



# INTEGRATING THE BUSINESS REPORTING SUPPLY CHAIN

A report based on recommendations from key  
business leaders from around the world



International Federation  
of Accountants

# KEY RECOMMENDATIONS

## ***Improving Governance in Organizations***

Good governance starts with tone at the top.

Principles-based, stakeholder-driven governance codes offer a stronger chance of success than a legislative approach.

Further international convergence is desirable.

More independence should be required of boards of directors.

Directors should competently fulfill their duties.

Risk and liability for directors should be addressed.

The primary responsibility of directors is performance—not compliance.

Expand from a shareholder to a wider stakeholder perspective.

Organizations should take social and environmental, as well as economic, performance into account.

Executive remuneration should be aligned with the organization's sustainable performance relative to its competitors.

Ongoing risk management and control should be a key part of board oversight.

Collaborative effort is required to address systemic risk.

A globally coordinated system of governance, regulation, and oversight is needed to prevent future crises, but with care not to deter innovation.

Investors and other stakeholders should more actively pursue their responsibilities.

## ***Improving Financial Reporting***

It is critical that financial reporting becomes more relevant and understandable to the various users.

The use of a direct cash flow statement should be encouraged.

Additional support for retail investors is required.

Financial reporting standard setters should simplify their standards.

The financial reporting burden on smaller and non-listed entities should be limited.

The use of fair value in financial reporting should be supported.

The application of financial reporting standards should be more principles based.

Global capital markets would be best served by one set of principles-based, high-quality financial reporting standards.

Professional behavior and a minimum level of qualification should be required for preparers of financial statements.

## ***Improving Financial Auditing***

Audit choice should be increased; organizations should be encouraged to use smaller audit firms.

Auditors should be supported with additional practice development.

The audit profession should consider shifting the focus of its audit reports from conformance to information.

Auditor communication should be improved.

## ***Steps Toward Integrated Business Reporting***

Improving business reporting should start with broadening the stakeholder perspective.

Business leaders should present a cohesive explanation of their organization to help stakeholders assess its overall performance.

Management commentary should put the numbers into context.

A new, integrated business reporting model should be developed to present a cohesive explanation of the business.

More continuous business reporting should be encouraged.

To remain relevant, auditors should expand the scope of their audits and provide assurance beyond the financial statements.

# ACKNOWLEDGEMENTS: BUSINESS REPORTING INTERVIEWEES

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## IFAC'S MISSION

IFAC's mission is to serve the public interest by:

- ✦ contributing to the development, adoption, and implementation of high-quality international standards and guidance;
- ✦ contributing to the development of strong professional accountancy organizations and accounting firms, and to high-quality practices by professional accountants;
- ✦ promoting the value of professional accountants worldwide; and
- ✦ speaking out on public interest issues where the accountancy profession's expertise is most relevant.

## THE IFAC BUSINESS REPORTING PROJECT GROUP

The IFAC Business Reporting Project Group consists of Charles Tilley (Chief Executive of CIMA), Graham Ward (retired Senior Partner at PricewaterhouseCoopers and past IFAC President), Norman Lyle (retired Group Finance Director of Jardine Matheson Holdings Limited and Chair of the former IFAC Financial Reporting Supply Chain Project Group), and Al Anderson (Managing Principal, Accounting and Assurance Services of Larson Allen and Chair, Assurance Services Executive Committee of the American Institute of Certified Public Accountants [AICPA]).

The project group was assisted by Stathis Gould and Vincent Tophoff (both of IFAC), and Amy Pawlicki (of the AICPA). IFAC Board member Joycelyn Morton kindly supported the project group by participating in a number of telephone interviews. For more information about this project, please contact Vincent Tophoff by email at [vincenttophoff@ifac.org](mailto:vincenttophoff@ifac.org) or see [www.ifac.org/frsc](http://www.ifac.org/frsc).

## FOREWORD

I was delighted to be asked to chair the current phase of IFAC's business reporting project, which builds upon the excellent work done in this area in previous phases. Society needs successful commercial organizations that act responsibly, and it is important that the business reporting system not only allows but actively promotes this corporate philosophy. There is much debate as to whether or not the current reporting system is fit for this purpose, and this report seeks to drive forward the debate in three key areas:

**Good governance is the foundation on which business success is founded.** Regulation in this field is a fact of life but whether or not it is a mandatory requirement, all those involved in the management of an organization should constantly ensure that they are acting and are organized to promote the organization's long-term sustainable success.

**Financial reporting in isolation can only paint a limited picture.** These reports cannot provide the necessary contextual information to help the reader understand the complexities of modern business transactions. How we improve financial reporting is highly topical and certainly on the agenda at the highest political levels.

**A key link in the business reporting supply chain is auditing.** It seeks to provide reassurance to external stakeholders that the financial position portrayed is a fair representation of economic reality. The financial crisis has promoted questions as to the role of the audit and the interviewees' ideas expressed in this paper contribute to this debate.

There will, undoubtedly, be ideas emanating from the interviews that will not resonate with every reader, but the quality of the interviewees should mean that each is worthy of serious debate and consideration. I look forward to being part of that ongoing dialogue as we each seek to improve global business reporting and urge all stakeholders including preparers, auditors, regulators, standard setters, and investors to actively take part.



Charles Tilley,  
Chair, IFAC Business Reporting Project Group



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## INTRODUCTION

**H**igh-quality business reporting lies at the heart of strong capital markets and sustainable economic growth. All those involved in the business reporting supply chain play a critical role in making business reports more relevant, understandable, and reliable. This will enable the various stakeholders who use those reports to make informed decisions with respect to an organization's social, environmental, and economic performance.

IFAC's recent interviews with key business leaders from around the globe capture recommendations on governance, financial reporting, financial auditing, and broader business reporting from prominent preparers, directors, auditors, standard setters, regulators, and investors, made in light of the financial crisis.

This report analyzes what, according to interviewees, the various participants in the business reporting supply chain should do to further improve governance and the usefulness of business reports, as well as the preparation and audit of those reports.

Unless otherwise stated, the recommendations in this report apply to all organizations and businesses.

### ***Business Reporting Project***

In response to the report, *Financial Reporting Supply Chain: Current Perspectives and Directions* (2008), the IFAC Board established a project group to study progress in the areas of governance, financial reporting, and financial auditing with a focus on meeting investor needs. Its first output, *Developments in the Financial Reporting Supply Chain—Results from a Global Study among IFAC Member Bodies*, was issued in 2009. This study indicated that, although some progress had been made, several significant issues remained unresolved in the following areas of the business reporting supply chain:

*“In times of crisis,  
the basic elements of  
managing a company,  
such as governance,  
accounting, and  
auditing, should  
stand like a rock  
in the storm.”*  
– **Joe Kaeser, CFO,  
Siemens AG**

**1. Governance in organizations:** (a) governance in name but not in spirit; (b) over-regulation; (c) risk and control systems that are too narrowly focused; (d) development of a checklist mentality; (e) lack of safe harbor protection for those charged with governance; (f) insufficient integration of governance into the overarching business model, so that governance often costs more than it delivers; and (g) insufficient alignment of executive remuneration with longer-term organization and stakeholder interests.

**2. Usefulness of business reports:** (a) reduced usefulness due to complexity and disclosure overload; (b) use of fair value measurements, especially in the current market circumstances; (c) focus by organizations on compliance instead of reporting on the essence of the business; (d) unclear links between the organization's environment, strategy, and results; and (e) lack of forward-looking information.

**3. Preparation of business reports:** (a) overly complex financial reporting standards; (b) the challenges of fair value accounting—particularly in the context of the current financial crisis; (c) the need to comply or to reconcile accounts with more than one set of financial reporting standards; (d) the costs of transition to IFRSs; (e) development of suitable reporting standards for small- and medium-sized entities and other entities, such as not-for-profit and public sector organizations; and (f) liability concerns restricting frank and open communication with stakeholders.

**4. Audit of business reports:** (a) limited choice of audit firms; (b) reduced scope for professional judgment; (c) challenges for small and medium accountancy practices to keep up-to-date with regard to changes in International Standards on Auditing (ISAs) and other standards; (d) difficulties in working with various sets of auditing standards for multinational clients; (e) increased litigation risks in today's turbulent environment; (f) liability fear leading to boilerplate audits and a lack of innovation; and (g) limited auditor's communication with external stakeholders.

### ***Final Phase: Recommendations from Key Business Leaders***

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In the final phase of this project, the project group interviewed 25 key business leaders from around the globe to explore potential solutions to the major governance, business reporting, and auditing issues and challenges that were identified in the 2009 report and that, in some cases, were exacerbated by the global financial crisis of 2008. The central interview question was: What should investors, preparers, organizational managers and directors, auditors, regulators, and other participants in the business reporting supply chain do to effectively make business reports more useful?

The interviewees agreed that the fallout from the financial crisis and the uncertain path to recovery require markets and organizations to evaluate what went wrong, and to take measures to prevent it from happening again. Governance and the sustainability of the organization are key elements in (a) achieving long-term social, environmental, and economic performance, and (b) enhancing investor and other stakeholder confidence. These elements must be better integrated into the strategy, operations, and stakeholder communications of organizations.

Among the recommendations were sweeping changes to the current format of reporting to integrate these elements. Many believe that current financial reports are becoming less relevant due to their growing complexity and too narrow focus, and suggested that

*“At the end of day, the financial statements are only as strong as the weakest link in the chain of preparers, boards, auditors, etc.”*

**– Richard Deutsch,  
National Assurance  
Leader, PwC**



they be replaced with integrated, connected, more understandable, and holistic business reports, which would focus on the social, environmental, and economic fundamentals of an organization.

The interviewees agreed that this will be very hard to accomplish, and will require all stakeholders in the business reporting supply chain to deal in a coordinated way with the challenges that may inhibit change, such as litigation risks and stifling box-ticking regulation.

This report summarizes and analyzes the recommendations of the 25 interviewees on (a) further improving governance, financial accounting, and financial auditing, and (b) integrating business reporting.

### ***Defining Integrated Business Reporting and the Business Reporting Supply Chain***

**F**or the purpose of this report, ***integrated business reporting*** is the collective term used to describe the delivery of periodic information in any medium, via any channel, for the purpose of communicating the social, environmental, and financial performance and position of an organization to various stakeholders.

This reflects the view of the majority of the interviewees that stakeholders should receive sufficient information about the organization with which they interact, as only that information allows them to effectively engage with the organization. Organizations should, therefore, expand their communications from traditional financial reporting to shareholders (although still very relevant and important) to a broader type of business reporting, capturing information about the social, environmental, and economic performance of an organization, for use by a wider group of stakeholders.

The ***business reporting supply chain*** refers to the people and processes involved in the preparation, approval, audit, analysis, and use of business reports.<sup>1</sup> All links in the chain need to be robust and closely connected to yield high-quality business reports.

<sup>1</sup>In the spirit of the interview recommendations to expand financial reporting to business reporting, the (original) term *financial* reporting supply chain has been changed to *business* reporting supply chain.



## GOOD GOVERNANCE IS FUNDAMENTAL FOR GOOD BUSINESS REPORTING

Good governance lies at the core of good business reporting. This analysis therefore starts with the recommendations to further improve governance in organizations. The interviewees provided suggestions to improve governance with respect to board responsibilities, expansion to a wider stakeholder perspective, and integration of sustainability, governance codes, risk management and control, remuneration, litigation, and regulatory oversight.

### **Good Governance Starts with Tone at the Top**

The financial crisis has stressed that good governance counts. Corporate governance failure is at the core of all of the issues experienced during the global financial crisis. The strongest form of defense against governance failure comes from an organization's culture and its behaviors. Effective governance in organizations depends on employees' integrity, which starts with management's tone at the top. Interviewees recommended that boards should formulate the values to which they will adhere in a code of conduct and, subsequently, instill those values throughout the organization.

*“You all have heard of ‘the tone at the top.’ I talk about ‘the tone at the top, the tune in the middle, and the beat of the feet at the bottom.’”*  
– **Mervyn King, Chair, King Committee on Corporate Governance**

### **Developing an Effective Code of Conduct for Organizations**

In 2007, IFAC issued the International Good Practice Guidance titled *Defining and Developing an Effective Code of Conduct for Organizations*. This guidance assists professional accountants and their organizations in developing and implementing a code of conduct. It stresses the importance of a values-based organization and a values-driven code to promote a culture that encourages employees to internalize the principle of integrity, and to behave accordingly.

### **Governance Codes Should Be Principles-Based and Stakeholder Driven**

A response by governments to the financial crisis has been a louder call for increased regulation. However, according to interviewees, changes in market mechanisms usually have a more important and longer-lasting effect on corporate behavior than regulatory changes have. Interviewees stressed that—particularly in light of the financial crisis—regulators should be careful not to be too reactive to political pressures, as it is not necessarily the regulation that needs to be revised.

A principles-based, stakeholder-driven approach to governance—implementing guidelines in accordance with the “apply or explain” principle—usually has a stronger chance of success than a heavy legislative approach. This provides boards with the freedom to apply a recommendation differently, or to apply another practice, if they consider that to be in the best interest of the organization. But then they must explain the departure from the recommendation.

To reinforce the culture and behaviors necessary for good governance, boards of directors should routinely check their own actions against the applicable governance principles. In particular, interviewees expected boards to ensure that they are sufficiently independent, competent, and focused on sustainable organizational performance.

In addition, interviewees agreed that useful governance disclosures will show the actual governance performance of the organization, not only the governance policies and principles.

### **Further International Convergence is Desirable**

To reduce the complexity and costs associated with the application of varying governance, risk management, and internal control requirements or recommendations across jurisdictions, interviewees urged further international convergence and standardization in these areas. However, to take account of relevant cultural, legal, and economic backgrounds, global governance, risk management, or internal control guidelines should contain broad solutions that could be implemented locally.

*“When developing and implementing global standards, regulations, and oversight, one should not ignore cultural background and history.”*

**– Masayasu Uno,  
Board of Corporate  
Auditors, Daito  
Construction and Trust**

### **Alignment of Governance, Risk Management, and Internal Control Guidelines**

The recommendation for further international convergence and standardization is supported in a 2010 [survey](#) conducted by IFAC, in which a large majority of the respondents indicated that international alignment among the various governance, risk management, and internal control guidelines would be very useful. Based on the outcomes of this survey, IFAC plans to collaborate with the various issuers of guidelines, such as the [Committee of Sponsoring Organizations \(COSO\)](#), and help facilitate further alignment.

### **More Independence Should Be Required of Boards of Directors**

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Organizations need sufficiently independent non-executive directors, who will instill confidence in investors and other stakeholders by, for example, holding management accountable and speaking up against unethical behavior or recklessness. Interviewees recommended requiring over one-half of the board members to be independent non-executive directors, and separating the positions of chief executive officer and board chairman, the latter office to be held by an independent non-executive director to ensure a greater degree of independence.

In this regard, the way organizations appoint their independent non-executive directors is critical. Ensuring the independence of board members needs to start with improving the independence of the nominations committee and the way it operates. In addition, regulators should also take action to further increase the number of independent non-executive directors on boards and further empower them to take an independent view.

Another recommendation was to provide the independent non-executive directors with a venue for disclosures, such as their own section of the business report, where they would have to disclose any concerns or issues on which they have disagreed with the rest of the board.

### **Directors Should Be Competent**

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In addition to being sufficiently independent and able to devote sufficient time and attention to their roles, directors also need the competency to adequately perform their expected duties. For strong governance, organizations should ensure that their boards have the capability—the qualifications, and breadth and level of experience—to approve an organization’s strategy and to evaluate the way it is executed and reported on. Interviewees recommended that boards consist of directors with various backgrounds, diverse skills and, for organizations that operate internationally, a wide diversity of international experience. There was a strong view that audit committee members should have a background or experience in finance, accounting, and/or law, and also a professional qualification.

Independent non-executive directors could be better supported with a formal induction into the organization and professional development, training, and practical guidelines on topic areas, such as corporate governance, supervision over implementation of financial reporting standards, and financial management.

*“Independent directors are there to provide the eyes and ears that investors can’t have for reasons of commercial sensitivity and practicality.”*  
– **David Webb,**  
**Investor, Hong Kong**

### ***Risk and Liability for Directors Should Be Addressed***

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Some interviewees feel that board members who act prudently and reasonably should be given a degree of liability protection, which may make them less risk-averse and may also increase the supply of qualified and competent candidates for board positions. In addition, governments should legislate the apportionment of blame and damages for a corporate failure to make clear that all stakeholders have to assume a degree of responsibility to prevent corporate failure. The application of good governance is considered to be the first step to minimizing litigation risk.

Other interviewees feel that the risk of liability actually drives desirable behavior and, as directors take on significant responsibilities, a sensible cautionary liability framework should be in place.

### ***The Primary Responsibility of Directors Is Performance—Not Compliance***

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According to interviewees, governance codes should strike the right balance between providing oversight and driving long-term performance. Directors need to make sure that compliance with regulations does not override their responsibility to analyze the big picture and make decisions in the overall best interest of the organization. Good governance is the foundation for doing business, but also needs to provide space for entrepreneurial behavior, focused on longer-term sustainable value creation for all stakeholders.

Interviewees cautioned that good governance is not a guarantee against business failure; well-managed organizations depend on outstanding directors who stay focused on the real purpose of their roles beyond compliance: the achievement of long-term, sustainable organizational success. Therefore, to optimize stakeholder value, directors need to balance their essential compliance efforts with actions to further improve their organization's performance.

#### ***Good Practice Guidance on Governance***

I FAC released the International Good Practice Guidance, *Evaluating and Improving Governance in Organizations*, in 2009. This guidance helps professional accountants to further improve the governance structures and processes in the organizations they work for—something critical to ensuring an organization's viability and accountability. The guidance encourages organizations to balance conforming with rules and regulations and driving organizational performance. It also focuses on how to create sustainable stakeholder value in the form of high-quality products or services, economic profitability, job security, safety, and fulfilling other social and economic responsibilities.

### ***Expand from a Shareholder to a Wider Stakeholder Perspective***

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Both public and private sector organizations have an ever-growing impact on social and economic life and are of increasing significance, not only for their owners and other investors, but also for their clients, employees, suppliers, local community, governments,

regulators, financial markets, and for societies as a whole. Moreover, individuals could have several stakeholder roles at the same time, such as customer, employee, neighbor of a production location, or investor, for example, via his or her pension fund. To accommodate these different and, at times, conflicting perspectives, interviewees recommended that organizations adopt a wider stakeholder view in their strategy and their operations, as well as in their stakeholder communications.

### ***Organizations Should Take Social and Environmental, as Well as Economic, Performance into Account***

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Sustainable performance is the combination of the social, environmental, and economic performance of an organization that determines overall stakeholder value and allows the organization to succeed and prosper in the long term. The notion that, in addition to economic performance, social and environmental performance are integral to the sustainability of an organization, often requires a change in mindset at the top, which then has to be communicated throughout the organization.

Generating sustainable stakeholder value involves considering social, environmental, and economic factors. This is not only because different stakeholders have different interests, but also because these factors are interdependent. For example, social and environmental factors can also determine or affect the economic value of an organization.

According to interviewees, organizational leaders also need to take into account the sustainability issues pertinent to their organization, which can then drive a more integrated form of business reporting. Responsible leaders should direct their organization's strategies, operations, and stakeholder communications with a view to achieving sustainable economic, social, and environmental performance.

#### ***Sustainability Framework***

The *IFAC Sustainability Framework*, developed in 2009, highlights the issues that organizations must address to make sustainable performance an integral element in their business models. For example, it offers guidance on how to inject sustainability leadership into the management cycle, from making and executing strategic decisions to reporting on performance to stakeholders.

A second edition of the framework to be launched in early 2011 is designed from three perspectives—business strategy, operational management, and reporting—to reflect the various ways in which sustainability should be integrated into an organization. Organizations embracing sustainable development, and integrating it in their vision and leadership, strategic planning, operations, and stakeholder communications, typically look beyond delivering short-term results to please impatient stakeholders/investors to long-term results that take into account both financial and non-financial factors. Such organizations tend to have more success when viewed in a wider context that attaches importance to social, environmental, and economic impacts.

### ***Executive Remuneration Should Be Aligned with the Organization's Sustainable Performance Relative to Its Competitors***

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It is critical that the culture and the behaviors of executive directors be better aligned with the long-term goals of the organization, and that short-termism is discouraged, for example, through better alignment of remuneration with the sustainable social, environmental, and economic performance of the organization relative to competitors.

The interviewees agreed that organizational stakeholders and boards together should consider the right balance between the base and variable aspects of executive remuneration, including performance-based remuneration. They also need to consider how much remuneration should be monetary, how much should be deferred in the form of shares, and how much should be subject to clawback if the organization collapses or encounters severe difficulties within a specified number of years. Appointing a board with an independent non-executive chairman and sufficient independent non-executive directors, together with an independent remuneration committee, helps to ensure that executive directors are remunerated fairly and responsibly. Boards should develop a remuneration policy for their executive directors and put it to a non-binding vote of shareholders.

### ***Ongoing Risk Management and Control Should Be a Key Part of Board Oversight***

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The financial crisis demonstrated that in some organizations—especially in some financial institutions—risk management and control practices were flawed as, according to interviewees, these organizations did not fully understand or grasp the risks to which they were exposed. Before the crisis, organizations were overly focused on a financial controls-based monitoring framework. The crisis highlighted that many of the most impactful risks are derived from external circumstances. Moving forward, risk management and control systems should take a wider perspective, considering that organizations exist as part of an open system of dynamic variables.

Ongoing risk management and internal control should be a key part of integrated management at every level of an organization and across all operations. This also requires integrating sustainability issues into the organization's governance, risk management, and internal control structures.

### ***Collaborative Effort Is Required to Address Systemic Risk***

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Many interviewees referred to systemic risk, which impaired the orderly functioning of financial markets, as a cause of the financial crisis. Most organizations overlooked the systemic risks that had accumulated in the global financial system and that eventually led to the financial crisis. Not only did most organizations not see it coming, neither did accountants and auditors, nor prudential regulators, and the result of this failure of the financial system proved to be disastrous.

Interviewees indicated that a globally interconnected system with gigantic global fund flows necessitates global regulation and oversight. There will only be a solid international financial infrastructure if the securities regulators, the central banks, and the other financial regulators across the globe collaborate and are willing to provide results-based assurance statements on the absence of material systemic risks that might impair the

*“In some ways, difficult periods show whether or not the CEO is doing a good job. And if CEOs are good in these tough times, you should ... reward them.”*

**– James Allen,  
Director of Capital  
Markets Policy,  
CFA Institute**

*“What the financial crisis highlighted is that many of the risks that have the greatest impact on a business may be derived from the external operating environment.”*

**– Ernest Kan,  
Senior Partner, and  
Chief of Operations  
(Clients and Market),  
Deloitte**

orderly functioning of the markets. A so-called “coordinated approach” no longer suffices. According to some interviewees, an empowered, supranational oversight body should be established to identify systemic risks in the markets. This body should have not only monitoring responsibilities, but also trans-border information access rights, such as a truly empowered, accountable, and well-resourced international financial stability board.<sup>2</sup> Moving to global regulation and oversight with respect to financial reporting and auditing should be part of this new financial infrastructure.

### Systemic Risk

The *Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations* (Financial Stability Board et al., 2009) defines *systemic risk* as a risk of disruption to financial services that (a) is caused by an impairment of all or parts of the financial system, and (b) has the potential to have serious negative consequences for the real economy. Fundamental to the definition is the notion of negative externalities from a disruption or failure in a financial institution, market, or instrument. All types of financial intermediaries, markets, and infrastructure can potentially be systemically important to some degree.

According to interviewees, however, organizations and their auditors could and should also have done more themselves to identify, assess, and determine the potential impact of systemic risk. Moving forward, interviewees expect the development of better risk assessment models that are more reliable in their predictions, and in which the relationships between an organization and its environment are dissected and explained in new and innovative ways. Professional accountancy organizations at the national level could anonymously compile and synthesize systemic risks, so that individual audit firms would not have to risk compromising their client relationships. A global organization such as IFAC could bring together and publish the analysis of national databases of systemic risk.

*“We need a supra-national oversight body ... I know it is very unpopular, but if you go for less, the next crisis will be waiting in the wings.”*

**– Jules Muis, Former VP and Controller, World Bank; Former Director-General and Chief Internal Auditor, European Commission**

### Recommendations to the G-20

IFAC, as the representative international organization for the global accountancy profession, actively collaborates with various international institutions, such as the World Bank, the Organisation for Economic Co-operation and Development (OECD), the Financial Stability Board, the United Nations Conference on Trade and Development (UNCTAD), the International Organization of Securities Commissions (IOSCO), etc., to support the further improvement of the global financial infrastructure.

IFAC submitted a series of [governance, business reporting and auditing recommendations](#) for the reform of the global financial system to the G-20 Working Groups that met during 2009 in London, United Kingdom, and in Pittsburgh, United States, and during 2010 in Toronto, Canada.

<sup>2</sup> For example, the [European Systemic Risk Board](#) as the body responsible for the macro-prudential oversight of the EU financial system (to be established in 2011), is a step in the right direction.



### ***Issuance of Collective Management Letter for Insurance Sector***

FAC member body NIVRA from the Netherlands seeks to bundle the collective knowledge of the accountants who are active in a particular sector along with any indications emerging from it, and to present it to the organizations that are active in that sector, as well as to their stakeholders. NIVRA has issued the first [collective management letter for the insurance sector](#). The document also includes a reaction from the Dutch central bank on this initiative.

### ***Investors and Other Stakeholders Should More Actively Pursue Their Responsibilities***

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Increased stakeholder participation is part of effective governance and leads to more useful business reporting. Responsible investor codes of conduct, such as the Institutional Shareholders' Committee (ISC) [Code on the Responsibilities of Institutional Investors](#), are considered to be a route to much-improved monitoring of governance as, according to interviewees, investors have not been proactive in their role as owners and should start to take more interest in their investments.

According to interviewees, other stakeholders such as retail investors, customers, employees, regulators and oversight bodies, and society at large, could increase their engagement with the organizations in which they have an interest in various ways, for example, by increasing their social and environmental awareness.

In this respect, an extraordinary socioeconomic development has occurred. Wealthy families no longer are the majority of shareholders. Instead individuals, through their financial institutions and pension funds, make up that majority. These same individuals are also employees of the organizations, customers who choose between the products or services of various organizations, and voters for the government of the day and for the trustee of the pension fund. In addition, these individuals are citizens of a nation who expect their neighbors to act as decent citizens. As a consequence, individual citizens expect the corporate citizen to act as a responsible citizen.

However, interviewees pointed out that stakeholders can only effectively engage with an organization when they receive sufficient information about the organization. This is why business reporting is so important for stakeholders.

### ***Investor Codes of Conduct***

Investors have power, and they should use their power well to incentivize a long-term perspective. Various organizations throughout the world are developing an investor code of conduct that identifies their responsibilities, for example, by ensuring that the directors they vote for have the ability and capacity to carry out their duties.

The United Nations-backed Principles for Responsible Investment (PRI) Initiative is a network of international investors working together to put the six [Principles for Responsible Investment](#) into practice. So far, over 800 investment institutions from 45 countries have become signatories.

The United Kingdom's Financial Reporting Council published a [Stewardship Code](#) for institutional investors in July 2010. The purpose of this code is to improve the quality of corporate governance through promoting better dialogue between shareholders and company boards, and more transparency about how investors oversee the companies they own.

In September 2010, the [Committee on Responsible Investing by Institutional Investors](#) in South Africa released a draft *Code for Responsible Investing by Institutional Investors in South Africa*, which should ensure that institutional investors implement policies that guide their day-to-day actions when it comes to responsible investing.



## IMPROVING FINANCIAL REPORTING

Following on the discussion with respect to improving governance in organizations, the interviewees considered the issues with respect to financial and wider business reporting. This section deals with interviewees' recommendations to further improve financial reporting.

### ***It Is Critical That Financial Reporting Becomes More Relevant and Understandable***

Interviewees stressed that complexity continues to pose a challenge. As financial reports become more complex, and as the pace of change in financial reporting increases, it is becoming increasingly difficult for many stakeholders to understand the performance of an organization.

The recent financial crisis has once more highlighted the deficiencies in financial reporting. According to interviewees, things like off-balance sheet accounting, warehousing of financial instruments, mark-to-market valuation, and many other issues have made financial information opaque and have increased the complexity of financial statements. Hence, it is critical that financial reports continue to evolve and become more understandable and relevant to the various stakeholders.

The complexity of financial reports has also increased due to the emergence of additional detailed disclosures. According to interviewees, to reverse this trend, the relevance of additional disclosures should be discussed with various stakeholders. Users should carefully consider their requests for more disclosures, standard setters should limit their disclosure requirements, and organizations should restrict the number and level of detailed disclosures in their mainstream financial reporting to the essentials, and provide links to further disclosures elsewhere. As organizations prepare disclosures for their financial reports, they should consider all of the qualitative factors, such as understandability, completeness, relevance, and comparability.

*“Simply adding more disclosures will not fix the issues with financial reporting.”*

**– Jan McCahey,  
Lead Partner,  
Financial Reporting  
Standards, PwC**

*“Much of the critical performance information is actually in the accounts. It is just that it may be buried on page 425.”*

**– Tanya Branwhite,  
Executive Director of  
Strategy Research,  
Macquarie Securities**

To make financial reports more accessible, organizations should provide simple building blocks of business information—grouped around topics that stakeholders really want to understand, such as how an organization is funded or how it is performing—in which all pieces of information about that issue are brought together. However, as interviewees pointed out, the way in which standard setters are trying to make the financial reporting model more sophisticated is actually hiding these basic building blocks of business information.

### ***The Use of a Direct Cash Flow Statement Should Be Encouraged***

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According to interviewees, the cash flow statement provides information essential to the analysis of the financial performance of an organization. The use of a direct cash flow statement should therefore be encouraged, so that the wider investor community will see more clearly the operating performance, the investing decisions being made, as well as how the organization is being financed and any changes in the value of the assets and liabilities.

### ***Additional Support for Retail Investors Is Required***

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The interviewees agreed that specific consideration should be given to simplifying financial reporting for retail investors. The accounting profession should better define the accounting terminology and develop (a) a simplified balance sheet, (b) a simplified profit-and-loss statement, and (c) simplified related notes in understandable language, so that the average person can understand it. Interviewees also pointed out the importance of educating retail investors. Companies selling sophisticated financial products should be required to educate retail investors before they launch a product, by providing clearer information on the product and its risks. In addition, stock exchanges or other parties could provide retail investors with more information, such as analyst reports, to facilitate their investment decisions.

### ***Financial Reporting Standard Setters Should Simplify Their Standards***

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According to interviewees, improving the understandability of financial reporting standards should be at the top of the financial reporting standard setters' priority list. They should ensure that their standards are not only comprehensive but also as simple as possible, so that stakeholders can understand and implement them properly.

To enhance the standard-setting process and to simplify the financial reporting standards, the standard-setting boards need to be made more diverse by encouraging more non-accountants to participate in the standard-setting process. Users of financial reports should get more involved in this process and put forward solutions to some of the issues.

Interviewees recommended that, before developing or revising the standards, standard setters should undertake a cost-benefit analysis to take into account the economics, the relevance, and the value of such changes.

*“We should not only increase the competence of the preparer of financial information, but also the competence or financial literacy of the users of financial reports.”*

**– Igor Kozyrev, Deputy Chief Accountant, International Reporting, OAO Lukoil**

*“Most investors want to understand the historic operating profit number.”*

**– David Phillips, Partner, PwC**

*“The standards have gotten so complex that unless you are a professional analyst, you probably will not be able to wade through those standards and actually understand what they are telling you.”*

**– Euleen Goh, Chair, Accounting Standards Council, Singapore**

### ***Financial Reporting Burden on Smaller and Non-Listed Entities Should Be Limited***

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Interviewees indicated that, as financial reporting standards become more complex, standard setters and regulators should consider how they can reduce the burden of financial reporting for non-listed, private entities that do not seek public investment. In particular, they should consider whether or not they should provide a limited set of financial reporting standards for smaller and non-listed entities. There is a need for a very straightforward accounting standard for micro-entities, based on the historical cost model.

### ***The Use of Fair Value in Financial Reporting Should Be Supported***

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The use of fair values in financial reporting was the topic on which interviewees' opinions most diverged, although there was general agreement that fair value accounting produces useful information for investors.

A number of the interviewees—especially those from the investor side—argued that the use of fair value in financial reporting should be supported, because fair value information is the most relevant information for financial decision making, and provides stakeholders with information that properly reflects an organization's economic condition. They recommended implementing a wider and more consistent use of fair value.

Other interviewees argued that organizations outside the financial services sector should not clutter their operating results with fair value,<sup>3</sup> as most investors want to know the historic operating profit. Rather than further expanding the use of fair value in financial reports, standard setters and regulators should better distinguish the impact on earnings that results from changes in fair value, versus those changes that result from the day-to-day running of the business. For that reason, they should reduce the amount of theoretical balance sheet adjustments that are booked through the profit and loss account, to narrow the gap between the numbers in the financial statements and the true underlying performance of an organization.

However, the financial crisis has made apparent that preparers, auditors, and all stakeholders need much clearer guidance and advice to understand the inherent risk before they can put a fair value on an asset. Interviewees suggested that greater use of explanatory footnotes could enhance users' understanding of fair value accounting.

### ***Application of Financial Reporting Standards Should Be More Principles Based***

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To capture the true economic substance of a transaction, interviewees recommended a more principles-based application of financial reporting standards. However, the global trend in standard setting is, worryingly, becoming rules based.

A more principles-based application of financial reporting standards has to go hand-in-hand with the use of professional judgment. Financial reporting standard setters should, therefore, provide sufficient room for professional judgment in their standards, that is, by defining the principles and providing sufficient latitude for management to portray the economic reality. And regulators should establish a fair enforcement process. Specific

<sup>3</sup>As they recognize that fair value can be a meaningful metric for companies that provide financial services, some interviewees recommend the development of a separate reporting model, including more fair value accounting, for that sector.

*“Fair values lie at the heart of all exchanges and reflect the most complete estimate and expectation of the value of assets and liabilities.”*

**– Matthew Waldron,  
Director of Financial  
Reporting Policy  
Group, CFA Institute**

*“When you don't understand the risk, you can't put a value on the asset.”*

**– Richard Petty,  
Professor, Macquarie  
Graduate School of  
Management; Chair,  
Hong Kong-Based  
Investment Company**

financial reporting rules should be embedded as a subset within overarching principles. When the application of the rule conflicts with the principle, the principle should prevail.

Directors and auditors should take responsibility for financial reporting, using their professional judgment in applying principles-based standards, and basing their decision making on the substance of a transaction. Interviewees said that auditors should settle any interpretation questions with their clients using their professional judgment instead of asking the standard setters for additional rules, exceptions, and guidance to validate their assertion.

### ***Global Capital Markets Would Be Best Served by One Set of Principles-Based, High-Quality Financial Reporting Standards***

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Interviewees indicated that further convergence to a single set of international financial reporting standards, such as the International Accounting Standards Board's International Financial Reporting Standards (IFRSs), is vital because the increasingly globalized supply of capital requires the support of one global set of high-quality financial reporting standards. A converged set of clear and concise financial reporting standards would enhance comparability and analysis of investment opportunities globally, and ultimately increase investor confidence.

Interviewees on the preparer side recommended that various jurisdictions further converge and standardize their financial reporting requirements—as well as their requirements in other areas, such as governance and auditing—to reduce the complexity and costs associated with compliance.

Although achieving international convergence of financial reporting standards is important, the quality of standards is more important than the speed of achieving convergence. So, the priority of the financial reporting standard setters should be the quality of financial reporting: making the information in the accounts more relevant, reliable, transparent, consistent, and understandable.

### ***Professional Behavior and a Minimum Level of Qualification Should Be Required for Preparers of Financial Information***

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As financial reports are only as strong as the weakest link in the financial reporting supply chain, a minimum level of professional qualification and behavior should be required for preparers of financial statements. Therefore, organizations should take a rigorous hiring and training approach for their accounting staff.

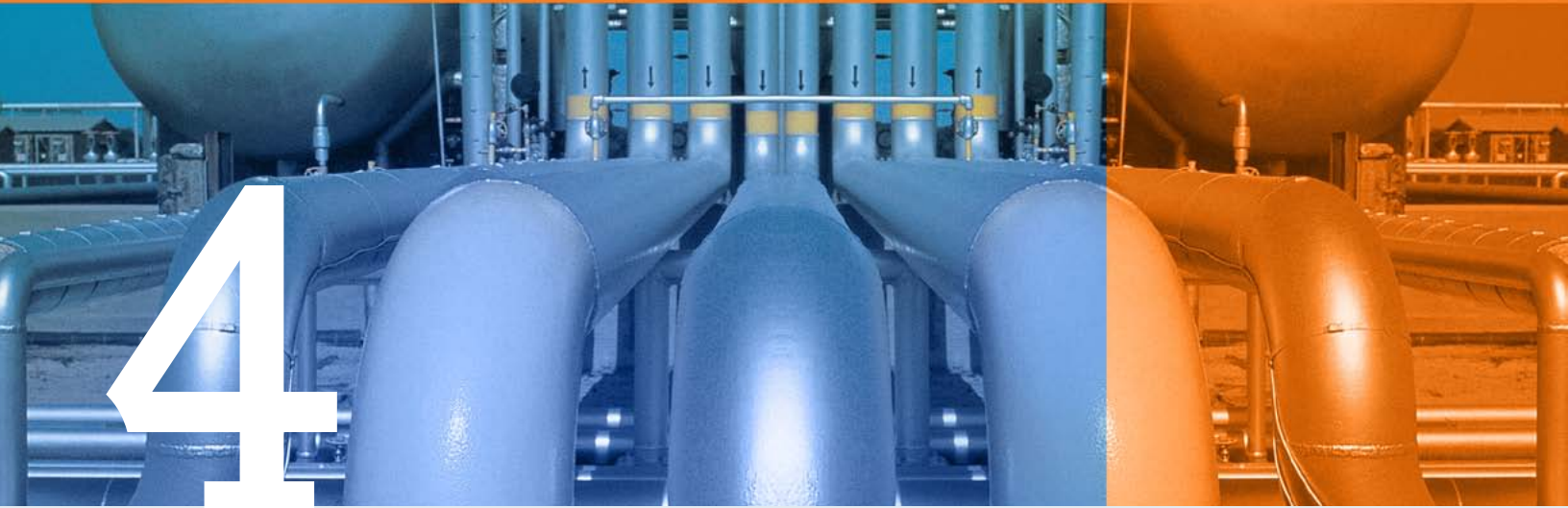
*“What people are asking from us [the Office of the Chief Accountant of the SEC] is exactly what we are asking from them: to exercise professional judgment.”*

**– James Kroeker,  
Chief Accountant,  
US Securities and  
Exchange Commission**

### ***How To Achieve Further Convergence***

**T**he interviewees offered the following recommendations on how to achieve further convergence:

- Financial reporting standard setters should prioritize the convergence of key standards, and moderate the pace of creating new standards and revising current standards, to allow stakeholders to keep up with the changes.
- Regulators should preemptively clear the various tax-related and other obstacles that hinder further global convergence and standardization. In addition, international coordination and collaboration—for example, by holding regional policy forums, discussing (financial reporting) exposure drafts, and sharing implementation experiences—will make individual countries stronger and much more robust in the way they apply international standards to local circumstances.
- Local standard setters should take the lead in ensuring that financial reporting standards reflect the economic and legal substance of their marketplace. Otherwise, international comparability will not be possible.
- Preparers of financial information should clearly indicate how changes in financial reporting standards have impacted their financial statements, so that users can better understand the results of those changes.
- Education should be provided to promote a swift global transition to International Financial Reporting Standards.



## IMPROVING FINANCIAL AUDITING

Auditing forms a cornerstone of financial reporting, providing external assurance on whether financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. The interviewees made various recommendations (a) to further increase auditor choice, (b) to further promote practice development, and (c) to further improve auditor communication. They also recommended that auditors expand their assurance services beyond the financial statements to include non-financial information, for example, in an integrated business report (see the next section).

### ***Audit Choice Should Be Increased; Organizations Should Be Encouraged to Use Smaller Audit Firms***

According to interviewees, the auditing services market is dominated by the Big 4, Deloitte, Ernst & Young, KPMG, and PricewaterhouseCoopers. Interviewees therefore recommended that the potential sources of catastrophic risk faced by these audit firms be monitored, and that some sort of safety mechanism be created in case one of them suffers irreparable reputational damage.

Interviewees were of the view that, to decrease reliance on the Big 4, auditor choice needs to be increased. They suggested that this could be done by boosting the mid-size audit firms—for example by uniting larger local and regional firms to form associations or franchises—so that they would have the capacity to audit larger, cross-border organizations. Regulators should reduce barriers to the growth of smaller auditing firms, such as by reducing the increased litigation risk and extending insurance coverage when audit firms want to accept certain larger engagements. Modification of regulatory requirements relating to firm ownership, for example via introduction of outside capital into audit firms, could also bring benefits in the form of reducing the cost of capital for those firms. To offset



the perceived lack of quality in smaller audit firms, an independent auditor oversight body could inspect those firms, and openly communicate whether or not they are doing what they are supposed to be doing.

Increased auditor choice is also in the hands of individual organizations and their stakeholders: the more business they give to small- and medium-sized audit firms, the easier it will be for them to grow into larger audit firms that can compete with existing larger firms.

### ***Auditors Should Be Supported with Additional Practice Development***

To further increase the quality of the audit and assurance services provided by audit firms, the accountancy profession could be supported with further practice development. For example, interviewees recommended the development of high-quality professional accountancy qualification programs and the establishment of accountancy services research centers. Auditors should also supplement modern, technology-based auditing techniques with traditional procedures, such as reviewing and discussing operations, assessing the internal control environment, and communicating clearly with those charged with governance so as to stay in touch with the underlying business.

According to interviewees, auditors could also do more to detect fraud, such as by better verifying purported sales through calling customers directly and asking for written confirmations, and by better verifying with banks whether the deposits claimed by the client are correctly stated. In light of the financial crisis—partly caused because very few people understood the inherent risks of very complicated financial products, which during the crisis turned into toxic assets—interviewees recommended developing a specialist class of auditors who are able to assess risk related to complex financial instruments, and who may advise other audit professionals who do more general audit work.

*“The auditor should be the umpire, rather than the scoreboard operator.”*

– **Michael McKersie,**  
**Assistant Director**  
**of Capital Markets,**  
**Association of**  
**British Insurers**

### ***New Guidance on Auditing Complex Financial Instruments***

In 2010, the [International Auditing and Assurance Standards Board \(IAASB\)](#) released for public exposure a new proposed pronouncement—International Auditing Practice Statement (IAPS) 1000, *Special Considerations in Auditing Complex Financial Instruments*—that highlights practical considerations for auditors when dealing with complex financial instruments. The pronouncement particularly emphasizes auditing considerations relating to valuation and disclosure issues for financial statement items measured at fair value.

### ***Improving Auditing Standards and Oversight***

The main objective of a financial statement audit is to provide reassurance to stakeholders by expression of an opinion by the auditor on whether the financial statements are prepared in all material respects in accordance with an applicable financial reporting framework. Retaining principles-based approaches to financial reporting and auditing would encourage this. According to those interviewed, auditing standards should be principles-based and allow for professional judgment and a more risk-based audit approach. The ISAs issued by the IAASB should be globally recognized and implemented. In addition, according to

interviewees, a set of auditing standards specifically for the audit of small- and medium-sized entities (SMEs) should be considered; these would significantly reduce the cost of implementation, reduce complexity, and increase ease of communication with smaller audit clients.<sup>4</sup>

The interviewees were also of the view that greater national and international regulatory oversight of the auditing profession should safeguard the quality of the audit and enhance confidence in the auditing profession and financial reporting.

### **Support for Small and Medium Accountancy Practices**

IFAC's Small and Medium Practices (SMP) Committee in 2010 issued the *Guide to Practice Management for Small- and Medium-Sized Practices*, which provides guidance on how this sector can better manage their practices and, ultimately, operate in a safe, profitable, and professional manner. The committee also issued the *Guide to Quality Control for Small- and Medium-Sized Practices*, which is intended to help SMPs understand and efficiently apply the *International Standard on Quality Control 1*. Finally, it issued the *Guide to Using International Standards on Auditing in the Audits of Small- and Medium-Sized Entities*, to help practitioners understand and efficiently apply the *clarified ISAs*.

### **Auditor Communication Should Be Improved**

According to interviewees, the limited nature of an auditor's communication with stakeholders is an obstacle to increased transparency that needs to be dealt with. We should, therefore, rethink the relationship and interaction between (a) the auditor and executive management, (b) the auditor and non-executive management (including the audit committee), and (c) the auditor and the external stakeholders. The financial and other disclosures of corporate entities, including the independent auditor's report on the financial statements, are part of an organization's governance framework. The financial statement audit should have a beneficial behavioral impact on how the organization makes its judgments. To improve auditors' current position, there should be more space for them to exercise their professional judgment without fear of liability. To achieve this, some form of apportionment of blame needs to be implemented.

In addition, the audit profession should consider improvements to its standard reporting model. Interviewees are of the opinion that auditors' reports should be simple, so that qualifications are clear and easy to understand and interpret by all stakeholders. The audit report should therefore move away from a standard boilerplate, and provide more of the information that was used by the auditors to reach their opinion, such as the auditors' risk assessments, materiality, applications of professional judgment, etc.

As an alternative to expanding their reports, auditors could provide more discursive board and audit committee reports to enhance the communication between the directors and the stakeholders of an organization.

<sup>4</sup> IFAC believes that the IAASB's ISAs are designed to apply to audits of entities of all sizes, as set out in IFAC's Policy Position 2, *IFAC's Support for a Single Set of Auditing Standards: Implications for Audits of Small- and Medium-sized Entities* (2008).

### ***Improving the Auditor's Report***

**T**he IAASB has undertaken a research initiative to study user perceptions of the auditor's report. The results clearly point to the need to explore ways to enhance the usefulness of auditor reporting. The IAASB is planning a public consultation on auditor reporting in the first half of 2011, to seek users' and other market participants' reactions to broad proposals for improving the usefulness of auditors' reports. The outcome of this consultation is expected to establish a basis for the IAASB's consideration of whether to undertake standard-setting projects to further develop the ISAs addressing auditor reporting.

Further information is available from the IAASB website: [www.ifac.org/IAASB/Projects.php](http://www.ifac.org/IAASB/Projects.php).



## STEPS TOWARD INTEGRATED BUSINESS REPORTING

There was a general consensus among interviewees that if we are going to take into account social, environmental, and economic factors, while generating sustainable stakeholder value, as recommended in section 2, then we need to take a broader view of business reporting. And, as a result, we need to expand the current financial report to an integrated model that will communicate the social, environmental, and economic performance of an organization to a broad range of stakeholders.

### ***Improving Business Reporting Should Start with Broadening the Stakeholder Perspective***

The interviewees agreed that business reporting must serve the needs of a broad range of stakeholders. Stakeholders should receive sufficient information about the organization in which they interact, as it is only with that information that they can effectively engage with these organizations. Users of business reports are better qualified to determine whether reporting information is useful. Organizations should therefore be more receptive to the information needs of their investors and other stakeholders, to establish what information is relevant to their needs and to adjust their business reporting accordingly.

*“Corporate reporting tends to be very compartmentalized. You have social responsibility and sustainability reports often being churned out independently, but they are integral to the longer-term wealth and health of the company and to its reputation.”*

**– Guy Jubb,  
Investment Director  
and Head of Corporate  
Governance, Standard  
Life Investments**

### ***Management Commentary Should Put the Numbers into Context***

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Management commentary enhances the understanding of financial information and overall performance. Financial reporting shows the raw facts/numbers, and narrative reporting puts these numbers into context by providing management’s view of the entity’s performance, position, and development. Interviewees believe that the narrative is an opportunity for management to provide additional information that (a) describes their organization’s environment, and (b) links that information to their business model, strategy, risk management, actual performance, and their expectations, so that investors and other stakeholders can understand the broader picture. To improve their management commentary, boards should be more open, transparent, and forward-looking, trying to provide better insights into what drives their business, and the risks and opportunities they are dealing with.

Interviewees pointed out that many organizations have become better at providing more balanced narrative reports, as the recent turbulent financial environment forced them to focus carefully on (a) the impairment of their assets, (b) the challenges of getting financing, and even on (c) the appropriateness of going concern as the basis for their financial statements. One of the good things that might come out of the crisis is that organizations continue their more open approach to business reporting by sharing their assumptions, identifying potential risks, and providing additional explanatory information. However, to foster more open narrative reporting, investors and other stakeholders should change their approach and culture in regard to director litigation, because otherwise management commentary will remain stuck in boilerplate disclosures.

Comprehensive guidance, including application guidance and illustrative examples, could help organizations to improve their management commentary. Such guidance should also cover the use/application of financial and non-financial key performance indicators (KPIs), which (a) could help stakeholders to better understand the organization’s objectives and how it is planning to achieve them, and (b) could be used to better measure performance against those objectives. Performance metrics can cover numerous topics, such as productivity, environmental impact, the value of human capital, organizational (structural) capital, customer, and relational capital.

*“Business reporting is not a compliance exercise, but a communications exercise with your stakeholders.”*

**– Jane Diplock,  
Chair, Securities  
Commission of  
New Zealand**

*“Accounting doesn’t do things too well sometimes and that is why the narrative statement is going to be so important in addition to the raw facts.”*

**– Sir David Tweedie,  
Chair, IASB**

### ***Investor-Oriented Information on Climate Change Issues***

FAC is involved with the [Climate Disclosure Standards Board](#) to develop the Climate Change Reporting Framework (CCRF). The requirements of the CCRF are designed to encourage a harmonized approach to the preparation of climate change-related disclosures that complement financial statements, and inform investors on what management views as the most important climate change-related issues, including those affecting the organization’s strategy, economic performance, and prospects.

### ***A New, Integrated Business Reporting Model Should Be Developed***

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Interviewees agreed that organizational leaders should be able to present a cohesive explanation of their business to help stakeholders assess organizational performance. Therefore, the current format of a narrowly focused financial report should be expanded

to a more connected and holistic business report that integrates the various social, environmental, and economic aspects of an organization into one cohesive explanation of the business.

Not only will stakeholders benefit from a unified integrated reporting model, but also the quality of financial reports will be improved, as many social and environmental aspects have a real impact on an organization's performance. By better and more effectively communicating their corporate social responsibility information to their investors, organizations can help them make more informed investment decisions and appeal to a broader cross-section of stakeholders.

In addition, the increased consciousness about corporate responsibility requires the development of more comprehensive corporate reports. Organizations should integrate sustainability information and related scorecards with their business reporting to explain their operating philosophy and policies with regard to (a) their financial, social, and environmental sustainability efforts, (b) their risk appetite on all relevant fronts, (c) their objectives, (d) their trade-offs between the shorter- and longer-term strategies, (e) how they have fared against those benchmarks in practice, and (f) what timelines they foresee for bridging any gaps between their objectives and the actual outcomes.

To consolidate the various segmented reports (including the information on the corporate website), a new, integrated business reporting model should be developed that would bring together all these pieces of information to present a cohesive explanation of the business. When social, environmental, and economic results of an organization are integrated into one report—with all the key metrics included, taking into account the various interdependencies, and allowing users to drill deeper into topics to access more detail—interviewees believe it will then be possible to better assess the overall performance of the organization.

*“By its nature, risk information must be forward-looking and the shareholders are entitled to have the board’s best view on this.”*

**– John Coombe,  
Non-Executive Chair,  
Hogg Robinson Group  
plc; Non-Executive  
Director, HSBC  
and Home Retail  
Group plc**

*“The largest part of a company’s intangible value is the confidence investors have in the management team.”*

**– Carlos Madrazo,  
Head of Investor  
Relations, Grupo  
Televisa, S.A.B.**

### **Integrated Reporting Gains Traction**

**T**he recommendation to develop an integrated reporting framework is gaining widespread traction around the globe. The new governance code for South Africa (King III, 2009), for example, recommends integration of economic, social, and environmental reporting, recording how an organization's actions have impacted positively and negatively on the community, and how it intends to enhance those positive aspects and eradicate or ameliorate the negative aspects in the year ahead.

The recently established [International Integrated Reporting Committee \(IIRC\)](#), in which IFAC participates, has set out to develop an overarching integrated reporting framework including:

- key principles setting out the scope and content to be covered by an integrated report;
- criteria for determining material items for inclusion; and
- form of reporting, e.g., integration into the “mainstream” report, prescribed or flexible reporting format, use of technology, e.g., XBRL.

According to interviewees, users should be able to find the information they need, and the level of detail should not obscure material and relevant information. A strategy for integrated reporting can be applied by starting off from one top-level, multi-stakeholder integrated report, connected to more detail to provide additional information for specific user groups via modern information and communication technologies—such as websites, databases, and XBRL.

### ***More Continuous Business Reporting Should Be Encouraged***

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Increasing the frequency and timeliness of business reports should be encouraged because it would help improve market efficiency. More continuous business reporting would get investors and other stakeholders away from the fact that they operate in an information vacuum, going from reporting period to reporting period. It would prevent them from having to go through every single line item to see what has changed every three or six months. It would also help investors to pull back from short-termism, because they would not be focusing on quarterly information.

Faster and more frequent reporting also motivates organizations to get their internal information systems working properly, in order to provide such reports promptly and at the lowest possible cost. That improved internal information flow should benefit management decision making as well. Interviewees also noted that listed companies could possibly raise further capital from existing shareholders by using some form of continuous reporting, focusing on material changes instead of issuing a full prospectus.

### ***Auditors Should Expand the Scope of Their Audits and Provide Assurance beyond the Financial Statements***

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To remain relevant, auditors should expand the scope of their audits and provide assurance beyond the financial statements. According to interviewees, the audit profession should, therefore, seize the huge opportunities of a redefined, broadened, and more transparent reporting framework (as discussed above), which will effectively expand the need for assurance. Audit firms could provide assurance on such integrated reports. Such expanded or integrated assurance would be extremely important to users of expanded business reports to ensure that these reports provide a candid, balanced, and transparent disclosure of what has happened in an organization.

Interviewees believe that it is important that auditors have a clear view on what works and what does not work in such expanded, integrated reports, so that they can express a clear opinion on these reports. To stay ahead of alternative providers of assurance, accountancy firms need to maintain their objectivity, maintain their independence, and stay focused on transparent reporting and not just compliance. To avoid any additional expectation gaps, however, standard setters and professional bodies should clearly communicate the scope and the limits of such expanded audits.

*“Part of our problem is that we are great at creating new things to report, but what we haven’t done well is create a framework to consolidate all these things.”*

– **Samuel A. DiPiazza, Jr., Former Global CEO, PwC**

*“As more companies adopt sustainable business practices, they will start to incorporate that into their reporting.”*

– **Patricia Cochran, Former CFO, Vision Service Plan**

### **High-Quality Standards for Other Assurance Services**

The ISAs are focused on the audit of financial statements. The IAASB also recognizes, however, the importance of [high-quality standards for assurance services](#) other than audits. The IAASB has developed a number of existing International Standards on Assurance Engagements (ISAEs), and also has a number of further ISAEs currently under development, for example:

- ISAE 3000, *Assurance Engagements other than Audits or Reviews of Historical Financial Information* (currently being revised).
- Proposed ISAE 3410, *Assurance Engagements on Greenhouse Gas Statements* (currently under development, Exposure Draft issued in January 2011).
- Proposed ISAE 3420, *Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus* (currently under development, Exposure Draft issued in April 2010).

Emerging areas where assurance standards may have application include assurance on an entity's statement of governance; and on aspects of compliance, for example, an entity's anti-bribery program.

Further information about the IAASB's standards, and work program to develop further standards including assurance standards, can be obtained from the IAASB [project page](#) on their website: [www.iaasb.org](http://www.iaasb.org).





## NEXT STEPS

Following the financial crisis, there has been much debate about what actions are needed and by whom for markets and organizations to move beyond this crisis and to avoid future social, environmental, and/or economic crises. Because these business reporting interviews were conducted after the initial financial crisis, many of the interviewees provided their recommendations on how to further improve governance, financial reporting, and auditing to make business reports more useful, in light of the financial crisis.

IFAC is expediting the development of standards and guidance on key issues in light of the crisis and to further improve the various links in the business reporting supply chain—governance in organizations, financial reporting, financial auditing, and working toward a new, integrated business reporting model. See, for example, the various IFAC actions that are included within this report. IFAC encourages the other participants of the business reporting supply chain to join IFAC and work together to solve these issues.

Hopefully, the interviews and the recommendations provided by the 25 key business leaders in the IFAC business reporting series will inspire other participants in the business reporting supply chain to look at how to further improve governance in organizations, financial reporting, and financial auditing, and at how to make business reporting more useful in the future.

Summary articles of the interviews, as well as the full interview transcripts, can be downloaded free of charge from the IFAC website at [www.ifac.org/frsc](http://www.ifac.org/frsc).

*“If we try to discuss accounting subjects in a time when the economic climate is calm, we are not going to bring many people to the table because they consider the subject too complicated or too technical. If we try to discuss accounting in a chaotic and highly impassioned climate... we will bring to the table people who are very angry and who believe the problem is not their business, but the form of accounting measurement.”*

**– Guy Almeida Andrade,  
Partner, Magalhães  
Andrade S/S Auditores  
Independentes**

## APPENDIX: BUSINESS REPORTING SUPPLY CHAIN INITIATIVES

This appendix provides a selection of recent business reporting publications and initiatives from IFAC's 164 members and associates, as well as from other organizations.

### Business reporting initiatives from IFAC member bodies:

- The Canadian Institute of Chartered Accountants (CICA) paper, *Producing Financial Information for Canadian Capital Markets* (2010), summarizes the key elements of the financial information production process, including the various parties involved in the process. The paper emphasizes that for the production process to be reliable, those parties need to work together in an environment of respect and cooperation.
- In January 2010, the Chartered Institute of Management Accountants (CIMA) published *Enterprise Governance: Restoring Boardroom Leadership*, which explores governance issues in an effort to help boards understand what they must do to be more effective.
- The Institute of Chartered Accountants in Australia (ICAA) published the leadership paper, *Broad Based Business Reporting*, in 2008 and a supplementary paper in 2009, which encourage organizations to build business reports that effectively communicate with their capital markets, including a clear articulation of their business strategies, KPIs and risks, and prospects based on economic, social, and governance (ESG) principles.
- In 2009, the Institute of Chartered Accountants in England and Wales (ICAEW) published, *Developments in New Reporting Models*, which argues that business reporting has to change to reflect changes in business, in information technology, and in users' needs, and addresses recent calls for a new reporting model for business.
- The report, *The Future of Assurance* (2010), by the Institute of Chartered Accountants of Scotland (ICAS), calls for the duties of company auditors, directors, and non-executives to evolve in order to provide greater transparency and accountability to shareholders and others.
- In February 2010, the Institute of Chartered Accountants of Scotland (ICAS) published the paper, *Making Corporate Reports Readable—Time to Cut to the Chase*. The paper contains a pro forma short form report of a fictional universal bank and produces—in less than 30 pages—the key information of interest to investors.

### Business reporting initiatives from other organizations:

- *A Comprehensive Business Reporting Model: Financial Reporting for Investors* (CFA Institute Centre for Financial Market Integrity, 2007). The model proposes 12 principles to ensure that financial statements are relevant, clear, accurate, understandable, and comprehensive.
- The *Corporate Reporting Users' Forum* (CRUF) was formed in 2005 as a discussion forum, with the aim of helping its participants in their approach to the debate on current and future corporate reporting requirements.
- The *Financial Crisis Advisory Group* (of the IASB) is considering how improvements in financial reporting could help enhance investor confidence in financial markets. The advisory group also helps identify significant accounting issues that require the urgent and immediate attention of the accounting standard setters, as well as issues for longer-term consideration.

- In 2009, a shareowner-led working group published enhanced disclosure guidelines to assist directors, audit committees, and investors. For a look at the examples at the working group's website, see [www.enhanceddisclosure.org](http://www.enhanceddisclosure.org).
- On March 1, 2010, the *King Code of Governance for South Africa* (King III) came into effect. The code recommends integration of economic, social, and environmental reporting, recording how a company's business has impacted positively and negatively on the community.
- In its *Final Report* (2008), the US Securities and Exchange Commission's (SEC) Advisory Committee on Improvements to Financial Reporting provided a number of proposals to improve financial reporting.
- The website, [Microsoft Investor Central](#), was developed to demonstrate the potential of using technology and non-financial reporting to provide more relevant information to investors. It takes advantage of new technologies like XBRL and Silverlight that provide an interactive user experience. As you navigate the site, you'll view financial data presented in graphical forms and find links to useful information, including video and audio presentations.
- The UK Financial Reporting Council (FRC) paper, *Louder than Words: Principles and actions for making corporate reports less complex and more relevant* (2009), addresses complexity and improving the quality of financial reporting.
- [Report Leadership](#) is a multi-stakeholder group that aims to challenge established thinking on corporate reporting. Their aim is to develop simple, practical, yet effective, ways to improve narrative and financial reporting.
- *The Landscape of Integrated Reporting: Reflections and Next Steps* (2010) contains a series of contributions from participants in the October 14-15, 2010, workshop on Integrated Reporting: Frameworks and Action Plan, which was held at the Harvard Business School, Boston, USA.

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