It's all about results

How do you evaluate the success of a sponsorship deal?

Revenue recognition
The implications of the new converged standard

Do the right thing
Why ethical behavior in business matters

It’s more than the numbers

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Screen readable format
Dear readers,

As 2014 draws nearer to a close and many companies are preparing their year-end accounts, we've been reflecting on the increasing demands for complex international businesses to promote greater transparency and comparability. As you read through this issue, you'll find many of the articles present the case that it isn't that simple. Corporate reporters need to balance measurement, compliance and communication constantly — and it is no easy task.

You will find that we are looking at measurement from a slightly different perspective in this issue — examining elements of business activity that are not part of financial statements, but can have a significant impact on corporate reputation and deserve thoughtful consideration. Our cover story (page 27) is on corporate sponsorship; a significant and high-profile investment in brand — but is it evaluated well? Our article examines the challenges of measuring the return on investment and how it should be reported to show the value it creates beyond an increase in financial capital. On page 36, we examine ethical business and suggest that measurement of ethics has some way to go.

In the three interviews in this edition, communication is top of mind for successful senior executives. Ana de Pro's interview on page 20 goes into detail on her communications focus as CFO of Amadeus. Gordon Naylor, CFO of CSL, explains the challenges of a fast-growing biotech company on page 18. Also very interesting is Maurizio Lauri's colorful analogy regarding corporate reporting on page 31. (Maurizio chairs the Board of Statutory Auditors for UniCredit and three other leading Italian companies.)

EY has long been a supporter of the adoption of global accounting and reporting standards, but global standards and their implications are not straightforward. Our review of the new global revenue recognition standard on page 13 considers the challenges for certain organizations. You will find Leslie Seidman's thoughtful comments and reflections regarding global standards on page 8: the challenge in implementation is the diversity of economies, investor behaviors and historical context. Similarly, the new requirement for conflict minerals reporting has a positive and ethical intent — but our article on page 4 points to the issues that organizations experienced in trying to increase transparency over their supply chain in the first year of enactment.

So, once again, in Reporting we have presented a series of issues that we hope will be of interest and worthy of debate. Please get in touch with your EY contact and we will continue the discussion.

FELICE PERSICO
Felice Persico is the Global Vice Chair, Assurance

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Chain reaction
New regulations to identify sources of conflict minerals have forced companies to ask tough questions of their supply chains

The quest for comparability
Leslie Seidman, former Chairman of the FASB, argues that, when it comes to global accounting standards, consistency is key

The poll
EY’s latest Global Fraud Survey reveals a degree of compliance fatigue and highlights the need for the board and senior management to set the tone from the top

Rewriting the revenue rules
The new converged revenue recognition standard has important implications for preparers – we explain the main points

5 things I’ve learned
Gordon Naylor, CFO of Melbourne-based biotechnology company CSL, shares five lessons from his successful career

The persuader
Ana de Pro, CFO of travel technology company Amadeus, talks us through her career to date and explains her approach to telling a company’s performance story

Executing growth
Why companies considering investment opportunities in Africa need to embrace the continent’s complexity and volatility

It’s all about results
We examine different ways of measuring and evaluating the ultimate value of a sponsorship deal

My wish list
Maurizio Lauri of UniCredit on the ways in which corporate governance and communication could be improved

The buy side
Those considering investing in Japan face a set of unique issues: Adrian Lim of Aberdeen Asset Management explains why it pays to do your homework

Why ethics matter
An ethical reputation is important for any company. We investigate what ethical behavior in business means and how you can measure and encourage it

... and more
Recent publications from EY, plus books that may be of interest
INFORMATION: CONFLICT MINERALS REPORTING

**Chain reaction**

New regulations designed to identify sources of conflict minerals have forced companies to evaluate their supply chains. As *Helen Gardiner* discovers, the results of the first year of reporting suggest that many companies underestimated how much work that would involve.

**Tantalum, tin, tungsten** and gold (often abbreviated to 3TG) are all essential in the manufacture of everything from laptops and smartphones to cars and aircraft. A significant proportion of these minerals originate from the Democratic Republic of the Congo (DRC), where more than five million people have died in the worst conflict since World War II and where militias, rebel groups and warlords use these “conflict minerals” to fund their activities by extorting money from mine owners and using forced labor.

In a bid to stop the trade in conflict minerals – and the associated human rights abuses – the US Congress has imposed a requirement on companies to trace the source of these minerals. This is intended to put pressure on supply chains and so reduce funding for armed groups in the DRC. As a result, the

“Companies are now having to reveal information about their supply chain that was previously proprietary business information”

Dr. Chris Bayer, Tulane University

US Securities and Exchange Commission (SEC) ruled that, under Section 1502 of the *Dodd-Frank Act*, reporting companies had to identify whether their products contained conflict minerals and establish how they are implementing due diligence in their supply chains before filing a report by 2 June 2014. (For more details of the requirements, see panel, p7.)
Dr. Chris Bayer, of the Payson Center for International Development at Tulane University in the US, has been studying the impact of the SEC ruling. “Conflict minerals reporting means that companies are now having to reveal information about their supply chain that was previously proprietary business information,” he says. “It can be a way of engaging with people across the organization and is a powerful tool for communicating your values and commitment to transparency,” says EY’s Mark Woodward.

In addition, a deep delve into the supply chain can help to identify cost efficiencies. The SEC ruling covers a range of sectors, including telecoms, medical technology, electronics and semiconductors. It includes not only minerals from the DRC, but also the nine countries that border it.

Dr. Bayer explains that industrial buyers face the challenge of telling the difference between legitimate minerals and minerals sourced amid conflict: “Affected industries are undergoing somewhat of an information revolution in order to comply with the regulation.”

The SEC ruling covers a range of sectors, including telecoms, medical technology, electronics and semiconductors. It includes not only minerals from the DRC, but also the nine countries that border it. Of those companies filing a Specialized Disclosure Report (Form SD), 85% were headquartered in North America, with the remainder being headquartered in Europe (10%), Asia-Pacific (3%) and other areas (2%).

According to John DeRose, Executive Director in EY’s Climate Change and Sustainability Services team, the number of companies filing reports was lower than expected. “The SEC was expecting that, in the first year of filing, about 6,000 companies would be impacted and around 4,500 would be required to file a report,” he says.

Most filers in this first year of reporting were unable to determine the origin of 3TG in their products and said they needed to carry out further due diligence. Many of these companies have complex supply chains and reported difficulties in tracing the origin of the 3TG in their products, given insufficient supplier responses to their inquiries; in many cases, suppliers did not respond to questionnaires or did not provide complete or adequate responses.

Of those reports that were submitted, only four companies obtained an independent private sector audit (IPSA) including the due diligence framework used and activities undertaken. The vast majority indicated that their reports were not subjected to an IPSA, as the rule provides a two-year transition period for those firms whose 3TG status is uncertain.
their supply chain. More than 85% of these filed an associated conflict minerals report, but it’s clear that most companies were not yet able to determine the origin of the conflict minerals in their products. More than 40% identified that at least some portion of their sourcing originates in the covered countries, but indicated that additional due diligence was necessary for some portion of their product components and suppliers. Most companies did not have sufficient information to trace the source of 3TG materials fully. About half were able to identify some portion of smelters as conflict-free and only 27% provided a list of smelters and refiners. (To read the full report, go to ey.com/lets-talk-governance.)

As Woodward says, “it takes a great deal of time and effort to do it thoroughly and trace components all the way through the supply chain back to a smelter. Many large, complex organizations deal with several hundred thousand suppliers, many of them supplying 3TG. In the vast majority of cases, there was no way an organization could cover all of them in the first year, so they had to identify the highest risks and engage with suppliers to persuade them to play a role in the process.” He adds that supplier relations are changing, though: “Companies are putting the onus on their suppliers to provide them with the necessary information, but suppliers are not always complying.”

For some companies, particularly those in the technology sector, conflict minerals reporting goes beyond mere compliance and has become an issue of corporate reputation. The technology industry is at the forefront of this movement, and the Electronic Industry Citizenship Coalition is working with a number of leading companies to eliminate conflict minerals from the industry.

**AN EVOLVING PROCESS**

The issue is certainly not going to go away. In March 2014, the European Union (EU) proposed voluntary rules to prevent European companies importing conflict minerals. EU Trade Commissioner Karel De Gucht said the proposal “is intended to complement Dodd-Frank by focusing on upstream users like EU importers and providing pressure points in different parts of the supply chain to ensure the scheme is used. What distinguishes our proposal from Dodd-Frank is essentially that the EU system is ‘voluntary,’ based on due diligence, whereas the US system is ‘enforceable’ by law.” The aim is to ensure that companies do not turn away from the DRC entirely, as that would have severe economic implications for its people.
As companies get to grips with conflict minerals reporting, DeRose says it will be interesting to see how that reporting, and the resulting increase in transparency, evolves. “There is currently a lot of speculation, which isn’t helpful, but I do think that companies will have to prepare for this on an ongoing basis rather than taking an ad hoc approach. The expectation is that this will be a continuous improvement process that will work its way through the supply chain.”

The SEC’s requirements are for disclosure only and there is no ban or penalty imposed on companies that continue to sell products containing conflict minerals. It is expected that a growing number of companies will begin to see conflict minerals reporting as not just a compliance issue, but as a way of building and protecting reputation as they face increased pressure from business customers, end consumers, shareholders, activists and NGOs to prove that the minerals they use are conflict free.

As those that have filed this year have discovered, it is a difficult and complex process to follow the trail through the supply chain, so it is vital that companies begin to address the issue fully as soon as possible.

For more insights on the first year of conflict minerals reporting, go to ey.com/lets-talk-governance.

How it works

In August 2012, as required under Section 1502 of the Dodd-Frank Act, the SEC issued a final rule on conflict minerals disclosure. This requires all reporting companies (including foreign issuers) to file a Form SD if they determine that conflict minerals – 3TG – are “necessary to the functionality or production” of products they have manufactured or contracted to be manufactured. The requirement has an impact on a range of industries, including aerospace, automotive, electronics, industrial equipment, telecoms, semiconductors, medical technology, metals and mining, oil and energy, cosmetics and luxury goods, and household appliances.

Companies in these industries must conduct a “reasonable country of origin” inquiry to determine if any of the 3TG materials originate in the DRC or the nine countries that border it – Uganda, Rwanda, Burundi, Tanzania, Zambia, Angola, Republic of the Congo, Central African Republic and South Sudan. A company must also file a conflict minerals report if it knows, or has reason to believe, the conflict minerals may have originated in the covered countries, and are not from recycled or scrap sources.

A conflict minerals report must show that a company has exercised due diligence on the source and chain of custody of conflict minerals. These due diligence measures must conform to a nationally or internationally recognized due diligence framework, such as the due diligence guidance approved by the Organization for Economic Co-operation and Development. Companies must also obtain an independent private sector audit once the transition period has passed – two years for large filers, four years for smaller ones.

The rule was challenged by several business groups, but in 2013, the District Court for the District of Columbia granted summary judgment in favor of the SEC. Additionally, in April 2014, the US Court of Appeals for the District of Columbia Circuit rejected the majority of the plaintiffs’ claims on appeal. The court determined, however, that the requirement to describe products as “not DRC conflict free” unconstitutionally affects free speech. As a result, the SEC issued guidance indicating that, for now, companies are not required to describe their products as “not DRC conflict free,” “DRC conflict undeterminable” or “DRC conflict free,” although they may voluntarily elect to do so.

Companies are required to file annually by 31 May for the prior calendar year, regardless of the timing of their fiscal year-end.
As with any area where views diverge, the process of setting global accounting standards is often accompanied by intense debate. Not only is this debate healthy, it is also an extremely important part of the process. Accounting is not a natural science, after all. Intelligent people can – and do – disagree about the best way to represent economic activity. So standard-setters make their judgments after listening to the views of a range of different parties about presenting financial information in a neutral, useful and comparable way.

For me, the standard-setting process should ultimately be guided by what investors will find useful and whether a certain accounting standard will enable companies to provide that information in a cost-effective manner. Investors are clear that consistency is what really matters when it comes to global accounting standards, argues Leslie F Seidman, former Chairman of the Financial Accounting Standards Board.
they want comparable financial information from preparers, which makes consistent accounting standards a logical starting point. But unfortunately, they do not always agree on the best way in which that financial information should be presented.

Over the past decade, the US Financial Accounting Standards Board (FASB), the International Accounting Standards Board (IASB) and other standard-setters have been working hard to achieve consistent global accounting standards. But this is more difficult than it might seem. Not only do different countries have different cultures and different perspectives on issues such as use of judgment and materiality, but they also have different regulatory regimes and different penalties for violations or infractions of accounting and other standards.

Furthermore, challenges come with trying to reconcile principle-based standards with rule-based standards. A broad principle with no supporting guidance simply won't work in certain jurisdictions. All of these factors can result in different ways of applying a standard, which can then lead to information that is not comparable. Meanwhile, many, if not most, jurisdictions still require preparers to apply local GAAP for statutory filings, tax and other purposes. So we are a long way off from using one set of standards for all forms of financial reporting.

For these reasons, I personally don't think it's critical that we have a single set of global standards that have been issued by one particular standard-setter. Instead, I think the goal should be to have comparable information, based on comparable standards and comparable approaches to auditing and enforcement. But even just achieving this will be challenging; we only need to reflect on the differences between the two boards on the controversial topics of financial instruments, insurance and leases to see that.

Nevertheless, the new, converged revenue recognition standard is a major accomplishment for the FASB and the IASB. It is a set of principles with a reasonable amount of interpretation guidance, and will significantly simplify the work of investors who analyze companies around the world. It will be interesting to see how different jurisdictions interpret the standard in future and how the system handles any diversity in interpretation. Following implementation, it will be important to review how consistently the standard is interpreted in practice, to see whether information from similar transactions, in different jurisdictions, does in fact end up being comparable. That is how we will be able to measure the success of the standard.

Looking into the future, I think it's important for the standard-setters to work together to complete the conceptual framework, especially in the areas of measurement, disclosure, and recognition and derecognition. But it is important to note that there appears to be a growing acceptance that some countries are not going to simply accept and endorse a standard if it is not suitable for their environment. Instead, they will modify it so that it is suitable for their jurisdiction.

Furthermore, accounting often affects sovereign policy matters and it is extremely difficult for different countries to agree completely on policy matters, as we've seen in many other areas, including regulation and contract law. So I think it's more productive to focus on the goal of comparable information with good coordination among rule-makers, auditors and regulators, rather than to only measure progress against an aspirational goal of a single set of standards.

“The views of third parties set out in this publication are not necessarily the views of the global organization or its member firms. Moreover, they should be seen in the context of the time they were made.
EY’s latest Global Fraud Survey suggests that compliance efforts are running out of steam and highlights the need for robust board oversight and senior management engagement to combat bribery and corruption.

EY’s 13th Global Fraud Survey, based on interviews with more than 2,700 executives across 59 countries, presents some disturbing trends. It suggests that the easy gains and quick wins for the compliance function in combating fraud have been secured, and further progress from here may be difficult for many companies. Indeed, for some, compliance fatigue may have already set in. Against this backdrop, it is vital that the board and senior management are seen to be leading anti-bribery and anti-corruption (ABAC) efforts.

Acting unethically
The survey shows the apparent willingness of executives to take risks when it comes to bribery and corruption. When asked which from a list of potentially unethical actions they felt justifiable to help a business survive, over a third chose at least one as being acceptable.

Leading in the wrong direction – willingness to act unethically

Q: Which, if any, of the following do you feel can be justified if they help a business survive an economic downturn?

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<thead>
<tr>
<th>Action</th>
<th>Total</th>
<th>C-suite</th>
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<tbody>
<tr>
<td>Offering entertainment to win or retain business</td>
<td>29%</td>
<td>35%</td>
</tr>
<tr>
<td>Personal gifts to win or retain business</td>
<td>14%</td>
<td>18%</td>
</tr>
<tr>
<td>Cash payments to win or retain business</td>
<td>13%</td>
<td>13%</td>
</tr>
<tr>
<td>At least one of these</td>
<td>36%</td>
<td>41%</td>
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Base: all respondents (2,719); C-suite (941)
According to our respondents, there has been no reduction in the perceived level of bribery and corruption since our last survey. In 40% of the countries we surveyed, more than half the respondents said corruption was widespread. Worryingly, one-fifth of respondents said that either their business still does not have an ABAC policy or that they do not know if there is a policy—a proportion that has changed little since our last survey. This is despite the numerous high-profile bribery and corruption prosecutions and new or more robust laws in many key markets. The C-suite may have insufficient awareness of the risks they face because of lack of training.

Respondents to the survey in both developed and emerging markets reported that the board is now less likely to receive regular updates on fraud, compliance allegations and investigations than two years ago. And with a smaller proportion of C-suite executives attending ABAC training than other employees, it would seem that the tone is not currently being set from the top.

**Boards receive fewer regular updates on fraud and corruption compared with two years ago**

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<tr>
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<th>C-suite 2014</th>
<th>C-suite 2012</th>
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<tr>
<td>Applies</td>
<td>65%</td>
<td>69%</td>
</tr>
<tr>
<td>Does not apply</td>
<td>26%</td>
<td>22%</td>
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**The C-suite attend proportionally less ABAC training than overall participants in the survey**

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<th></th>
<th>Total</th>
<th>C-suite</th>
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<tbody>
<tr>
<td>Yes</td>
<td>52%</td>
<td>61%</td>
</tr>
<tr>
<td>No</td>
<td>47%</td>
<td>38%</td>
</tr>
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</table>

**Q: Does your board receive regular updates on fraud and compliance allegations or investigations?**
Base: extended C-suite 2014 (824); extended C-suite 2012 (762)
The “don’t know” percentages have been omitted to allow better comparison between the responses given.

**Q: Have you attended ABAC training?**
Base: all respondents (2,719); C-suite (941)
The “don’t know” percentages have been omitted to allow better comparison between the responses given.
Compliance fatigue?
The survey shows that compliance efforts may be at risk of losing momentum and of not having the lasting impact that they need to have to protect organizations from the clear threats of fraud, bribery and corruption.

While boards often set a zero-tolerance tone and encourage management to build teams to address the risks of bribery and corruption, our experience tells us that ongoing oversight from the board is essential if the risks are to be more effectively mitigated.

It is not enough to launch a program and show support at the start. Ongoing and meaningful commitment is the key to driving positive behaviors across the organization. Boards need to challenge management appropriately regarding the quality and frequency of their risk assessments, particularly around new risks such as cyber fraud and cyber crime. Board members can push the company to foster better collaboration between legal, compliance and internal audit, and they should request regular updates from management regarding fraud, bribery and corruption risk.

For a copy of the full report, please go to ey.com/fids.

David Stulb, Global Leader of EY's Fraud Investigation & Dispute Services practice, comments:

“Our research suggests that there may be a persistent or residual level of inappropriate conduct that cannot be eradicated. That is not to say that companies and their stakeholders should simply accept such behavior – rather, companies need to uncover such conduct faster and focus on minimizing its impact on the business as much as possible. Companies also need to address the emerging external threats – such as cyber crime – which have the potential to cause significant reputational and financial damage.”
Revenue is one of the most important measures investors use to assess a company’s performance and its prospects. Understandably, then, it attracts the intense interest of standard-setters.

In particular, the issue of recognizing revenue from contracts with customers has preoccupied the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) for some time. Earlier this year, the two boards finally unveiled a new approach to this when they issued their long-awaited converged accounting standard.

The new standard will be included among International Financial Reporting Standards (IFRS) as IFRS 15, Revenue from Contracts with Customers. It will replace existing standards IAS 18, Revenue and IAS 11, Construction Contracts as well as their related interpretations. In the US, Accounting Standards Update 2014-09, Revenue from Contracts with Customers, will introduce the standard into the FASB’s Accounting Standards Codification as Topic 606 (ASC 606). The converged standard will apply to all contracts where goods or services are provided to customers, unless the contracts fall within the scope of other IFRS or US GAAP standards, such as the leasing literature.
“In future we will see various sectors redesign their contracts”
Peter Wollmert, EY

**BUSINESS IMPLICATIONS**
With the new standard, the IASB and FASB are aiming to enhance the quality and consistency of the way revenue is reported in different jurisdictions. They also want to improve comparability between the financial statements of those companies that report using IFRS and those using US GAAP. This means that, in future, companies may have to change the way they account for complex contracts that bundle goods and services together, such as mobile phone contracts that provide a free, or discounted, mobile device with a monthly service package.

Instead of treating the contract as a single service, as they may have done in the past, companies that have these contracts will need to break them down into different economic components known as “performance obligations.” Companies would estimate the total expected value of the contract (the “transaction price”) and allocate the transaction price to each performance obligation based on their estimated relative stand-alone selling price. The revenue associated with each performance obligation would be recognized when, or as, each obligation is satisfied.

**Case study: Microsoft**
Stacy Harrington, Director of Corporate Revenue Assurance at US software giant Microsoft, welcomes the converged standard. She says: “For industries like software, where we have very specific rules, we are going to get answers that better reflect the economics of our business, rather than having prescriptive rules that can lead to an accounting outcome that makes little sense.”

In particular, she approves of the fact that the rules will allow US companies to estimate the value of an outstanding component of a contract, and defer recognizing the revenue for it accordingly. “So if you have delivered 95% of the contract and software updates are a further 5%, you can defer 5% versus 100%,” she explains.

Harrington also approves of the fact that US-listed companies will need to apply more judgment under the new rules. She notes, though, that “it’s also something companies need to prepare for, because they may not have the people, processes and systems in place to deal with it.”

Work on assessing the impact of the new standard has already started at Microsoft, which has also begun enhancing its IT systems and documenting its revenue streams. “We offer lots of different services, so we need to make sure that we understand, by business line, the significant impacts as well as the impacts that people may not be thinking about,” says Harrington. “We’re training and educating the right people as we go through this evaluation process, and we’re participating in several benchmarking groups with other companies to make sure we can share best practice.”

As part of its preparation, Microsoft is also following and supporting the deliberations of the Joint Transition Resource Group, which the FASB and the IASB put together to consider issues that arise during the implementation of the new standard.

For companies in certain sectors, this could have far-reaching implications for their IT systems, their processes and even their business models. As a result, accounting teams will need to liaise closely with their colleagues in the IT, legal, marketing and sales functions in order to educate them on the need to prepare for, because they may not have the people, processes and systems in place to deal with it.

“Nobody needs to become a chartered accountant because of this,” says Ken Marshall, EY’s Financial Accounting Advisory Services (FAAS) Leader, Americas, “but they should certainly start to hear how these provisions will affect their business.”
When we work with clients implementing the new standard, we often see that the IFRS 15 issues can quickly consume management time," observes Daniel Feather from EY’s Capital Markets group in London. “So, to handle the IFRS 15 issues effectively, we advise companies to follow an implementation plan that progresses issues rapidly, but allows for flexibility and has good governance. Such an approach can pay significant dividends later on in the design and implementation phase of the program.”

The sectors that are most likely to be affected by the change are those that typically use complex or long-term contracts with their customers or those that earn royalties from granting licenses to use software or intellectual property such as patents. Telecommunications will probably feel a significant impact, because companies in this sector typically have a variety of arrangements with millions of retail customers. But there are also significant implications for the construction, oil and gas, pharmaceutical and technology industries. Not every company in these sectors will be affected by the changes, however, and those companies that are will not necessarily be affected in the same way as their peers. As Peter Wollmert, EY’s Global and EMEIA FAAS Leader, puts it: “It’s not one size fits all.”

**LEVELS OF GUIDANCE**

As well as adjusting to the actual changes in the way that revenue is accounted for, companies must also adapt to the different level of guidance that is provided under the principles-based standard. Preparers who use IFRS will now have more detailed guidance than they had in the past, while those who report under US GAAP will have less. But, while the pared-down guidance will require US-based preparers to use more judgment than before, it will help to address the existing complexity that surrounds revenue recognition. Almost 200 different pieces of guidance on revenue recognition have been issued in the US to date, and many use contradicting concepts. As a result, economically similar transactions sometimes yielded differing revenue recognition.

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**What can you do to prepare for IFRS 15/ASC 606?**

- **Make a start right now.** The standard is here to stay and adoption will come around sooner than you think.
- **Put a project team together to assess the impact of the standard.** The team should comprise individuals from the finance, IT, tax, legal, marketing and sales functions.
- **Carry out a diagnostic assessment of different income streams from across the organization in order to understand which changes need to be made to your systems, processes and business practices.**
- **Find out what additional data you need to collect in order to meet the new disclosure requirements.**
- **Decide which transition method you are going to follow – full retrospective or modified retrospective adoption.**
- **Draw up a project time line in order to identify what needs to be done when and by whom.**
- **Follow the discussions on implementation issues at industry forums or the IASB-FASB Joint Transition Resource Group.**
“Previously, there was limited application guidance for IFRS preparers,” explains Tracey Waring, Global IFRS Leader — Mining and Metals at EY. “Now there is a clear principle that can be applied to a range of transactions.”

The new standard also has lengthy disclosure rules that require companies to provide more useful information to users. These disclosures relate to the way in which contract assets, liabilities and revenue are presented, as well as the retrospective adoption measure chosen. Leo van der Tas, Global IFRS leader at EY, points out that the complexity of the additional disclosures required under the standard will create more work for accounting teams.

Arrangements with “variable consideration” will be a further test. These are the components of a contract that are not fixed in price, such as bonuses, incentives, rebates, returns and penalties. The standard requires companies to estimate the value of these components at the inception of the contract and then update them over time once more information is known. These estimates are also subject to a constraint in order to reduce the risk of having to recognize and then reverse revenue in subsequent periods.

**RETROSPECTIVE ADOPTION**

For IFRS preparers, the new standard is mandatory for annual periods beginning on or after 1 January 2017. Meanwhile, US GAAP preparers that are public benefit entities (as defined by the FASB) must adopt the standard for annual periods beginning after 15 December 2016. Early adoption is permitted for entities that report under IFRS, but not for public benefit entities that report under US GAAP.

IFRS 15/ASC 606 requires retrospective adoption, with preparers having the option of either a full retrospective or a modified retrospective approach to presenting their financial statements.

With full retrospective adoption, preparers would apply the provisions of IFRS 15/ASC 606 to each period presented in the financial statements (with some reliefs). Alternatively, with modified retrospective adoption, they would apply the standard to the most recent period presented in the financial statements and recognize the cumulative effect of initially applying IFRS 15/ASC 606 as an adjustment in the opening balance of retained earnings. If preparers use the modified retrospective approach, they would not need to restate their prior-year accounts, but they would need to make additional disclosures instead.

**TIME TO ACT**

There are many reasons why companies need to be thinking about the new standard now. “This is not just an accounting change,” says Christopher Bolash from EY’s FAAS practice in New York. “Something as significant as revenue has a pervasive effect throughout the organization. There may be accounting and finance function-related issues...”

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**Glossary of key terms**

**Contract** — an agreement between two or more parties that creates enforceable rights and obligations

**Performance obligation** — a promise in a contract with the customer to transfer goods or services (or a bundle of goods or services) to the customer

**Transaction price** — the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties

**Variable consideration** — a component of the transaction price that may vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items
such as systems and internal controls. But there may also be implications for business practices and compensation arrangements. Changes in measurement and timing of revenue recognition from a book accounting perspective could have a tax effect as well."

“The complexity of the standard might trigger changes in contract models,” Wollmert predicts. "Some companies are already looking at getting their contracts checked by their accounting teams because they want to avoid getting into a situation where they have uncontrolled revenue recognition.”

He continues: “In future, will there be a reduction in the different kinds of contracts that exist? That’s what I expect in certain industries. We will see simplification of the application of revenue recognition in practice and we will see various sectors redesign their contracts.”

To prepare for the new standard, Bolash recommends that companies assess a sample of contracts representing different revenue streams from across the organization. “If you collect the right samples and do the right analysis of the revenue streams, that will inform the rest of the implementation process,” he says. “Which processes and contracts should be redesigned? Which system changes need to be made? Can these be handled internally or are external resources required? What is your existing ERP vendor doing in response to the new standard? All those types of considerations will flow from what you learn from the diagnostic exercise.”

He adds that undertaking this diagnostic exercise will also help companies to decide whether to use the full retrospective or modified retrospective approach when transitioning to the new standard. This is a decision that needs to be taken sooner rather than later, as US companies that want to use the full retrospective approach may need to record transaction data relating to their contracts on a day-to-day basis from the start of January 2015.

Public companies that use US GAAP have to provide three years of income statements, in contrast to their peers that report under IFRS and typically just present two years of financial statements. As a result, US-based preparers are already ahead of their European counterparts in terms of planning for the new standard.

But Waring believes that IFRS preparers also need to act promptly, especially since they may be signing long-term contracts today that they will still be reporting on in 2017. “It may seem that 2017 is a long time away, but actually it isn’t,” she says, “and companies face a significant exercise to find out just what is required.”
Gordon Naylor brings skills honed during assignments in the US, the UK, Austria, Ireland and Switzerland to the boardroom of Melbourne-based CSL. Here, the global biotechnology firm’s CFO shares wisdom he has acquired in the course of his career.

**5 things I’ve learned**

1. **Work hard on communication**

   As CFOs, we need to be able to communicate information succinctly and accurately, and that can be hard work. Having said that, if you are under pressure from shareholders or other stakeholders to explain an issue, it’s easy to be stampeded into a poorly thought-through response, so take the time to be completely clear. That’s not because we are in the biotech industry; the same thing applies if you’re selling cement. I find it helps to use colorful metaphors to communicate complex messages succinctly.

   We’re a global, 24-hour-a-day company with executives in 27 countries. We could not operate without all the modern tools of communication. But it’s not just about the technological tools; these have to be backed up by the company’s global human network. We highly value interpersonal relationships within the company, and I’ve visited the general managers in every country in which we operate and spent time with them. It’s all about putting the work into a human context. If you’ve socialized with people, are on first-name terms and know a little of their personal lives, they’re no longer just names on an email.

Gordon Naylor became Chief Financial Officer of CSL in 2009 and is also responsible for the biotechnology firm’s global strategy and corporate development, as well as leading its Australian operations. A graduate of the University of Melbourne, with degrees in engineering and computer science, he later completed an MBA at Melbourne Business School. He started with CSL as a project engineer overseeing automation, electrical and process systems before being posted overseas. Immediately prior to his present position, he served as CSL’s Executive Vice President for Plasma, Supply Chain and Information Systems.
Be straightforward
I quite enjoy talking to shareholders because of the intellectual engagement with smart people. Again, that’s not because we are a science company; it’s more about the discipline of thinking quickly and clearly. It’s something that you can learn to a degree, but some people are never comfortable doing it.

I believe you have to be straightforward and consistent with the message, especially if you will be going back and presenting to the same people a year later. If you’re in this for the long run, then you have to depend on the fundamentals of science – which is especially important in our industry and needs to be explained clearly and without misleading anybody – as well as economics, logic and common sense. You cannot be swayed by management fads.

On the other side of the coin, it’s also important to stand your ground if you are being told something that does not make sense to you. Don’t hesitate to push back respectfully. That’s vital.

Keep your feet on the ground
We have had remarkable long-term success, but the challenge is to maintain that edge and not become arrogant.

When you’ve been in the same organization for a long time – as I have – it’s important not to become part of the problem. You have to be honest about emerging trends and your responses to them, about your competitors’ capabilities and your own capabilities. It would be a mistake to believe your own PR all the time.

Embrace differences
For a global company such as ours, there will always be variations in the way in which things are done in different places. There’s a tendency toward homogeneity and pretending that differences in culture and working style are not there, but I think it’s important to recognize our differences and celebrate them, sometimes with humor. Whenever I meet up with our staff in different parts of the world, I make a point of getting out of the office and into a more comfortable environment where comments and thoughts – and jokes – flow more freely. Diversity of background and perspective makes for richer debate and decision-making.

Take the long-term view
We have a very long investment cycle for both research and development and capital projects – often between 5 and 10 years – and the lives of the resulting assets normally run into decades. While we need to innovate and create new products for many years in the future, however, investors often only see this as an expense. It can be quite interesting to reconcile those two sides. It encourages us to think carefully in strategic terms and to make those investments for the long term.
In early 2011, Ana de Pro faced a challenge. As CFO of Amadeus IT Group, a technology company focused on the travel sector, she was keenly aware that the group needed to refinance its balance sheet — to the tune of €2.7b. The group produced healthy cash flows that had helped it pay down significant portions of debt accumulated during years of private equity ownership, before the company’s flotation in April 2010. But the remainder was now coming due.

The timing was far from ideal. The macroeconomic situation in Spain did not create the ideal backdrop for a corporate debt refinancing by a company headquartered in Madrid. Although Spain’s sovereign debt levels were below the European average, the borrowings on companies’ balance sheets were a worry: the International Monetary Fund estimated that total corporate debt for non-financial Spanish companies stood at about twice GDP and that a third of that was owned by companies struggling to cover interest payments with pre-tax earnings. Nor did corporate pre-tax earnings look likely to rise quickly: unemployment in Spain was at a 20-year high, and austerity measures meant to dampen rising interest rates on government debt had drawn angry protests — threatening still further an already weak economic recovery.
“It was challenging at that time to go to the market and ask for bonds,” de Pro admits. Her plan was to be as transparent as possible—a tactic whose value she had learned in previous roles as an investor relations (IR) specialist. “You know you have to provide enough information to the market so that they can understand your company and follow it,” she says. “You have to give KPIs that can be measured on a quarterly basis. You need to make management available so that the market can ask questions.”

Now she would be the one answering those questions—quite possibly tough ones, given the wider economic picture. She had a key weapon on her side: operating in 200 countries across the world, Amadeus was doing well. Revenues were stable and rising, thanks to a strong business model and geographical diversification. But communicating that would still be a challenge.

It was one that Amadeus surmounted. “We were very successful in explaining the business model,” de Pro reflects. The group secured €2.7b in senior unsecured credit facilities from a pool of nine banks—“less expensive and more flexible debt,” according to de Pro at the time. The deal included a bridge loan ahead of Amadeus going to the capital markets. Two months later, it issued €750m of bonds.

“That was a great example of going beyond the minimum requirements in terms of reporting,” says de Pro of the effort she made to persuade lenders of Amadeus’s health. “Taking those steps beyond really helped us.”

OPPORTUNITY KNOCKS

Twenty-five years earlier, de Pro had not imagined herself being at the center of a major corporate refinancing deal, working with banks and investors. A native of Madrid, she studied auditing and knew only that, after university, she would seek a job in that field. Other than that, she had no career “master plan.”

She got that first auditing job in 1990 at Arthur Andersen. From there, as she tells it, it was a matter of working hard enough so that opportunities came to her, and then seizing those opportunities. She began working with a client in the property sector, Metrovacesa, and when that company asked her to join their team, it seemed an easy and natural fit. Two years later she became Finance Director.

Her move into IR was unexpected, but looking back, it can be seen as a natural evolution. Metrovacesa’s CEO approached her about the additional role: “Our head of IR is leaving. You know the numbers, you speak good English—do you think you could take on this role?” At first, she wasn’t sure. Her career up to then had been all about the numbers, with a clear technical, auditing and control focus. But once she started work in her new role, she found she enjoyed helping outsiders understand the business.

That wasn’t to be the only instance of her being coaxed into an entirely new field. In 2002, she moved from Metrovacesa to a larger group, construction company Sacyr Vallehermoso, and was working there in IR when her Chairman...
approached her to take on a wider role as Director of Marketing. After all, if she could explain the company to investors, why couldn’t she explain it to a wider audience?

“At first I was unsure about it. I didn't feel that marketing was my area at all,” she recalls. She agreed to try it, though, and soon discovered there were specific methods and formulas in an area she had previously seen as driven primarily by opinion and instinct. “There are whole sets of techniques, rules and strategies behind everything done in marketing. I enjoyed that very much. But it was never a plan of mine to move from one business area to another in quite that way.”

BORDER CROSSING

As de Pro describes it, there is a clear thread linking auditing, IR and marketing. In each role, you're telling a story. That’s clearly the case for marketing and IR teams, less so perhaps for auditing. But as she explains: “We put the business into numbers and communicate those numbers to the world. I always think of ‘number crunching’ as taking a picture of the business, or as a translation.”

Her job involves translation in more ways than one. Amadeus was already an international concern at its birth in the late 1980s, when it was created by Air France, Iberia, Lufthansa and SAS to distribute their seats to travel agencies. By the time de Pro joined in 2010, it had embraced an international approach on a much larger scale. Today, the company serves airlines from five continents, has offices in 195 countries and derives its profits from a diverse portfolio of geographies. About 40% of the bookings made through its systems in the 2013 financial year came from Western Europe, just under a sixth each from North America, Asia, and the Middle East and Africa, and about 10% from Central and Eastern Europe. Latin America contributed around 7% to the total.

This diversity is what convinces investors that they are looking at a global group. It also presents challenges to the finance team. De Pro seeks balance between respect for local markets, local regulations and local ways of doing things and a “common layer” that makes not just consolidation of results possible, but also consistency when it comes to the finance department supporting other functions within the company, from payroll to marketing to sales.

It helps that, unlike in many other global companies, where each local office is filled with staff from that country, Amadeus has people from a wide range of backgrounds spread around the world. In the Madrid office, for example, 83 nationalities are represented. “We don’t all work the same way and it’s very enriching having different cultures and different teams working together to achieve the same objectives.”

A VALUABLE INTERNAL RESOURCE

When asked to name the biggest challenge of her career, de Pro doesn’t hesitate: it was getting to understand the travel and tourism sector when she joined Amadeus. She was attracted by the very fact that the job offered the chance to immerse herself in a new industry, but that didn’t stop it being a steep learning curve.

“None of the financial aspects differ much from one company to another,” she says. “But the knowledge of your own industry, the knowledge of your own business, your products, your services, your solutions, your strengths, is what makes you valuable and better able to serve the various business units.”

Having mastered all of this also makes her a valuable internal resource when it comes to devising the business’s strategy. She sees her team’s role as that of devil’s advocate, asking individuals or departments whether one investment is really going to deliver the revenues they anticipate, or if, on the other hand, another project is ambitious enough.
“The finance department always has to be the owner of the risk, to a certain extent,” she says. “The final purpose of the finance function is to make sure that you have the financial capability and soundness to ensure that the business can go ahead. We are the last link in the chain. We have to be clearly more than just an excellent transaction processing area. We have to be a customer-oriented service, even if our services are largely devoted to internal customers; we need strategic analysis capabilities, and if you do not understand the dynamics of an industry, you cannot provide an insightful opinion.”

In late 2013, de Pro’s finance team helped to execute the US$500m acquisition of US hotel reservations company Newmarket International. The acquisition is part of the group’s diversification into new markets in terms of products and services, not just geographies. Amadeus’s IT solutions division now provides technology not just to airlines, but also to airports, train operators and hotel booking companies.

KEEPING TIME
De Pro is a CFO who is as comfortable talking about overarching strategy as about net debt to EBITDA or shareholder payout ratios. But she remains the careful auditor at heart, mindful of the details. She considers that the most demanding part of her job is “making things right” – ensuring that work is done properly and, as importantly, in a timely fashion.

“In finance, you always have a deadline close to you: if it’s not the accounting closing, it’s the budget timing. If it’s not the forecasting timing, it’s the quarterly results presentation,” she says. It is, in her opinion, a bit like conducting an orchestra: every instrument has to play the right note at the right moment.

Does the stress get to her? She tries not to let it – less for her own sake than because she sees stress as deeply inefficient. “I’m a passionate person and I work intensely, but I try to keep the stress under control,” she says, and then adds with a laugh: “But that’s what we all say, isn’t it?”

ANA DE PRO: CV IN BRIEF
- Graduates in Business Studies from Universidad Complutense de Madrid, specializing in auditing
- Completes IESE Business School’s Programa de Dirección General executive program in 2000-01
- Joins Arthur Andersen as an auditor straight from university
- Moves to property group Metrovacesa in 1994, where she becomes Finance Director in 1996
- Moves to the construction company Sacyr Vallehermoso in 2002, working in corporate development, IR, marketing, e-business and communications
- Joins Amadeus as Finance Director in February 2010, two months before the company’s debut on the Madrid Stock Exchange
- In 2013, IR Magazine names Amadeus’s IR team the best in Spain, third best in Europe and sixth best worldwide
The perceived attractiveness of Africa as an investment destination, relative to other regions, has improved dramatically over the past few years. The continent has moved from third-from-last position in 2011 to become the second most attractive investment destination in the world, behind North America.

Sixty percent of those interviewed for *Executing growth: EY’s 2014 Africa attractiveness survey* said there had been an improvement in Africa’s investment attractiveness over the past year, up four percentage points from 2013. Only 17% believe that conditions have deteriorated. Despite this, in 2013, the number of new foreign direct investment (FDI) projects in Africa declined for the second consecutive year, by 3.1%. This was largely caused by the decline in North Africa, due to regional political uncertainty. More positively, the number of new FDI projects in sub-Saharan Africa (SSA) increased by 4.7% in 2013. Furthermore, Africa’s share of global FDI flows has been improving year on year. In 2013, this share reached 5.7% – its highest level in a decade.

Executing growth

Africa’s attractiveness to investors is steadily growing, with more and more companies embracing the continent’s uncertainty, complexity and volatility as they seek to grasp opportunities for growth.
KEY TRENDS
Three broad shifts identified in previous EY surveys continue to gain traction:

1. The SSA growth story has caught investor attention, with an increasing number of FDI projects being directed there. While South Africa remains the largest destination within SSA for FDI projects, a number of other countries, including Ghana, Nigeria, Kenya, Mozambique, Tanzania and Uganda, are becoming more prominent on investors’ radar.

2. Intra-regional investment is growing, encouraged by improving regional value chains and strengthening regional integration. The share of FDI projects in Africa with other African countries as their source reached 22.8% in 2013—an all-time high.

3. There is a change in sector focus from extractive to consumer-facing industries. Mining and metals, and coal, oil and natural gas have become less prominent as service- and consumer-related industries—particularly technology, media and telecommunications; retail and consumer products; and financial services—have increased in relative importance.

Africa’s cities are now emerging as hot spots of economic and investment activity. Transportation corridors and trade routes are being developed to connect these cities, transforming them into urban clusters large enough for consumer-facing companies to target. Survey respondents highlighted that, to attract greater investment, cities need to focus on critical factors such as infrastructure, consumer base, local labor cost and productivity, and a skilled workforce.

PERCEPTION GAP
While investor perceptions about Africa have improved dramatically, the rise in FDI numbers has been more modest. The most likely reason is an enduring perception gap. Those with an established business presence are more positive than ever about Africa’s prospects and have concrete action plans to generate growth there. But only 39% of investors not yet established in Africa believe its attractiveness has improved, and only 51% believe it will improve in the future.

Many potential investors continue to view the region as high risk, often based on perceptions that are 20 to 30 years out of date. Even for those who don’t share these views, Africa remains a complex and challenging environment in which to do business. From a risk perspective, many African markets are very similar to other rapid-growth markets, but there are key differences.

Foremost among these are the sheer scale and diversity of the continent, with 54 states spread across a land mass larger than Europe, the US, China and India combined. For most companies, few of Africa’s individual markets are likely to provide the kind of scale that makes them commercially attractive in isolation. As a result, most growth strategies in Africa must target multiple markets.

Overall, the continent offers abundant opportunities, coupled with many risks and challenges. Despite this, an increasing number of companies—both global and African-headquartered multinationals—are successfully growing in Africa. Fourteen of them—growth leaders investing in new opportunities, creating jobs and executing growth strategies in Africa—share their stories in the EY report.

To read Executing growth: EY’s 2014 Africa attractiveness survey, go to emergingmarkets.ey.com.
To help clients execute their growth strategy in Africa, EY has created a systemic model, the 7-P model. The starting point is purpose: why would you invest in this continent? If you start with a risk management mindset, you'll find lots of reasons not to invest. But if you start with the purpose that you're going to invest, then you can move on to recognizing the risks and managing them.

The common issues that any company considering investing in Africa has to consider are an infrastructure gap, the ability to tap into a skilled labor force, the regulatory environment and corruption, or perceived corruption.

Looking specifically at South Africa, people might be surprised to learn that it is rated number 1 out of 144 countries in the World Economic Forum's Global Competitiveness Index (GCI) in terms of the strength of its financial and auditing reporting standards. What's more, the country has won this accolade four years running.

In fact, South Africa was one of the first jurisdictions to adopt IFRS, and the majority of African countries have now followed suit or are planning to do so. IFRS removes one of the “barriers to entry,” in the sense that it gives you the ability to compare financial results across countries, whereas having to comply with local GAAP can create inconsistency.

Another of the pillars of the GCI is the efficacy of corporate boards. The question asked is: in your country, how would you characterize corporate governance? And no fewer than 11 of the top 50 countries are African. So the continent is heading in the right direction when it comes to corporate governance, and that removes another barrier to entry.

South Africa has been a trailblazer in this area, with integrated reporting being included in the King III corporate governance code, which has been a Johannesburg Stock Exchange listing requirement for 400 companies on an apply-or-explain basis since 2010. The Integrated Reporting Committee of South Africa plays a pivotal role in driving integrated reporting forward, and the involvement of bodies such as the Association for Savings & Investment South Africa, the Institute of Directors in Southern Africa and the Banking Association of South Africa is creating a strong collaboration between business and investors.
Corporations are embracing sponsorship in increasing numbers. Marketing consultancy IEG estimates that global expenditure on sponsorship has risen by 24% since 2009 and projects that US$55b will be spent on it in 2014, with 9 out of every 10 of those dollars going into sports sponsorship. In North America, the biggest market, sports sponsorship is leading entertainment, charitable causes and the arts in terms of growth rates.

Why the overwhelming appeal? Marketing professionals commonly cite the qualities associated with athletes, including courage, strength and dedication, as well as the breadth of the audience, which (depending on the sport) can span age groups, geographies, income levels, genders and races. Moreover, by drawing subtle parallels between idealized activities – whether that is sport, art or charity – and companies themselves, sponsorship can create an emotional connection with a brand. Indeed, the values of a sport can be integrated into the brand itself; for example, ‘Football – the beautiful game.’

With this comes an emotive element to sponsorship deals that finance directors may not have to contend with when making other funding decisions – say, whether to back an R&D project, an employee training scheme or an advertising campaign – where consideration of metrics such as return on investment (ROI) is paramount. Yet sponsorship often involves huge sums and commitments over many years, making rational evaluation all the more important. Research by US academics
Jonathan Jensen and Joe Cobbs found that only 1 in 10 sponsors of Formula 1 teams between 2006 and 2010 enjoyed a positive ROI as measured by televised brand exposure, despite spending stretching into the tens of millions. Part of the challenge is a dearth of accepted measurement tools. A 2013 report by the US Association of National Advertisers (ANA) found that only a fifth of companies were “very satisfied” or “completely satisfied” with their ability to assess the ROI of sponsorship activities, while 15% were “not at all satisfied” – twice the proportion that said this in the equivalent survey in 2010.

“Goals cited by clients include enhanced brand image, motivating employees and strengthened customer loyalty”

KEEPING SCORE
Rising dissatisfaction may be the result of growing awareness of the problem. There is still little agreement on how to evaluate sponsorship’s benefit to a company. Seventy percent of respondents to the ANA poll cited the quantity of media exposure generated by a sponsorship deal as one useful metric, but David Powell of Redmandarin, a London-based sponsorship consultancy, believes this is a circular argument. “Saying a sponsorship is successful because it delivered US$10m worth of media is like saying an advertising campaign is successful because you bought US$10m of media,” he says. “We talk about sponsorship as if getting a broadcast message out there is in some way a vindication.”

He agrees that sponsorship can provide value for money in terms of media exposure, but still believes that calculating that exposure and stopping there is a confused approach. Instead, he argues, sponsorship should be measured as part of the overall marketing mix, using longitudinal studies or controlled market tests to analyze the extent to which it adds incremental value – in terms of sales, say, or margin. This is a complicated process, particularly since sponsorship usually works across multiple media channels.

Ultimately, says Powell, “the business case should come back to tangible business metrics.” Of course, different companies – and different people within companies – may want very different things from sponsorship. Andrea Bertini, who works in Advisory Services for EY in Italy, has compiled a list of more than a dozen goals cited by clients, including enhanced brand image, motivating employees and strengthened customer loyalty. “Last, but not least – but also not first, and depending on the industry – there’s increasing sales,” says Bertini.

“We look at sponsorship like an investment,” says Powell. “You determine what it would cost to issue a bond for the money being put into the project and then ask whether you will get a return above that.” It is also essential to track the investment over time, making sure that assumptions about, say, the degree to which the brand will be enhanced are tested by actual measures, such as improved brand survey results. Loretta Lenzke, a Principal at EY in Chicago, says some clients, when speaking about multimillion-dollar sponsorship deals, maintain that a revenue increase during, or immediately after, a sponsored event isn’t something they demand or expect – so long as the intended impact on their brand is achieved, and can be validated by measurement.

THE VALUE CASE
How, then, to measure ROI? Richard Evans, a Director in EY Advisory Services and EY’s Major Events Leader, who is based in Qatar, factors in five elements when building the “value case” for any sponsorship:

► How well does it complement the company’s existing commercial and marketing strategy, and to what degree can that strategy help the team get the most from the sponsorship?
► To what extent does it create new business for the company, measured in qualitative and quantitative terms? By what factor will it boost revenues?
► Can it either attract new clients or demonstrate the company’s values and capabilities to existing clients?
Will the sponsorship develop the company’s brand in new or existing markets?

To what degree will the sponsorship develop the skills of the workforce and promote employee engagement?

A company deciding between multiple sponsorship opportunities (i.e., portfolio sponsorship evaluation) might give each sponsorship opportunity a relative score based on these five elements, and then map that against cost to sponsor as a way of identifying the best opportunity in terms of ROI, Evans explains. But he cautions against being too reductive when analyzing the results. “Measuring return can either be based upon too much qualitative information and not enough analytical, quantitative information, or it can be the opposite, with little qualitative information such as staff sentiment or client opinions,” he says.

It can also be important to recognize the value of certain elements of a sponsorship that help achieve a company’s aims but won’t turn up on a traditional balance sheet, or might get lost under “intangible assets.” In practical terms, this might mean companies embracing triple bottom-line reporting, where an operation’s impact on “people” (the communities in which it works) and “planet” (the environment) is assessed alongside the impact on profits. Some aspects of a sponsorship that boost the benefit score in Evans’ Return on Sponsorship Investment (RoSI) formula without having any significant positive impact on the bottom line could still be demonstratively valuable – and have a place in sustainability reports or integrated reporting.

"Beyond the balance sheet"

Andy Westlake, Chief Executive of sports and entertainment marketing agency Fast Track, believes the corporate world is increasingly aware of the potential of sponsorship to offer value beyond what is seen on an income statement. This is demonstrated by the rising numbers of sponsors attempting to engage with the community. “The grassroots elements of sponsorship deals 10 or 12 years ago were there because companies felt they ought to be there, but they weren’t genuinely executed or activated,” he says. “Nowadays, brands are putting more and more effort into making their partnerships in local communities feel like they have genuine credibility and depth.”

“Credibility” is a key word in a world populated by increasingly media-savvy and skeptical customers, and companies must stay alert to the danger that their activities will feel superficial, alienating the very stakeholders they are trying to appeal to. Here, says Shaun Whatling, CEO of Redmandarin, community involvement offers real solutions, particularly for staff who might feel alienated by sponsorships of prestigious events or big-name teams. “Rediscovering a commitment to community can often have greater resonance with employees,” he says.

For B2B organizations, that commitment, alongside environmental efforts, might also increase revenues in a tangible way: by giving them an advantage when bidding for government contracts, where boasting a strong triple bottom line can make your bid stand out against similar competitors.

"Getting the board on board"

Due to the public-facing nature of sponsorship, deals often require early backing from the C-suite and board, even if their financial value wouldn’t necessarily call for approval at senior level. The challenge, then, is keeping the boardroom engaged. Evans points to five checks to ensure the business case for a sponsorship holds, with each having a different “owner”:

- The CEO determines the solidity of the strategic case.
- The COO looks at whether the project is achievable or not.
- The head of the commercial or marketing department decides whether a sponsorship fits within the larger brand and marketing strategy.
- The CFO and COO work together to examine the investment case.
- They then examine whether cash flows will support the deal.
“The decision to sponsor is a joint decision across the C-suite, and so, wherever other key investment decisions are made within an organization, that’s where the decision to sponsor should be made,” Evans concludes.

He adds that, while deciding what effects of a sponsorship to measure will differ from one company to the next, the same pillars of valuation — business, clients, people, brand — hold across sectors and regions. “Return on Sponsorship Investment depends on what the firm wants from the sponsorship,” he says. “If it is increased revenue, then it should choose a sponsorship product that will target the appropriate client group. If the client is the general public … then the sponsorship product should be linked to the market segment their clients relate to and are exposed to.”

So, while professional sports dominate the sponsorship world, funding youth development leagues might better boost the “people” element of integrated reporting. Similarly, sponsorships of environmental or health projects might make sense for a company trying to attract future employees who value working for “ethical” employers. “No type of sponsorship is inherently better than another,” says Evans. “It is all about preparing a good business case for the investment and making sure it stands up to scrutiny.”

For the finance director, then, the ultimate value of a sponsorship deal to the company will not necessarily be reflected in the financial statements alone, but in a broader assessment of corporate impact.

2 www.ana.net/content/show/id/28377. Please note that the full white paper covering the survey results is only available to members of the ANA
INTEGRATING GOVERNANCE
There are many people involved in governance and oversight in a financial institution: the board of directors, internal and external auditors, compliance and risk management officers, and various committees. Each of these roles and governing bodies was created to solve a specific issue, and each pursues a specific agenda, but they are not integrated. The next step for governance is to integrate the activities of governing bodies and the flow of information between management and the governing bodies.

BUILDING AN APPROPRIATE RISK CULTURE
There was a period before 2008 when businesses took too many risks with too little forethought, and then we reached a point where they hardly took any risks at all. But risk is part of business and it provides reward. In the future, we must build a risk culture so that institutions can take appropriate risks, but with the capability to measure them.

“Boards generally get either too much or too little information”

It's not a question of avoiding all risk, but of constructing a culture that enables an organization to take risks it can manage and sustain. And this has to be done throughout the organization, which is no easy task.
A QUESTION OF APPETITE
Risk appetite is a crucial metric, and yet this is not clearly embedded in the strategies that firms communicate to stakeholders. For example, an oil exploration company that decides to look for oil 600m below the surface of the ocean will have a high appetite for risk. That’s not necessarily a good or bad thing, but the fact that there is risk must be established. It may be that a competitor doesn’t take those risks and, as a result, its returns are smaller but probably more sustainable. The difference between these two companies needs to be clear to anyone considering investing in them; it is important to communicate your appetite for risk.

ENSURE COMPLIANCE RUNS THROUGHOUT THE ORGANIZATION
If you consider how internal controls work, it’s essentially the case that one area of the business takes care of operations and another is in charge of compliance, creating a “silo” culture. But the silos will never function well, because each has a different set of objectives. If the company is constructed in such a way that operations and compliance are separate functions, it will fail: they have to work together. You need to establish a compliance culture in the business, and the only way to do that is to convince managers that taking compliance into consideration will enable them to do a better job.

IMPROVING THE QUALITY OF INFORMATION
Boards generally get either too much or too little information. The perfect way for a manager to transfer responsibility to the board is to write hundreds of pages without filtering any of the data. Once the board has been provided with all that information, it must decide what is important and act on it.

I don’t say this because I want to limit the responsibility of board members but because I want to foster responsibility all round. After providing hundreds of pages of information, if there is a problem, the manager can say, “I communicated everything; it’s not my fault.” But it is important to establish responsibility and values. The board should refuse to accept reports of more than 10 pages; that would require managers to decide for themselves what is important.

MORE USEFUL ANNUAL REPORTS
My biggest wish is to make financial reports more useful and concise. There’s a parable about a farmer who holds a contest to see who can most accurately guess the weight of a pig. One person wants to know what he’s feeding it, and the contestants decide it would only be fair if everyone had that information. Someone else analyzes the information, and that person is then assessed to make sure he is being honest and transparent. Then someone develops a logarithm to track the average of the guesses so far. Now you have someone controlling the information, someone assuring it is correct and another person analyzing it. At a certain point, they finally decide to weigh the pig – and the pig is dead.

Financial reporting is like that: auditing, double-checking, copywriting, more analyzing, risk assessment – but nobody reading and paying attention to the right things. A real evolution would be to act quickly and produce clear and accurate financial reports that are limited to 30 pages and can be understood by everyone.

Profile
Born and raised in Rome, 52-year-old Maurizio Lauri is Chairman of the Board of Statutory Auditors for UniCredit, Italy’s largest bank in terms of assets, stock market capitalization and employees. Educated at Rome’s LUISS University and at the London School of Economics in the UK, Lauri is a tax law expert and a certified accountant and auditor. His expertise includes not only the banking sector, but also energy production and distribution.
How Japan does business

ADRIAN LIM, SENIOR INVESTMENT MANAGER AT ABERDEEN ASSET MANAGEMENT, EXPLAINS HIS FIRM’S APPROACH TO THE UNIQUE ISSUES THAT FACE THOSE WHO ARE CONSIDERING INVESTING IN JAPAN

There are more than 3,600 listed companies in Japan, many of them – especially small and medium enterprises – under-researched, which means the premium on doing proper due diligence is all the greater. In Japan, as with other countries we invest in, we only make decisions based on our own research, and we prefer to visit companies and meet their management, where possible.

We rotate responsibility for company visits among team members so we can form a collective view and avoid individual biases. We visit companies on a rolling basis, even after a stock has been bought, and in 2013, we conducted more than 300 meetings with Japanese companies.

PROFILE
Adrian Lim is a Senior Investment Manager on the Asia-Pacific (formerly Japan) equity team and Senior Investment Manager on the Aberdeen Japan Investment Trust, which is listed on the London Stock Exchange. He originally joined Aberdeen in 2000 as a manager in private equity, on the acquisition of Murray Johnstone, but transferred to his current post soon afterwards. Previously, he worked for Arthur Andersen LLP as an Associate Director, advising clients on mergers and acquisitions in the region. He graduated with a BAcc from Nanyang Technological University, Singapore, and is a CFA Charterholder.
In Japan, the concept of how a company is run, and who it is run for, is profoundly different from Western models. Staff, suppliers, bankers and local communities are all seen as important stakeholders — not just shareholders.

The payment of a dividend can be a useful signal that the company has investor interests at heart. Start-ups tend not to pay out cash because they need it. More mature businesses will return cash to shareholders mainly when underlying cash flow is more than investment needs. The crucial thing about a dividend is how far it can be maintained. Payment of a dividend can represent a promise that good management will strive to keep.

Japan ranks quite low in governance tables, but its position is improving (see panel, page 35). Some multinational companies are leading the way by appointing external directors to their boards, although that is not yet mandatory.

In fairness to local companies, Japan’s institutional shareholders have been reluctant to exercise their rights. And in June 2014, 127 institutions signed up to the “Principles for Responsible Investment,” which potentially makes directors more accountable.

**WIDESPREAD OPPORTUNITIES**

The opportunities in Japan are widespread, but company-specific. We prefer leading-edge global names in fields such as autos and robotics, typically those with a strong global franchise and defendable margins. We do find opportunities domestically, especially in simple consumer businesses that are easy to understand and linked to strong trends (convenience stores, funeral parlors and so on). We tend to avoid cyclical and companies with unpredictable earnings.

We look for good company characteristics first — strong cash flow, solid balance sheets and products or services that are unique or differentiated so they can’t be easily copied. These characteristics apply equally to domestic or more international Japanese companies.

But companies don’t easily fall into predictable categories, and the idea, for example, that Japan has a large pure export sector is somewhat out of date. Nevertheless, some outsiders faithfully adhere to this idea; a weak yen tends to encourage foreign buying of the stock market on this mistaken basis.

The more salient point is that Japan’s companies have been incredibly adaptable, using automation and relocation offshore to lower break-even levels continually and boost productivity. The better-run companies are now very strong generators of cash, and business confidence (unlike consumer confidence) continues to improve. We are strong believers in our investments and less concerned about macro developments in general.

**ACTIVE, NOT ACTIVIST**

We do sometimes push for major change at the businesses in which we invest in order to realize shareholder value, but a distinction has to be made between being “active” and “activist.” We are active insofar as we don’t buy shares with a view to shaking up boards. Instead, we prefer to work with management where we can. Unfortunately, many Japanese companies have the security of big cross-shareholdings (hence small free floats), and most have “poison pills” in place to ward against unwanted takeovers.
Cross-shareholdings have been part of corporate Japan's landscape for decades. From a purist perspective, they are a bad use of a company's capital because they make earnings more volatile and tie up cash. Within any industry, they also reduce competition and are inefficient, because companies feel obliged to do business with their friendly owners rather than seek new suppliers.

In theory, a rising stock market should encourage companies to realize the value of cross-shareholdings. One major electronics manufacturer sold a portion of its cross-shareholdings in 2013, to pay down debt – though it did have stakes in more than 300 companies at one point.

Could other companies follow suit? We think it unlikely. But that hasn't deterred us. After investing in Japan for so many years, experience tells us that homework pays and you can make money.

Change is in the air
A number of recent developments promise to improve corporate governance in Japan in the near future:

• More than 100 institutional investors, both domestic and international, have signed up for a new stewardship code which commits them to monitor closely companies in which they invest and highlight any concerns.

• The Government is planning to introduce new corporate governance rules, with the most notable feature being the recommendation that companies have at least one independent director. Although this is a voluntary measure, companies that fail to comply will be asked to explain themselves.

• In early 2014, the Tokyo Stock Exchange introduced a new index, called the JPX-Nikkei 400, which is made up of companies that offer higher returns and better governance.
Why ethics matter

An ethical reputation is increasingly becoming a business asset, valued by customers and investors alike. Dan Atkinson and Tim Turner examine what constitutes ethical behavior in business and how it can be measured and encouraged.

It can take a company years to build a trusted brand, but only minutes to see that reputation ruined. In a world of social media and 24-hour television news, bad news travels fast and reputational damage can quickly reach crisis point. Companies value an ethical reputation for many reasons, not least the commercial advantage it brings. According to figures from the Institute of Business Ethics, companies with strong ethical commitments have historically outperformed the average. An index of the World's Most Ethical Companies showed that these organizations outperformed the S&P500 and FTSE 100 every year from 2005 to 2010.¹

Maryam Hussain of EY’s Fraud Investigation & Dispute Services (FIDS) team, author of Corporate Fraud: The Human Factor (Bloomsbury, 2014), confirms this. “There is evidence that customers want to buy from organizations they respect,” she says; “from companies that do respect the communities and environments in which they work, that care about the quality of their products and display openness when there is a problem.”

But are there really sufficient incentives for a business to behave ethically when its primary purpose is to pursue profit and return for shareholders? In considering this question, it is important to bear in mind that a company can lose...
“I think of it as asking: how do individuals in the organization make decisions?”
Maryam Hussain, EY

A sound ethical reputation helps recruitment, too, as it makes it easier to attract high-caliber employees.

Since the global financial crisis, the spotlight has been turned on the boardroom; tighter regulation and easy access to company reports and research mean that businesses are under constant scrutiny. The world is watching and there is an increased onus on businesses to behave ethically. But what does that actually mean?

SEEKING A DEFINITION
Applied Corporate Governance, a specialist in corporate governance training, defines business ethics as the “application of a moral code of conduct to the strategic and operational management of a business.” According to the Stanford University Encyclopedia of Philosophy, meanwhile, “business ethics is the applied ethics discipline that addresses the moral features of commercial activity.” But the difficulty of arriving at a universally agreed definition is laid bare in the ensuing caveat: “In practice, ... a dizzying array of projects is pursued under its rubric.”

These definitions refer to how companies should behave in the world of commerce and how their actions affect others. In practice, identifying an ethical business is not always straightforward, since the criteria are so hard to define. A 2013 survey of British adults by the Institute of Business Ethics found that the top three ethical issues they were concerned about were corporate tax avoidance, executive pay, and employees being able to speak out about a company’s wrongdoing. But this list can change at any time, depending on what is dominating the news headlines.

Hussain suggests it is more useful to talk in terms of principles followed than rules broken when defining an ethical organization. “I think of it as asking: how do individuals in the organization make decisions?” she says. “What are the principles by which the organization is run? Principles are always better than a myriad of laws and regulations. The world is fast changing, and it is not possible to have a set of rules covering all eventualities.” She adds that rules reduce individual responsibility by encouraging a box-ticking mentality.

Dov Seidman, Chief Executive of LRN, a company that helps build ethical corporate cultures, agrees that an ethical business is defined by its conduct and identity, which in itself differentiates and adds value. “We are in a world of almost instant copying, whether of business processes or of products,” he says. “But what cannot be copied is who you – the organization – are. That makes an ethical corporate character a valuable business asset.”

MEASURING ETHICAL PERFORMANCE
A significant threat to this corporate character is the phenomenon that psychologist Robert Sternberg has identified as “ethical drift” – a gradual, unconscious lowering of ethical standards within an organization.

The fact that ethical standards can fall without the leadership being aware of it shows how problematic it is to appraise, monitor and, ultimately, maintain ethical performance. There are more than 250 global and local index schemes that guide those looking to invest ethically; companies are assessed on their performance against a range of environmental, social and governance criteria, including their response to...
ethical issues that might arise in the course of their operations, such as corruption and fraud. There is, however, little consistency between these schemes. The Ethical Corporation website gives the example of two companies that, in September 2010, were simultaneously deleted from one of the best-known ethical business indices, the Dow Jones Sustainability Index, and added to another, the FTSE4Good.5

It could be concluded that ethical performance cannot be objectively measured, but Seidman disagrees. “They said the same about gauging quality — that American bosses instinctively knew when a car, for instance, was up to standard, that it couldn’t be measured. Then the Japanese showed that it could be measured, and today, quality is ‘job one.’ It’s the same with ethics and compliance.”

John Smart, EY’s UKI FIDS leader, agrees: “Business has sophisticated tools for dealing with commercial risks, but no business seems to have the tools or the technology for assessing integrity. Is it possible? It must be.”

Currently, the metrics available to companies to measure ethical behavior are fairly basic; they include whistle-blower hotlines, scores in business ethics training sessions and the results of compliance surveys. Many of these metrics measure the negative, i.e., unethical behavior, rather than positive aspects of performance. Nor are they absolute measures; an increase in the number of calls to a hotline may be due to internal training raising awareness of potential issues, rather than an actual rise in the number of issues. Surveys are also flawed, as Smart acknowledges: “People can work out what they are supposed to say. You need tools that go beyond that and into profiling.”

TAKING THE LEAD
Ultimately, the ethical performance of any organization is effectively the sum of the behavior of the individuals of which it is comprised. That behavior, in turn, is driven by belief systems, which is why the culture of a business is so important, and why it is key that the tone is set from the top.

Psychologist Sternberg certainly insists the onus is on leaders within a business to encourage a focus on ethics. He suggests that there are stages of reasoning all businesses have to go through in a given situation: recognizing that there is an event to react to, that it has an ethical dimension, and that it is serious enough to require an ethical response. It is then a case of establishing the ethical rules that apply — for example, by referring to the company’s values statement or charter. It is the responsibility of business leaders to ensure such a charter is in place and understood by all within the company. A clearly defined charter also makes it easier to measure outcomes and hold people to account.
Smart agrees that those at the top must lead by example. “If you see the person above you in the hierarchy doing something in one way, then you are more likely to do it in the same way,” he says. “Business needs to work out how to get that cascade effect in a positive way. I would characterize it as a question of business leadership; it has to come down from the board.”

One practical suggestion is for ethics to be woven into the daily routine. “On a building site, they start the day with a talk on health and safety,” says Chris Fordham, who leads EY’s FIDS team in Asia-Pacific. “A good company should be doing the same thing with compliance. It needs to be made clear that the culture of the organization says that doing it right is doing it well.”

MORE THAN ONE MODEL
It sometimes seems as if there is only one model for the ethical business – open, transparent, usually international. Could an insular, rather secretive, local company not be ethical?

Certainly, says Hussain: “You could have a company that operates in a very confidential way, either because of the type of work it does or simply because its culture is inward-facing. That company need be no less ethical than any other.”

Amid the lack of clarity over the definition, and measurement, of ethical behavior in business, Hussain suggests the key for any company is to focus on fundamental elements of its culture. “What matters are three things,” she concludes. “One, that there is a culture of integrity; two, that there is a culture of skepticism in which people are encouraged to escalate things that don’t look right; and three, that there is a culture of equal treatment in which the chief executive who appears to have crossed a line is treated in the same way as a junior employee.”

1 isbe.org.uk/EthicsFactsandFigures#sthash.PBa9t4vS.dpuf
2 http://plato.stanford.edu/entries/ethics-business/
3 ibe.org.uk/userassets/briefings/attitudes10yr2013.pdf
5 ethicalcorp.com/business-strategy/ethical-indices-how-do-you-measure-ethics
BRIDGING THE DIVIDE: HIGHLIGHTS FROM THE 2014 TAX RISK AND CONTROVERSY SURVEY

Earlier this year, EY published the first in a series of reports with actions to help businesses prepare for the tax hazards that must be overcome in order to navigate the current environment. Our latest survey of 830 tax and finance executives in 25 jurisdictions indicates that the tensions described in our previous reports are escalating.

ey.com/taxriskseries

EUROZONE FORECAST

The September 2014 edition of the forecast reports that the Eurozone recovery is expected to gain momentum gradually after disappointing near-stagnation in H1 2014. A new driver of the upturn will be investment, sustained by gradually improving external demand and enhanced competitiveness from a weaker euro. Further easing in bank credit conditions, together with stronger final demand, may give a lift to business lending.

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PERFORMANCE

This edition of the journal, Issue 6.3, explores trust, purpose, innovation and communication. Articles investigate topics such as the power of purpose for innovation and transformation, placing trust in the future of co-creation, and what drives awareness and success in a new media environment.

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On the shelf
New and recently published books

**The Reconnected Leader: An Executive’s Guide to Creating Responsible, Purposeful and Valuable Organizations**
by Norman Pickavance (Kogan Page, December 2014)

In the aftermath of the global financial crisis, trust in businesses and business leaders is at an all-time low. Pickavance argues that the solution lies with leaders, and draws on case studies from international organizations to prove his point. He invites readers to rediscover the true purpose of their business and find more innovative solutions that integrate the challenge of long-term societal needs and short-term financial results.

**Bitcoin: The Future of Money?**
by Dominic Frisby (Unbound, November 2014)

In 2008, a computer programmer called Satoshi Nakamoto registered a website – bitcoin.org. With it, a new form of electronic money was born. Frisby explains how this emerging global phenomenon works and considers its potential economic, political and social implications.

**The Shifts and the Shocks: What we've Learned – and Have Still to Learn – from the Financial Crisis**
by Martin Wolf (Allen Lane, September 2014)

Written by one of the world's most influential economic commentators, The Shifts and the Shocks identifies the origin of the financial crisis in the complex interaction between globalization, hugely destabilizing global imbalances and our dangerously fragile financial system. Wolf also examines what has been done to reform the financing and monetary systems, and argues that further crises seem certain.
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