Given the concerns raised about the integrity of management and the increasing risk of fraud, survey respondents called for increased and more effective regulation, including 70% of respondents from our *European Fraud Survey 2009* who believe that directors should be held personally liable for frauds that occur under their watch.

The general public, employees, regulators and other stakeholders increasingly want to see senior management — and in particular the board — take a more proactive role in evaluating and improving the company's anti-fraud activities. Directors and management need to consider the geographies and cultures in which the company operates, and must be prepared and decisive in their response when instances of fraud occur. In addition, the audit committee needs to challenge the quality of current corporate compliance programs and determine whether additional programs would increase the effectiveness of the organization's anti-fraud measures.

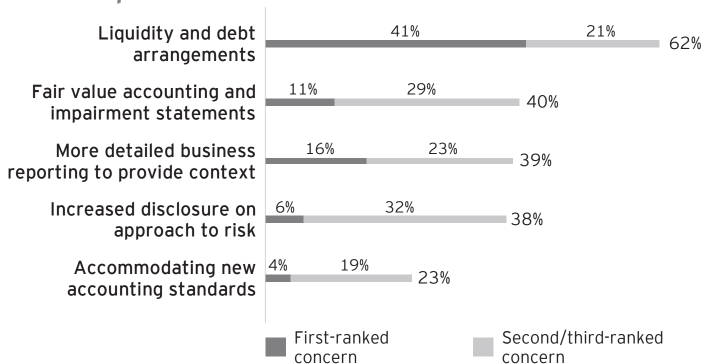
Evaluating the funding and liquidity strategy

For many entities, revenue growth by organic expansion or acquisition has ended, with most commentators predicting market stagnation for at least another year. Defaulting debtors, challenges in the supply chain and restructuring costs contribute to unforeseen cash requirements which deplete cash reserves. A more cautious financial sector is limiting the supply of credit and changing the terms of existing banking arrangements; fund raising through equity or debt issues is only available to a few. Funding for 2009, and through the end of 2010, is a priority for many, as cost control may not be sufficient. As the combining effects of all these challenges could have a significant impact on a company, management must proactively consider topics such as: how to optimize cash flows, should current banking relationships be renegotiated and what should the company do if debt covenants are broken.

The persistent difficulties in the banking sector have posed significant challenges for companies trying to secure funding. Therefore, companies need to consider options in order to address those challenges, such as moving quickly to secure funding, developing deeper relationships with multiple banks, and thinking beyond the banks. For example, as the cost of loans in the current environment is expensive, entities in need of funding should be thinking of alternatives such as equity and bond issuances and asset-backed lending, vendor financing, commercial paper and medium-term note programs.

In our recent *Reporting in adversity* survey (July 2009), CFOs were asked what they considered to be their top concerns for the next reporting period; they put liquidity and debt arrangements at the top of their list. An overwhelming 41% rated it as their most important concern, with more detailed business reporting a distant second at 16%.

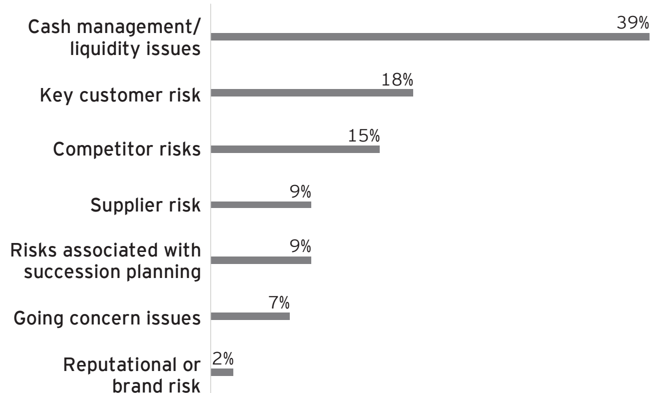
What are your top financial reporting concerns for your next interim report?



Shown: percentage of respondents.

Funding and liquidity concerns by CFOs are also shared by audit committees, which was underscored by the results of our *Global Audit Committee Survey*. In looking specifically at the elements of risk information critical to being an audit committee member, 39% stated that "cash management/liquidity issues" were most important, reflecting recent (and current) economic pressures. Only 2% stated that reputational or brand risks were most important.

In your role as an audit committee member, which of the following pieces of risk information do you consider to be most important?



Shown: percentage of respondents.

The challenges companies face in the current economic environment are placing new demands on boards and audit committee. Audit committees are finding themselves much more involved in monitoring funding and liquidity issues. This focus has led to more frequent meetings and has also prompted closer communication with the treasury function. Audit committees also need to keep an eye on such details as the cross-default provisions in debt covenants and the potential impact of margin calls by counterparties.

The fundamental concerns facing companies today, such as funding and liquidity, will continue to affect all organizations, with the investor community pressing for more information, more frequently. The challenge is finding the right balance between information and cost of preparation. The good news is that our recent *Reporting in adversity* survey showed that company executives are taking action. Respondents said that to maintain liquidity, their companies are more proactively communicating with lenders, analysts and rating agencies.

Assessing the impact of regulatory and accounting rules

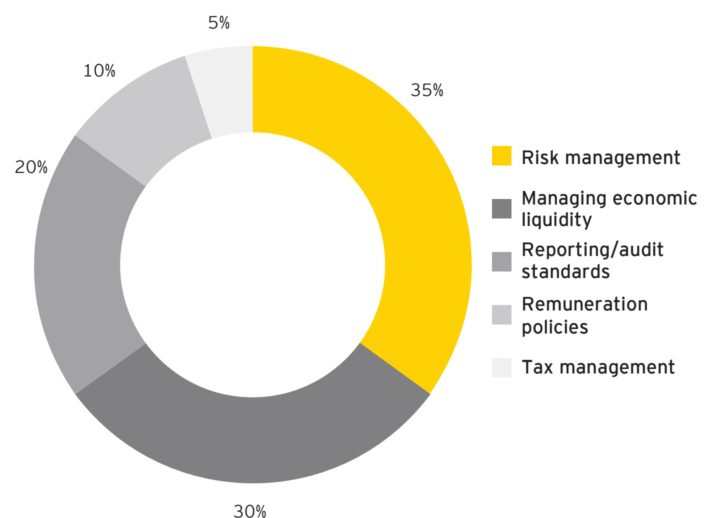
Both regulatory and accounting rules continue to evolve at a fast pace. Companies must understand the implications of new rules not only from a financial perspective, but also from a business perspective. This is critical as it may result in management's need to develop a strategy to effectively mitigate the impact of a new rule or monitor a new regulation.

For example, the banking crisis has exposed weaknesses and failures of regulation, both in the underlying frameworks and their implementation and policing. Recent economic events have resulted in regulators imposing additional requirements on companies in certain industries. This in turn has resulted in increased activities around risk identification and mitigation by management, boards and audit committees.

In our June *Opportunities in adversity* study, we asked executives where regulatory intervention is needed most. A majority of respondents were broadly supportive of intervention by government in the financial services sector, with 59% believing that government action on an international basis has been instrumental in addressing the economic crisis over the past year. While the majority agree in principle with the need for new regulation, and, 65% of companies have considered the impact of new regulation on their markets, prior history suggests that simply asking for more or better regulation does not always resolve the problem or remove the responsibility from business.

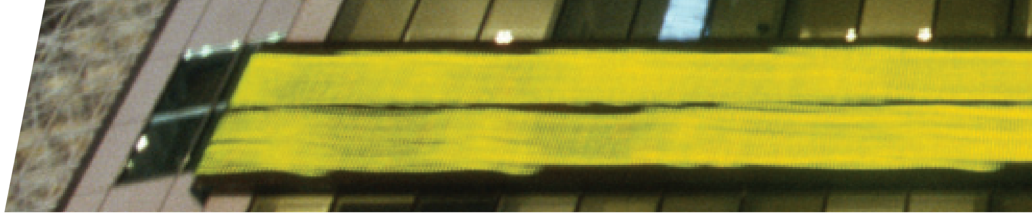
In looking at specific areas of regulatory intervention, the top responses from executives included: risk management (35%); managing economic liquidity (30%) and reporting/audit standards (20%).

In which of the following areas do you believe that regulatory intervention is most needed to address deficiencies highlighted by the crisis?



There is little doubt that regulatory oversight will continue to increase in response to recent events. Many questions still remain, however, regarding the type and overall scope of regulatory responses. While regulatory intervention may vary based on geography, industry sector and size of company, some of the potential developments and impacts that may occur in the near-term include:

- Regulations driven by the US Securities and Exchange Commission (SEC) will likely focus on risk and compensation disclosures. SEC Chairperson Mary Schapiro seems to be stressing enhanced enforcement with a focus on making boards hold management more accountable to shareholders for their actions, particularly on risk and compensation.
- Additional regulations and changes to accounting standards will generate the need for external auditor support. In our sponsored audit committee network meetings, many have reemphasized the need for stability in accounting standards and indicated the importance of management and the external auditor in navigating increasingly complex accounting pronouncements, such as purchase price accounting, efforts on other comprehensive income versus profit/loss, and the risk of inconsistent application of accounting standards.



- As a result of regulatory requirements and guidance — and also in response to investor requests — published reports and other financial communications will contain more forward-looking information, with more detail on the judgments made to assess value.

Certain accounting issues have received much attention during this past year primarily due to the economic environment. For example, asset impairment and fair value remain hot topics. Many tangible and intangible assets have declined in value. Market conditions have made asset valuations more complex with greater judgment involved, and entities must address financial reporting concerns related to representing impairments with an appropriate amount of information, especially since there is a heightened interest in impairment and asset valuation disclosures. Providing better information will help to enhance both credibility and financial reputation.

Other accounting issues have received much attention recently due to events unrelated to the economic crisis. One topic of interest is business combinations. In January 2008, the International Accounting Standards Board issued revised standard IFRS 3 Business Combinations (IFRS 3), which significantly modifies the accounting for business combinations and transactions with noncontrolling interests, and likely will result in changes to the way management approaches potential business combinations.

Another topic of interest is carbon reporting. As climate change caused by greenhouse gas emissions gains more attention of the international community, accounting for emission reductions is quickly becoming an important topic of discussion and debate.

It is clear that these types of regulatory and accounting changes are impacting how boards, management and audit committees go about their business. As entities are challenged by the implementation and oversight of new regulatory developments and accounting standards, there must be increased activities around risk identification, monitoring and strategic mitigation.

Protecting financial reputation

In the market uncertainty over this past year, business leaders have had a key asset to protect — their financial reputation. While financial reporting has always been a key driver of financial reputation, the challenges of today's economic environment are driving stakeholders and investors to demand better information and transparency. The result is an increasingly strong bond between financial reputation and the transparency of financial and nonfinancial reporting.

While protecting financial reputation used to be about hitting forecasted results, investors are now valuing speed of communication in an environment where forecasts are constantly changing. In addition, with the immediate pressures on boards and audit committees, companies may be less likely to focus on their governance processes and focus more time and attention on identifying, understanding and disclosing their risks in financial reports.

As stakeholders will continue to expect increased disclosure of all information that might have an impact on a company's financial status, the call for transparency is not likely to diminish in the short term.

The most recent financial reporting cycle has presented a number of challenges for many companies, some of which include:

- Increased analysis — The need for more extensive analyses regarding the application of accounting standards
- Additional dialog — The need for additional interaction between management, the audit committee and the external auditor
- Greater scrutiny — The increased scrutiny from investors and regulators

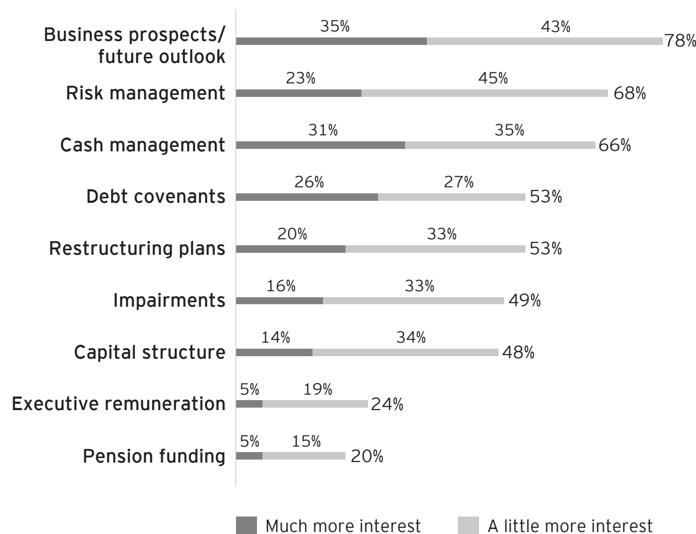
Yet, these challenges have also led to positive outcomes, including greater reporting transparency for stakeholders. As we look at the changes and challenges in financial reporting, it is evident that the content of financial reporting has changed. In our *Reporting in adversity* survey, we asked CFOs how the content of their annual reports has changed during the past year. A significant percentage of the respondents told us that they had increased the content of their report in several areas. In fact, 72% indicated they provided more detailed content around business risk, 53% reported more content around cash/debt reporting and 49% provided additional information on impairment and asset valuation disclosures. These results demonstrate that companies are becoming increasingly conscious of investors' demands for greater explanation and detail in areas that were affected by the economic crisis.

How has the content of your reporting changed from the previous year?

Shown: percentage of respondents.

Related to the amount of forward-looking information that is now being included in financial reports, we asked CFOs where investors were showing more or less interest, as a result of recent market conditions. Not surprisingly, 78% of CFOs surveyed reported increased investor focus on business prospects and overall future outlook. In addition, 68% reported more interest in risk management, and 66% indicated more interest in cash management.

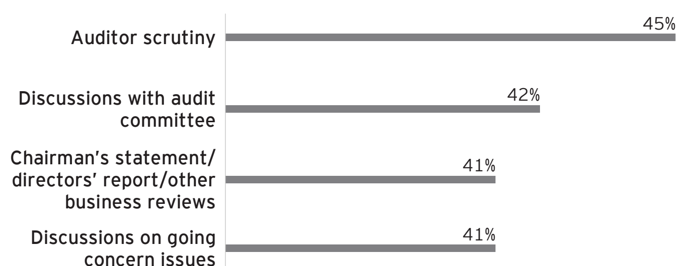
Compared with the previous year, are analysts and investors showing more or less interest in the following areas?



Shown: percentage of respondents.

Given the changes to financial reporting, and the increased emphasis on more forward-looking information, it is not surprising that the amount of time spent on the financial reporting process has increased. In looking at how the time spent on various processes changed from the previous year: 45% indicated increased auditor scrutiny; 42% in the amount of time spent in discussions with audit committees; 41% with the chairman's statement, director's report, other business reviews and discussions; and 41% on "going concern" issues.

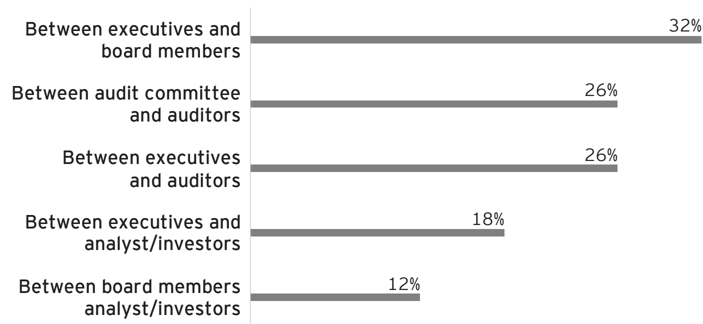
When preparing your company's latest financial statements, how did the time spent on the following processes change from the previous year?



Shown: percentage of respondents.

There have been positive outcomes from the increased scrutiny and time invested in the financial reporting process. As an example, over 25% of the CFOs we surveyed reported improved relationships with key stakeholders. CFOs reported improved transparency and interaction between executives and board members (32%); between audit committee and auditors (26%); and between executives and auditors (26%).

How has this year's reporting process affected key boardroom relationships?



Shown: percentage of respondents.

Increased scrutiny and transparency will be critical focus areas for the 2009 financial reporting process. For example, investors will be looking for more disclosure around debt covenants, such as covenant ratios and sensitivity analyses. As we expect the incidence of impairment charges to increase throughout 2009, quality disclosures regarding management's assumptions will be of high importance to stakeholders and regulators.

Summary

The business and financial landscape is being transformed by a number of global events and trends, which are creating many challenges in the financial and accounting environment. To address these challenges, some of the key areas of emphasis and potential considerations for management, boards and audit committees include:

- **Corporate governance** — Corporate governance reform is at the top of investor, regulator and board agendas. Organizations face the prospect of new governance rules and higher expectations. Boards and audit committees will need to take an increasingly broader view of enterprise and external risks, and ask tough questions of management to fully understand the controls in place and any proposed changes to managing the key risks that could impact the organization's overall performance.
- **Risk management** — As a result of recent economic events and increased investor scrutiny, risk management will expand to address more enterprise and external risks. Some of the specific areas of increasing risk management concern for audit committees to discuss with management and auditors include (1) the overall risk management infrastructure and (2) ethics and the potential for fraud. Companies will face challenges in moving from a decentralized, silo-based risk management model, with the resulting redundancies and gaps in coverage, to a more coordinated infrastructure, with an aligned mandate and scope, consistent risk management methods and practices, supported by common information and technology.
- **Funding and liquidity** — Difficulties concerning companies' funding efforts will likely extend into 2010. Although bank lending may be improving slightly, it remains very restricted. One suggestion is for companies to build deeper relationships with multiple banks while also tapping other sources of funding, such as equity and bond issuances and asset-backed lending. Also, audit committees should monitor companies' liquidity and funding closely.
- **Regulatory and accounting rules** — Regulatory developments and accounting standards continue to evolve at a fast pace, and companies must understand the implications of new rules, not only from a financial perspective, but also from a business perspective. This evolution will continue to impact how management, boards and audit committees go about their business, especially with activities related to risk identification, monitoring and strategic mitigation.
- **Financial reputation** — New developments have and will continue to necessitate increased analysis, additional time, dialog and greater scrutiny to address the needs and expectations of investors, regulators and other stakeholders. The content of financial reporting will also feature more forward-looking information, with more detail on the judgments taken by management. Additional corporate risk management infrastructure and investments will be needed to address these changes. Boards will need to reflect on how to be proactive in regard to governance, yet constantly react to financial and regulatory developments, requiring them to protect one of their most important assets — their financial reputation.

Related financial reporting topics

A number of other Ernst & Young thought leadership materials are available on related topics, many of which were referenced in this report. For more information, contact your local Ernst & Young office, any of the contacts listed below or visit ey.com.

Assurance leaders			
Christian Mouillon	Global Assurance (Paris)	+33 1 46 93 66 56	christian.mouillon@fr.ey.com
Thomas Hough	Americas (Atlanta)	+1 404 817 5300	tom.hough@ey.com
Pascal Macioce	Europe, Middle East, India and Africa (Paris)	+33 1 46 93 78 65	pascal.macioce@fr.ey.com
Clive Saunderson	Far East (Beijing)	+86 10 58153308	clive.saunderson@cn.ey.com
Hidetoshi Watanabe	Japan (Tokyo)	+81 3 3503 1100	watanabe-hdtsh@shinnihon.or.jp
Tony Johnson	Oceania (Melbourne)	+61 3 9288 8647	tony.johnson@au.ey.com

Ernst & Young

Assurance | Tax | Transactions | Advisory

About Ernst & Young
Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 135,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

For more information, please visit www.ey.com.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

About Ernst & Young's Assurance Services
Around the world, the journey to success is governed by increasingly complex and broadening regulatory requirements and stakeholder demands. Strong independent assurance helps meet these demands by providing a timely and constructive challenge to management, a robust and clear perspective to audit committees and critical information for investors and other stakeholders. The quality of our audit starts with our 60,000 assurance professionals, who have the breadth of experience that comes from auditing many of the world's leading and fastest-growing companies, and to whom we provide ongoing personal and professional development. We provide a consistent worldwide audit by assembling the right multidisciplinary team to address the most complex issues, using a proven global methodology and deploying the latest, high-quality auditing tools and perspectives. And because we understand that, to achieve your potential, you need a tailored service as much as a consistent methodology, we work to give you the benefit of our broad sector experience, our deep subject matter knowledge and the latest insights from our work worldwide. It's how Ernst & Young makes a difference.

© 2009 EYGM Limited.
All Rights Reserved.

EYG no. AU0365

Ernst & Young is committed to minimizing its impact on the environment. This document has been printed using recycled paper and vegetable-based ink.

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.