LEADERS
IN PROFESSIONAL SERVICES

SPECIAL REPORT

Three Pillars of Success

ERNST & YOUNG

An Interview with James S. Turley, Chairman and Global Chief Executive Officer, Ernst & Young, New York

James S. Turley

EDITORS' NOTE *Jim Turley joined Ernst & Young's U.S. practice in Houston in 1977. He became a partner in 1987, and from 1987 to 1990 was U.S. national director of Client Services and Business Development. After serving as area director of Entrepreneurial Services, he was named Upper Midwest managing partner in 1994. Turley was named Metropolitan New York Area managing partner in 1998, and was appointed global deputy chair in July 2000. A year later he became global chair, and in October 2003 he assumed the additional duties of global CEO. Turley holds a bachelor's and a master's degree from Rice University.*

COMPANY BRIEF *Ernst & Young is one of the Big Four accounting firms and a global leader in professional services. With more than 100,000 employees in 140 countries, the global Ernst & Young organization reported total revenues of $14.5 billion for the fiscal year ended June 30, 2004.*

Ernst and Young has more than 100,000 people operating in 140 countries and you have some of the world's largest global organizations to service. How do you manage yourselves?

Our size is daunting, especially when you consider our commitment to providing the highest quality seamless service consistently to our clients throughout the world.

Our global structure reflects the different legal and regulatory rules that govern our profession throughout the world, requiring the formation of independently licensed country entities. At the same time, our country practices are closely integrated as members of Ernst & Young Global. Our country practices are organized into areas on the basis of shared markets, culture, geographic location, and/or language. Within areas and globally, we align infrastructure, allocate resources across borders, streamline processes and programs, leverage training and knowledge, and share best practices. Area managing partners have responsibility for leading the implementation of our global strategies.

We also have global vice chairs for our three service lines – Assurance and Advisory Business Services, Tax, and Transaction Advisory Services. Cutting across this are groups of industry specialists who work within all our professional disciplines.

How has Ernst & Young continued to attract the best and brightest professionals to join its practice? Is that an important initiative for the firm?

It's incredibly important, and we have been very successful in attracting great people. The relevance of our profession has never been more visible, and on a global basis, more students are going into accountancy than before. We feel positive about our ability to attract large numbers of those people. We invest heavily to ensure Ernst & Young is the place where people can grow and build fantastic careers.

Quality is at the forefront of Ernst & Young's corporate philosophy. How is quality measured and how do you drill the message of quality through the organization?

It's interesting. Quality has always been the focus for our business but the corporate governance scandals of several years ago made it necessary for our profession to make quality much more explicit in what we do. We have scrubbed every process that could touch the delivery of quality to the marketplace – our hiring practices, the supervision of our employees, the technical resources that we use to support our teams in the field, our client-acceptance process, and so on. We evaluate each of our people based on the quality they bring to their own activities and how they support the firm's culture of quality. It's central to who we are and what we do.

Do you evaluate potential clients by the same standards of quality that you use to evaluate your employees?

Yes. Every year we decide whether to reaccept every client we serve. We want to do business by having our great people deliver great service to great clients. All three of those pieces have to work just right.

How do you evaluate the firm's growth?

We look at growth in many different ways. Obviously, it's easy to measure revenue growth and audit share. It's not as easy to measure our revenue share of the tax and transaction advisory services marketplace. We look at growth across the key industries we serve, such as financial services, technology, communication, entertainment, energy, and others. We look at growth along emerging markets and mature markets. So we evaluate our growth across geographical lines and across various business lines, as well.

Our strategy is built on three pillars: people, quality, and growth. I am making certain that our people understand that the strategy only works in one direction; it starts with great people, and then those people deliver quality service, which leads to the growth of the business. That's how it has to work. We can't think about growth before focusing on people and quality. Without those other two elements, we can't drive growth.

How do you ensure that your people worldwide understand that message?

It's critical that all of our people understand both the strategy and its execution. So we make sure it is cascaded down through the organization. Ernst &

Young is blessed with a great global leadership team which spends a lot of time on the road visiting with our teams and our clients to make sure that we're all thinking about things in the same way.

How much growth do you anticipate for Ernst & Young in the Chinese market?

I am extremely optimistic about the future of our business prospects in China. We have some 4,000 people there currently, and it is clear that China is the fastest growth market and will be for the next decade or more. Eventually, it's going to be necessary to employ about 20,000 to 25,000 people there. China is going to be one of the world's biggest economies and we're going to need that many people there to service that market. So we're going to work with universities and governments to ensure that we're developing a sufficient pipeline of talent coming into the profession. We need people that have the language skills and other capabilities to service that market.

Does India offer similar growth opportunities?

It's a great market for us, and we're happy to have a leading share there. India, over the last several years, has developed a great sense of confidence in its ability to build great businesses that can compete around the globe. I think both China and India will be long-term successes.

And is Russia on a similar path?

We clearly want to be a key player in that market. Russia, through its prime minister, has been involved with the Foreign Investment Advisory Council, of which Ernst & Young is also a part. Through that council, business leaders from around the world discuss the reforms that are needed to attract foreign direct investment in Russia. I think their involvement will be beneficial for the growth of the Russian economy and it's something we're pleased to be a part of.

Are you optimistic for the growth of Ernst & Young's business in Latin America as well?

I am, because I think it has great resources and a great workforce. Within Ernst & Young, our country practices have a very positive working relationship across South America. They are able to deploy great resources to meet client needs, regardless of location, in a very seamless and efficient way.

Has Eastern Europe been a focus for the firm? Have you been able to attract the talent you need in those local markets?

Yes, we have actually. As I mentioned earlier, there is a great interest in our profession, and as such, we are able to draw on local talent pools quite easily. We're seeing a lot of growth around Eastern Europe; it's a very attractive place to do business. Hungary, Poland, the Czech Republic, and other countries are all vibrant places to do business.

You seem to look at the big picture when it comes to the accounting profession. Does the industry ever work collaboratively in the efforts to develop that talent pipeline, for instance, or is it too competitive for that kind of unified endeavor?

We compete like crazy in the marketplace; we always have and always will. That said, on both professional and policy matters, we try to leave the competition at the door and work for the good of the profession. I feel good about our combined support of regulations that will ensure the public's confidence in the financial markets. That is so important.

> **We try to leave the competition at the door and work for the good of the profession.**

Does differentiation between the Big Four firms come down to people alone? How do you define what makes Ernst & Young unique in the marketplace?

First and foremost, we differentiate ourselves with our people and our ability to put together teams of people that understand their particular practice and the industries in which their clients are operating. It's not good enough for our employees to be just "technology experts." They need to know the specifics of hardware, software, and so on. If they are working in our telecommunications practice, they need to understand wireline and landline networks. Having expertise at the sector level is very important, because it determines the level of service our clients are going to receive.

Will there ever be a global standard or regulation for corporate governance?

There's a lot of tension in the world today on a variety of fronts, but I think we're living through a period of convergence. The International Financial Reporting Standards [IFRS] are being adopted by 100 countries in 2005, and there is continued convergence between IFRS and U.S. GAAP. They are moving toward a common global standard. I think the same thing can be said about auditing standards and regulatory standards in many parts of the world. The European Parliament will vote on the EU Eighth Directive on statutory audits of annual accounts and even though each country's regulatory systems are somewhat different, common themes are emerging. The importance of audit committees and independent directors, and of management teams taking responsibility for financial outcomes, is common around the globe. I think that kind of convergence is great.

Do you ever worry that with so many regulatory concerns CEOs will be unable to spend as much time on strategy and planning as they have in the past?

Executives are sensitive to regulations because they're fairly new. But without question, we all need to work toward a more seamless and streamlined implementation as we move forward. The regulators and the registrants are aligned in the focus on internal controls, but we need to implement them more efficiently. In my opinion, the regulatory environments are going to continue to converge, and we'll develop a better equilibrium so that great companies can continue to focus on strategy, vision, and competitiveness.

Is it difficult for you to create a balance between your many far-reaching responsibilities?

Well, I think it's critically important that all of our leaders within Ernst & Young maintain their connectivity with the marketplace. So I do an awful lot of traveling, as do many members of our management team, because that's the only way to stay connected. My most important responsibility is to make sure that, every day, 100,000 Ernst & Young people wake up understanding that nothing is more important than their own integrity and their own commitment to delivering high-quality service to our clients. Our biggest client is no more important than the integrity of a senior accountant in Manila, for instance.

I'm convinced the only way to ensure that those 100,000 people wake up thinking the right way is to visit with them from time to time, to have our leaders out in the marketplace with our teams and our clients, and to live our values. We have a common global set of values within Ernst & Young that every person within the global organization tries to live by, and it's incredibly important that we make those values come alive. It's important that our people know that it's their job to raise their hand if something appears wrong with a client or if something smells wrong within Ernst & Young. So we have to travel to different Ernst & Young offices to make sure our people understand and believe that. ●

SPECIAL REPORT

People First in a Global Market

ERNST & YOUNG

An Interview with Pierre Hurstel, Global Managing Partner, People, Ernst & Young, London

EDITORS' NOTE *Pierre Hurstel was appointed Ernst & Young's global managing partner, people, in July 2005. He had served as EY's France people leader since 1998, and was people leader in Continental Western Europe starting in 2001. Hurstel has more than 25 years experience as an auditor in France, working with the retail bank and entrepreneurial growth market sectors.*

Pierre Hurstel

Are you pleased with Ernst & Young's ability to attract the necessary talented people to its organization around the world?

In 2005, we will hire 22,000 people. So the question is: How do we find a small city's worth of people at the level we expect? In some respects it is easier to recruit now than it was 10 years ago. In recent years, the difficulties in the financial markets have placed our profession under a great deal of public scrutiny. However, that intense spotlight means potential recruits are more aware of our profession's fundamental importance and the difference it – and they – can make to the financial world. Our profession has never been more relevant. We have also worked hard to make Ernst & Young attractive to recruits. We want to inspire and develop people; we want them to be attracted to the roles we offer, our values, and our culture. We want them to know that this is a place where they can grow and succeed, reach their full potential, and build a great career.

How do you build a culture in an organization of 100,000 diverse employees spread across the globe?

Our culture is based on our values, our commitment to quality, and the ethics and behavior outlined in our global code of conduct. We're building that culture – whether it is in China, Brazil, Africa, or Europe – through investment in our people, in their learning, and in the behavior of our leaders, who set the tone.

How important is it for you to employ local people in Ernst & Young's various offices in countries around the world?

It is very important to employ local people; clients expect us to provide people who understand local markets. But Ernst & Young is a global organization, so people who want to work for us tend to be globally minded and are often skilled in English or other second languages. People who combine local knowledge with a global mindset are ideal for us. We generally find the number – and type – of people we need, but in certain growth markets it is a challenge and recruitment is intensely competitive. We are constantly looking to improve the ways we recruit and retain people in these markets, and the ways we mobilize people with in-demand specialist skills from other parts of our organization into these markets.

At Ernst & Young, how much emphasis do you place on the training of your people and how do you work to make learning a part of your corporate culture?

The training – or learning – we provide is both crucial to the development of our people as individuals and is a key element of the quality we deliver to our clients. We probably provide six million hours of learning a year. We have the equivalent of 4,000 full-time employees just doing learning. We use in-the-field training and Web-based learning, which allows every employee to access the wealth of learning materials that exists across our global organization via their PC. We also have senior people conduct the training. I know that in my career – I was an auditor before I was an HR guy – I have learned more from a few sentences from the mouths of respected people than I would have in months and months of lessons. Ultimately, we see the learning and development of our people as an important part of what we call our "people first" environment. "People first" is based on a simple premise: When our people achieve their full potential, our clients benefit and our business prospers. It's a two-way commitment with our people. We expect them to take individual responsibility for their professional and personal development, and for delivering high-quality service every day. To make that happen, we provide the learning, technology, and tools they need to fully develop their skills. So, in that respect, learning is absolutely critical to us as an organization.

You spent 25 years in client service. Do you miss that, now that you are in an internal management role?

Yes, but I have kept one client. It's a sort of addiction; after 25 years of serving clients, I can't stop it. In addition, I want to understand what my people on the ground are going through, and working with clients helps me to do that. As EY's global people leader, I think that I can better gain the respect of our people if I am out there experiencing what they are experiencing and presenting myself as a role model for my values and behavior. So I keep my client relationship because, even if I only spend a small percentage of my time on it, the rest of my time – which I spend largely trying to understand our people and gain their respect – will be that much more productive.

What are the priorities for you in the year ahead?

My first priority is to ensure we consistently foster our high-performance culture in every country in which we operate. I also want to increase the attractiveness of our organization and help our country practices find the best people by strengthening our brand. We also need to promote the mobility of our people globally. Not only does this help deliver globally consistent, high-quality service for our clients, it also provides our people with great opportunities for personal and professional development. Finally, I want us to be a model of inclusiveness, so that regardless of rank, role, or geographic location, all our people feel valued and proud to work for Ernst & Young. ●

SPECIAL REPORT

ERNST & YOUNG

Doing the Right Thing with the Right Clients

An Interview with Susan Frieden, Global Managing Partner, Quality & Risk Management, Ernst & Young, London

EDITORS' NOTE *Sue Frieden joined Ernst & Young in 1971 with a B.A. from Syracuse University and an M.B.A. from Columbia University's School of Business. She joined the partnership in 1983 and has served as the coordinating partner for several* Fortune *500 clients. From 1998 to 2002 she was the practice leader of the Northeast and New York Transaction Support Group. Frieden has been a member of the EY U.S. Accounting and Auditing Committee and the Partner Advisory Council, and served on the AICPA SEC Regulations Committee. She was appointed Americas vice-chair of quality in 2002, and in 2003 became vice chair of quality and risk management and a member of the Americas executive board. She was appointed global managing partner, quality and risk management, and was also made a member of the global executive board, in July 2005.*

Susan Frieden

How do you define quality leadership?

Quality starts at the top, and for me that means with Jim Turley, our global chairman and CEO and our leadership teams. Although quality has always been a focus at Ernst & Young, we put quality explicitly back into the center of our strategy in 2002 and soon after created the global executive board position of global managing partner, quality and risk management [Q&RM]. Of course, quality leadership needs to cascade throughout our organization and with the support of our seven area Q&RM leaders we ensure that quality is on everyone's agenda.

How does Ernst & Young's quality focus impact its client relationships?

Our focus on quality impacts everything we do. It's not just about delivering the highest-quality service, it's also about working with the highest-quality clients. In other words, we not only want to do the right thing, but we also want to do it with the right clients. Through our global acceptance and continuance process our member firms have a consistent approach to help evaluate risk when taking on new clients and on an annual basis re-evaluate those risks to decide if we should continue working together.

Is there a general understanding of the impact of quality and risk management in Ernst & Young's offices around the globe?

Globally, we have to ensure that our culture reflects this focus on quality throughout the whole of E&Y. Our Q&RM leaders around the world are working hard to ensure that all our people understand this and share this vision. Jim Turley delivers the message that getting Q&RM right in every area and every country practice is critical. Have we had to make some changes to embed our quality culture globally? Have we had to emphasize things differently in different markets? Of course we have. But the leadership and our people are as committed to the Ernst & Young brand wherever they are in the world.

How daunting is the challenge of communicating Ernst & Young's focus on quality to all of your global organization's employees worldwide?

Of course communicating our quality message to more than 100,000 people is a challenge. But we have in place an excellent network of area Q&RM leaders who are, in turn, supported by Q&RM leaders in each of the countries in their area. These leaders are usually either on their area and country executive boards or have a direct report in to them and are therefore well placed to drive our quality agenda through their practices. Of course having in place things like our global audit methodology and a global client-acceptance and continuance policy also helps to really embed our quality approach in everyone's day-to-day activities.

Does that training include educating employees on the necessity of adhering to procedures?

Absolutely. We created what we called a consequence management task force to examine that globally. But we don't think of it just in terms of consequence management, rather we think of it in terms of our people and our organization being mutually accountable for doing the right thing.

What key procedures, policies, and tools have you put into place to ensure that Ernst & Young does not have conflicts of interest, and professional independence is maintained?

In my view the risk of conflicts keeps on rising. This is in part due to the reduction in the number of large public accounting firms but also due to changes in regulation, an active acquisitions market in the '90s, and increasingly complex business and relationship structures. In response to these ever-increasing risks we have in place rigorous identification, documentation, and disclosure procedures, which are consistently applied with the help of our network of conflicts coordinators. Indeed conflict checking is a mandatory element of our global client acceptance and continuance process. In addition to our robust conflicts checking process we have significantly enhanced our independence infrastructure as a whole over the last 12 months. We have appointed a global vice-chair of independence who reports directly to me, and supporting him are seven full-time area independence leaders as well as a large global independence compliance team. Add to this the revisions to our independence policy, a new global independence system, and the mandatory training that all client serving personnel undertake and I believe we are really demonstrating our commitment to maintaining our auditor independence.

How do you define your role with Ernst & Young?

Many people say to me, "Sue, you have such a hard job. You carry so much on your shoulders." And my instant response is, "It's on all of our shoulders." I manage it by making sure we all feel the responsibility for quality and risk management. No one person is going to make this happen. Rather, 100,000 Ernst & Young people are making it their responsibility to make it happen.

Are you ever satisfied?

Never, but then that's my job. ●

SPECIAL REPORT

Global Auditing Methodologies

ERNST & YOUNG

**An Interview with Stephen M. Todd, Director,
Global Professional Practice , Ernst & Young, London**

EDITORS' NOTE *Now based in London, Steve Todd joined the Cleveland, Ohio office of Ernst & Young in 1970. He has held various leadership roles within the U.S. firm. Todd has also been active in the academic field; he was a part-time professor of accounting at Cleveland State University and later Queens College, North Carolina. He coauthored the Audit and Accounting guide,* Audit of Finance Companies *published by the American Institute of Certified Public Accountants in 1988. Todd has served as a board member of several community organizations.*

Stephen M. Todd

What is the function of the professional practice group [PPG] within Ernst & Young?

Our role is to ensure the quality of our audits throughout the world, along with the consistency and quality of our financial reporting. Our audit quality professionals conduct checks of our audits to see that we have performed them to the highest standards. For accounting methodologies like IFRS and U.S. GAAP, we make every effort to achieve consistency worldwide in our application of those standards. As such, we have U.S. GAAP, SEC, PCAOB, and IFRS experts that consistently update the way we conduct audits in response to regulatory changes and provide guidance on the application and interpretation of accounting standards. So those are our main functions. In addition, we set global risk management policies on auditing and accounting matters for all of our member firms to follow.

How has Ernst & Young's focus on quality evolved?

The accounting profession has faced challenges in recent years, and we have significantly enhanced our global professional practice group to work more effectively with our practices around the world on improving the quality of our audit services. We do this in various ways; effectively executing our global audit methodology, implementing educational initiatives, and placing accounting and auditing experts in various cities around the world for our people to consult with.

Does Ernst & Young aim to have one consistent, global message for its quality initiatives and accounting standards?

That is our goal. As a global firm, we support two major systems: U.S. GAAP – with its related SEC and PCAOB requirements – and IFRS. In working within either system, we want to consistently interpret and implement those standards around the world. So, for instance, an IFRS statement that is prepared in Germany and audited by the German member firm will be prepared and audited in the same way as a similar statement under IFRS in Australia.

Is the need for quality auditing and accounting understood by people worldwide?

Absolutely. The corporate scandals in the U.S. and Europe have highlighted that need. There is no country in the world that doesn't have the need for quality auditing and accounting. For example, in China, emerging businesses may need better internal controls than they have at present. A lack of internal controls could lead to a financial irregularity or misreporting. So as I mentioned, our people throughout the world follow the same standard auditing methodology. We have consistent training on how we conduct our audits, and a consistent auditing tool for gathering, storing, and assembling information. Our challenge is to make sure those tools, processes, and methodologies are available to all of our professionals and executed properly.

Do you feel that IFRS has been effective?

Yes, but consistent interpretation and implementation is very difficult. Every country has a different GAAP background, so they are coming from different perspectives as they adopt IFRS. IFRS is a principle-based accounting system, and it requires judgment and interpretation. As such, our member firms act and consult together and we provide question-and-answer databases for our engagement teams; otherwise we would run the risk of having inconsistent applications and interpretations of IFRS around the world. So that is why we have put IFRS experts in all of our major practices and why we have developed a global IFRS center where we prepare technical publications, Web casts, and other educational programs on IFRS to provide consistent guidance to our professionals and clients.

Is it a challenge to keep people up to date on auditing methodologies?

It is, because the auditing standards keep changing. U.S. registrants have PCAOB standards to meet, but other countries have their own auditing standards and regulations. So while we develop benchmarks to meet PCAOB and international standards, we also have home-country supplements to meet the requirements of particular countries.

In addition, as I mentioned previously, we have a global methodology group, composed of representatives from all over the world, to monitor the newest auditing standards and incorporate them into our audit methodology. We hold training programs, on at least an annual basis, on the updates to our methodology and international auditing standards.

Can Ernst & Young use its focus on quality to differentiate itself from the competition?

All firms talk about quality, but it's the execution and delivery of quality that is most important. Our clients are very interested in audit quality, and they rely on their auditors to help maintain the integrity of their financial reporting and avoid material weaknesses in their internal controls. Those things will really impact their share price and their overall growth. So I think that companies and accounting firms are very interested in quality, but getting to that quality in this complex environment is the challenge. ●

ERNST & YOUNG

Growth Worldwide

An Interview with Thomas P. McGrath, Global Managing Partner, Client Service and Accounts, Ernst & Young, London

EDITORS' NOTE *Prior to assuming his current position, Tom McGrath was the AABS (assurance and advisory business services) managing partner for Ernst & Young's New York financial services office, and served as global coordinating partner and senior advisory partner for a number of major financial-institution clients. A graduate of Miami University (Ohio), McGrath is a CPA, a certified information-systems auditor, and a member of the American and New York Institutes of CPAs, and the Bank Administration Institute.*

Thomas P. McGrath

What is your current role and function within Ernst & Young?

Ernst & Young's heart is our people and our clients and the seamless delivery of high-quality services around the world. My team facilitates that delivery.

How does Ernst & Young structure its services to global clients?

We have an account-centric approach, focused on the client's specific business objectives. Our global accounts are led by a global client-service partner, who brings to bear the right resources in the right place at the right time, in order to serve the client, wherever they operate.

How is Ernst & Young different in its positioning than the rest of the Big Four firms?

The range of a firm's services is not as important as the quality of those services. We believe that in today's market the demand for the highest quality requires firms to focus, and we are no exception. We have chosen to focus our efforts on assurance, risk, tax, and transactions – services in which we have built or can build a global leadership position.

Equally important is the differences in the way the Big Four work with their clients. Our style is to see each client as unique in its issues and its opportunities. We aim to leverage our world-class methodologies and tools and, through appropriate collaboration with the client, customize our services to ensure that we do the right thing for that client.

How is Ernst & Young doing in the marketplace?

We are very happy with our progress. We are gaining market share in our strategic markets and sectors with both audit and non-audit clients.

How much growth is driven by new regulations in existing markets?

The new regulations have been and continue to be major drivers of recent growth. Sarbanes-Oxley and other corporate governance initiatives around the world – as well as the migration to IFRS in the EU and other countries – have increased work for our clients.

In addition to those services directly originating from regulatory changes, there is an increasing awareness of risk and corporate governance. So we are also seeing a significant increase in demand for other services. For example, our transaction-related services are in very high demand due to purchasers wanting a heightened level of assurance. Thus they look to us for more due diligence and tax-structuring services. This, combined with a significant increase in transaction volume, has resulted in tremendous growth in our transaction service line.

How much growth is driven by new services?

There are two types of new service opportunities for Ernst & Young. One is to take existing services into new markets such as bringing transaction-support services into a market like China. Sarbanes Oxley Section 404, which specifies new requirements for internal control reporting, has opened up opportunities for us with foreign companies listed in the U.S. The other opportunity is to develop new offerings, as we are doing with finance, risk, tax, and fraud investigative services.

How are the prospects for your non-audit services?

Outstanding. We offer a range of services related to risk, finance, tax, and transactions, and we deliver them to both non-audit and, where appropriate, audit clients. We are experiencing strong demand for such services and we expect this to continue into the future. As the challenges facing companies constantly evolve, we will continue to develop our services to help them.

How is the rapid development of new economies driving growth?

The sheer scale and global impact of the emerging economies is astonishing and never fails to impress me. China has some 20 percent of the world's population, and 400 million of India's people would be classified as middle class in Europe. We are seeing rapid growth in these markets, but we are also seeing growth in the established markets, driven by companies investing in new economies.

How important are mid-market companies to Ernst & Young?

Last year, the mid-market was approximately $6 billion of our global revenue, and it will remain central to our success. A growing number of mid-market companies – both entrepreneurial and publicly listed companies – are operating internationally and they need our skills, services, and global reach. Our commitment to entrepreneurs goes deep, as evidenced by our customized services for this market and our long-standing Entrepreneur of the Year program.

We also recognize that some of our mid-market clients will grow into global companies. Over the past five years we have increased our market share in the *Fortune* 1,000; approximately 80 percent of our new clients in the *Fortune* 1,000 got there through organic growth. So smaller, fast-growing companies represent a key pipeline for our future success.

What makes Ernst & Young different from the other professional service firms?

As a Big-Four firm, we are a global, professional, multidisciplinary, and high-quality organization. But clients can differentiate between the Big Four at the firm and partner level. Ernst & Young has a particular reputation for working well with clients and for teaming and sharing. These are increasingly important attributes that we will continue to build upon. ●

SPECIAL REPORT

China's Current and Emerging Challenges

An Interview with David Sun, Country Managing Partner, Ernst & Young, China

EDITORS' NOTE *A council member and past president of the Hong Kong Institute of Certified Public Accountants (HKICPA), David Sun also serves as a government-appointed, nonexecutive director of the Hong Kong Mortgage Corporation Limited; a nonexecutive director of Mandatory Provident Fund Schemes Authority; and a member of the board and GEM listing committees of Hong Kong Exchanges and Clearing Limited. He assumed his current post in May 2005.*

David Sun

China's economic development has been attracting global attention. What is your assessment of the current market and its characteristics and potential?

In spite of the accelerating pace of globalization, each market is unique. China's uniqueness – and its challenges – stem from the fact that its national economy is undergoing a dual transition: from a developing country to an industrialized country, and from a centrally planned economy to a market-oriented economy. Globalization is providing the impetus, as well as challenges, for Chinese companies. China's rapid economic growth may mask the ongoing and forthcoming challenges that the country has to overcome in undergoing dual transition.

China has been remarkable in attracting foreign direct investment and overseas capital, as well as in utilizing its abundant manpower resources to develop its export sectors, especially along its coastal areas. These developments have in turn fostered demand for investment in infrastructure, property, and the services sectors. In 2004, the country's GDP per capita exceeded $1,000 for the first time in its history. In terms of GDP, China is already the sixth-largest economy in the world, after the U.S., Japan, Germany, the U.K., and France.

Ernst & Young has been successful in positioning its services in tandem with the reform and growth of the China market. Over the last decade, we have been a leader in assisting Chinese companies listing overseas. We have also been active in assisting foreign companies to invest in China. Indeed, our knowledge, experience, and close working relationships with many leading Chinese companies and government agencies have also enabled us to provide assistance to our multinational clients in helping them achieve their objectives in the country.

How is Ernst & Young preparing itself for unfolding developments in China?

China's challenges in staying on its current growth trend hinge on the reform of its state-owned enterprises [SOEs] and its banking and financial sectors. China had been operating under a planned economy for almost 40 years before it allowed market mechanisms to thrive. Many of its SOEs and financial institutions are still operating in a business environment and system different from their Western counterparts.

China made a commitment in joining the WTO to open up its economy. Its financial sector will be opened up by the end of 2007. Efforts are being made to implement regulatory changes, address pertinent issues such as corporate governance and risk management, as well as progressively enhancing competition, deregulating markets, and giving step-by-step entrance to foreign participation. With WTO membership, the local sales base of Chinese companies will no longer be protected. They have to adopt a more global mindset and different management systems and practices to expand globally.

Ernst & Young positions itself in two ways. Firstly, we are continuing to grow the resources we have within the China practice – we will soon have 5,000 people – and develop our people to face both inbound and outbound service demands. Secondly, through developing our service lines and industry specialization, we are building the right skills and the right knowledge to bring value to our clients.

What has Ernst & Young undertaken to meet the emerging needs you mentioned?

While continuing to improve our existing services, namely in IPOs, audit, tax, and transaction support, we have also been working very closely with the State-owned Asset Supervision and Administration Commission [SASAC] of China's State Council, for instance, to develop an enterprise risk management model for Chinese companies and assist them in its implementation. SASAC was established in 2003 to promote and provide guidance for the reform and restructuring of SOEs. At the request of SASAC, Ernst & Young organized two major conferences – one in Beijing and the other in Hong Kong – for more than 600 participants on the subject of corporate governance and enterprise risk management. Participants were senior officials of the state council and SASAC, and senior officials from local SASACs, and senior managers, chairmen, and supervisory board members from SOEs.

What is your manpower plan to support your development strategies for China?

In addition to upgrading our recruitment and training plans, the support of Ernst & Young Global and other offices is crucial to the realization of our strategies for China. Our plan is to increase the total number of staff in China significantly.

What is Ernst & Young's strategy for winning quality clients in China?

Ernst & Young established its Hong Kong office in 1973. In 1981, we were the first international accounting services firm permitted by the PRC government to establish a representative office in Beijing.

Our aim is to become the leading professional services firm in the country. To accomplish this objective, we will redouble our efforts to monitor the development and changing demand for professional services in China, be proactive in our marketing efforts and service quality, and above all, adopt a client-centric approach to win and maintain quality clients. ●

Toward Global Convergence

Ernst & Young

An Interview with Christian Mouillon, Global Vice Chair, Assurance and Advisory Business Services, Ernst & Young, London

EDITORS' NOTE *Christian Mouillon joined Ernst & Young in 1978 and has held numerous senior roles within the firm. He also represented France for the working group on corporate governance of FEE (European Federation of Chartered Accountants and Auditors) and was Ernst & Young's representative on the executive committee of the French National Institute of Auditors (CNCC) for listed companies from 2002 to 2004.*

Christian Mouillon

For the past six months you have been globally leading the largest business line within Ernst & Young. What are your observations?

I had been the lead partner on a major global financial services client for a number of years, so I was used to operating internationally. However, since taking on the vice chair role, meeting with so many clients and client teams over the world has been a revelation. While I think there is a growing convergence between regions in thinking about governance and regulation, the variation in detail remains tremendous and extremely challenging for companies and accountants. I suspect that the more real exposure you have to the global economy, the more you question a single global model; there are so many exceptions. But I do think you can see an increasingly shared view of governance and reporting emerging around the world, and local laws will need to take this into consideration.

What comprises the advisory business services part of your practice?

The advisory business services practice comprises a range of specialty services based on accounting skills that are relevant to audit clients, but which also have broad applicability to non-audit clients. The three largest advisory businesses we have are business risk services, technology security and risk services, and a growing fraud and disputes services capability.

What impact are new regulations having on Ernst & Young's assurance and advisory business?

Sarbanes-Oxley has created major changes in the U.S., and the adoption of IFRS is driving significant change in the rest of the world. These changes are creating tremendous demand from both our audit and non-audit clients.

We have recently completed the most extensive study of accelerated filers in the U.S. These are companies who have already implemented Sarbanes-Oxley and are preparing their second year accounts. We have found that, while the level of external assistance required is falling somewhat, the management effort required to comply with these new regulations remains as high as in the first year.

What changes are the new regulations forcing?

Audit quality is under increased scrutiny by regulators and audit committees. Audit committees are meeting more frequently and are more involved in the detail of financial reporting than they used to be. This is resulting in our partners working more closely with audit committees and management to provide timely and relevant conclusions, and having increased hands-on involvement in the audit.

Our major challenge is to ensure that we are adopting consistent interpretations of IFRS around the world. In the days of national auditing standards, there was understandable variation between different countries, so a client would have different rules and interpretations to deal with. The U.S. Securities and Exchange Commission is tightly monitoring the correct application of U.S. GAAP to domestic and foreign registrants. So consistency throughout Europe is crucial if we are to achieve convergence. With IFRS, we have to ensure that companies operating in the same sector get consistent interpretations of these new accounting rules. So we have put teams with specialized technical resources in each area of the world to support our engagement teams and clients.

Are you expecting major changes with the new Eighth Directive?

The Eighth Directive is still being debated as we speak. However, my expectation is that we will see a bigger role for audit committees, the adoption of international audit standards, and some clarification of independence criteria across Europe.

Do you think the regulatory balance is right?

I think we can all agree that business evolves and gets more complex in scope and operation. Regulations will also continue to evolve to keep pace with new developments. Evolution is never a smooth path; it is a series of steps, and it takes time to know which steps are best. We seem to have moved into a new era in which the quality of financial reporting has taken on a greater significance. I think this is important but whether investors will pay the increased cost associated with it remains to be seen.

With the adoption of IFRS in some 90 countries, we have moved into a bipolar world with two basic but quite different accounting models – IFRS and U.S. GAAP. Convergence will likely take some time. In the short term, I hope we can move to equivalence and mutual recognition. That would certainly reduce the costs to companies.

How important is global assurance to a market like China or Russia?

Without assurance, investment is just high-risk speculation; no one is clear about whether the returns are good or bad, real or fraudulent. There will always be some investors prepared to take these risks, but the returns they demand are very high, and the amount they are prepared to risk is relatively small.

Global assurance brings emerging markets into the mainstream and is the key to the massive levels of international investment that real economic development in countries like Russia and China require. An investor in Paris or New York or Cleveland can look to investments in these markets with much greater understanding and confidence when global assurance processes are in place. ●

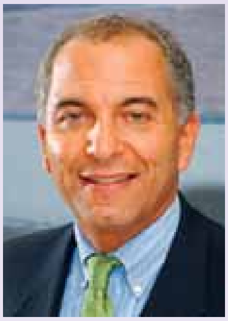
SPECIAL REPORT

Adapting to Changing Client Needs

ERNST & YOUNG

**An Interview with Sam H. Fouad,
Global Vice Chair - Tax Services, Ernst & Young, London**

EDITORS' NOTE *During his 20-year tenure with Ernst & Young, Sam Fouad has advised clients on international tax matters globally. Fouad has a J.D. from Georgetown University Law Center and a B.S. from the University of Southern California. He was appointed global vice chair of tax services in 2003.*



Sam H. Fouad

How does Ernst & Young differentiate its tax services from those of its competitors?

Among accounting firms, Ernst & Young strives to distinguish itself through the quality of its relationships with clients, the quality of its people, and its ability to deliver seamless, consistent, high-quality tax services worldwide through its networks of specialty tax services.

The standards for performance in business have changed. In the '70s and '80s, tax was generally considered to be a matter of compliance and cost. During the '90s clients began to explore ways to increase cash flow and earnings. This led many to proactively, and some to aggressively minimize their taxes. More recently, emphases on financial reporting accuracy, internal controls documentation, corporate governance, and risk management have led clients – as well as Ernst & Young – to comprehensively and systematically review the way tax matters are addressed. Today, our clients expect that we will provide them with insights and prudent advice on the tax aspects of their business, while helping them to understand, and accurately reflect, their tax positions and risks in their financial reporting and tax compliance filings. As a public accounting firm, Ernst & Young recognizes that we must continue to deliver our tax services with a view towards the very highest evolving professional standards applicable to financial and tax advisers in each of our chosen markets.

Are audit committees and boards of directors paying closer attention to tax issues these days?

Absolutely. Implementation of the U.S.' Sarbanes-Oxley Act and the European Union's proposed 8th Directive, as well as other national initiatives, are redefining the roles of corporate directors and the audit committee. Ernst & Young research carried out last year, showed that tax directors are now getting greater exposure to the audit committee than in the past, as well as greater direction from board-level leadership.

This is appropriate given the significance of income and indirect taxes for financial reporting and internal controls purposes. For example, for those U.S. SEC registrants who recently disclosed either a material weakness or other internal control deficiency, tax was one of the most frequently occurring weaknesses. This explains why tax is gaining increased attention among our clients' financial priorities.

What was the reasoning behind the establishment of your tax accounting and risk advisory services [TARAS] network?

Publicly-traded companies have significantly increased their focus on financial reporting, documenting of internal controls, corporate governance, and risk management.

One example of these trends is the emergence of International Financial Reporting Standards [IFRS], and their convergence with U.S. GAAP standards. This creates a market demand and expectation for consistency regarding financial reporting around the world. The trend is illustrated by research we carried out earlier this year on the impact of IFRS on corporate tax departments. We found that interpretation of the technical standards, the process or methodology used for implementing IFRS conversion, and risk analysis and impact modeling of the conversion were the top three areas of concern for tax directors and CFOs.

While internal controls documentation requirements have most prominently figured with respect to U.S. publicly-listed companies, similar requirements and best practices are also emerging across Europe, Asia, and Latin America.

Our TARAS practice comprises tax specialists closely linked with our assurance and risk advisory professionals to help them address the tax aspects of financial reporting, internal controls analyses, and other risk advisory services as appropriate to our audit and non-audit clients.

For audit clients, TARAS is focused on the review of the tax aspects of our clients' financial statements and internal controls attestation. For non-audit clients, TARAS helps them with a variety of needs, including support for reporting and compliance calculations and filings, and internal controls documentation.

How does Ernst & Young's "quality in everything we do" message play out in the tax services group's work?

In today's marketplace, quality needs to be explicit and consistently delivered around the world. We have redoubled our efforts to ensure quality by focusing on establishing common processes, methodologies, learning, technologies, and review procedures to support our practices around the world. We regularly review our partners' work to reinforce the fact that consistent high quality is our expected standard for performance. High quality is more than a prerequisite for a public accounting firm with a leading global tax practice – it is a real source of competitive advantage.

To what do you attribute the growth of Ernst & Young's tax services business?

Our business is growing because we have responded to the market's evolving demands and the re-prioritized tax needs of our clients. Multinational corporations want globally consistent tax services, whether they are an audit client or not. As our clients' businesses continue to expand, their need for advice and assurance can only be met by organizations such as ours which have made the necessary investment to provide depth and breadth of technical and market knowledge. Our market-leading strength combined with our global tax specialty services networks together enable us to deliver the seamless, consistent, high-quality service that our clients expect of us. This has been key to our growth. ●

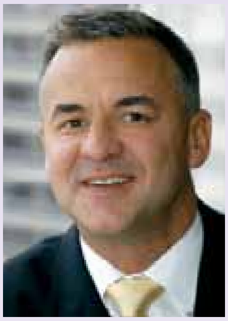
SPECIAL REPORT

ERNST & YOUNG

Investing in Emerging Markets

An Interview with Dave Read, Global Vice Chair, Transaction Advisory Services, Ernst & Young, London

EDITORS' NOTE *Dave Read has specialized in transaction support, debt and equity offerings, and stock exchange transactions, and has, over the past 15 years, served as an advisor for more than 250 transactions. He has been a key member of the transaction advisory services industrial products team and has been involved with a number of transactions in the United States, Europe, and Asia, working with multinational corporate and private equity clients.*



Dave Read

You have just taken on your current role. What have you found, and what are your plans for the future?

In my previous role, I was responsible for advising a number of multinational clients and saw the challenges that clients face with cross-border transactions. The deals are inherently complex and require objectivity, reliable advice, and speed to meet the needs of our corporate, private equity, and capital-markets clients. In my new role, my goal is to ensure our business is best aligned to meet these challenges. Our three priorities are to improve the quality of service consistently across our practices, located in 70 countries; increase our market share of transactions advice to corporate and private-equity firms; and focus on the retention, development, and recruitment of quality people. Our people are at the heart of our success.

What capabilities does Ernst & Young have in the transaction market?

We support clients across all stages of the transaction lifecycle, from opportunity identification to deal close and integration. Our three largest businesses are transaction support, valuation, and transaction tax. Other fast growth areas are project finance and transaction integration. We offer specialist services in M&A advisory and restructuring in numerous key markets.

How does Ernst & Young attract the skilled employees it needs to compete in this market?

Whether they are part of a private equity firm or a corporate deal team, dealmakers work in a competitive, fast-moving, and challenging environment. As transaction specialists, our people receive global mobility opportunities, work in cross-border teams, have tailored transaction learning and development, and work on some of the world's biggest deals.

What projects has Ernst & Young been involved with in China?

We have advised on many deals in China, including a recent billion-dollar acquisition. The deal spanned 160 countries. Ernst & Young provided financial advisory and related due diligence, tax structuring, human capital due diligence, and new benefits plan design, as well as public company advisory related to the Hong Kong Stock Exchange filing requirements. A large global, cross-functional team was formed to assist before and after the deal's completion.

How is private equity changing the transaction landscape?

Over 15 percent of the total global M&A volume last year was conducted by private equity firms, and in some countries the proportion was even larger. For example, private equity activity accounted for 37 percent of the total M&A volume in Germany and 22 percent in the U.K. Private equity funds are raising larger funds across the world and with this leverage, they have significantly increased buying power. This greatly impacts the transaction landscape and the global economy. The German Private Equity and Venture Capital Association recently disclosed that their members hold a portfolio of €20.3 billion invested in almost 5,600 small and medium-sized companies in various investment stages. Indirectly, the private equity industry ranks as the second-largest employer in Germany. A similar impact is emerging in many other markets across the world, particularly in Europe and the Americas.

Why is a company's corporate development officer important?

The corporate development officer [CDO] is generally the most senior person responsible for transactions in a corporation. In reality, the role has many different titles including head of M&A or director of business development, and so on. From our research, we see the role of CDO becoming increasingly important and gaining a higher profile in the organization; many are reporting directly to the CEO and are involved in corporate strategy. In particular, the corporate development function has become increasingly important to a company's ability to compete for the best deals with aggressive and streetwise private equity firms.

What have CDOs been telling you?

CDOs are finding virtual teams more and more critical to the execution of cross-border transactions. The effective management of virtual deal teams can provide a competitive advantage. With only a small, dedicated team – most CDOs have less than five full-time employees – and an increasing mandate to move into new markets, CDOs have a growing dependence on resources that are spread across an organization and its geographies. This is complemented by an increased reliance on external advisers. CDOs need advisers, like those at Ernst & Young, that team well, that have an objective perspective on the transaction and that operate globally.

How big an opportunity are emerging markets for transaction services?

According to our recently released "Corporate Development Officer Study," over 50 percent of companies surveyed are considering China, Eastern Europe, Southeast Asia, or India to transact in over the next 12 to 24 months. This is a small snapshot of the overall global-transaction picture. Add to that the well-funded private equity firms that are also looking for opportunities, and I predict an ongoing demand for transaction advisory services for at least the next two years. A sizeable opportunity for us is attached to that. ●