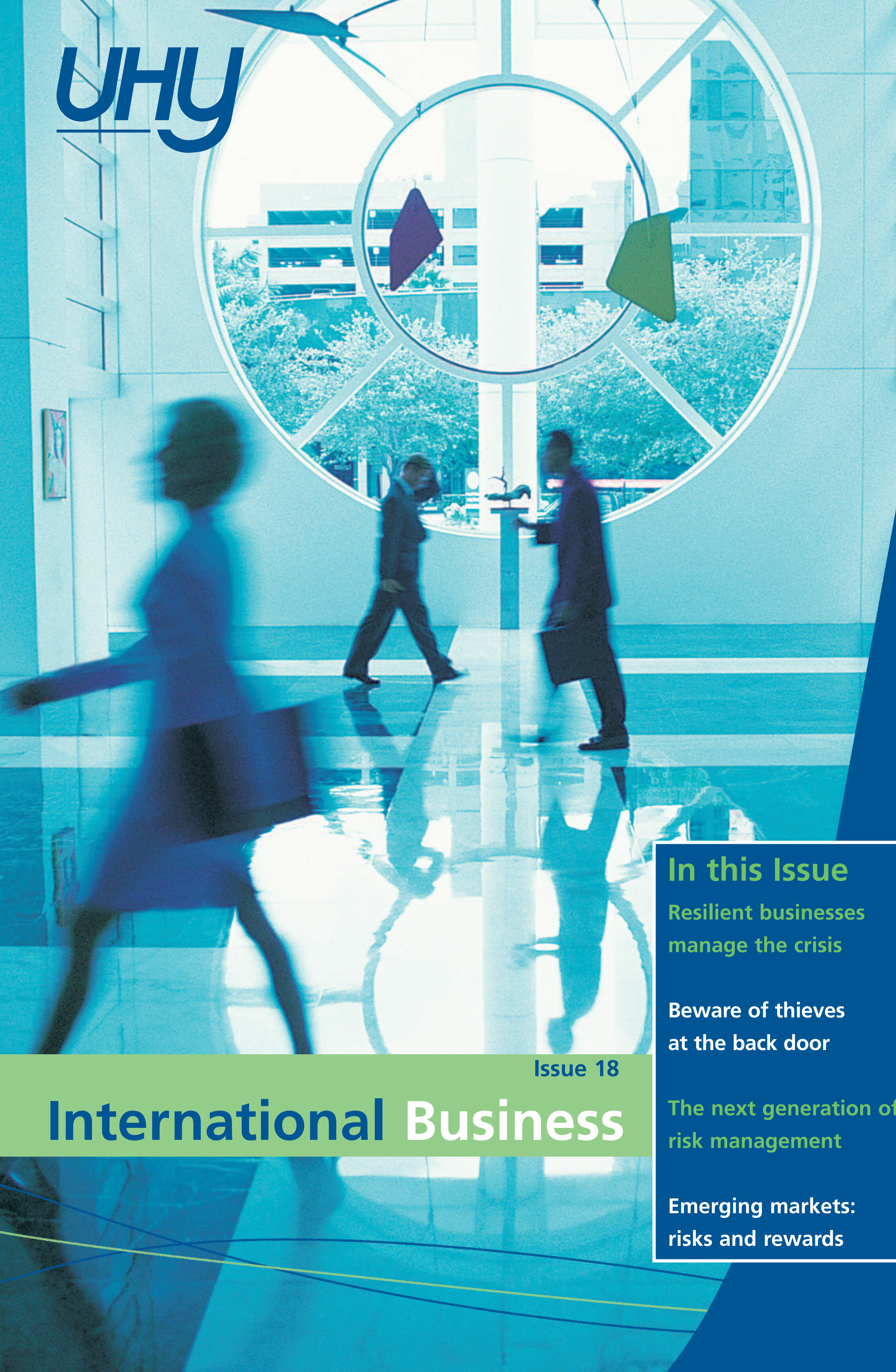

International Business

Issue 18

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Resilient businesses manage the crisis

Turbulence in the global financial market has damaged the well-being of smaller and mid-market companies – but many businesses remain upbeat and positive outcomes are also now being reported, according to global surveys.

The *UHY 2009 Business Outlook Survey* gauged the economic and business confidence of UHY business clients throughout the world and assessed to what extent – despite the credit crunch – clients see positive outcomes and opportunities.

Of the respondants, from all continents, 63% have turnovers of less than USD 10m; 15% have turnovers of USD 10-25m; 22% have turnovers of USD 25m and above.

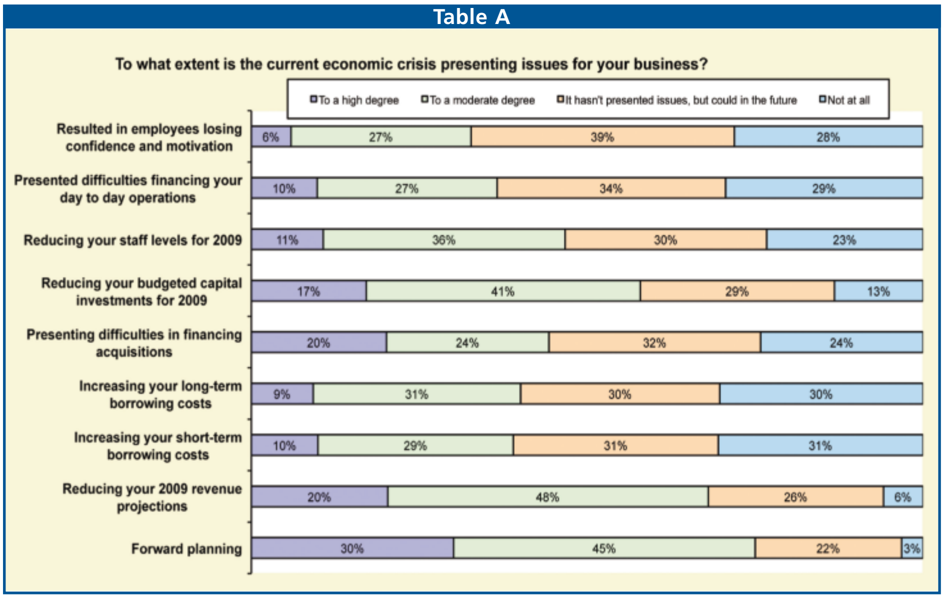
Many of the respondents are from business services (30%), finance (20%) and insurance (14%) but other responses are from agriculture, arts and entertainment, construction, energy, health care, hospitality, manufacturing, real estate and retail/wholesale sectors.

Affects on business

Respondents seem to be able to maintain current operations, however, their confidence in their ability to sustain their future plans for their businesses is reduced. Achieving revenue projections, maintaining current staff levels and funding capital expenditure and acquisitions all seem less likely in 2009 (see Table A).

Fifty per cent report no issue at present regarding access to operational finance, borrowing (short- or long-term) or staff motivation, although about a third of these respondents believe these measures may present issues for them in the future.

Table A



Indeed, overall, confidence in forward planning has been adversely affected – 75% report a high or moderate degree of affect. This level of uncertainty is having a negative affect on respondents' revenue projections. All but 6% confirm reductions in revenue forecasts.
When asked about their strategic activities, most (up to 71%) of respondents expect these activities to remain at current levels (see Table B).

But 22% of respondents expect to increase their level of international trade and business in 2009 (perhaps to compensate for reduced domestic opportunities). However, conversely, 27% expect to have less international business.

Outsourcing and off-shoring plans are set to increase for 10% of respondents but reduce for 18%.

Plans to expand into emerging markets overseas are being reconsidered – 31% of

Table B

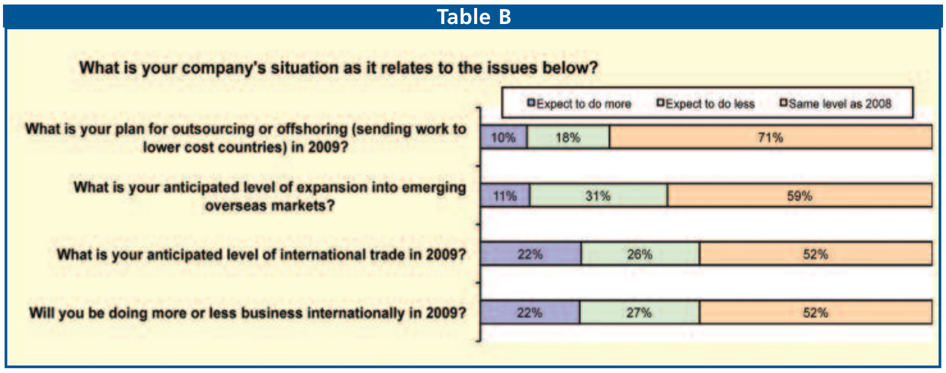
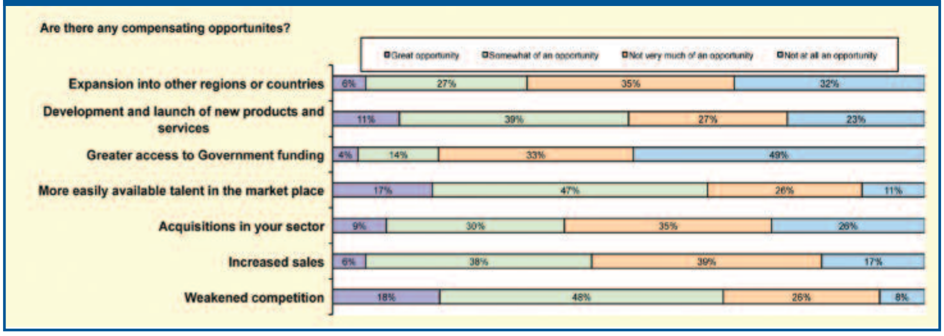


Table C



respondents expect to do less this year and only 11% say they expect to do more.

Compensating opportunities

More than 60% of respondents see two key compensating opportunities for their businesses given the current economic climate: weakened competition, and more easily available talent in the marketplace (see Table C).

To take advantage of these market conditions respondents are most likely to develop and launch new products or services and/or increase sales, however their plans around acquisition or expansion are less likely to be fulfilled.

Many respondents (51%) regard new product or service development as a great/somewhat opportunity, combined with a view from 44% of respondents that there are opportunities to increase sales, both of which are the key means by which some will take advantage of the diminishing competitive landscape.

However, increased sales are not necessarily expected to convert into increased revenues given the general view of reduced projections for 2009.

Acquisitions and expansion into other regions or countries are regarded by about a third of respondents as presenting opportunities; while about 65% see little or no opportunity.

Few (28%) regard greater access to Government funding as an opportunity for them.

Outlook for the future

Respondents have split views on when their country's economies will pick up:

- 5% believe it will do so in the next six months
- 31% in the second half of this year
- 26% in the first half of 2010
- 22% in the second half of 2010
- 12% in 2011
- 4% later still.

In a separate survey, by the UK's Institute of Chartered Accountants in England & Wales (ICAEW) – which received feedback from finance officers and directors in businesses of all sizes across four global regions – more than 80% of businesses are planning growth over the next two years, with businesses in Singapore and Malaysia by far the most optimistic.

Most respondents see the effects of the credit crunch lasting into late 2009, or possibly 2010. However, they say, this will be influenced by the scale of activity by investors and financial authorities. Far East businesses are the most optimistic about an early recovery – 40% anticipate recovery within a year, compared with only around a quarter in other regions.

The ICAEW survey details:

More opportunities for business acquisitions – Some businesses see benefit in weakened competitors and say the credit crunch has increased their opportunities for business acquisition;

Bigger cash balances – Businesses are now putting more focus on increasing their cash balances and reducing debt;

Sustained interest in cross-border business – Businesses continue to embrace globalisation: around 90% (outside the UK) are engaged globally, either through having customers or operations abroad, or through outsourcing. This compares with little more than 60% in the UK.

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UHY

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Whereas 60% of all survey respondents say the financial turmoil has had a negative effect on their businesses (of these, 15-20% say the effect has been very negative), their growth plans suggest an in-built resilience. For example, UK businesses (which, out of all regions, reported the most pessimistic growth expectations) have an average annual growth target of 12.4%, compared with 13.4% before the financial crisis began.

"Businesses know that the climate isn't going to improve in the short-term," says Clive Lewis, ICAEW head of small-medium business issues, "yet despite this, and after all they have had to respond to in the last 12 months, they remain focused on growth and profitability."

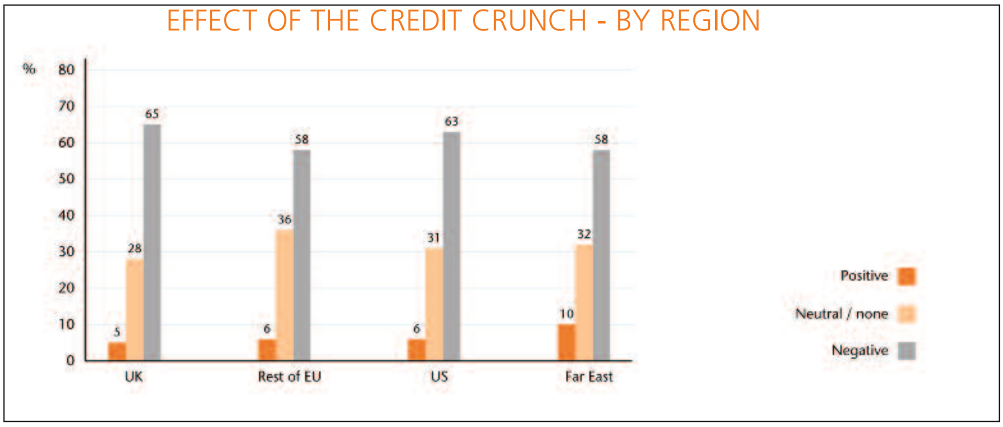
Despite fundamental optimism, respondents in all four regions identify significant barriers to international growth, says ICAEW.

The prominence of staff issues – deemed to be a significant barrier to international expansion – indicates that governments have to do more to improve skills if they are to make their countries an attractive location for inward investment.

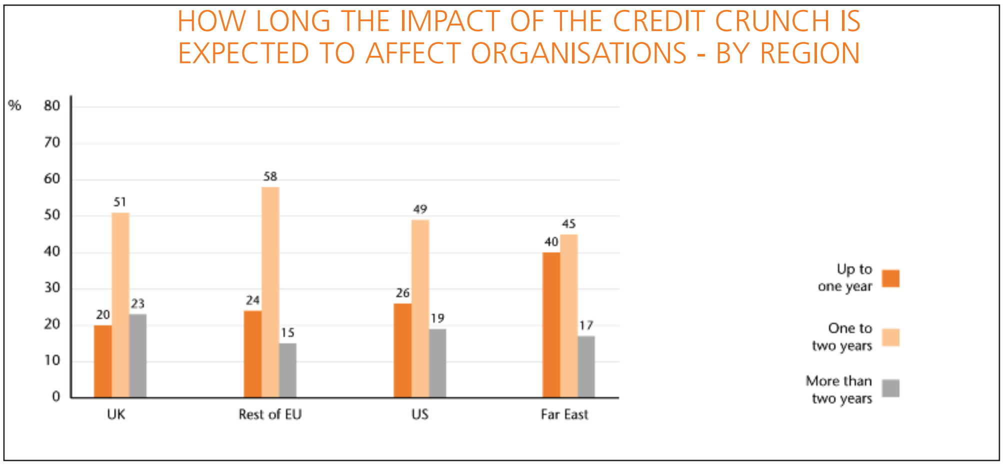
Many businesses, particularly in the Far East and the US, pinpoint the non-availability of specialist and technical skills, and the lack of exceptional leadership talent.

Other main barriers identified include 'corruption' and 'information on markets and competition'.

"These findings… suggest that politicians need to be mindful that international trade – a key driver of political and economic stability – will need help to continue to thrive," says ICAEW.



Charts from the ICAEW *Global Enterprise Survey Report 2008.*



Governments will also need to consider how to respond to concerns about the regulatory and tax environment in their countries. Just under half of businesses in the UK and in the continental European Union say that their regulatory and tax environment is business-friendly. This outcome contrasts with the US where 66% describe the environment as business-friendly and the Far East where 87% are of that opinion.

UHY chairman John Wolfgang says that from the survey results it is evident that many businesses remain upbeat despite the downturn in the global economy. "Managers see challenges ahead in terms of financing and cost-cutting through reducing staffing levels," he says. "Most companies do not predict an increase in sales but do not expect a massive contraction in sales either."

UHY's *2009 Business Outlook Survey* is available in full at: www.uhy.com

ICAEW's *Global Enterprise Survey Report 2008* is available in full at: icaew.com

Beware of thieves at the back door

By Jeffrey Harfenist and Frank Rudewicz, UHY Advisors, FLVS, Inc., US

Fraud occurs within companies of all sizes, every day, in good times and bad. But it is likely to increase during economic downturns as employees find it more difficult to pay bills or sustain excessive lifestyles, and companies focus more on big-picture problems than monitoring internal controls. Motive and opportunity tend to rise to the highest levels at times like these.

Theft is committed by people who are dishonest and by those under unusual pressure. They have access to corporate assets, or the accounting records and systems used to verify transactions and protect the company's assets.

While theft of physical assets occurs, financial fraud is significantly more dangerous. The process often requires a conspiracy and seeks to skim, undetected, very large sums from the company.

Fake vendors

One of the most common methods of siphoning payments from a company is the creation of artificial vendors. These vendors are either paid for work they do not perform, or overpaid for goods or services delivered. If the controls associated with the creation of vendors are not strictly enforced, opportunistic fraudsters will exploit this loophole to wrest huge sums from a company.

In one case, a very large international company became concerned that fraud was on the increase within its organisation. A UHY Advisors team in the US analysed all international operations and found significant 'red flags' within several operations, including its Latin American wing. With the help of UHY's Mexican firm, UHY Glassman Esquivel y Cía, the UHY Advisors team undertook a detailed analysis of the operation.

A very complex fraud was uncovered involving local mid-level management. Contracts were secured using inflated labour rates. Legitimate contractors were hired to do the work, but at less than half the quoted labour rates. Dummy contractors owned by the conspirators were formed and approved as vendors. False work orders and invoices were created so that it appeared some of the work was performed by these dummy contractors. The fake entities, of course, performed no services at all.

All of the contracts were completed on time and under budget. Management even received bonuses as a result. Meanwhile, a substantial amount of the expected costs were funnelled to fake contractors. It was suspected that bribes were paid from the dummy contractors to government officials to secure competitively bid contracts at lucrative rates.

Hundreds of thousands of dollars were fraudulently misappropriated through this scheme. Even more importantly, the company could face criminal exposure for the actions of its local division.

A simple review of the books and records of the company would find nothing unusual. Once the dummy vendors were approved, the internal controls systems did not detect a problem. It took a deeper forensic review to identify the 'red flags' and a thorough investigation to apprehend the perpetrators.

Financial statement fraud

In addition to the creation of fraudulent vendors, there are many ways to manipulate financial statements to cause a company to voluntarily pay cash to conspirators: the creation of fake invoices from legitimate vendors; many small payments under control limits; one-time consulting contracts approved by an authorised manager; payments from petty cash; expenses reimbursed without supporting documents, or with fake supporting documents; and profit manipulation to secure large bonus payments.

Someone within the financial office will be involved. Occasionally, he or she will work alone, but just as often there is an accomplice in another part of the company, in a vendor or customer, or within upper management. In each case the conspirators have found a hole in internal controls to exploit.

Uncovering fraud

As companies struggle to remain in business, attention must not stray from enforcement of internal controls. An individual's personality dictates whether he or she will commit fraud. Opportunity opens the door, pressure and rationalisation draw one toward it; but the individual must

Continued overleaf

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recognise the opportunity and take advantage of it. Sometimes notice of internal controls, and a clear effort to enforce them, can interrupt and even end such thoughts.

Early detection of fraud is critical. Automated electronic data mining processes are invaluable tools in uncovering fraud. These systems highlight anomalies within the company's transactions: sequential payments to the same vendor: immediate payment to a new vendor; establishment of a vendor with the same address as an employee; payments made on shorter terms than normal; etc. While many of these may be legitimate, they are 'red flag' areas to be reviewed.

Performing background investigations into key employees can uncover revealing changes in circumstance. Changes in behaviour, attitude or activities can be an indicator. Rumours often have significant truth to them. An alert and diligent management team can help prevent or uncover fraud.

Rapid response

Once fraud is suspected, concerns should be held in the strictest confidence and action should be immediate. Most incriminating data is stored electronically and can be easily deleted at the first hint of an investigation. Digital forensics can often recover deleted data and trace copied data. In all cases, however, time is the enemy. The longer the period from deletion to investigation, the greater the likelihood that the information is lost forever.

Conclusion

Fraud is probably happening in your organisation. Hopefully, it is of the very petty variety. But as you fight for every penny at the front end in a downturn economy, be wary that some of it may be leaving by the back door.

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The next generation of risk management

Nearly a decade ago, Sarbanes-Oxley (SOX) legislation was hailed in the US as a corporate saviour. It fundamentally changed the way companies and subsidiaries abroad handled their financial reporting in a bid to reduce fraud and increase transparency.

Become SOX-compliant and all would be well, so went the mantra.

But Freddie Mac, Fannie Mae, AIG and Lehman Brothers were all SOX compliant. And in the global economic downturn it didn't take long for US boardrooms to realise that SOX didn't go far enough – that more was needed than statutory regulation alone.

Today, the SOX foundation is yielding to the next generation of risk management that transcends financial reporting or regulatory compliance – and this will apply just as much internationally as it will in the US – at a level never dreamed of before.

"We're entering the era of governance, risk and compliance (GRC), in which companies are empowered by robust software to monitor activities throughout their organisations; to not only assure that things aren't being done wrong, but that the right things are being executed," says managing director Norman Comstock, of UHY Advisors, UHY's firm in the US.

"For the first time in our business careers, management has the ability to create a virtual 'crystal ball' that enables them, using simple but powerful dashboards, to get a view of a company's operations at every level – and, more importantly, to examine the interdependencies within the organisation in real time."

Chief information officers and other risk-minded professionals may feel they have been alerting boardrooms to risk for quite some while without making much impact.

Directors have understood about mitigating risk from regulatory non-compliance, lack of uniform processes for work delivery, and other metrics related to strategic execution. But risks associated with corporate governance – an integrated control over actions and ethics, the paucity of which may have led to the downfall of hitherto untouchable financial services brands – may have eluded them: till now.

Integrated risk control

An effective GRC programme is the convergence of three areas – people, processes and systems. Technology alone is not a GRC panacea, although often it is the most easily managed. Numerous software packages can be added to an existing system, or provide a standalone solution.

The process aspect is more difficult to manage because many GRC capabilities as promoted, for example, by the Open Compliance and Ethics Group (www.oceg.org – a Phoenix, US-based, not-for-profit body promoting corporate governance, risk management, compliance and culture) – are missing from corporate life. Business consultants like UHY can help plug the gaps.

Norman Comstock,
UHY Advisors, US.

That leaves the most difficult aspect of an effective GRC programme – people, especially those at the top of an organisation who need straight talk and patient guidance, says Norman Comstock. Active endorsement of a GRC programme at a high level is vital.

Without the top setting the tone as a true believer in the protective and strategic benefits of a GRC programme, even if you're given the go-ahead to implement a programme, its propensity for failure is magnified.

GRC first steps

First-step tips on setting up a GRC programme are:

Make it real

Identifying your own risk gaps is the most compelling evidence of the need within your organisation. More than industry peers' adoption, or seemingly unrelated risk breaches that have been publicised, centering the GRC conversation on your company's risks, vulnerabilities and lack of ownership is a far more compelling way to convince management of the strategic and executable value of a GRC programme.

Do your homework on companies with whom you share board members

"A CRO [chief risk officer] client of mine was able to find a friend in the boardroom by doing some homework," says Norman Comstock. "He knew that a certain board member also sat on the board of a company in another sector who had recently adopted a GRC programme. He sought advice from this board member on how the other company viewed GRC, as well as the operational and communications issues it had to overcome. Not only did the CRO gain true insight, but during the process he was able find an ally in the boardroom."

Find friends in operations

A GRC programme, by its nature, is a 'silo-killer'. The end result will be a seamless, real time view of the company. So it stands to reason that an initial approach to GRC should be multi-faceted as well. Inclusion of those in operations, sales, marketing – in addition to the usual early adopters in finance and risk management – will assure a more streamlined adoption later in the process.

Set a time budget and double it

"Adoption and sell-through is tough," says Norman Comstock. "After conceptual approval, training and education of management is the typical first step. Given shifting priorities, travel schedules and some latent resistance in various corners of the organisation, the first stage takes longer than you think it should.

"But based on my experience, once that phase is completed, the true implementation is easier to keep on a reasonable timetable."

Dr James Flagg, accounting professor at Texas A&M University, who serves on three corporate boards, says that GRC is the foundation on which directors should ensure they protect shareholder value. "It's not just on the radar screen – it is the screen," he says.

"It's how you measure the corporation's integrity, so you don't lose the confidence of the shareholders. If the board is not involved with changes in core strategy, then there's a lack of trust. Ultimately, that intangible – trust – is what makes governance, risk and compliance work within an organisation.

"Understanding risk should be a company-wide task," he says. "Every board needs to be aware of risk, and stress its importance to management, because when it becomes important to management, it becomes important to the employees."

'Opportunity risks'

But, nowadays, more and more companies are not just looking backwards in terms of financial reporting, but looking forwards at 'opportunity risks' as well. "We all think of risks as the bad things that can happen," says James Flagg, "but that's evolving to maximising the good things… that's part of the discussion. Boards talk about new business, new opportunities, and the risks associated with not doing it.

"GRC will become more entrenched… like SOX has become [in the US] over the past several years," he says. "It will make more and more sense for companies to have programmes to allow them to focus on all areas that may impair them from achieving the desired results."

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Emerging markets: risks and rewards

The growing status of some emerging markets in the new economic world order is one of the few positive outcomes of the global financial turmoil.

No longer can Western nations of the G8 assume complete control: no longer can they go it alone in their bid for global financial stability.

They've had to cede at least some power to countries such as Brazil, India and China in the wider G20 community.

And other nations, such as Vietnam and parts of the African continent, are beginning to gain economic influence.

Some economists are even beginning to question whether China, and possibly Brazil, should be described as 'emerging' for much longer: they've almost emerged.

After all, China is poised to have more impact on the world over the next 20 years than any other country. If current trends persist, by 2025 China will have the world's second largest economy and will be a leading military power. It also could be the largest importer of natural resources (and the biggest polluter), according to *Global Trends 2025: A Transformed World*, by the US National Intelligence Council, published in November 2008.

And investments in Brazil look less risky during 2009 than in some developed countries, such as the UK, where recession is now biting. In terms of its trade surplus, indebtness as a proportion of gross domestic product, and the size of its foreign exchange reserves, Brazil beats the UK hands down. Brazil's economy is expected to grow at 3% next year, while the UK's is shrinking.

Basic recommended steps for expanding into emerging markets are:

- Establish a presence through cautious entry
- Consolidate it through organic growth to get to know the market
- Expand through acquisition if returns look promising.

Market entrants will need to consider:

- What structure should I adopt in my chosen destination?
- Which of the structures available to me best meets my business needs?
- What are the start-up issues?
- What operating restrictions may apply?
- What structure could I migrate to in the future?
- Can I open branches later?
- How could I take over an existing business?
- What should I do with my existing representative office?

The US National Intelligence Council also predicts that the recession, hitting the US and Europe, is not just a cyclical downturn but marks a long-term shift of economic power towards China and other 'emerging' markets – partly as a result of demographic trends, such as the ageing of a baby-boom generation, making it likely that consumption will not rebound to previous levels.

In the short-term, emerging markets haven't looked promising as investors, seeking to reduce risk, have piled out of them. Furthermore, when liquidity dries up, less actively traded markets are expected to suffer.

However, while developed markets struggle to shrug off recession, emerging markets will start to seem more desirable, say economists: so it is little wonder that investors are reported to be bullish about the medium-term outlook for emerging economies.

Foreign direct investment (FDI) – which reached record levels, worth USD 1.5 trillion in 2007 – has been dampened temporarily. But, according to a survey of world investment prospects in 82 leading FDI recipient countries by the Economist Intelligence Unit (EIU), a world leader in global business intelligence, FDI growth will resume steadily during 2009-2011, with China forecast to remain by far the biggest recipient of FDI inflows during 2007-2011 (attracting 16% of projected inflows into emerging markets).

That underlying trend – providing an encouraging backdrop to companies, medium-size or multinational alike, looking to take advantage of emerging markets – is reflected in our own experience. By far the majority of client companies expanding abroad report strong rewards, exceeding their expectations, as well as boosted returns in their respective home markets.

If you would like to examine more closely opportunities to develop business internationally, email us initially at: info@uhy.com and we will put you in contact with one of our business advisors most suited to your requirements.

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