



ACL 'TECTONIC SHIFTS IN FINANCE'
Survey 2007

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EXECUTIVE SUMMARY

Finance and audit departments in large organisations have been through a considerable transformation over the past five years. Changes in technology applications, enterprise planning processes, and corporate mergers and acquisitions have all impacted the financial operations of the business. Combined with new external regulatory pressures across international markets, this has created an increased focus on financial controls and corporate accountability. Companies are trying to get a clearer view of financial operations and processes, whilst financial exchanges, professional bodies and governments are demanding increased reporting and improved oversight into the operations of the enterprise. This ACL Services Ltd.-sponsored report explores how organizations are responding to the changing business and regulatory environment.

A survey of 300 organisations across three major commercial regions (Germany, the UK and the United States) provides a snapshot of why some of the world's largest companies are concerned about risk assessment, auditing and financial review. The concept of 'tectonic shifts' describes the effects brought on by an unstable organizational landscape that can lead to limited financial visibility and oversight. In many cases, this is due to changes such as expansion and growth of the business. Unfortunately, the financial 'fault lines' that are created are all too often identified only after a damaging event, a situation that all businesses are keen to avoid.

In any market, some businesses are likely to be more exposed to risk and erroneous financial practices than others. The results of this research help to identify some of the key common factors that leave businesses more prone to financial risk and resource pressures than others, including:

- Businesses experiencing an increase in the complexity of financial transactions
- Businesses utilising high levels of financial outsourcing
- Businesses exposed to high levels of operational change
- Businesses that have experienced a recent merger or acquisition

Key findings from the survey are summarised as follows:

Tighter Control Needed

- 61% of respondents are seeking to improve the effectiveness of financial transaction analysis and monitoring
- 64% are seeking to improve the effectiveness of compliance performance
- 57% of businesses attribute the need for improvement to 'demands for better risk and compliance requirements'

Audit Storms

- 55% of respondents state that frequency of company audits has increased in the past 12-24 months only 4% have seen a decrease in this area
- Despite 59% of respondent agreeing that continuous auditing and monitoring of financial transactions across their organisation is an effective way to mitigate risk and improve accuracy, only 17% of businesses has continuous controls monitoring technology in place

Risk of Change

- 52% of the respondent's companies have either merged, been acquired or undergone a department merger in the past 12 months
- 85% of businesses have undergone some level of change in their financial analysis applications over the past 12 months, with 22% stating this as being significant change
- Almost half of respondents (47%) believe that their financial systems have been undermined by operational change within the business, only 26% felt this was not the case

The survey identified that one in three (32%) businesses have changed their approach to risk over the past financial year. The references below, from respondents of the survey, are reflective of key commercial risk issues giving corporations cause for concern:

"We are moving to a shared service centre so our exposure has increased during this process, it will decrease in the long run. Third party suppliers and outsourcing has also meant that we have tightened up risk management."

"We are accountable to our stakeholders and due to a number of high level exposures of other competitors we have really increased investment in internal audit procedures to give our investors assurances, particularly in light of the slumping stock ratios in companies where scandals prevail."

With high levels of organizational change reported, combined with a continued reliance on ad hoc and manual testing, significant resources are invested in shoring up financial reporting. Within organizations that were considered 'dynamic' due to the levels of change they reported in the past year, this figure was even higher.

In light of these findings, the report concludes that significant external forces, such as M&A, organisational change and external compliance cause a fault line in financial processes, with such events exposing weaknesses in the system, i.e. time consuming analysis, as well as concerns about the quality of data. Forty one percent of respondents agreed, or strongly agreed with the statement that "our organization is struggling to find the right balance of controls" in order to ensure effective governance and keep pace with the ever-changing needs of the business.

An inability to respond effectively to external conditions can also cause instability within the business. The greater the level of complexity and change experienced by an organisation, the higher the chances of potentially costly events, such as internal fraud or regulatory breaches. These events can be considered as tectonic shifts shaking the financial foundation of organizations. Businesses must put in place measures to detect fault lines and mitigate the effects of tectonic shifts on the fiscal health of the enterprise.

Only through proactive monitoring and measurement can a business first identify and then reduce the likelihood of these events. The fundamental challenge is in the transformation from reactive financial investigation, to proactive financial fault-line detection.

RESEARCH METHODOLOGY

The ACL survey was undertaken by Loudhouse Research, an independent B2B research consultancy, in July 2007. The survey methodology involved Computer Assisted Telephone Interviewing (CATI) with a total of 300 senior finance professionals from large organisations in the UK, Germany and United States. 100 interviews were conducted in each region. Breakdowns of company size and industrial sectors included in the study are shown in the graphs provided.

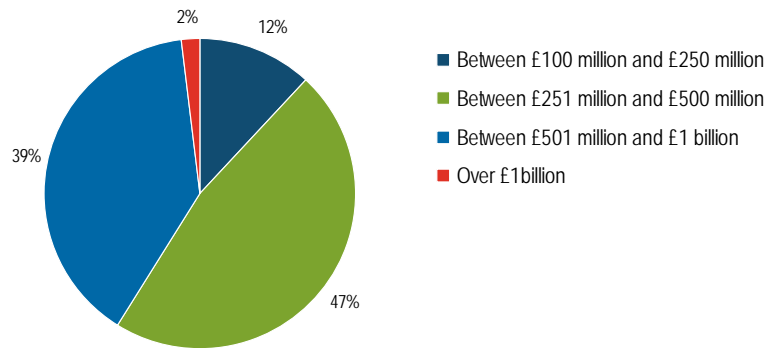


Chart 1: Company size

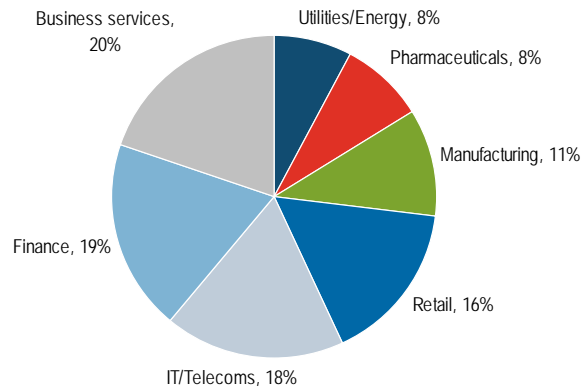


Chart 2: Sector breakdown

SCENE CHANGES

According to the survey, it seems that today's organisations are facing growing levels of complexity and change. Operational reorganization, business process complexity and transaction volumes are all steadily on the rise. As shown in Figure 1, more than 76% of respondents thought that each question shown was either applicable to some degree or very applicable to their organisation (level 3-5), suggesting that businesses are having to deal with increasing levels of change at a faster pace than previously experienced.

Most interestingly, however, was the fact that organisations were split equally into three distinct groups, in terms of levels of change and complexity. For the purposes of this report, these three groups are termed 'high', 'medium' or 'low' dynamic businesses. These businesses differ predominantly in terms of their dynamism, and do not necessarily by any other business demographic, for example, size of business, turnover, industry sector or private/public ownership. This is important to note, as it defines the sample by a set of company 'characteristics', that also show considerable influence in other aspects of the survey.

The level of operational change that businesses are currently facing on a continuous basis is further highlighted in Figure 2, which shows that 30% of financial departments have been through a departmental merger in the last 12-24 months, while 28% have seen the organisation either acquired or merged with another business over the same period. In total 52% of businesses have either acquired or merged with another business, or undergone departmental mergers.

The findings suggest that the amount of change indicated in Figure 1 is not just confined to business processes, or new software system implementations, but relates to far-reaching operational changes. At the same time, high-level strategic changes, such as M&A activity, is bringing significant disruption to financial departments.

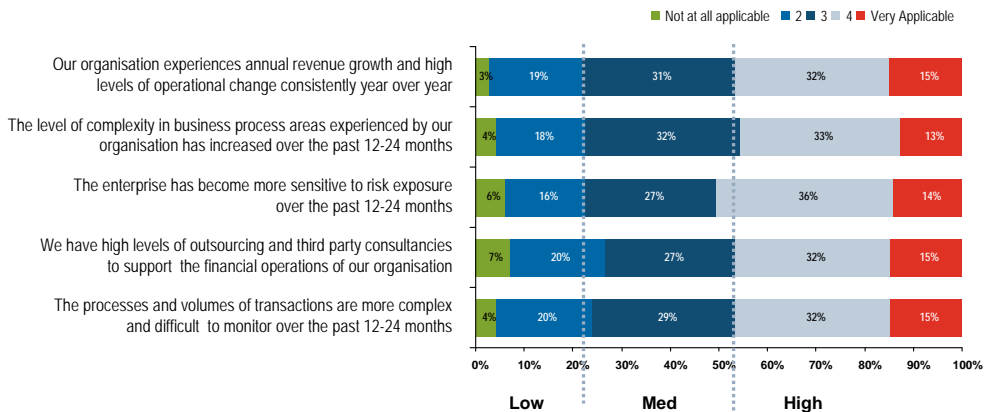
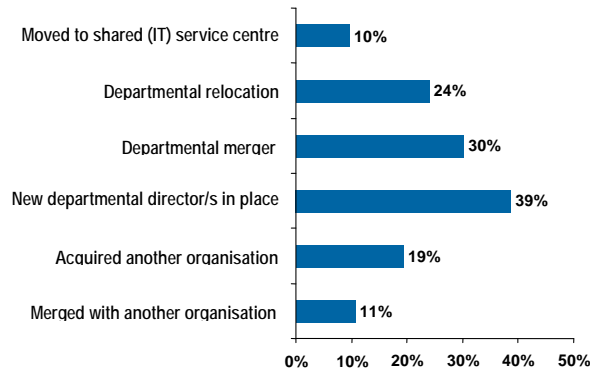


Fig 1. Statements establishing business dynamics



*Fig 2. Q7. Has your business experienced any of the following events over the past 12-24 months?
Companies were able to select more than one event from the list.

In addition to these operational changes, organisations are facing continual technological change, as shown in Figure 3. For example, 51% of survey respondents have seen significant change (level 3+) in their overall ERP systems in the last 12-24 months.

The corporate landscape is changing, with unprecedented levels of M&A activity in recent years, which in turn is having a significant impact on the day-to-day operations and levels of complexity in the financial department. The following sections seek to ask how this is changing the behaviour of organisations and their perception of risk.

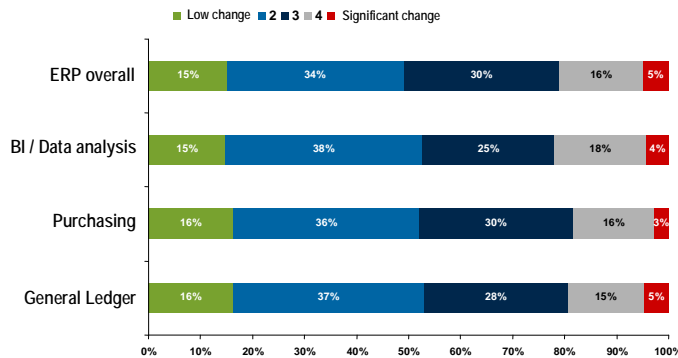


Fig 3. Stated levels of change (1-5) experienced with financial applications over the past 12 months

RISK ISSUES

As shown in Figure 4, the audit, due diligence and governance requirements of organisations has increased over the last 12-24 months, with 55% of respondents experiencing an increase in the frequency of audits within their organisation in order to support regulatory compliance requirements – only 4% noted a decrease.

Interestingly, the 'high dynamic' group of businesses (as defined in Figure 1 of the previous section) have experienced the largest increase in auditing requirements over the last two years, with 63% noting an 'increase' or a 'significant increase'. This result was 19 percentage points above the 'low dynamic' group (44%) and 15 points above the 'medium dynamic' group (51%).

Figure 5 highlights the efforts that are being made to improve the current measures, processes and systems currently in place within organisations in order to deal with the increase in audit workload. Overall, 63% of organisations can be seen to be making efforts to improve compliance processes, while 61% are looking to improve their financial transaction analysis and reporting.

In turn, this suggests a general low level of satisfaction with current auditing capabilities and reveals a strong desire to improve both audit and financial processes within the enterprise.

However, the differences become marked when responses are split into dynamic business groups, with 73% of high dynamic organisations making efforts to improve compliance processes and 77% looking to improve analysis and reporting, compared to 53% and 39%, respectively, of businesses in the 'low dynamic' group. The findings suggest that organisations in the high dynamic group are more acutely aware of the need to make improvements in their overall auditing capabilities.

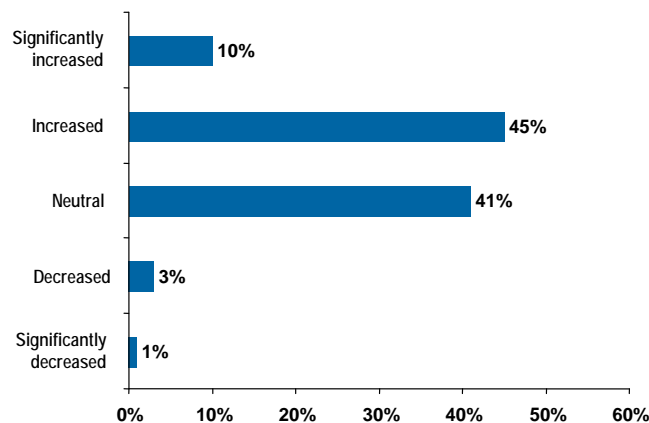


Fig 4. Q11. As a general trend over the past 12-24 months, has the frequency that your company is audited to support regulatory compliance requirements changed?

The responses shown in Figure 6 suggest that it is external factors, rather than internal change for change's sake, that are driving this need/desire for improvement in auditing capabilities. The biggest driver for change cited was the need to respond to a general increase in risk and compliance requirements, as chosen by 57% of respondents. In contrast only 25% blame existing processes and IT systems.

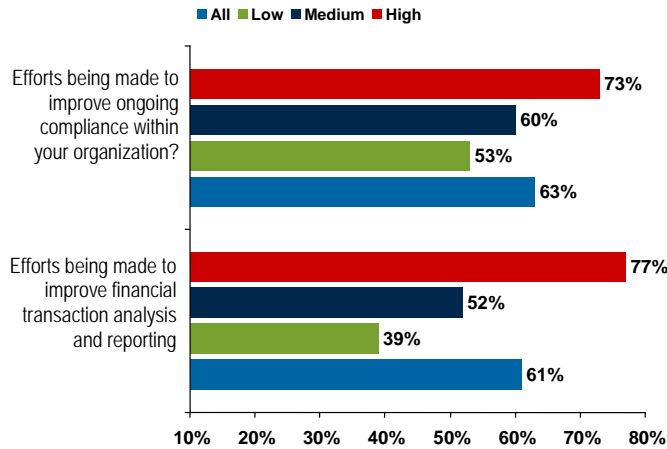


Fig 5. Are there currently efforts being made internally to improve the effectiveness of A: Financial transaction analysis and reporting? B: Ongoing compliance within your organisation?

It is also worth noting that only 30% of respondents cite a need to reduce cost as a driver for improving audit capabilities. Cost reduction and efficiency gains are typically the perennial drivers for most IT projects, however in this case, it appears that organisations are feeling exposed to risk and compliance requirements, and looking to regain some control over external factors, such as increased complexity and overall audit and compliance requirements.

This uncertainty is also changing the behaviour and attitude of organisations towards risk. Thirty-two percent of survey respondents said that their organisation or department had changed its approach to risk in the last year. Interestingly, this was again split among each dynamic group of businesses, with 44% of organisations in the high dynamic group noting this change in attitude, compared to 25% in the medium group and just 18% in the low dynamic group.

Overall, these findings suggest that risk is becoming a major issue for businesses across the board, and that much of the increased vulnerability is from external changes that are outside the control of organisations.

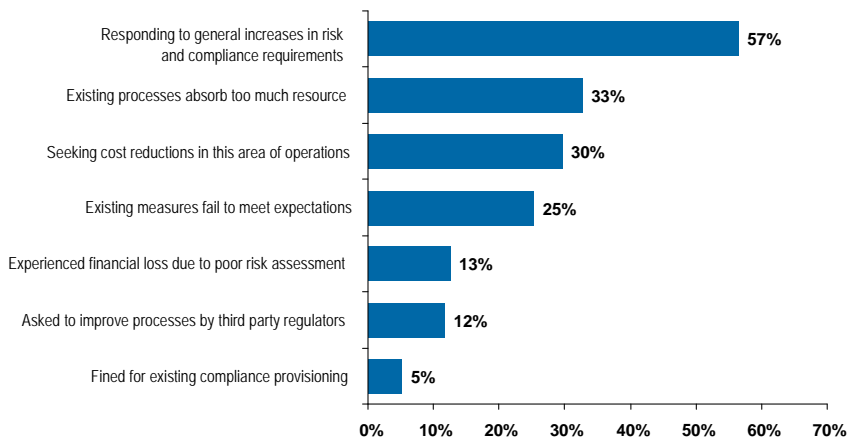


Fig 6. Please select from the following the main drivers for seeking improvements to existing systems and processes (Base 230)

ACCURACY AND ERROR

Concerns over external factors, such as increased audit and compliance requirements and industry change, are also being exacerbated by a lack of confidence in the accuracy of financial reporting.

Figure 8 shows the most likely source of inaccuracies, with 24% of respondents finding errors in departmental financial reporting and 26% noting departmental spend errors – again, while the figures at first appear low, it is important to realize that these inaccuracies are appearing on an on-going basis.

Given the size and established nature (majority £500 plus enterprises) it's surprising the level of uncertainty that exists within the surveyed companies regarding their data quality and accuracy.

In turn, this accuracy issue is set against a backdrop of increased complexity and change, and a general increase in auditing and compliance requirements, and highlights an important area that businesses need to urgently address.

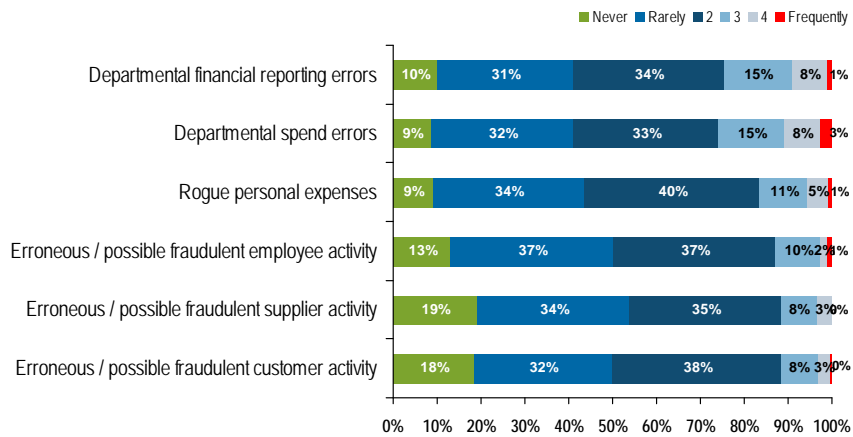


Fig 7. To what extent do you think that the following events occur within your organisation?

MONITORING

When asked about existing methods for monitoring transactional data, 34% of respondents said that their organization used a mixture of automated monitoring and ad hoc analysis. Only 17% of the sample said that their organization used continuous auditing or monitoring to review financial transactions.

The findings show that only a minority of organisations use this best practice to monitor data on an on-going basis. However, this should not necessarily be seen as a case of the 'haves' and 'have nots'. Indeed, the majority of organisations operate some form of automation in conjunction with ad hoc analysis on an 'as required' basis. Though there is a clear business case for and continuous auditing and monitoring, it still seems that large businesses need a flexible approach that applies both automated and ad hoc analysis in order to satisfy all of their audit requirements.

Evidently, respondents seek a balance between the two and the measured view is that 'automated' and 'ad hoc' should not always be seen at opposite ends of a scale. In fact, when dealing with the increasingly dynamic organisation environment, perhaps both are synonymous with flexibility and best practice.

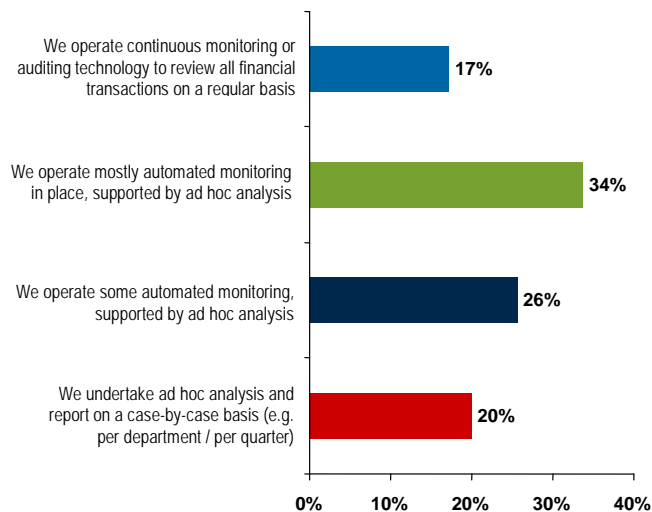


Fig 8. Do you perform any continuous monitoring or auditing of financial transactions to assess risk, find control problems, errors and fraud?

As highlighted in previous sections of this report, there is a broad consensus amongst finance professionals that there is a question mark over the integrity of existing financial processes, given the increasing complexity and change that organisations are facing driven by factors outside of their influence. This means that organisations are constantly in a reactive position, attempting to keep pace within this increasingly dynamic environment.

Alongside these challenges, there is an awareness of the need to improve existing processes in order to cope with the increasing auditing and compliance burden. In short, financial reporting is becoming increasingly complex and ever more challenging for organisations.

Figure 9 supports these sentiments, with 49% either agreeing or strongly agreeing that confidence in the integrity of financial controls is a challenge in certain parts of the business due to the operational complexity involved. That's one out of two businesses surveyed.

While many acknowledge the need to improve monitoring systems in order to deal with these challenges, Figure 9b shows a gap between 59% of respondents who believe that continuous auditing and monitoring of financial transactions across the enterprise is an effective way to mitigate risk and improve the accuracy of financial reporting, and those organisations that currently have such systems in place (17% as shown in Figure 8).

It appears that most organisations acknowledge the need to improve existing financial reporting and monitoring systems, however many that are either still prevaricating over doing something about it or simply lacking a clear strategy. After all, if the drivers you respond to are prone to change, it makes the solution to financial reporting something of a moving target.

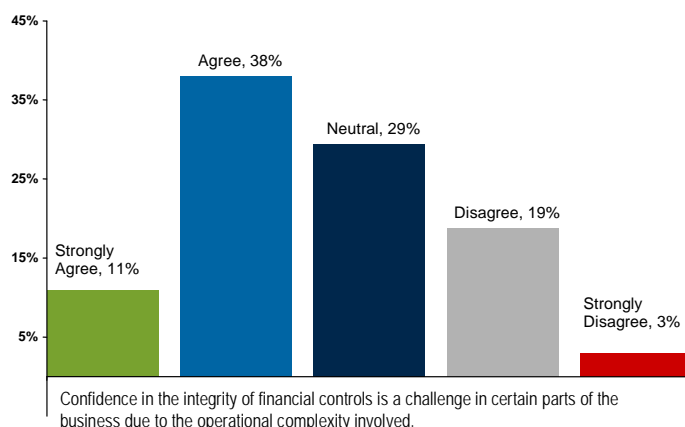


Fig 9. Statements establishing business dynamics

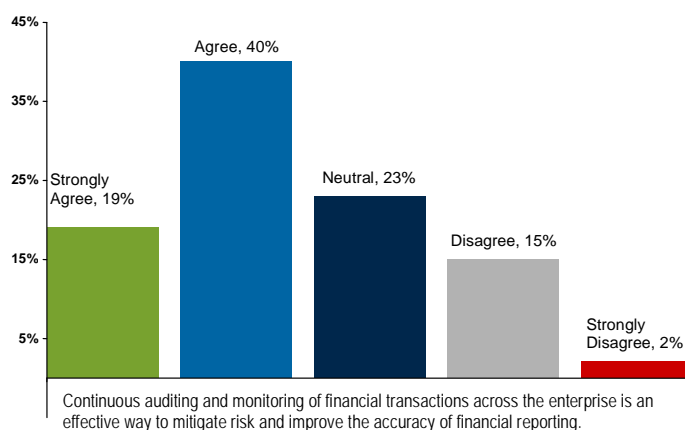


Fig 9b. Statements establishing business dynamics

CONCLUSION

ACL's "Tectonic Shifts in Finance" survey reveals that beneath the apparently still surface of today's organisations, there are dynamic changes occurring. Over the last three years, changes in technology applications, increased M&A activity, increased business complexity and the growing burden of compliance, have combined to dramatically alter the landscape of auditing and financial departments across the board.

Companies are trying to get a clearer view of financial operations and processes. This is largely being driven by financial exchanges, professional bodies and governments demanding increased reporting and improved oversight into the financial operations of the enterprise. And to compound the issue, organisations are suffering from a notable lack of confidence in their current ability to provide accurate financial reporting and analysis data on an-going basis.

In combination, these 'tectonic shifts' occurring below the apparently calm surface of today's organisations create the potential for an unstable organisational landscape, which is constantly at risk of being shattered by the appearance of financial fault lines. The weakness of existing reporting and monitoring capabilities and processes means that these fault lines can appear at any time. Unfortunately, they are often identified only after the damage has been caused.

M&A activity, organisational changes and external compliance requirements are exposing weaknesses in the finance function, and those organisations that lack the flexibility and capability of adapting to this constantly changing environment are increasingly vulnerable to those risks that lie in wait. In turn 'high dynamic' organisations that experience the greatest levels of change and complexity are the most vulnerable.

Today, a myriad of external factors contribute to risk analysis. A key finding from the survey is that large businesses are experiencing surprising levels of error and inaccuracy in financial reporting. What is financial management if not a process of ensuring that the numbers add up?

In response to the survey findings, the following points should provide large organisations with a simple starting point from which to review existing financial auditing challenges and seek to improve on the financial management status quo.

Measure the Business Dynamics

As the findings show, dynamic businesses are more exposed to the issues identified in the survey, the first step is to consider what level of change and complexity your business is exposed to. A measure of change against competitors, or even like-sized supplier business can provide anecdotal evidence on which to benchmark your organisation.

Continuous Auditing, Continuous Control

Establish a level of continuous auditing and monitoring within your business as an empirical means of measuring activity. Not all audit events are driven by regulatory mandate, with many internal governance measures placing further pressure on the audit function. A simple evaluation of this can throw light upon drivers for audit increases and help move auditing away from a wholly reactive process. Auditing on a more continual basis ensures the 'always on' nature of financial applications is mirrored by the monitoring support

Error and Inaccuracy

Rarely is finance on a corporate scale flawless. However, it is important to ascertain what level of error is tolerable without creating financial and accounting risk. Financial faults in isolation may seem low risk, but they have a bad habit of creating a cumulative problem. It is important to understand from the finance and IT function whether errors are increasing, stable or decreasing and to consider how accuracy can be improved. Technology will play a pivotal role in solving risk, error and accuracy issues and fault lines will have to be monitored on an ongoing basis in order to catch errors, fraud and abuse before it impacts the financial reporting of the business.

COMPANY OVERVIEW

ACL Services Ltd. is the leading global provider of Business Assurance Analytics to the audit and controls professions and the financial management community. Combining market-leading data analysis software and professional services expertise, ACL solutions give organizations confidence in the accuracy and integrity of the transactions underlying increasingly complex business operations and in the effectiveness of controls processes. Since 1987, ACL's proven technology has enabled financial decision-makers to assure controls compliance, reduce risk, detect fraud, and enhance profitability – all with a return on investment measured in weeks, not months.

Our international customer base includes 70 percent of the Fortune 500 companies and nearly 65 percent of the Global 500, the Big Four public accounting firms, and hundreds of national, state, and local governments. ACL software solutions are delivered in multiple languages in more than 130 countries to over 170,000 licensed users through a global network of ACL offices and channel distribution partners.



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