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INTERNATIONAL

International Business

Issue 7

Global compliance

How will the Sarbanes-Oxley Act be implemented around the world? International Business assesses possible pitfalls

The Sarbanes-Oxley Act (SOX) is expected to have a significant impact on corporate governance and the accounting profession throughout the world. The Act applies to companies registered with the US Securities Exchange Commission (SEC), while the Public Company Accounting Oversight Board (PCAOB) has jurisdiction over those firms and accountants that provide services to registered companies.

In our global economy many of these registrants and firms are not US based, resulting in concern as to how the new regulations can be implemented internationally, while respecting national sovereignties. There are also important corporate governance issues for private companies, governments and non-profit organisations, which are not covered by SOX but which may be regulated by other agencies or jurisdictions.

The SEC issued final regulations relating to auditor independence in January 2003. Issues that are of concern internationally include:

- The requirement to make papers available for the PCAOB's inspection, which may violate confidentiality laws in many countries.
- The convergence of principle-based international accounting and auditing standards is proposed for adoption throughout Europe by 2005. It is currently unclear which direction the PCAOB will take on this.
- There are multiple requirements for inspection and oversight by several regulators without co-ordination or co-operation, leading to prohibitive costs of compliance.

Graham Ward, a past president of the Institute of Chartered Accountants in England and Wales, says, "Global investor confidence can arise only from a standard-setting process that is genuinely global and participative rather than imperially imposed from afar… regulation without consultation… is likely to lead to conflicts between local requirements and those imposed from afar and to duplication of effort, resulting in extra costs and a wasteful misuse of management time."

At the time of writing, the PCAOB is discussing the registration of oversight of non-US public accounting firms. We can expect continuing dialogue before all foreign firms register with the PCAOB by April 2004.

As both companies and accountants work towards regaining and improving public confidence in financial reporting there will undoubtedly be further movement at an international level to push towards the convergence of global standards in financial reporting and monitoring of corporate compliance. UHY member firms have significant resources to help companies comply with the new requirements.

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SOX requirements

Many of the key provisions of SOX are directed towards the improvement of corporate governance and focus on the responsibilities of Boards of Directors and management. These include:

Independent audit committees

Audit committee members must be members of the Board and shall not receive any fee other than for service on the Board. The committee will be responsible for appointment, compensation and oversight of the work of any public accounting firm providing services to the company.

Financial reports

The CEO and CFO of each registrant must certify the appropriateness of the financial statements and disclosures. There are significant penalties for intentional violation of this requirement.

Officers and directors

SOX makes it illegal for any officer or director to fraudulently influence, coerce, manipulate or mislead any auditor in the performance of an audit.

Insider trades

The purchase or sale of stock by officers, directors or other insiders is prohibited during pension fund black-out periods.

Enhanced disclosures

Financial statements must disclose all material off-balance sheet transactions, relationships with unconsolidated entities and other related parties.

Assessment of internal controls

Each report by a registrant must contain an 'internal control report' which recognises management's responsibility for establishing and maintaining adequate internal control structures and procedures for financial reporting. It must also contain an assessment of the effectiveness of these controls. The auditor will provide assurance on this report in accordance with current standards for attestation.

Management assessment of internal controls has several interrelated components including control environment, risk assessment, control activities, information, communication and monitoring.

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Protecting identity

Jeffrey Zalusky looks at how to prevent identity fraud and the theft of data via the internet

A single unexplained charge on your credit card bill could be the beginning of identity theft. Or it could take the form of a systematic programme to extract and reassemble vital pieces of private, personal information about you over a period of weeks or months in order to strip away your effective existence as an individual.

In January the US Federal Trade Commission (FTC) published its annual list of consumer complaints. Once again, identity theft topped the list, accounting for 43% of the complaints in the FTC's Consumer Sentinel database. The number of complaints about fraud jumped from 220,000 in 2001 to 380,000 in 2002, and the losses consumers attributed to fraud grew from $160 million in 2001 to $343 million in 2002.

More worrying than this rise in reported cases is the increasing ease of access to large amounts of personal information that can be directly or indirectly used for criminal purposes. While fraudulent impersonation is a crime as old as recorded history, the ability to steal personal information has been made both easier and more anonymous by the internet.

The real threat

Following the events of 11 September, there was a public outcry in the US for some form of universal identifier to help law enforcement agents track the comings and goings of individuals ‘of interest’. But this poses an increasing risk that it will become even easier to link multiple sources of personal information, residing in commercial databases of all kinds worldwide, to create even more sophisticated, difficult-to-trace forms of identity-related fraud.

The real threat is not how identity theft takes place, but what the recipient is able to do with the information, and how much it costs, in time and money to repair the damage. The US General Accounting Office estimates that it can cost from $200 to $800 and months of effort for an individual to restore his or her own creditworthiness after a breach. The costs of a police investigation into each such instance can range from $11,500 to $20,000, making it unlikely that such investigations will reach a sufficient value threshold to be pursued.

There are a few common-sense practices that individuals can follow to protect their identity. There are also a number of resources available to help those who have been victimised by identity thieves. Firstly, keep track of your own ‘identifiers’. This includes credit card numbers and any common numbers that could be used to link database files and financial instruments.

In the US, the social security number serves this role; while other countries have other official (and unofficial) national ID numbers either in place or planned. The key is to be aware of where and for what your identifiers are used, and to learn about the privacy practices of the organisations using them (see box for further information).

Public and private organisations, including governments, bear a special additional responsibility for safeguarding identifiers. This has become even more important today with the open door that electronic commerce has created. In May, the popular auction service eBay was targeted by fraudsters. The scams included phony escrow services and password ‘verification forms’ that were cleverly interposed into eBay's bidding and payment system to lure legitimate bidders offsite to complete transactions that were both fraudulent and difficult to track down. The activity was only discovered when legitimate buyers either did not receive the merchandise they ordered, or found unexplained charges associated with payment information provided online.

At risk, of course, is the reputation of a legitimate business (eBay) and its ability to serve its customers in a safe and secure manner. Even one breach could lead to ruin – many countries have laws requiring that all customers of a bank or other company be notified in the event of an unauthorised disclosure of personal information.

Limiting the risk

Public entities such as universities are also at risk, given their status as a venue for open discourse and the home for bright young people with technical skills. In March, authorities filed federal charges against a 20-year-old student accused of hacking into a University of Texas computer system and stealing social security numbers and other information from more than 55,000 students and staff members.

Appropriate security planning tools and techniques are critical to the success of limiting liability and exposure to risk. Security-focused audits of information technology and business operations can be used to identify areas that require attention. The ISO 17799 standards serve as the foundation for comprehensive reviews of technology and should ideally be addressed as part of any business audit. Satisfying these ISO standards through an independent audit will help demonstrate the effectiveness of an organisation's information technology controls with respect to potential fraud and identity theft prevention. International in scope, any global enterprise that adheres to them will be more likely to prevent identity theft than those which don't.

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Further information

Log on to Privacy Rights International at www.privacyrights.org. It provides information and links to many sites focusing on identity theft prevention, including the Identity Theft Center, available in English and Spanish, at www.idtheftcenter.org.

The FTC has a good introduction on its website located at www.ftc.gov. The site stresses the importance of periodically checking with the major credit reporting agencies to determine if any unauthorised credit checks have been performed in your name and advises other ways of staying vigilant.

Risk assessment

Accountants, financial advisers and lawyers can minimise risk for their clients by working together

When assessing your attitude to risk it is not enough to pick a number on a scale of one to five, or to state that you are a cautious or high-risk investor. There are important factors to consider including:

- Tax status
- Domicile and residence
- Marital status (both present and future)
- Future inheritances
- Potential liabilities
- Dependants
- Age
- State of health
- Existing investments, including linked assets such as trusts and pension funds.

A number of these factors can only be considered by working alongside existing advisers. For example, it is no use having a superbly performing investment portfolio, only for the taxman to take the 'lion's share' in taxes. There are many plans which can be incorporated with investment arrangements and which can reduce taxes. However, this involves a risk assessment on how such arrangements would withstand a challenge by the tax authorities. Such risk assessment can only be carried out by a client's tax advisers, in conjunction with other advisers.

Clients also need to assess risk when giving personal guarantees or taking on liabilities and the impact this might have on personal assets should those liabilities not be met. This might involve sheltering existing personal assets, including the family home, so that they cannot be attacked in the event of a default.

More frequently, however, it is the financial adviser who must explain to clients the application of risk in relation to investments that are being purchased, whether that be a single investment or a portfolio of investments.

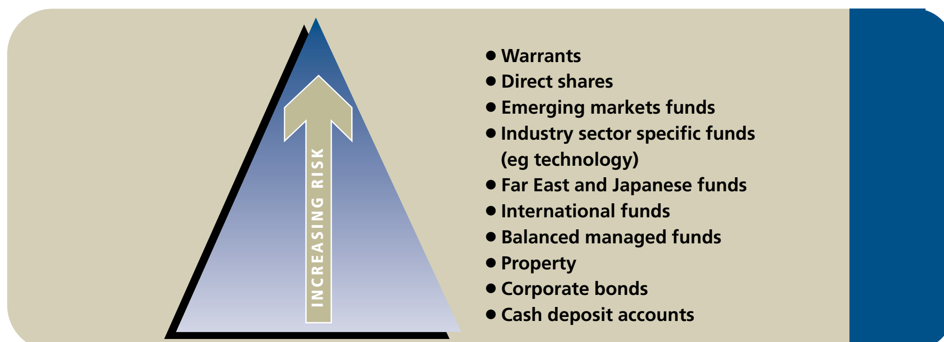
It is a well understood philosophy that risk and reward are inextricably linked. Put simply, the higher the risk, the higher the potential reward.

Once a safety net of rainy-day money has been established, it is the role of the investment adviser to solve the quandary presented by establishing a balance between acceptably low exposure to losses and an acceptably high level of potential investment returns.

The risk pyramid

Risk can take on many forms. Commercial property, for example, carries risk, as selling an office building is not a speedy process. The quality of the tenant and the term of the lease would be important elements of any risk assessment. At the other end of the scale, over-reliance on cash deposits can also involve a risk in today's low interest rate environment. There is a very real inflationary risk that the value, in real terms, will fall.

When compiling an investment portfolio, many Thomson's Wealth Management advisers begin with a risk pyramid (see box below).



From this starting point, the appropriate proportion of a portfolio is allocated to asset classes, mindful of their potential risk-and-return characteristics.

Taking this basic model as the starting point, portfolios can be created to match exactly the required risk characteristics and potential growth or income requirements. It does not follow that all portfolios will include all of these asset classes.

Let us consider a typical balanced investment portfolio. This might contain a relatively high proportion of assets in cautious and medium-risk investments, such as corporate bonds, property and equities. There would then be a smaller percentage allocated to more risky investment classes such as overseas equities, industry-specific sectors and direct shares.

Over a reasonable period of time, we would expect the return from the higher risk assets to be greater and, after a couple of years or so, the risk profile of the portfolio would have shifted.

This is the behaviour of a portfolio which is doing exactly what it was designed to do. And the overall risk profile of the portfolio would rise as a larger proportion of the overall total would be invested in higher risk asset classes.

The importance of regular investment reviews to rebalance risk cannot be overstressed. We would recommend that these reviews are conducted annually, and they should always include input from both tax and legal advisers. This ensures that their views and risk assessments are taken into account, particularly in light of applicable legislation.

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Membership benefits

Poland's EU referendum result has highlighted how much it must do to comply with regulations

Following the collapse of the Communist systems in 1989-1990, the countries of central and eastern Europe looked to the European Union (EU) hoping for economic improvements and an increase in living standards. Within the EU, however, doubts grew as to whether such countries would attain a reasonable level of alignment with 'acquis', a precondition of joining the EU.

Poland is a classic example of this dilemma. The country was invited to negotiations with the EU in 1997 after the European Council decided that Poland fulfilled the required basic democratic, economic and social conditions necessary for membership. The change of the economic system from a planned economy to a free market one has been complicated by the lack of home-owned capital and managerial capacity. Rapid privatisation has not proved to be a solution to all problems and has opened the door to quick, speculative profits resulting in diminishing economic capacity and corruption. Many privatised plants have since closed down or gone bankrupt either because their utility to foreign owners has been exhausted or because their new owners lack managerial ability.

The Polish Parliament adopted the EU's legal requirements but implementation has caused problems. This is considered to be one of the main barriers to transforming the economy. The administration is also blamed for inefficiency and for tolerating corruption.

The newly adopted rules are expected to cause anxiety for managers. A large number of newly created, medium-sized enterprises, which are already burdened by administrative requirements, fear they may not be able to meet the new obligations. The domains which need to be aligned with EU standards include:

- Free flow of goods and services
- Fisheries' social problems and free movement of labour
- Audiovisual rights
- Competition
- Industrial policy
- Financial control

Applying these rules to Polish firms requires significant structural changes and the adoption of different marketing methods. Another preoccupation is financing. Many firms suffer from a shortage of capital and cash-flow problems. Delays in payment among firms aggravate the situation and expensive credit, reluctantly granted by commercial banks, makes their position worse. It is hoped that either state grants or state-guaranteed loans could ease the situation. However, this would not be permitted under the EU rules of free competition except in special cases. It is suspected that, after accession, foreign companies will dominate the market because of their stronger financial position.

Foreign investors

It is likely that accession to the EU will make Poland more attractive to foreign investors. However, there are numerous obstacles including the need for work permits for foreign employees, the increasing number of licences required, complicated company law, and financial regulations. It is hoped that many of these will be removed with accession.

Auditors and economic consultants have had a very difficult task helping foreign and domestic investors keep their finances in good order. The role of such firms will become even more important after the accession.

Foreign investment in the Polish economy is necessary. The system change formally introduced new rules but provided no capital. Investment is being 'assembled' from individuals or from state enterprises which have been deprived of liquid assets. The most important solution has been foreign capital in different forms. So far most foreign capital consists of speculative funds attracted by high rates of interest, fixed interest governments bonds and a flexible exchange rate.

The accession will partially remove these speculative funds by easing legal restrictions on economic activity whether of domestic or foreign origin.

There is concern that medium-sized firms will struggle to afford the necessary investment in new techniques and information systems. The inheritance from the Communist era means that companies rely on foreign inventions. However, given the interest in new technology, new solutions find fertile ground and are quickly absorbed into the Polish economy.

Government must improve

Bureaucracy remains the biggest obstacle to growth and innovation. Anxiety about accession is being caused largely because the government acts slowly, is often incompetent, and is not using all available EU assistance. Government improvement in this area is imperative.

At present it seems that the government awaits the accession before implementing the agreed terms. Better terms could have been fought for but the country was threatened with the termination of negotiations. The government seemed determined to enter at any price.

Since the positive result of the referendum the government's agencies have started to admit to and look for solutions to the problems discussed in this article. Taxes for all types of enterprises have been lowered and promises made to eliminate bureaucratic barriers preventing economic development.

With a precarious majority in Parliament, it seems likely the government will continue using EU authority to create conditions for quick economic development.

Yet, the most important obstacle may become abortion. To please Church leaders, existing laws were not changed before the referendum. It is likely the issue will now be raised. The question is whether any discussion becomes a substitute for lack of reform or a distraction from the social and economic problems that need addressing.

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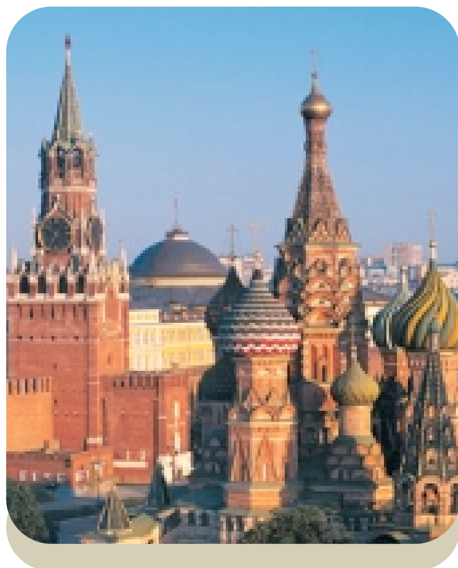
Economic reforms

The Russian economy is beginning to reap the rewards of a thorough overhaul



During 2002, Russia experienced economic growth including a slow increase in consumer prices, a rise in real terms in household income, and the expansion of fixed capital investment. The banking system managed to reach and surpass the levels which preceded the 1998 crisis.

The Bank of Russia's monetary policy was designed to maintain financial stability and create conditions conducive to sustainable economic growth. The Bank of Russia reacted promptly to changes by taking steps such as cutting interest rates, damping down inflationary expectations and slowing the inflation rate in order to stimulate positive economic dynamics. As a result, the rouble has gained in value in real terms and financial market stability has increased.

Liberalisation complete

To make the Russian payment system more transparent, the Bank of Russia introduced reports on credit institutions and its own regional branches, taking into account international experience, methodology and a surveillance of different payment systems.

Liberalisation of Russia's currency legislation took two years. A new law was passed on 14 March 2003 which loosened the restrictions on the currency. The law has expanded the list of operations for which it is not necessary to receive the Central Bank's permission. Today Russia is becoming safe in every respect. Manufacturing is increasing, the budget is in surplus and the exchange rate is stable. As a result, foreign investment is expected to grow in the near future (see box below).

However, the year of economic reforms was difficult for industrial companies. Problems were created by the liberalisation of prices, a sharp drop in demand, surplus stock, high inflation and a strict monetary policy. To survive companies had to resort to extraordinary solutions which included barter, non-payment of contractors, withholding of taxes, and delayed payment of wages.

The industrial sector faced a stark choice – to follow demand and reduce production or to use non-monetary schemes to sell produce. For the last few years, Russian industry has had an opportunity to experience normal market growth due to normal monetary demand. This has given managers the chance to compare two ways of life – barter and non-payment or monetary payment of suppliers and workers.

Audit and reporting

Until recently many companies deliberately altered their official reporting in order to minimise 'losses' such as tax and other payments to the State. Today such distortions have been eliminated largely due to the changed economic conditions.

Those working in professional consulting in Russia face a number of tasks including securing the rights of proprietors, managing taxable bases and helping rehabilitate companies coping with difficult financial positions.

Essential progress has already been achieved in a number of key areas including improved transparency of companies' financial activity and reliable financial reporting.

The market for audit services is developing rapidly – the rate of growth is measured by dozens of percentage points. A law governing auditors has come into force. In accordance with this, a council on auditor activity at the Ministry of Finance of the Russian Federation considers important questions of audit legislation and normative regulation.

Russia's most competent auditors are part of the council and one of its 54 members is Vladimir Skobarev, a partner in NP Consult. This firm has considerable experience of finance, the economy and systems analysis and is able to use its knowledge to create original ways to help companies adapt to the country's changing economic conditions. NP Consult now has more than 350 clients, 30 of which are among the largest companies in Russia.

Leading Russian auditors are experienced at working for large enterprises, including the natural monopolies. The practice of enlisting Russian auditors to report according to IAS standards is developing. Often this work is done in co-operation with international audit experts and consulting networks. As the practice of continuous audit becomes part of the Russian economic landscape, clients are being advised on tax and legal issues, market estimates of any assets, and the restructuring of companies in difficult financial circumstances.

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Foreign investment

Since 1999 foreign investors have had a right to invest in Russia through:

- Participation in the capital of companies established jointly with legal entities and natural persons of the Russian Federation;
- Establishment of enterprises fully owned by foreign investors and establishment of affiliates of enterprises of foreign legal entities;
- Acquisition of stock, shares, other securities and property which may belong to foreign investors under Russian legislation;
- Acquisition of other property rights;
- Other investment activity that is not prohibited by Russian legislation.

The following entities and persons may be foreign investors in the Russian Federation: foreign legal entities, including, in particular, any companies, firms, enterprises, organisations or associations that are able to carry out investments in accordance with the legislation of the country where they are located; foreign citizens; stateless persons; foreign states; international organisations. Foreign investments may be made in any property that is not prohibited for such investments, in particular: securities; scientific and technological products; rights in intellectual property; property rights.

Maximising productivity

Even when times are tough there are steps you can take to improve employee and financial performance

Evidence from many sources suggests that there is a direct link between the talents of employees and the financial performance of the company that employs them.

The crucial question is are you doing enough to optimise this connection?

Companies can greatly improve productivity by aligning employees' talents with company goals (see chart).

If the company's goals have been aligned with customers' needs, employees talents will be more directly linked with those needs. But this can only be achieved by first understanding customer needs.

Customer needs

The company needs to begin with an audit of its market to ensure that it understands the needs of customers related to both primary and supporting products and services.

Company goals

While the needs of customers are being evaluated, or re-evaluated in the case of a company that feels it has a strong sense of market needs, the company should consider what talents it needs to develop, deliver and support its products and services.

> *There is a direct link between employees talents and company financial performance*

The goals of the company begin to emerge from this analysis, as do the talents required to meet customers' needs more effectively.

Employee talents

As customer needs and company goals become clearer and the talent required to meet customers' needs is identified, the company can begin to define the talent that is required in each position in the company (or, for more immediate needs only in key positions or departments).

The company can then develop a plan to match employees who possess needed talents with positions in the company.

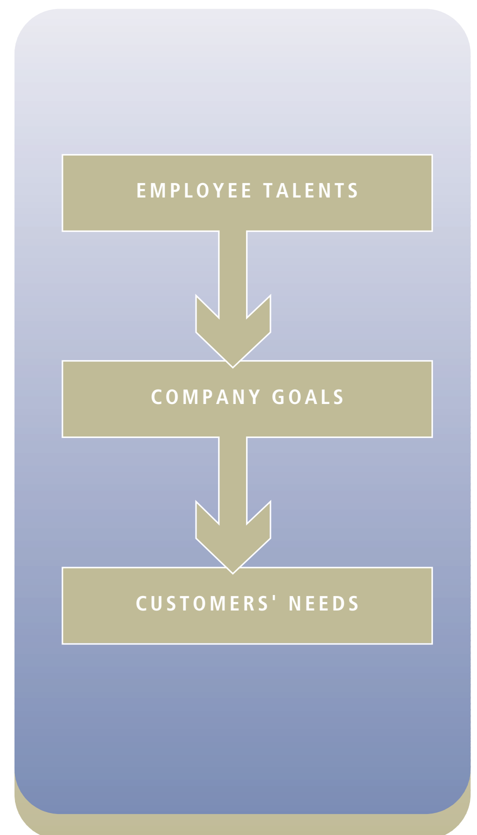
This process also leads to new management practices that can deliver improvements in:

- employee performance
- customer relations
- financial performance.

Understanding individuals

"Recognising talent in employees is not a new concept," says Roberto Macho, "but it is often misused. The better that companies understand and utilise the talents of every individual the more they are able to improve productivity and profits."

Macho continues, "Think of a small business owner. Most small businesses are started by people who have a specific talent to organise or manage or design. The founder works with people with complementary talents to develop the products or services that make the company successful. This simple representation captures the essence of the approach."



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Flexible working

Flexible working is known to improve employees' performance and productivity.

Many employers already allow employees to work either flexible hours or from home.

In the UK, the Employment Act 2002 – Flexible Working for Parents Regulations came into effect last April giving employees with children the right to request flexible working hours. The law makes it clear that an employee must follow the correct procedure when applying for flexible working options.

In order to have the right to request flexibility an employee must fulfil certain conditions which include:

- Being an employee (not a contractor or agency worker);
- Working for the company for at least 26 weeks at the date the application is made;
- Being responsible for a child under six, or under 18 if the child is disabled;
- Being the child's mother, father, adopter, guardian or foster parent, or married to or the partner of someone who fulfils these criteria.

The employee can request working patterns such as:

- Annualised hours
- Compressed hours
- Flexitime
- Job-sharing
- Staggered hours
- Term-time working.

Provided the employee is eligible and has applied in the correct way, an employer must consider the application and must reply within 28 days.

If the application is refused, clear business grounds must be provided.

If the employee is refused flexible working hours and does not agree with the employer's reasons, he or she has the right to go to a tribunal in order to settle the issue.

For a full list of the eligibility criteria for employees and the obligations for employers, go to the DTI's website at: www.dti.gov.uk

Keeping it in the family

Research reveals the success secrets of working with those you are related to

The research

A number of Dutch family businesses were questioned as part of the research. Questions asked included:

- **How important are family relationships?**
- **How do family members, who are often from different generations, build up a successful family business?**
- **Why are some families successful and others not?**
- **What is the role of the somewhat elusive concept of family psychology alongside formal aspects such as selection and recruitment, performance appraisals, control, finance and strategy?**
- **What is the difference between a family team and a management team?**
- **How do entrepreneurs find the right practical balance between family and business?**

The research findings have been published as a book – *Family in Business* – to celebrate the 75th anniversary of Dutch company Govers, which employs 125 people.

A staggering 80% of the companies in the world are family businesses. Some grow in the course of a few generations to achieve the status of a large group of companies, while some remain small and specialised for generations. In some cases, families withdraw through choice or are forced from their businesses and control passes into the hands of external managers.

According to research by Dutch company Govers Accountants/Consultants, family teams often owe their success to a shared upbringing. Brothers, sisters and cousins who spend time together while growing up know each other well. They develop respect for each other and informal codes of conduct for maintaining their family relationships. This forms the basis for the culture of the family business.

The research also revealed that those involved in running successful family businesses are usually aware of their strengths and weaknesses. As a result they may realise that the only way to compensate for weaknesses is by bringing in outsiders. This sometimes means appointing an outsider to a management position or assigning the external accountant an important role. The outsiders not only have a professional task, they are often the determining factor when making vital and/or painful decisions. In this way, the emotion and impulsiveness of the family team is supplemented by the rational and logical approach of the outsider. However, outsiders must always know their place, which, if necessary, will be spelt out by the family team for which they work.

Maintaining family ties

It is worth noting that effectively functioning family teams not only share their passion and enthusiasm for the company, but often also have common interests outside work. Family members consciously do things together privately to avoid drifting apart, the research found. Maintaining their family ties strengthens their working relationships.

Another crucial aspect is that family members are, on average, better at prioritising their common business interests above their separate or individual interests than external managers. This is because they have a combined objective of business continuity and maintaining family cohesion. Family members are also more likely to give each other the space needed to develop personal skills. This realisation of freedom in restraint is extremely important.

Lastly, the research revealed that effective family teams stress the importance of registering agreements and codes of conduct in formal documents. This provides a framework for coping with situations in which the team members have differences of opinion.

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NAFTA AT TEN

The impact on Mexico and prospects

On 1 January 2003 the North American Free Trade Agreement (NAFTA) reached its first ten years in operation. During this period, an increased integration of the Canadian, US and Mexican economies has taken place with a steady shift of capital, technology and job opportunities in all three countries toward more productive uses. The result has been a rise in the region's productivity and improving standards of living.

By far the most noticeable impact of NAFTA has been the growth in trade and investment among its three partners. The lowering or full removal of trade barriers has led to a boom in inter-regional trade. From 1993 (the year preceding the start of NAFTA implementation) to 2002, trade among NAFTA nations climbed 107% from $297 billion to $615 billion. Each day the NAFTA parties conduct nearly $1.8 billion in trilateral trade. As for foreign direct investment (FDI), between 1994 and 2002 NAFTA countries accounted for 28% of total world FDI inflows.

These inflows have become an important link between economies, as well as a catalyst for the growth of domestic investment and companies' competitiveness. The intangible assets that FDI offers – knowledge, technology, skills, management know-how and market access – are becoming increasingly important for economic growth and development in host countries.

In relative terms, Mexico has benefited most from NAFTA, not only in terms of trade and investment flows but also in other areas, such as the adoption of international standards on the environment, intellectual property and labour regulations, among others. Mexico exported $142 billion to its NAFTA partners in 2002, an increase of 279% from 1993, and despite the slowdown of the world economy in 2001-2002, trade in the region fell less than that with the rest of the world.

FDI flows also have had a significant rise, averaging $12.3 billion per year since 1994, three times the annual amount received in the seven years prior the agreement.

As a consequence, the export sector has been the most dynamic engine of growth in the past ten years, as well as the sector where the majority of new jobs have been created. Further, wages in export related industries have risen faster and are approximately 30% above other sectors in the economy.

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