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Directors' Series
BEYOND COMPLIANCE

Succeeding amid change and uncertainty: Action plans for audit committees

Making financial reporting more relevant to stakeholders

Accounting standards have undergone several waves of change and revision. As organizations grew more diverse and globalized, new standards were introduced to address new business models and reporting issues highlighted by major business failures.

When stakeholders demanded better information about organizational performance, regulators introduced revised rules around revenue recognition, consolidations, use of financial instruments, compensatory arrangements and segmented reporting.

Enron's collapse sparked actions to improve the reliability of information by requiring the certification of financial statement fairness, attestations of internal control effectiveness, and the establishment of whistleblower procedures.

Amid concerns about transparency and responsible business conduct, earlier requirements for "Plain English" financial disclosures and fair disclosure practices were augmented by International Financial Reporting Standards, eXtensible Business Reporting Language, integrated reporting, Compensation Discussion and Analysis, pay for performance and proxy reform.

All of these new requirements have made accounting less straightforward than it was in the past. As a result, financial reports are more voluminous, making them difficult if not impossible for stakeholders to read and understand.

Growing accounting complexity does not need to automatically result in more complex financial reporting. It has to date because organizations struggling to remain compliant with the deluge of new regulations had little additional time to ensure the information they disclosed continued to resonate with stakeholders.

Audit committee action plan…

- Assess the quality of the organization's financial reporting (annual report, MD&A, financial statements and press releases) for clarity of message, balanced approach, simplicity and consistency.
- Challenge complex narrative and boilerplate descriptions in financial reports.
- Encourage the use of tables and charts to promote user friendliness.
- Monitor evolving reporting standards and participate in the process to help shape the outcome opportunities to adapt systems in an integrated way.

In this environment, audit committees face two important challenges.

First, they cannot wait until new standards are approved and about to take effect before asking about their impact on financial reporting. Nor can they fully outsource financial reporting to management and the independent auditors. Instead, audit committees need to understand the evolving standards and participate in the standard setting process to reduce the implementation challenges associated with new requirements and ensure that their perspective is being brought to the table.

Second, audit committees should understand what is important to their stakeholders to ensure the information disclosed to stakeholders is relevant and useful.

The International Accounting Standards Board (IASB) is considering changes to make the financial statements more informative to users, such as possibly amending IAS 1, *Presentation of Financial Statements*, to allow more flexibility in the ordering of notes to the financial statements so significant items can be reported at the beginning of the notes, giving users a better insight into what management considers important financial information.

The International Integrated Reporting Council (IIRC) has published its initial International Integrated Reporting <IR> Framework under which an organization will be able to explain the relationships between its various operating and functional units and the capitals (financial, manufactured, intellectual, human, social and relationship, and natural capital) used or affected. Integrated Reporting is not intended to replace existing regulatory required reporting, but to instead provide an overarching picture of all significant matters affecting an organization's performance.

Audit committees, together with management, may wish to consider the impact these and other proposals may have on their organization's reporting to its stakeholders. When new rules are introduced, audit committees should help stakeholders understand how they differ from current accounting practices, their likely effect on financial position and results, the way changes will be applied to historical information, and so on. Providing pro forma information, even if not required, may help improve stakeholders' understanding of the new rules.

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