Has your internal audit transformation journey begun?

Progressive actions that internal audit functions should consider in its transformation agenda.
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Internal audit functions have been operating in the same fashion for a long period. However, converging forces are shifting how they should respond to risks and are redefining what value internal audit brings to the business.
Welcome to our first issue of the Internal Audit (IA) Transformation Agenda series for the Greater China region.

This is the first launch of the EY Global IA Transformation Survey for Greater China, an ongoing research study on how progressive IA functions should evolve along with the market and technology disruptive age. In our recent survey, we asked over 600 participants worldwide of which about 100 participants were Chief Audit Executives (CAEs), C-suites and members of Audit Committees in the Greater China region, on their expectation of the future of IA and to explore possible approaches in transforming the existing IA. Unlike conventional quantitative survey, qualitative interviews and in person interviews were conducted, where possible, with participants to understand their views specific of the IA function transformation agenda and how that aligns with the business. In addition, what difficulties they encounter during their journey.

Articles on the IA Transformation Agenda will be released periodically, backed-up with fresh survey data and relevant insights. We have taken this new approach to use the survey findings to help drive a regular drumbeat of topical content, designed to spark continuing conversations among IA practitioners in the region.

This issue is intended to share insights from the Survey through the story of a Chief Audit Executive (CAE) for a retail organization operating in the Greater China region on capitalizing on valuable touchpoint with business in positioning IA as a value and relevant advisor through the risk assessment program, and exploring a resourcing model that aligns with delivering what the business expects. We have framed our questions below to guide the discussion:

- How can risk assessment transform the IA function from a provider of hindsight to foresight?
- What should be considered in the strategic workforce planning, and how to bridge the gap between the IA team's current capabilities versus future skills required?

In our next article in the series that is planned for release later this year, we will address the challenges facing the CAE and IA in exploring the adoption and deployment of technologies or tools, as part of the IA transformation journey.

We hope that you enjoy reading our insights and we would like to thank all interviewees and survey respondents who contributed to this publication. We appreciate the time they took to share with us their personal experience and challenges.
Jane Huang, the Chief Audit Executive of a retail operator in Greater China, is planning the new year roadmap of her IA program after her annual one-on-one meeting with the CEO and key senior management.

The CEO has indicated that he would love to see her IA program provide more business insights and be positioned as a business partner while the group continues to transform their business and operations with the adoption of advanced technology and digitalization in the coming years; and currently IA appears to only focus efforts on compliance type reviews. On the other hand, some senior management expressed concern if IA is capable or ready to advance themselves in this digitalization age as the predominant mindset seems traditional and manual, while some of the IA team members did not appear to have sufficient business knowledge in advising management during discussion.

Last year, Huang has begun investing effort to kick-start her IA in shifting the operating model from a traditional assurance provider toward a strategic partner by introducing data analytics and changing the resourcing strategy to include business and IT specialist joining her team. However, these changes were not as visible or recognized by senior management as Huang had hoped.

For this year, Huang plans to brainstorm with her managers and an external consultant to start with looking into the existing risk assessment process and people strategy currently used, and addressing what needs to change, and how it changes in order to meet her goals for IA – be seen to be making a step toward being a business partner and equipping her IA function to do so.
Moving from hindsight to foresight in aligning with business transformation

Huang's team recognizes the need to step out of its traditional gatekeeper role and embrace the role of an "Anticipator", and in using talent and insights to drive value rather than just responding passively to the needs of the business. She started with asking herself and her team the following:

How can risk assessment transform my IA function from provider of hindsight to foresight?

Do I understand the current pain points within my organization?

Internal auditors have cultivated a long legacy as purveyors of hindsight, reporting to management where past mistakes were made, while more often than not, the management are already aware of what these are. However, in the era where fast-paced risks emerge at disruptive speed, Huang's IA function will need to focus ahead on the risks of tomorrow to enhance organization value it brings as a partner to the business. She understands the need to be able to bring insights today in anticipating changes, and demonstrate her team has the ability to leverage hindsight from their knowledge of the business accumulated over the years. She understands that her team's ability to demonstrate this starts with the annual risk assessment program where she has the opportunity to engage with a captive audience – senior and middle management of the business and begin to make her initiative to change visible.

Risk management is one of the top 5 most important skills/knowledge that an IA function needs to build/improve upon as selected by over half (56%) of our survey respondents.
Based on our survey, the top 5 emerging risks that the enterprises of our respondents are tracking/monitoring include:

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<th>China Mainland</th>
<th>Hong Kong and Macau</th>
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<tr>
<td>Major shifts in technology</td>
<td>Cybersecurity</td>
<td>Competitor innovation</td>
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<td>Regulation around data privacy</td>
<td>Competitor innovation</td>
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<td>Cybersecurity</td>
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<td>Economic stability</td>
<td>Customer preference</td>
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<td>Competitor innovation</td>
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How can my team add value to address risks that are critical but not seen as having a silo perspective by the management and the Board?

As expected before the emergence of the COVID-19 pandemic, risks associated with technology advancement, including competitor innovation, cybersecurity, data privacy etc., are common top emerging risks identified by our respondents in the region. While these may constantly be under some level of scrutiny within the organization, there are instances where emerging risks may not be taken seriously by the business. Take sustainability and climate change risks as example while this is increasingly coming under the spotlight and has drawn attention from regulators, and thus, C-Suites, management and investors in Greater China, only 10% of our respondents selected this as one of the top 5 emerging risks.

In Huang’s case, she will need to work with her Chief Sustainability Officer (CSO) to understand how the business and its suppliers drive compliance with the regulatory and industry standards. Due to the increasing expectation from consumers and even employees on corporate social responsibility, Huang and her CSO were aware that climate change and sustainability are becoming more and more important to the business. However, the Board does not currently share the same thought. In surfacing this topic for attention, Huang is collaborating closely with her CSO to leverage the risk assessment program to highlight the importance of enhancing the processes around climate change and sustainability. In turn, the CSO appreciates the support from IA and recognizes the need to partner with IA when it comes to discussion around risks.
Based on our survey, the top 5 emerging risks that the enterprises of our respondents are tracking/monitoring include:

Progressive actions that internal audit functions should consider in its transformation agenda
Risk assessment now

Huang’s team took part in business led enterprise risk management process as an observer and advisor, and her team has been advising to initiate a separate emerging risk assessment process since last year. However, neither the senior executives nor the stakeholders recognize the need or do not understand how to do so, considering this being a different process from the current program. She therefore proposes to advise the business on how and what to consider in embedding emerging risks discussion into the current program and approaches an external consultant to assist her on the change.

From the Survey, less than one-third of our respondents’ IA functions are heavily involved in and having a separate emerging risks assessment process, and 19% of respondents indicated they used third party service provider to assist in the risk assessment process.
While planning her path toward transforming the risk assessment program, Huang was interested to know how and what other industries will be doing in the coming 3 years.

Our interviews with CAEs in the region indicated that the advancement in technology and flexible resources model will enable their team in providing insights for risk assessment, in addition to more efficiently facilitating the risk assessment program.

Our survey result showed more than half (62%) of respondents from China mainland, Hong Kong and Macau were expected to become heavily involved in identifying and assessing emerging risks in the next three years while there were only 9% of respondents from Taiwan that thought in the same way. In our survey, majority (82%) of respondents from Taiwan were already involved in identifying and assessing emerging risks today.

This increasing expectation of emerging risk assessment acknowledges the need to embed foresight in any risk discussion and is an important element of a progressive IA function. IA function should further position themselves as a partner to the business through a collaborative process with management to identify and address emerging risks during risk assessment discussions.
Creating value through understanding risks

Historically, IA functions have had limited access to leverage technology in the risk assessment process, thereby resulting in a significantly manual effort to gather and process the necessary data.

How can risk assessment create value for my organization?

It is becoming increasingly complex for IA functions to evaluate and monitor the breadth of the risks through traditional risk assessment activities.

For Huang to be creating value as a business partner and being front and center of her transformation initiatives, she brought up the question of changes that may need to be made to the external consultant and managers; where they collectively decided to consider 3 directions in risk assessment where her team can adopt.
How can we use technology to improve the risk assessment process?

Forward-looking IA functions are disrupting their IA risk assessment process and leveraging data to provide insights during the IA risk assessment process. 39% and 58% of our survey respondents utilize data analytics in performing risk assessment today, and in three years respectively.

Have your IA function begun harness and analyze business and risks data for your risks assessment?

There are three types of business analytics that are used across IA functions today 1) Descriptive, 2) Predictive and 3) Prescriptive. Traditional IA functions have been using descriptive analytics to visualize and understand risks. Now more IA functions are moving away from descriptive to predictive analytics as it helps to predict what will happen in the future by analyzing prior patterns using simulation models, predictive modeling of future control failures, data mining and statistics clustering. Forward thinking IA functions are starting to adopt prescriptive analytics, which can help IA functions determine the action with the most desirable outcome by providing all the possible outcomes.
Has your internal audit transformation journey begun?

What will we cover in the future risk assessment?

Most businesses have undertaken some form of fundamental transformation due to customers’ changing expectations. These transformations have created three types of risks, downside (e.g., exposure to cyber threats), upside (e.g., opportunities to expand the customer base), and outside (e.g., political landscape in a country) risks.

Traditionally, IA risk assessments have fixated on the downside risks, however, to foster a successful transformation, IA functions will need to also shift their focus to embrace new upside opportunities that offer benefits to support the business strategy and objectives.

The following benefits may arise from embracing new upside opportunities:

- A larger and a more diverse consumer base by realizing the potential of allowing innovative ideas and solutions
- Opportunity to control developments within the industry by utilizing the organization’s increasing market share
- Effective and efficient business processes by acquiring, managing and deriving value from new assets and talents
How often do you perform risk assessments?

When respondents were asked how often they would perform an internal audit risk assessment, more than half (59%) responded annually. To adapt to the ever-changing risk environment, IA functions should adopt a more dynamic and iterative risk assessment process. The need for frequent interaction with stakeholders and to provide timely quantitative analysis is crucial. This is echoed by our survey where 18% and 13% of respondents conduct risk assessments continuously and quarterly respectively. More frequent engagement (versus a point-in-time or annual process) provides IA with greater insights and the opportunity to respond in a more timely manner to current and emerging risks and challenges.
Progressive actions that internal audit functions should consider in its transformation agenda

Has your internal audit transformation journey begun?
How are key risks and related risk indicators derived and reported?

A key element to a comprehensive and emerging risk assessment program is the ability to encourage collaboration between IA functions and the business stakeholders. Collaboration tools help drive deeper and more meaningful discussions from key business personnel. Using a collaboration tool that provides a forum to identify and discuss risks have been proven to be effective, and technology that embeds risk dashboard to report the emerging risks can help capture, evaluate and synthesize data on a real-time basis to drive better evaluation of risks within the business and in turn, help build a tailored risk response plan and internal audit plan.

In addition, most IA functions feel that reporting of the key risks identified is necessary and are currently using some form of dashboard as the reporting medium. At present, Huang manually prepares a risk heat map and summary of top risks and related actions for presenting the risk assessment result to the CEO, key senior management and the Audit Committee. While the material can be quite bulky and could not be updated with real time data, Huang and her manager are struggling to identify a better and efficient format that can be used - essentially a report that is useful and valued by its readers.

What EY can do to help your IA function?

EY provides different types of advices in enhancing your enterprise risk assessment process:

• Build risk profile using EY Risk Universe™
• Data-driven risk assessment process
• Virtual collaboration technology and workshop
• Risk and control indicators dashboard

Other EY services offering include:

• Program Risk Assessment
• IT / Cyber Risk Assessment
• Third Party Risk Assessment
Where EY can help you?

Most businesses are undertaking some form of fundamental transformation due to simultaneously changing expectations. As a result, speed to market is no longer just a first-line-of-defense concept – it needs to be carried over to the second and third lines to truly maximize value. New technologies, more and better data, and the maturity of and enhancements in first- and second-line control capabilities promise a future in which IA can provide real-time and holistic views of risks and controls. But to achieve this, IA will need to take steps to embrace and invest in technological changes that are aligned to the transformation within the business. We have helped our IA clients begin their transformation to hit-the-ground-running and embark on their journey through collaborative technology intended to change mindsets with the team and barriers.

As a technology consideration, Huang is assessing EY ThinkTank – a virtual, collaborative platform that engages participants in the same room or across the globe virtually that enables

- Improve quality and efficiency of the risk assessment process
- Reduce end-to-end cycle time, requiring risks identified are relevant and in need of urgent mitigation
- Allow virtual sessions for participation regardless of location
- Reduce executive time and cost of travel
- Capture all session data with one-touch reporting
After brainstorming with the external consultant and her manager, Huang has got some ideas on enhancing the risk assessment program.

For her next transformation initiative, she is going to meet the HR Director to discuss the 3- to 5-year strategic workforce planning related to workforce capacity, capabilities and cost required, and to identify gaps between the team’s current capabilities versus future skills required.
Defining the current and future IA talent and resourcing strategy

Talent, currently an IA function’s greatest asset, may one day become the biggest challenge if the team fails to embrace digitalization. The transformational change in IA requires a different approach to strategic talent planning, development and management.

What skills are most important within my IA function?

While Huang has started to shift her team from a traditional assurance provider to a strategic partner, the skillsets required for her IA team is beginning to look very different. To develop a changing workforce model, she first needs to identify what skills are important to her IA team in order to deliver her commitments.

Our survey respondents indicated that creative problem solving and knowledge of business are two of the top three skillsets required for the future. While respondents from China Mainland, Hong Kong and Macau think that innovative mindset is another key skillset, respondents from Taiwan consider flexibility is also critical as 73% of respondents from Taiwan did not engage third party service providers. Therefore, the availability and skills including technical and languages provided by the existing IA functions could be limited.

Having critical capabilities in mind, Huang has decided to specifically define the target proficiency levels for her IA team.

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<th>Top 3 skillsets that are most critical for IA of the future:</th>
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What skillsets are my IA function currently lacking?

As Huang defines the most important skills her IA team need, she also began to assess what skillsets are currently lacking. She observes that compliance, data analytics, fraud prevention/detection, process improvement, technology, risk management, business strategy and project management were currently listed in job advertisements as skills required and she would like to hear from an external consultant for more input, and if these skills are truly necessary.

Our survey respondents from China Mainland, Hong Kong and Macau, and Taiwan all agreed that “data analytics” is still one of the top three skillsets that are currently lacking, despite this being identified as a need for several years. The selection by respondents from China Mainland, and Hong Kong and Macau are quite similar – apart from “data analytics”, they both considered “business strategy” as also one of the key skillsets that are currently lacking. While respondents from China Mainland think “deep industry experience” is needed, respondents from Hong Kong and Macau think “critical/analytical thinking” is more important. For respondents from Taiwan, the result is slightly different. In addition to “data analytics” and “deep industry experience”, Taiwan respondents also considered “technology” and “risk management” are not sufficient as well.

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<tr>
<td>Top 3 skillsets that are currently lacking:</td>
<td>Data analytics</td>
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<td>Technology</td>
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<tr>
<td>1</td>
<td>Deep industry experience</td>
<td>Business strategy</td>
<td>Data analytics</td>
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<td>2</td>
<td>Business strategy</td>
<td>Critical/analytical thinking</td>
<td>Deep industry experience, and Risk management</td>
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Assessing and managing IA resources

In order to cope with the transformation within IA function, CAEs need to assess their IA team by understanding how the team is positioned within the business, what they need to deliver on their mandate, and how to manage the gap between positioning and need.

New technologies require new skills and, more importantly, new ways of working. Just employing people with different skills, or upskilling existing employees, is no longer the only answer.

To cope with the changing environment and skills availability, Huang will need to implement a more flexible model to have the right people at the right time and in the right place, including potentially, a combination of core audit staff, guest auditor, contingent workers, robotic process automation (RPA), external services provider and staff rotation to address the competency gap.

When we asked the respondents on their current resourcing strategy, it can be seen that most IA functions still heavily rely on core audit staff despite the competency gap. The two common ways currently used by CAEs in enhancing IA’s competency are through below and which is discussed in the next page:

- Rotation/guest auditor programs
- Engaging third part service provider

Transformation considerations

- Analyze people competence and availability
- Promote and establish a rotation program
- Transition to a flexible people resource model
- Define expectation at each rank and provide feedback on a periodic basis
Rotation/Guest auditor

While “deep industry knowledge” and “business strategy” are two of the top three skills the current IA functions lack, rotating internal auditors to other business functions or having guest auditor from business unit is one of the most common ways to quickly enhance business knowledge within the IA function. The level of staff eligible for rotation can be wide, ranging from staff to CAE. However, our survey respondents indicated that about half (51%) of the respondents utilize rotation program to enhance new skills and work experience for their IA function, indicating nearly half of the respondents still do not have such program largely due to lower level of support from the business.

Engaging third party service provider

Time and effort are required for talent development, such as one-on-one coaching to foster meaningful skills acquisition, in addition to in-depth training courses to develop soft and technical skills, etc. Besides, the needs for talents of different aspects are uncertain as different projects may be requested by the management that require different skillsets. When time and resources are limited, many companies (more than 70%) opt for engaging third party service providers. Our respondents indicated that “specialized IT skills” and “internal control testing” were the most popular services engaged as the IT risk was chosen as the top emerging risks by most of the CAEs interviewed, while the CAEs who chose the latter option strategized for their in-house IA function to focus on advisory works to provide value and insights to organizations.

We also enquired CAEs on the level of RPA currently adopted, and the responses varied within the region. Respondents in China Mainland expressed interest early on and indicated that they have already commenced to adopt some RPA in their audit cycle while in Hong Kong, Macau and Taiwan, respondents indicated the current automation level of business process is not sufficiently mature to adopt RPA in the IA process.

Top 3 areas that uses third party service provides

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<th>China Mainland</th>
<th>Hong Kong and Macau</th>
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<tbody>
<tr>
<td>1</td>
<td>Specialized IT skills</td>
<td>Specialized IT skills</td>
<td>Specialized IT skills</td>
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<tr>
<td>2</td>
<td>Specialized industry knowledge</td>
<td>General IA teaming or co-sourcing</td>
<td>Internal control testing</td>
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<tr>
<td>3</td>
<td>Internal control testing</td>
<td>Compliance control testing</td>
<td>Risk assessment</td>
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25% of respondent organizations allow manager grade or above to go on for job rotation

51% of respondent organizations allow staff grade or above to go on for job rotation

78% of respondents from China Mainland, Hong Kong and Macau

27% of respondents from Taiwan have engaged third party service providers for IA services
Bridging the competency gap and managing team feedback

A clearly defined people plan that encompasses innovative and ongoing feedback is a key pillar to successful IA transformation.

Which component of people aspect should be defined early during an IA transformation?

Huang realizes standard learning and career development plans in the past are not enough to ensure that the competency of her IA team will continuously meet business needs. She will need constant learning on how to adapt and utilize new skillsets and ways of working to operate as part of her transformation strategy.

When respondents were asked about whether they have a defined competency model, about one-third (36%) of respondents say that they do not have a framework to define the skill and knowledge required from the IA functions which correspond with the current and future business needs.

Therefore, it will be crucial for Huang to first establish a well-defined competency model which helps to identify areas of talent development needs. From thereon, relevant learning plan, coaching opportunities and structured experiences can be developed for each identified area.
How does my IA team function attract and retain the right staff?

Although Huang hired some staff with operational experience and IT knowledge last year, they did not stay long. Huang struggled with how to incentivize and retain her team members with the required skills.

When we asked CAEs, C-Suite, Board level and other stakeholders about where do people go if they leave the IA function, close to three quarters (73%) of respondents indicated people went to outside IA positions. Although some of the leavers transfer to other departments such as finance, operations and governance within the organization, CAE should find out ways to retain the right people within the IA function by developing a clear understanding the IA team and its people and helping to clarify how their skills and potential development analysis with IA mandate with the organization.

As part of the IA function transformation, we anticipate that the team will evolve by increasing the use of technology and data as well as contingent workers for specialized skills. However, the right people are not always easy to find. Huang should consider among multiple options whether to upskill and reskill existing team members, recruit and train fresh (STEM) graduates, hire experienced IA team, search for suitable candidates from other departments within the business, and engage an external service provider in order to meet the IA needs. Defining a competency model together with development path and complementary reward system helps retain talent.

As Huang may find difficulty in recruiting and retaining the right people, the idea of a flexible talent model that encompasses the above may need to be considered. 71% of our respondents indicated the biggest upside in flexible talent model is the ability to get the right skills in the right place.
What EY can do to help you?

**Internal audit resourcing** - we as our clients’ extended arm can assist on addressing challenges to cover risk effectively, responsively and add value at the right cost, skill sets from traditional audit skills to specific subject matter including cybersecurity, construction, analytics and IT, geographic reach, and at the right time. This internal audit support model is also flexible and scalable depending on needs.

**EY Robotic Process Automation (RPA)** - As Bots provide flexibility and connectivity between applications, increase the effectiveness of applications, and complete routine activities that previously required manual effort, we help IA functions leverage this capability in streamlining manual test procedures to increase execution efficiency and alleviating capacity that can be instead channeled to focus on higher risk areas.

**External quality assessment** - we assess how IA function aligns with stakeholder needs and expectations in addition to helping IA clarify its mandate from the Board. In addition, the assessment considers how IA is operating compared to its peers and leading practices maturity model. Ultimately, we assist on identifying targeted areas of improvement and recommendations to achieve a more effective, efficient and value-driven function - one that aligns with the Board and management expectations.
A call to action

After several meetings between her team and the external consultant/the HR Director, Huang has decided to embark on the below as an initial step towards transforming her IA function with a focus to win her CEO and senior management’s endorsement of her initiatives to align with the transformation that is occurring within the business:

• Introduce a collaboration tool to facilitate the risk assessment discussions
• Develop KRI and KPI dashboard to enhance the risk assessment program
• Design a competency framework and development path of each skillset to progress
• Re-assess the bandwidth of her team and determine which skillset should be developed or procured
• Initiate discussion for an internal rotation program
• Design a roadmap for each of the steps above that embeds timely reflection of effectiveness and feedback from various stakeholders, in addition to endorsement from the CEO and Audit Committee
Survey Methodology

Profile of participants

Respondents by percentage

Respondents by total annual company revenue

Respondents by number of employees

Respondents by role/title

Survey Methodology

Progressive actions that internal audit functions should consider in its transformation agenda

Survey Methodology

Respondents by percentage

Survey Methodology

Respondents by total annual company revenue

Survey Methodology

Respondents by number of employees

Survey Methodology

Respondents by role/title

Has your internal audit transformation journey begun?
Start building with EY

EY teams are committed to building a better working world - with increased trust and confidence in business, sustainable growth, the development of talent in all its forms, and greater collaboration. EY wants to build a better working world through actions and by engaging with like-minded organizations and individuals. This is our purpose - and why EY exists as an organization.

EY, one of the largest professional services organizations in Greater China, has been present in the region for more than 50 years and in that time EY has achieved many major milestones: opening the first Hong Kong member firm office in 1968 as Arthur Young and in 1981, being one of the first international organizations to establish operations in mainland China.

The EY Greater China Region supports its clients through 29 office locations: Beijing, Shanghai, Hong Kong, Shenzhen, Guangzhou, Macau, Changsha, Chengdu, Chongqing, Dalian, Haikou, Hangzhou, Kunming, Nanjing, Qingdao, Shenyang, Suzhou, Tianjin, Wuhan, Xiamen, Xi’an, Zhengzhou, Hsinchu, Kaohsiung, Taichung, Tainan, Taipei, Taoyuan and Ulaanbaatar.
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