

# World Watch

Governance, Reporting and Assurance

Issue 3 2011

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# Charting the future – why the IIRC’s work is so critical

As someone who has spent most of his working life trying to improve corporate reporting, I think it is critical that everyone involved in this space clearly understands the value of the International Integrated Reporting Committee’s (IIRC) work and its recent discussion paper (page 28). Put simply it provides a vision of the future, a clear sense of the direction in which reporting should be moving.

This vision is, I believe, something around which companies, investors, policy makers, regulators and standard setters can engage and start to consider the procedural, structural and institutional implications for the reporting system we have today. We must be clear that what the IIRC has developed is a response to a market need, driven by innovating companies who recognise that the way both mainstream and sustainability reporting has evolved is not sufficient to meet changing economic, social and market needs.

The ambition of the IIRC is to make the case for a change to the mainstream model and, if successful, to put itself out of a job. But to do this, those who are responsible for the system need to consider how this type of model can evolve in a structured, valuable and logical way. This is not about ignoring all that is good about financial and other aspects of reporting today. But it is about creating a new integrated reporting model that focuses on what is strategically important and material to an understanding of a business’ long-term sustainability.

Is the vision of integrated reporting in the discussion paper the answer? No, it isn’t. Should we be rushing to introduce new standards tomorrow? Again, the answer is no. But we do need a reporting blue print to help inform and guide the reporting innovation that is taking place right now in the market place. This is what the IIRC has started to create. And it will be greatly informed by the pilot company programme that has just kicked off (page 29). This blueprint, even in its current form in the IIRC’s discussion document, can equally help policy makers, regulators and standard setters think through the implications for the evolution of regulatory reporting and the mandates and skills needed within the core institutions on which the reporting system relies.

At a time when so many aspects of the capitalist system are being debated (as this edition of *World Watch* illustrates), and when domestic agendas dominate the thinking of many policy makers and technocrats, it is interesting to see how much global interest and engagement there is around the IIRC’s work on integrated reporting. We should cherish this position - the IIRC’s ambition and momentum and the collaborative nature of its endeavour. We should also recognise success as the IIRC’s ability to find consensus and shape global thinking. It could be an important factor in achieving more effective business reporting that meets the needs of the capital markets and a resource-constrained world, both today and tomorrow.

David Phillips, senior corporate reporting partner, PwC

## Contact us

PwC has a strong and effective network of people worldwide who can advise on the developments and the implications of regulations. If you would like to discuss any of the issues raised in this publication, please contact your local office, the people named in specific articles or the editor.

To subscribe to *World Watch* magazine (usually published twice a year) or to contribute articles, please email [sarah.grey@uk.pwc.com](mailto:sarah.grey@uk.pwc.com)

[www.pwc.com/worldwatch](http://www.pwc.com/worldwatch)

[www.corporatereporting.com](http://www.corporatereporting.com)

### World Watch team

**Editors:** Sarah Grey and Nicole Wilson

**Consulting editors:** John Hitchins, David Phillips, Peter Holgate, Simon Friend, Alan McGill, Charles Bowman and Diana Hillier

**Contributors:** Christopher Ward, Stephanie Caunter, Tom Beagent, Jacqueline Cancro Sidoti, Jacomien Van den Hurk, Wendy Reed, Joanna Malvern, Alison Thomas, Bethany Tucker, Graham Gilmour, and PwC staff

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# Predicting risk in an uncertain world

Organisations are finding it increasingly difficult to manage and control risks. **Armoghan Mohammed** looks at why the dynamics of risk are changing

**The world is moving from a past in which boards believed in their ability to manage and control risks, to a present where established risk approaches and thinking are being repeatedly outflanked and outpaced.**

'Black swan' events – those that occur without warning and have a profound effect on society and business – are happening more frequently.

Today, 'black swans' are regarded as one of three types of risks that organisations face. They cannot be predicted or avoided. The others are 'known risks' that companies can identify and seek to avoid, plan for and mitigate, and 'emerging risks' that have come onto the radar, but whose full extent and implications may not yet be clear.

By their nature, black swan events should only occur at irregular intervals. Yet recent experience suggests that events fitting the criteria for black swans are happening with increasing regularity. This acceleration raises the question of whether the black swans are actually turning grey – meaning that, rather than being isolated, outlier events, they are actually manifestations of a new, more uncertain and less predictable reality.

### **From control to uncertainty**

Asked to highlight the changes they are seeing, boards generally point to three main shifts:

- Current risk frameworks and processes are no longer giving the degree of protection that's needed
- Escalation of the speed with which risk events unfold, and the extent of their impact across different risk categories. This is a particular concern for high-impact catastrophic risks, which can threaten the viability of an organisation and even affect the way an entire industry operates.

- A disproportionate amount of time and resource is being spent on running the mechanics of risk management, rather than moving quickly and flexibly to identify and address new risks.

### **New approaches**

If organisations are currently under-protected against the new risk environment, it follows that their existing risk management approaches and mechanisms are falling short. PwC recently conducted research into how various multinationals have responded to low-probability, high-impact risk events. Key findings include:

- The boards of big organisations do not generally fully understand the risks that they are running – or how the knock-on impacts can spread across risk categories. This makes it harder to manage organisations within their risk appetite.
- The internet and social media allow information to move instantaneously around the world, morphing opinion into fact. Companies that cannot deliver the right responses quickly are getting caught out.
- Checks and balances at board level are often not in place because the board may not have people with enough industry expertise to ask tough questions about executives' decisions. There is frequently a gap between what management says about risk, and what it delivers. It helps when the board is asking the right questions, such as: Are the CEO and board setting the right behavioural example and risk-aware culture, in line with the strategy? Are rewards encouraging risk-based thinking and behaviour? In addition to financial and operational risks, are we as a board sufficiently focused on managing strategic risks?

### **Taking action**

Assuming we will continue to live in a world where predicting and controlling risk events is no longer feasible, what is an appropriate approach? A key consideration for each organisation is how it frames and perceives risk. Our

view is that organisations should look to build on Enterprise Risk Management (ERM) by making changes to the way they frame and think about risk.

First, the business should move away from only identifying, measuring and prioritising the discrete risks they face. Management should focus more broadly on the resilience of the entire systems to which they contribute, ranging from global, industry, political and financial environments. All organisations need to progress from controls to risk cultures, managing in a coordinated way across different interests, organisational silos and external interactions.

Second, since analytics will not be enough on their own, boards will need to be more explicit about the organisation's risk appetite in pursuit of its strategy, and to build awareness at all levels of what risks it is willing to bear. Some may regard risk management as a distraction from the day job that is effectively someone else's problem. In fact, it is part of everybody's job, every day. Many non-executives voice frustration that the executives on their boards are too cautious in terms of risk – so greater clarity on risk appetite would certainly aid board effectiveness.

Third, there should be a parallel drive to integrate risk and strategy and to embed a risk-aware culture, behaviours and beliefs at all levels of the organisation. Ideally, this will be driven by the chief risk officer (CRO) or equivalent executive on the main board. Having more senior representation of risk will also help to remove the artificial distinction between financial, operational and strategic risk and uncertainty, and encourage a more holistic view.

### **Moving towards risk resilience**

Taking these actions in combination should help organisations to realise the key business benefits that will help them progress from managing specific risks to achieving wider resilience in a new landscape where risks arise more frequently and with continuous uncertainty.

**Armoghan Mohammed is a partner in Risk and a member of the Governance, Risk and Compliance leadership team at PwC.**

# The cyber-savvy CEO: Getting to grips with today's growing cyber threats

Operating securely in the cyber environment is among the most urgent issues facing business and government leaders today. **William Beer** looks at what needs to be considered when taking activities online

Far from being a barrier to participating in the cyber world, effective security is a critical enabler for any organisation seeking to realise the benefits of taking activities online. Achieving this requires two assets: an understanding of online operating and business models; and an ability to protect and support those business models.

Today, more and more organisations in all sectors are seizing the opportunities created by the Internet. In PwC's view, the only way to do this securely and sustainably is by ensuring that cyber awareness and responsiveness are infused into every employee, every decision and every interaction. It's time for CEOs to make this happen.

### Who's at risk?

In June 2011, Nintendo joined fellow online games company Sony and US-based defence contractor Lockheed Martin in confirming that it was among the latest targets of cyber attacks. The announcement came just days after the UK's chancellor, George Osborne, told an international conference that British government computers are now on the receiving end of over 20,000 malicious email attacks every month. The message is clear: No organisation in any sector is safe – and the threat is growing.

Nobody can say the world had not been warned. In January 2011 the World Economic Forum (WEF) named cyber attacks as one of the top five threats facing the world – alongside planetary risks posed by demographics, scarcity of resources, concerns over globalisation, and weapons of mass destruction. Far from suggesting that fears over cyber threats may be over-hyped, the WEF highlighted the danger that they were actually being underestimated.

### Unprecedented opportunities

The growing threat reflects the explosion of online services in all sectors. Across the world, more and more private and



public sector organisations are capitalising on web, mobile and social media platforms to improve their performance and serve customers more effectively. Online interactions bring a blend of four key benefits: lower costs to serve, higher speed to market, greater customer loyalty, and – in the case of the private sector – the potential for higher revenue growth.

These benefits are causing the cyber revolution to gain momentum at breathtaking speed. For example, we estimate 115 million Europeans will be using mobile banking services by 2015.

### The darker side

As the use of online services increases, so do the scale and sophistication of cyber attacks. Targets range from countries' critical national infrastructure and the global financial system, to less obvious targets such as mining companies.

One of the most alarming attacks was the Stuxnet computer virus that emerged in mid-2010. This malicious software (malware) program was created with the aim of sabotaging Iran's nuclear programme, by increasing the speed of uranium centrifuges to breaking-point and simultaneously

shutting off safety monitoring systems. Commercial cybercriminals are mounting equally sophisticated attacks. Such examples underline how opportunities and risks in the cyber world have risen to a new level.

### Key barriers

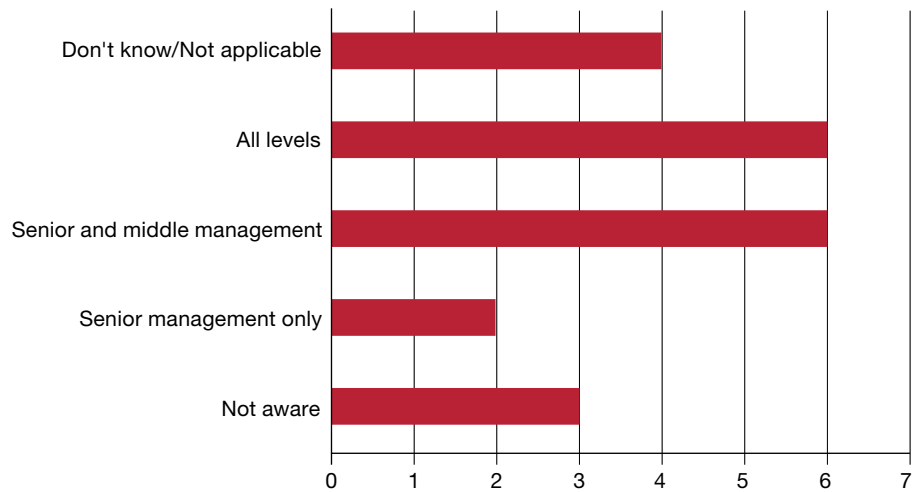
Organisations need to overcome a number of entrenched barriers if they are to defend themselves effectively against increasingly sophisticated attacks. Four are especially prevalent:

- **A need for new skills and insights:** To use a military analogy, the migration to cyber is as disruptive as moving from horses to tanks. In today's world, a fifteen year-old hacker might have a better understanding of security risks than a seasoned leader. The people engaged in securing cyberspace need to keep raising their game faster than the attackers.
- **Integrating security into the business:** Cyber security used to be pigeonholed as an IT issue, creating a communications gap between business managers and security professionals. Awareness is now growing that cyber security is not only a technical issue, but a core business imperative.

- **Consistent, aligned and connected responses at every level of the organisation:** Traditional organisational structures tend to be too slow and rigid to enable the speed and flexibility of response needed in the cyber world. Faced with attackers who move quickly and unpredictably, organisations need to be able to move information and decisions up, down and across their structures fast and flexibly.
- **Creating a cyber-risk aware culture:** A cyber attack can gain entry via any node on an organisation's network – including a third-party supplier, customer or business partner. This means that everyone involved in the organisation's cyberlinked activities shares direct responsibility for security, and that awareness of cyber risks needs to be an integral part of every decision and action. Yet we are in an era when many younger employees access social networks in the workplace, and when organisational cultures can change rapidly.

## How aware are your people of cyber risk?

Our research suggests that the challenges of creating and embedding a cyber-risk aware culture, and of ensuring aligned responses at all levels, are increased by a relative lack of awareness of cyber risks lower down the organisation. In our information security forum quick poll, only 29% said people at all levels of their organisations were aware of cyber risks. Even more worryingly, 14% of respondents said that nobody at any level was aware of these risks.



Source: PwC Information Security Forum quick poll

**William Beer is a director in Information and Cyber Security and a member of the Governance, Risk and Compliance team at PwC.**

[www.pwc.co.uk/eng/services/digitaltransformation.html](http://www.pwc.co.uk/eng/services/digitaltransformation.html)

# Six steps to 'cyber-ready'

## 1. Clarify roles and responsibilities from the top down

We believe that leadership by a CEO who truly understands the risks and opportunities of the cyber world will be a defining characteristic of those organisations that realise the benefits and manage the risks most effectively.

## 2. Reassess the security function's fitness

The IT security function needs to focus on upgrading or transforming the existing capabilities to deal with cyber risks. This means building on the existing base to ensure that the organisation's responses to its security needs fully encompass cyber security.

## 3. Achieve 360° awareness of the situation

To align the security function and priorities as closely as possible with the realities of the cyber world, the organisation needs a clear understanding of its current and emerging cyber environment. This awareness is a prerequisite for well-informed and prioritised decisions on cyber security actions and processes.

## 4. Create a cyber incident response team

The speed and unpredictability of cyber threats mean that the incident response team may need to be adapted and streamline to enable information, intelligence and decisions to flow more quickly up, down and across the business, from board level to IT and business operations, and sometimes to and from other organisations.

## 5. Nurture and share skills

Invest in cyber skills. Many companies are experiencing difficulty recruiting people with the cyber security skills they need. Yet most companies plan to create more jobs in cyber security in the next few years.

## 6. Take an active and transparent stance towards threats

The unpredictable and high-profile nature of cyber threats tends to engender a defensive mindset. But cyber-savvy organisations are adopting a more active stance towards attackers, pursuing them through legal means, and communicating more publicly about their cyber threats, incidents and responses.

# From compliance to competitive edge

As corporate reporting enters a period of major innovation, taking a compliance-driven approach is becoming a risky option, say **Charles Bowman** and **Mark O'Sullivan**. It's time to take positive action so that reporting gives you a competitive edge

Management teams today are constantly having to re-evaluate their business strategies in the light of significant economic uncertainty and changing market dynamics. Investors too must keep a very sharp eye on their investment strategies. Understanding the issues and having a clear strategy in place to respond to the changing dynamics – whether they are caused by financial crises, more global competition or resource scarcity – is essential to maintaining competitive edge.

No wonder, then, that the ability to access the right information for decision making is high on the agenda for all those with an interest in business performance – from management teams and the board, to investors, policy makers and regulators. Financial reporting, while providing the backbone of information, is backward-looking and is no longer enough on its own.

The financial crisis has placed a premium on a much broader set of information, including on the business model, risk management and good corporate governance. But nobody wants just more information; it has to be relevant, insightful and reliable and reflect the reality of a business today as well as indicate its future prospects. Stakeholders are demanding information that will enable them to understand the quality and sustainability of company performance.

We need to ensure that we all work together to achieve a meaningful and long-lasting solution that puts us in the best position to forecast and buffer the effects of economic upheaval.

### **Consensus for change**

For management, taking a narrow, compliance-driven approach to external



reporting – one that does not show a response to the changing context for business – is starting to look risky. Stakeholders are looking for evidence of management quality and credibility in reporting, and asking: “What does this reporting say about the company, its management, governance, ambition and prospects?”

Already fewer people are asking us: “Why should I improve the information I report?” And more are asking: “How can I get the quality information I need to run the business, compete and communicate effectively with my stakeholders? How much change is needed? Where and when do I start?”

In the latest round of PwC research into the narrative reporting practices of FTSE 350 companies, we found positive signs of improvement in some areas of corporate reporting. For example, the vast majority of companies now include some information on principal risks, discuss future market trends, and explicitly identify key performance indicators. But the quality of reporting on business risks, strategy and business models in particular shows that there

is still a long way to go before greater disclosure turns into effective reporting. See page 29 for the main results of this survey.

Today, companies need to look beyond compliance and be receptive to the growing external pressures from investors and other stakeholders. Help is at hand in the form of a number of initiatives to improve reporting. The International Integrated Reporting Committee (IIRC), for example, has proposed a new reporting framework and set up a pilot programme to explore practical and innovative solutions, without regulators necessarily dictating specific ‘standards’ (see IIRC article, page 29).

### **Competitive gains**

Management teams that currently take a ‘compliance’ approach to their reporting may be failing to spot the benefits because they are not always tangible or measurable. As innovative companies and investors engage with the IIRC, and other initiatives, we expect the benefits that come from communicating relevant information to the markets to become

clearer. The intangible benefits might include: no issues raised by regulators; increased confidence and trust across all stakeholders; enhanced corporate reputation (lower reputation risk); and productive dialogue with stakeholders. All of these can lead to better valuations by investors and a lower cost of capital or debt for companies.

But arguably, the most fundamental benefits spring from the discipline imposed on a company by shining a light on its internal workings. Companies are telling us that the real catalyst for improvement is finding ways of accessing better information to support management decision making, board review and employee awareness.

Certainly 'integrated thinking' is a central tenet of the IIRC's discussion paper on integrated reporting, and

uncovering opportunities to optimise management processes appears to be a key motivator for companies participating in the IIRC pilot programme. Coherent external reporting will follow, but the first goal is a better-managed company.

Our engagement with companies, users and regulators highlights a growing recognition that improving the effectiveness of reporting cannot be achieved through compliance and clever presentation alone.

### Where are you on the reporting journey?

We believe there are compelling options for every company looking for a way forward with its reporting. The right options will depend on where each company has got to on its reporting

journey. Some management teams might choose to get involved in influencing the future, joining the debate, experimenting and innovating. Others will want to focus on new requirements, getting inspiration from leading companies and finding quick wins to fill any significant gaps in their reporting. In our view, there is no excuse for inaction. Ideas for companies considering positive action on reporting are outlined in the chart below.

**Charles Bowman is a PwC partner in the UK on the assurance leadership team. Mark O'Sullivan is a director in the UK Corporate Reporting team at PwC.**

[www.corporatereporting.com](http://www.corporatereporting.com)

## How you can take your reporting forward

### Differentiate

Think beyond current reporting. Go for competitive edge with integrated reporting, eg:

- Report on your stewardship of all forms of capital – human, social, natural etc as well as financial
- Think beyond the accounting definition of 'control', consider risks and opportunities across your entire supply chain
- Pick up cutting-edge ideas from the companies signed up to the IIRC pilot programme
- Take a longer-term perspective with your reporting
- Provide your content with a forward-looking orientation
- Combine financial, operational, governance and environmental information in a concise and coherent way

### Innovate

Challenge today's reporting. Experiment with content, structure and integration, eg:

- Explore what a Strategy Report might look like and how you could pull the information together
- Understand investors' bug bears and find innovative ways to address them
- Challenge the content of your annual report and whether it is 'material'
- Innovate with your annual report to create a clearer narrative flow
- Experiment with structure and channels – place standing data on-line?

### Fix

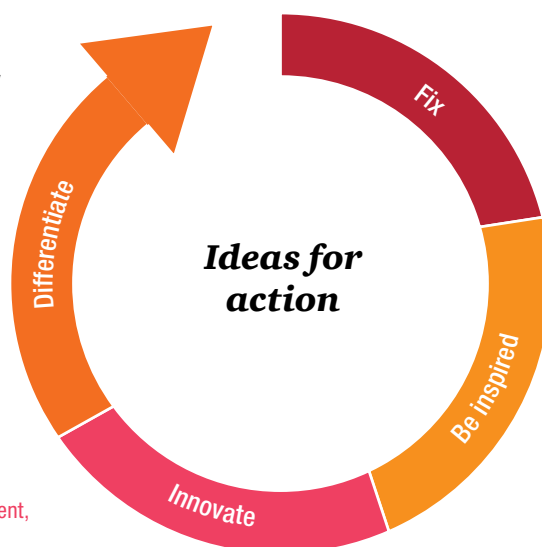
Keep up with current practice and new requirements. Focus on quick wins and fill any significant gaps, eg:

- Keep up with industry reporting trends and what other companies in your peer group are doing
- Look for ways to avoid repetition and reduce length to improve narrative flow
- Consider whether your risk descriptions can better reflect your industry and specific circumstances
- Consolidate existing content to build a picture of your business model – is any key information missing?
- Use clearer sign-posting and cross-referencing to demonstrate links between key information
- Explain why your 'key performance indicators' are key

### Be inspired

Learn from emerging and best reporting practices, eg:

- Use your strategy to underpin your reporting
- Demonstrate a clear link between your strategic priorities, KPIs and remuneration
- Discuss the group's risk profile and how it has changed
- Explain the drivers shaping the market in which you operate and how they influence your strategic choices
- Embed business model and corporate responsibility into your discussion of strategy and performance
- Provide more operational/non-financial KPIs to support your discussion of key resources and relationships
- Check out the good practice examples on [www.corporatereporting.com](http://www.corporatereporting.com)



# Puma's reporting highlights global business challenges

Puma's ground-breaking approach to costing its use of all kinds of capital could be a catalyst for radically different reporting by companies. **Alan McGill** shares his insights

PUMA Corporation's trailblazing 2010 environmental profit and loss (EP&L) account, published in November 2011, has been hailed as a major step forward for corporate reporting. But PUMA promises that this is just the first stage in a process that will see the business take account of all its environmental, social and economic impacts – including fair wages, working conditions, job creation and tax contributions.

This article takes a closer look at the practical and strategic implications of PUMA's holistic approach, just as the parent company, PPR, announces that its luxury and sport & lifestyle brands – including Gucci, Yves Saint Laurent, Bottega Venetta and Stella McCartney – will follow in PUMA's footsteps to implement a PPR Group EP&L by 2015.

Clothing and sports goods manufacturers are among the most prominent exponents of the outsourced production model. And PUMA is no exception. The company outsources most of its production, and acknowledges that this means “it is more difficult to control the impact on issues such as sustainability”. All the more remarkable, then, that PUMA's EP&L project sets out to give a true picture of the cost of producing its goods in terms of the natural resources used and the environmental impacts of its operations – from raw materials through to the retail transaction.

The ‘hidden’ costs that Puma's reporting highlights are enough to make any business pay attention. The PUMA EP&L offers a real insight into the environmental consequences of commercial decisions and at the same time highlights the potential commercial consequences of natural resource shortages. Puma's first step will help other companies consider how they can apply similar analysis in their own organisations.

Companies – big and small – are now reliant on global supply chains, making their environmental footprint much larger than many realise. Assigning economic values to the environmental impact of a company's operations enables a business to tackle vital questions, not just about environmental impacts, but about business risk, cost savings and finding new ways to become more effective. Without measuring them, the impacts cannot be managed, or reduced.

### **The results**

After publishing an economic valuation of €94m of greenhouse gas (GHG) emissions and water consumption in May this year, PUMA has now finalised its 2010 EP&L by adding costs of €51m caused by land use change for the production of raw materials, air pollution and waste along its value chain. PUMA worked with PwC and

Trucost to develop the methodologies to first quantify its most significant environmental impacts, and then apply values to account for the associated economic impacts.

The biggest contributors to the total impact of €145m were GHG emissions and water consumption. GHG emissions estimates were based on the ‘social cost of carbon’, which aims to value the costs to society as a result of current and future climate change. PUMA applied a value of €66/tonne of CO<sub>2</sub>, which results in a total GHG emissions value on the EP&L of €47m for 2010.

The economic impact of water consumption required different values to allow for relative scarcity in different locations. The EP&L used a Total Economic Value framework, taking into account factors such as how water is replenished relative to withdrawal, to arrive at an average water value of €0.81 per cubic meter. By this measure, water consumption was also valued at €47 million in 2010.

### **Impact on business models**

PUMA has positioned its EP&L exercise in the context of a longer-term imperative for global businesses to introduce more sustainable business models. For example, PUMA's direct operations in 2010 accounted for just €8m of the €145m environmental

### **PUMA's three-stage process for full environmental, social and economic reporting**

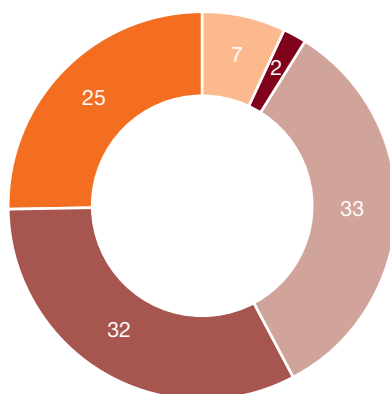
- 1. Environmental P&L** – covering GHG emissions, water use, the impacts of changes in land use on ecosystems and biodiversity, local air pollution and waste.
- 2. Social P&L** – to include social impacts such as fair wages; freedom of association, health; security and stability; empowerment; community cohesion; human capital; and gender equality. PUMA will collaborate with other corporate and civil society stakeholders to address social issues.
- 3. Economic P&L** – to focus on some of the beneficiaries of the economic impacts from PUMA's operations. This could include: job creation; wages; total tax contributions; indirect and induced employment; indirect and induced output; productivity and efficiency gains; business creation and growth.

impact costs. The remaining €137m was incurred by its entire supply chain, ranging from raw material production through to processing and manufacturing.

Jochen Zeitz, executive chairman of PUMA and chief sustainability officer of PPR, told us: “Our P&L has been indispensable for us to realise the immense value of nature’s services that are currently being taken for granted but without which companies could not sustain themselves. At PPR HOME, we view the PUMA EP&L as an essential tool to help drive PPR’s sustainability development across the group of brands because analysing a company’s environmental impact through an EP&L, and understanding where environmental measures are necessary, will not only help conserve the benefits of ecosystem services but also ensure the longevity of our businesses.” The company has shared its findings with governments, industry players and corporations in order to raise awareness of environmental impacts and risks in the global supply chain.

Fundamentally, Puma’s analysis is about risk management for the environment, and for business, because you cannot separate the two. This gives PUMA a unique and challenging insight into its supply chain. It’s a game-changing development for businesses to integrate environmental issues into their current business model like this, because it provides a basis for embedding their

### EP&L impact by category (%)



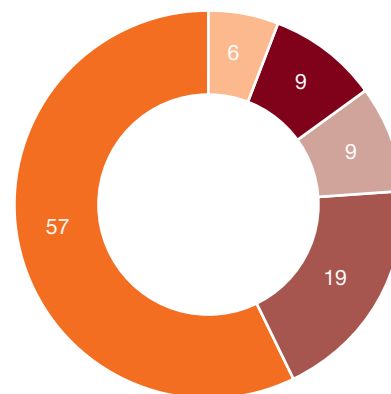
- Other air pollution
- Waste
- Water use
- GHGs
- Land use

Source: Puma

reliance on ecosystem services into business strategy. Tackling the impacts will need concerted efforts by the businesses in their supply chain as PUMA shares a common, but differentiated, responsibility with other brands at the production facilities.

PUMA’s EP&L underlines the corporation’s commitment to its stated aim to “make sustainability an integral part of the PUMA DNA that is deeply

### EP&L impact by supplier (%)



- PUMA operations – offices, shops, logistics etc
- Tier 1 supplier – manufacturers
- Tier 2 supplier – outsourced processors (printers, embroiderers etc)
- Tier 3 supplier – raw material processors (leather tanning, oil refining etc)
- Tier 4 supplier – raw material producers (cattle ranching, cotton farming, oil drilling)

Source: Puma

embedded in our entire value chain”. As it works towards completing its environmental, social and economic reporting model, it will be calling on a wide range of corporate and social stakeholders to collaborate with them and communicate their use of different kinds of capital.

**Alan McGill is a partner in the Sustainability and Climate Change team at PwC.**

### PUMA’s EP&L Account

	Water use	GHGs	Land use	Air pollution	Waste	TOTAL	
	€ million	€ million	€ million	€ million	€ million	€ million	% of total
	33%	32%	26%	7%	2%	100%	
<b>TOTAL</b>	47	47	37	11	3	145	100%
PUMA operations	<1	7	<1	1	<1	8	6%
Tier 1 – manufacturers	1	9	<1	1	2	13	9%
Tier 2 – processors	4	7	<1	2	1	14	9%
Tier 3 – raw material processors	17	7	<1	3	<1	27	19%
Tier 4 – raw material producers	25	17	37	4	<1	83	57%
<b>Geographic analysis</b>							
EMEA	4	8	1	1	<1	14	10%
Americas	2	10	20	3	<1	35	24%
Asia/Pacific	41	29	16	7	3	96	66%
<b>Segmental analysis</b>							
Footwear	25	28	34	7	2	96	66%
Apparel	18	14	3	3	1	39	27%
Accessories	4	5	<1	1	<1	10	7%

# Put data first – it's the lifeblood of business

Integrating finance and risk reporting is an imperative for many organisations. Focusing on data and not technology is the key to fast results that will pay off in the longer term, argue **Paul Morton** and **Symon Dawson**



Smart management of liquidity and capital is a vital element in the identification and execution of today's banking strategies. Fallout from the financial crisis has also heightened regulatory scrutiny of liquidity and capital adequacy, with further pressure likely to come from the implementation of Basel III.

Identifying and managing risks across the enterprise, at the same time as demonstrating transparency and control to investors, regulators and other key stakeholders, are core management tasks. For banks, effective decision-making demands faster, more frequent and more consistent information about risk exposures, the capital needed to support them and the resulting impact on present and future profitability. It also requires the ability to generate risk-adjusted performance measures (eg, return on risk-adjusted capital) at a granular level, be this by customer, country, asset or sector.

Success depends on comprehensive and integrated risk and financial information – but the reality for many (financial and non-financial institutions alike) is that current systems, processes and data may be obscuring this joined-up view. So, what are the barriers to aligning risk and finance and what's the best way to overcome them?

## ***Have you got the information you need?***

Within many organisations, risk and finance are still worlds apart, making it very difficult to generate integrated information and insights. Why is this? In our experience, there are a number of contributing factors:

- Reporting data, processes and systems for the risk and finance functions have generally been developed independently and have struggled to keep pace with regulatory pressures, including IFRS, Basel II and Sarbanes-Oxley. There has been a tendency towards short-term, tactical solutions that has hampered attempts to develop integrated systems.
- Underinvestment in back office processes and systems and a focus on delivering solutions at the lowest cost and with minimum disruption.
- Short-term front office requirements have set the agenda. The need to quickly implement a new product or bring on board a new client has encouraged the tendency to adopt tactical measures. A lack of front-office accountability for data quality and management has reduced the pressure to address systems problems.
- Even global organisations with the scale to allow them to make the most of the cost and efficiency benefits of enterprise-wide developments have struggled to reconcile the divergent regulatory and statutory requirements across their businesses, and have been forced to implement multiple local solutions.
- Delivery of the required reports has depended on manually intensive workarounds that can be expensive and prone to error.

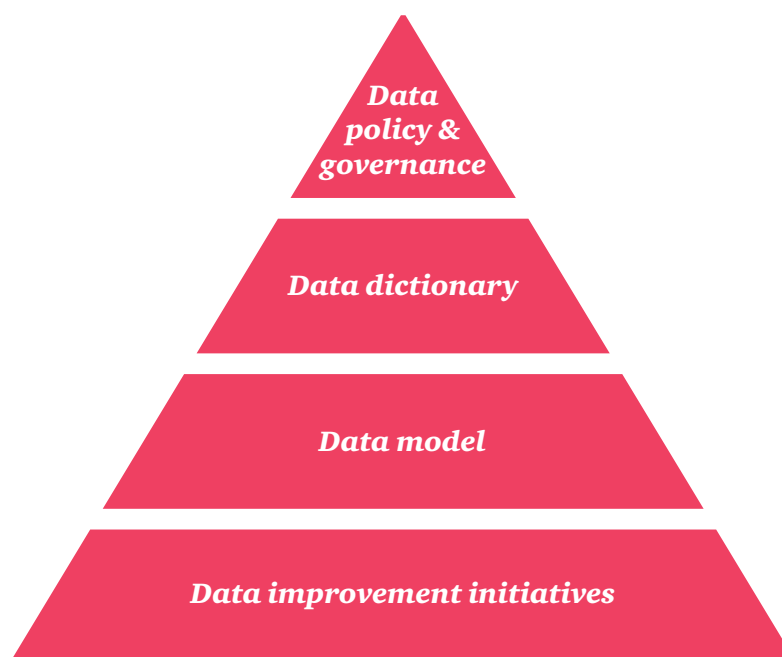
### **The solution?**

Many banks have trusted to technology to help integrate risk and finance reporting, often at great cost and with mixed results. A more pragmatic and cost-effective approach is to get the data right first.

To tackle the urgent task of developing a risk and finance data framework, some organisations have overhauled their reporting systems. Data warehouses are being used to bring together the required operational data. While this approach can enhance data mining and analytical capabilities, it can often fall down through poor data capture. The old adage holds true: 'rubbish in, rubbish out'.

Others have compounded the problem by building adjustments into their group-level reporting processes to help

## **Foundations for effective data**



Source: PwC

iron out some of the deficiencies in the source data. While this can often be a short-term necessity, the adjustments tend to multiply in the face of mounting regulatory or business demands. The transparent connection with the underlying data is often lost, which exacerbates the problem and creates a vicious circle of data issues.

Without improvements in the quality and completeness of data captured at source, changing the processes and systems will have little impact. Risk and finance cannot resolve the difficulties on their own. The entire organisation must recognise that good data and the decisions that flow from it are everyone's responsibility.

### **Pragmatic approach**

We think that putting data management rather than technology at the centre of the solution can really make a difference – see the diagram above, which outlines the core elements of this. The key is to look at what internal and external customers need ('demand perspective') rather than what the business currently produces ('supply perspective') to make sure that investment in new architecture is driven by a strategically aligned business outcome. For example, prioritising improvements in the quality and availability of risk modelling data used for Basel II, can derive significant capital reduction benefits for a relatively limited investment.

It makes sense to focus initially on the elements of data directly controlled by risk and finance – such as counterparty hierarchies, financial charts of accounts and legal entity and management structures, as well as transactional data from the front office. Next in line are all the other data elements owned by areas outside of these functions, but used by them to complete their reporting outputs. Examples include product classifications and customer hierarchies, instrument and market data, and other sales and marketing attributes. These are important when establishing robust risk-adjusted performance and economic capital metrics, which require capital, revenue and cost allocations across relevant business dimensions.

### **Data policy**

The data policy sets out the specific data elements required by risk and finance to meet their modelling and reporting requirements. It then defines clear ownership and the requirements for the quality, consistency and supply of each data set. This has clear advantages over the alternative approach that focuses on the business outputs (ie, reports produced), before identifying the detailed data elements required to produce them.

*Continued overleaf* >

## **Data governance**

Governance procedures to support the data policy include assigning data 'owners' – both the end user within risk and finance and the originator of the data at source. Ownership by end users ensures the reporting outputs are responsive to current and evolving needs. It also means the producers of data – typically the front office – can be encouraged to address poor quality data capture, for example through the introduction of data quality chargeback mechanisms or penalties. This helps the front office see the benefits to them personally and the wider business of adopting a different approach to data.

## **Data dictionary**

Identifying the data elements will allow you to put together a data dictionary, which sets out your data standards. This starts with the business demand for each element and what is needed to meet it, then maps the required data back to its sources and sets out how it is used, derived, controlled and verified. It not only defines data's meaning, but also its relationship to other data, origin, use and format. The mapping process will help to streamline supply by identifying and ironing out any logjams, duplication or inconsistencies. This information will then feed into any data remediation process required over the short term.

## **Data model**

The completion of a data policy and data dictionary triggers the development of a logical data model for risk and finance, which establishes how the data is to be structured and how each data element is related to another. This data model then provides the foundation for all process and system change.

## **Data improvement initiatives**

In parallel to establishing good data governance and design approaches, it's important to start fixing data and resolving any issues as soon as possible. It's important to make sure these fixes are aligned and controlled through appropriate business governance.

## **Benefits of 'data-first'**

The key benefits of adopting this pragmatic approach include:

- **Faster results** – putting data first, enables companies to get most of the business benefits quickly without having to wait for a fully integrated finance and risk architecture to be developed.
- **Improved return on investment in technology** – by ensuring that any future technology investment is closely aligned with business requirements and is using 'good' data, it is more likely to deliver the expected benefits.

- **Increased agility** – by being able to demonstrate to stakeholders that data quality and the timeliness of processes are improving, they will have greater confidence in the organisation's ability to meet tightening reporting deadlines.
- **Greater insight** – by focusing on data quality, fewer manual adjustments will be needed, which makes management information faster and cheaper to produce, as well as more accurate and focused on business needs.

## **Data at the centre**

Good data is the lifeblood of any business and requires effective management like all other assets. Fixing the data first helps address the key organisational issues at the heart of today's market demands for increased transparency and accuracy of reporting. It also gives a solid basis to drive more benefits from any future technology solutions, as well as making them significantly cheaper and less risky to implement.

**Paul Morton and Syman Dawson are both advisory partners at PwC.**

***“Without improvements in the quality and completeness of data captured at source, changing the processes and systems will have little impact”***

***“Good data is the lifeblood of any business and requires effective management like all other assets”***

# A new direction for the IASB?

As the new chairman settles into his role at the International Accounting Standards Board, **Peter Holgate** reviews what's dominating the board's agenda and how constituents can help steer its direction

It is now five months since Hans Hoogervorst took over from Sir David Tweedie as chairman of the International Accounting Standards Board (IASB). The early signs are that Mr Hoogervorst has made an active start and a good impression. He is on the conference circuit and meeting many people. Indications are that he sees that the relationship with the US Financial Accounting Standards Board (FASB) is important, as it is a major national standard setter, but not so important as in recent years, which have been dominated by the desire for convergence with US GAAP.

One of the first papers to appear since Mr Hoogervorst took over as chairman is the IASB's *Agenda Consultation 2011* – an invitation to comment on what the IASB should be doing in the next phase of its life. Rather than merely list the technical projects and ask: "Which ones, and in what order?", this consultation paper, rightly, asks the more fundamental questions about the broad strategic direction. So for example, it asks:

- What should be the role, priority and importance of the conceptual framework?
- To what extent should working with the FASB dominate the agenda?
- How should the IASB respond to the challenges of IFRS being implemented in Asia, Canada and Latin America?

At the more detailed level, there are questions to consider about the role of post-implementation reviews and improvements/interpretations of standards. Also, what is the future for the IFRS for SMEs that was published in 2009? Comments on this paper were requested by 30 November 2011.

The conceptual questions seem particularly important at this time. In part, this involves finishing off the IASB's conceptual framework, a project that has been in progress for many years already.



But it will be important for the IASB, in carrying out this work, to address the following important issues:

- Understanding what 'performance' is. What is the meaning of 'earnings'? What are the criteria for deciding what goes into earnings and what goes in other comprehensive income (OCI)? Should items be re-classified (re-cycled) from OCI into earnings and, if so, when?
- Identifying principles for presentation and disclosure. The IASB has a habit of adding more and more disclosures with each new standard. The forthcoming standards on leasing, revenue and financial instruments are likely to follow the same trend. (See disclosure reductions article, page 40)

One thing that is clear from the agenda consultation is that the IASB sees the need to finish and publish the four major standards that Sir David had hoped to finish by June 2011, namely: leasing, revenue, insurance and financial instruments. The need to finish these seems uncontroversial, although the same cannot be said for the proposals themselves. Finishing these will take up the whole of the first year of the new agenda. We comment on leasing, revenue and financial instruments on page 40.

**Peter Holgate is senior technical partner at PwC in the UK.**

[www.ifrs.org](http://www.ifrs.org)

# Audit reform – can it help us grow out of the crisis?

**Ian Dilks** and **Graham Gilmour** survey the current regulatory landscape for audit, and ask whether the regulatory measures currently under consideration will help restore market confidence and contribute to economic growth

**Audit has been much in the spotlight in the last few months, and this is expected to intensify since the European Commission (EC) issued its proposals on audit at the end of November.**

While accounting and audit were not responsible for the financial crisis that began with the freezing of the credit markets in mid-2007, it is to be expected that governments and regulators want to review all aspects of the financial architecture, to see if lessons can be learned. We agree that it is opportune to consider if changes can be made that will enhance market confidence in the quality of audited financial information.

As we explain further below, we support many of the proposals. However, arbitrary interventions in the audit market such as firm rotation and prohibitions on non-audit services would have done nothing to prevent the credit and banking crisis of 2007-08. And they will do nothing now to aid economic growth and recovery, whether in Europe or elsewhere. A further consideration is

proportionality. If these audit proposals are intended to be a response to a crisis that primarily affected the banks, should the consequences be felt by companies and investors across all sectors of economic activity?

## **Europe's radical proposals**

The commission's proposals, like its green paper of 2010, contain specific measures to change the ways that audits are done, how they are reported, how firms are structured, and the market for audit services for large listed companies. There are many aspects that we support. For example, we welcome:

- Enhancing the role of audit committees and other governance-related reforms
- Moves to promote greater audit committee transparency in selection of audit and non-audit services
- The idea of auditor 'EU passports', which would improve the portability of auditing qualifications within the EU to increase mobility for suitably qualified professionals

- Removing artificial barriers to entry for smaller audit firms such as legal covenants which require the use of a large audit firm
- Increased dialogue between the financial regulators and auditors which would simultaneously enhance the value of audit while addressing other concerns around independence and market structure.

PwC supports evidence-based legislative reforms that would enhance financial reporting and audit quality and remove any barriers, real or perceived, that might prevent the operation of a truly competitive audit market. At the same time, we believe that the focus of the debate should remain on audit quality and building confidence in reported financial information – avoiding any proposals that could, in practice, have no benefit or have the opposite effect. These include:

- Mandatory rotation of audit firms
- Prohibitions or significant further restrictions on non-audit services
- Audit-only firms

***“PwC supports all evidence-based legislative reforms that would enhance financial reporting and audit quality and remove any barriers, real or perceived, that might prevent the operation of a truly competitive audit market”***

***“We are also keen to debate and explore how today's assurance model could be recalibrated to accommodate changes in corporate reporting”***

This is not just our view. Most respondents to last year's green paper found little benefit in these measures. Based on our own analysis of the responses to the paper, over 75% of preparers and over 50% of investors were opposed to such measures. (This is supported by an excellent independent research paper published by the Goethe University in Frankfurt in November which led the authors to conclude that *"the Commission therefore should at least assess critically, in the light of the rejection by a substantial majority of stakeholders of the proposed changes, whether a far-reaching extension of regulation is really necessary"*.)

The European Parliament (EP), in its own-initiative report, issued in September 2011, did not come out in support of these measures either. It concluded on mandatory rotation: "It is not external rotation but rather regular changes in internal auditors which represents the best regulatory solution... and that the existing partner rotation arrangements provide the independence necessary for audits to be effective." In addition, the EP's report noted that a more in-depth impact assessment was needed before a final evaluation could be made of the Commission's proposals.

Despite a lack of support, these measures still feature in the proposals released in November. Although the Commission is not required to embark on a further public consultation, it cannot promulgate these proposals alone. The proposals will be subject to consultation, from early 2012, with the member states in the council and with the EP, as it is these bodies that have the legislative authority. There will be a lengthy period of debate.

Early press reports on the likely content of the proposals influenced a number of business organisations (for example Business Europe and the UK Hundred Group of Finance Directors) to write to the commission to voice their concerns even before the proposals were formally published. Business Europe's letter states: "We are concerned that a number of complementary measures for the audit market that are being discussed now may have undesirable consequences, such as an increase in the costs of audits and a significant lowering of the overall quality of audits."

Some European Parliamentarians were dismayed by the unauthorised

circulation of the draft proposals. Klaus-Heiner Lehne, an influential German MEP who chairs the EP's committee that has been leading the consideration of the audit proposals, was quoted as saying: "The commission is free to propose what they like. However, the EP has legislative power. We do not support this kind of revolution. Only a fraction of this proposal will survive."

Brussels is not the only place where changes to audit are being contemplated. As you will read on page 48, both the IAASB and the US PCAOB have recently launched consultations aimed at enhancing the information value of the auditor's report. We welcome these initiatives. We support change and have identified genuine enhancements in auditor reporting (page 18) that can be made in the shorter term, while more radical reforms will need to be framed as part of a wider review of the corporate reporting model.

### **US action**

The US PCAOB has issued for comment a concept release on auditor independence and audit firm rotation. While PwC does not support mandatory firm rotation, because we believe it will not result in improved audit quality, we are talking to the relevant stakeholders about other ways the profession can achieve the objectives in the release. We also recognise the important and interdependent roles of others in the financial reporting process, so we believe it may be helpful to consider how these roles can be enhanced as well – for example, the role of audit committees and how they report on their activities on behalf of investors.

### **UK consultations**

In the UK, the Financial Reporting Council (FRC) has issued a series of consultations aimed at learning the lessons of the financial crisis and proposing enhancements to corporate reporting and auditing. These include the FRC's initiative on effective company stewardship, and the recommendations of the Sharman Panel of Inquiry on going concern and liquidity risks published in November (see page 45). Both of these consultations propose means by which the directors and audit committees provide enhanced narrative explanation in the annual report on matters such as the company's business model, the sustainability of financing, and solvency and liquidity risks. They

also propose changes to the auditor's association with the company's explanation of the major financial reporting risks and judgements disclosed in the annual report.

### **Enhanced communication welcome**

We welcome measures that enhance the communication to investors and other users about the company's business strategy, risks and its financial position and performance. We also encourage action that results in a more coherent approach to the front and back halves of the annual report. PwC has been calling for such a review of the corporate reporting model for many years, predating the recent financial crisis. We are also keen to debate and explore how today's assurance model could be recalibrated to accommodate changes in corporate reporting.

One lesson of the financial crisis has been to reinforce the interconnectedness not only of the global financial markets, but also of all the players in the financial reporting supply chain. Changes that affect one part of the chain will have knock-on effects on other parts. Some of the audit proposals now being assessed could have unintended consequences for other stakeholders such as preparers, those charged with governance such as audit committees, and investors. For example, listed European companies could be put at a competitive disadvantage if they are restricted from choosing freely the auditors and professional advisers they believe will best serve their needs, as compared to their peers in the Americas and Asia.

Enhanced reporting by companies and financial institutions (and indeed improved transparency and reporting by sovereign states in their national accounts), coupled with enhancements in the auditor's role and reporting and improved communication between companies, auditors and regulators, could together make a valuable contribution to restoring market confidence. That is where we and policymakers should be directing our attention.

**Ian Dilks is PwC's global leader, Public Policy and Regulatory Affairs. Graham Gilmour is a director in the UK firm's Public Policy and Regulatory Affairs team.**

# Can we increase the relevance of auditor reporting?

Reporting by auditors is critical, but **Richard Sexton** and **Diana Hiller** argue that it can do more to meet investors' needs, improve transparency and build confidence in the capital markets system



The financial crisis proved the significance of the role of auditors but, at the same time, increased the scrutiny and interest that comes with it. Much of the attention has focused on competition and independence, but auditor reporting has been a lightning rod for debate around reform.

As a profession, we have not done a good job of explaining what an audit is, so we can hardly complain if auditing is not well understood. There is room to improve the transparency of the scope, processes and decision-making in an audit.

### **What investors want**

Investor surveys, including the PwC investor survey, *Audit today and tomorrow?*, consistently show that investors value the audit and the audit opinion. But they tell us that the current auditor's report is not meeting their

needs as well as it could. They greatly value the auditor's opinion on the financial statements, but they would like more informative reporting – greater insight into the entity's financial reporting and the audit, as well as assurance on other information or matters not within the scope of today's financial statement audit.

These perceptions are important. The audit report is the visible interface between auditors and users of company reporting, so investors' perceptions of the audit report inevitably influence their perceptions of audit quality and relevance. Auditor reporting has remained substantively unchanged for decades. Change is now both inevitable and an opportunity. We need to hold on to what is working well, but be bold enough to make it better – and, in so doing, embrace the opportunity to reassert the relevance of the audit to investors and other users.

The International Accounting Standards Board (IAASB), the US Public Company Accounting Oversight Board (PCAOB) and UK Financial Reporting Committee's (FRC) consultations (outlined on page 48) are framed within the context of today's corporate reporting model. Genuine enhancements in auditor reporting can be made in the shorter term even with that constraint.

Auditor reporting could do more to highlight the significant judgements made by management when they prepare the financial statements. This would enable users to see the key risks that the auditor addresses in the audit.

The most commonly voiced demand by many users is for auditors to provide greater insight into the significant judgements management has made in preparing the financial statements. This is perhaps unsurprising when you consider how reporting has evolved

over the past decade in response to the greater complexity in business models and transactions, sources of risk, and uncertainty.

‘Shining a light’ on management’s significant judgements could be achieved by different means depending on the environment and appetites in different jurisdictions, for example:

- Emphasis of matter paragraphs to signpost management’s disclosures
- Separate assurance on management’s discussion of significant financial judgements
- Enhanced audit committee reporting and assurance (as proposed by the UK FRC)

### **Markets need an evolved reporting model**

But of all of the information that companies publish, the current audit focuses on reporting at a single point in time on just one element, albeit an important one – the financial statements. The financial crisis fundamentally shifted the way the world views the capital market systems, and at the same time, highlighted significant shortcomings in the corporate reporting model we use today. To better meet the needs of our market-based systems and society as a whole, there is a compelling need to reform the overall corporate reporting model.

As corporate reporting evolves, a more comprehensive assurance model can further enhance the relevance and value of information for the capital markets. This may potentially include opinions that cover other aspects of the entity’s reporting, such as reporting on: non-GAAP financial information, risk, internal controls, governance, social and environmental impacts.

Viable options will need to be seen by users as enhancing the value of the audit to them – that is, providing substantial information value that is seen to clearly exceed the additional costs involved. At the same time, these options must not undermine audit quality or negatively affect the reliability of information reported by the company.

### **Impact on auditor/audit committee relationships?**

A perspective that will need to be considered in weighing-up all of the different options for enhancing auditor reporting is the effect each could have on

### **Principles for changes to auditor reporting**

1. Maintain or improve audit quality and enhance the value of audit to users
2. Increase the reliability of information companies provide in public reports
3. Maintain or enhance the effectiveness of auditor interactions with those charged with governance (eg, audit committees) and management
4. Ensure auditor reporting is sufficiently similar to enable comparisons of the underlying information between different companies
5. Provide greater insight on the audit but avoid the auditor being the original source of factual data about the entity
6. Consider different approaches in the short term to meet user needs for additional reporting

Source: PwC

the relationship between auditors and audit committees. Effective two-way dialogue is vital to auditors. Frank, open and challenging relationships are also something that both management and non-executives value. Capturing that exchange, as some investors want, in a meaningful way in public reporting will fall short of expectations. Further, any proposed changes in auditor reporting that are likely to reduce the quality of the dialogue between the auditor and audit committee would inevitably undermine audit quality.

It is also vital that additional audit reporting provides the much sought-after insight in a meaningful way. Reporting that could result in investors and markets being given differing views of the entity’s underlying economic reality or state of affairs would be counter-productive. Two auditors given the same fact pattern should report in a way that tells the same story.

More informative and valuable auditor reporting is possible – improvements can be made both in the short term and longer term if we start to work now on how audit and assurance can work to build trust in company reporting and our market system. We have outlined the key principles that we believe should be kept in mind as we make improvements (see box).

It is important that these improvements to audit reporting are seen in the context of the multi-layered change agenda that is needed to ensure the corporate reporting system continues to meet the needs of our market-based system and society as a whole.

**Richard Sexton is the deputy global assurance leader responsible for reputation and regulatory policy at PwC. Diana Hillier is the partner responsible for International Audit and Assurance Standards at PwC.**

**“The Investor Advisory Group believes that the current auditor’s report is deficient as a communication vehicle, and that significant changes to the format and scope of the auditor’s report are needed to remediate these deficiencies.”**

PCAOB Investor Advisory Group

### CORPORATE GOVERNANCE

# *Boilerplate reporting fails investors and companies, says new report*

Companies could considerably improve the value of their governance reporting if they focus more on explaining the substance of board decisions and less on the form of the board and committee structure, according to a new report produced by PwC, the Chartered Institute of Management Accountants (CIMA) and Radley Yeldar (the Report Leadership group).

The study, *Report leadership: Corporate governance*, finds that one of the last places investors go to understand how well a company is governed is its governance statement, because it currently fails to tell them what they need to know. It is regarded by reporting experts as a compliance document that falls short of being able to help end-users of accounts differentiate one company from another.

The current hostile market conditions have focused attention on how company boards and management explain their business models, the way their businesses are run, their key relationships, and how their remuneration structures influence corporate behaviour and risk-taking.

According to Report Leadership, a box-ticking response to regulatory obligations fails to create the trust needed between investors and the companies they support and will not communicate the impact of good corporate governance on the company's performance and prospects.

The study proposes a radical restructuring of governance reporting. It makes a clear distinction between strategic messages on governance, and compliance data. It also shows how critical information on governance can be integrated with discussion of the market environment, the business model, strategic priorities and risk, instead of sitting in an unconnected section of the report. The practical solutions put forward show how



companies can be proactive and put some of the ideas that regulators are already talking about into practice – for the sake of improved communication with their investors.

“Too much reporting today fulfils the legal requirements, but does not always enlighten the reader,” said Mark O’Sullivan, corporate reporting director at PwC. “With an integrated approach to reporting, organisations can turn governance documents into real communication that easily engages the reader with the information that they need.”

“At a time when government, regulators and investors are shining a light on whether boards are doing their jobs, it is essential that companies step up their engagement and we believe that the latest Report Leadership proposals will help companies do just that. Corporate governance needs to be brought to life so that it is part of an effective communication that provides a holistic picture of the business, its strategy, performance and prospects.”

[www.corporatereporting.com](http://www.corporatereporting.com)

# Information security at risk

Despite a growing understanding of the risks posed by data loss, cyber crime and threats to business continuity, executives have been reluctant to release funding to support the wider information security function that includes people, processes and technology. Instead, they continue to regard security as an IT problem and have limited their focus to investments in security technologies.

Just a few years ago, respondents to PwC's annual *Global state of information security survey* couldn't answer the most basic questions about the nature of security-related breaches, yet 80% of respondents to this year's survey were able to provide specific information about security events, including their frequency, type and source. And this seems to be influencing where companies are spending their money.

The 2011 *Global state of information security survey* considered the views of over 9,600 executives ranging from the CEO to directors of IT and security, on areas related to privacy and information security safeguards and their alignment with the business. It found that although financial hardship has had an impact on information security spending, the vast majority of executives in all industries are confident about the effectiveness of their practices in this area. In fact, nearly half (43%) see their organisation as a 'front runner' in information security, meaning they consider they have an effective strategy in place and are proactive in executing the plan.



One of the most dangerous cyber threats is an 'advanced persistent threat' (APT) attack. This year, significant numbers of respondents across industries agreed that APT drives their organisation's security spending, yet only 16% said their organisation's security policies address APT. And over half of respondents say their organisation doesn't have core capabilities directly or indirectly relevant to countering this strategic threat – such as penetration testing, identity management technology or a centralised security information management process.

The survey revealed a lack of consensus among business leaders on what's holding back effective information security. CEOs point to a lack of capital as a major hurdle, followed by themselves and the board. The CFOs rate the CEO and the board above a lack of finance.

The chief information officers (CIO) and chief information security officers (CISO) report a lack of vision and an ineffective security strategy.

*“Leaders have traditionally focused on the rewards stemming from operating in the cyber environment and not on the risks,” commented William Beer, a director in the information and cyber security team at PwC. “Confidence in the cyber environment can be misleading, and many organisations have delusions of safety. Operating securely in the cyber environment is among the most urgent issues facing organisations today, and the time has now come for them to get involved.”*

See page 6 and [www.pwc.com/gx/eng/information-security-survey](http://www.pwc.com/gx/eng/information-security-survey)

## SINGAPORE

# Regulators recommend governance reforms

**Tighter rules on independent directors and greater disclosure of executive remuneration are on the cards following an 18-month review of the Code of Corporate Governance for public companies in Singapore.**

The Monetary Authority of Singapore (MAS) is proposing that directors with more than nine years' service on the board or who represent major

shareholders would no longer qualify as independent. The proposals also call for full disclosure of the remuneration details of each named director and of employees in their immediate family earning over S\$50,000. Key changes to executive responsibility require the board to confirm that it received assurances from the CEO and CFO concerning the integrity of the company's financial

records, financial statements and the effectiveness of its risk management and internal controls system.

The MAS Corporate Governance Council is considering responses to its recommendations following a consultation period in June and July 2011.

[www.mas.gov.sg](http://www.mas.gov.sg)

# Strategy tops chairmen's agenda

Leading Danish company chairmen offer good practice guidance on implementing the Committee for Corporate Governance's 2010 recommendations. The guidance has a lot in common with good practice in other territories.

Company strategy, risk management and board effectiveness are top priorities for Denmark's leading chairmen, according to *Inspiration from the top – The chairman's agenda*, a PwC report published in September. The chairman's role in orchestrating board scrutiny of company strategy, ranging from the validity of strategic analysis to the capacity of management to execute its plans, is a key governance theme.

The report is based on extensive conversations with some of Denmark's most successful and experienced chairmen, representing companies as diverse as specialist healthcare multinational Novo Nordisk and global beer brand Carlsberg. All key aspects of Denmark's 2010 corporate governance recommendations are covered.



In discussing board composition and effectiveness, the chairmen favour the Danish two-tier structure – recommended but not compulsory in Danish company law – over the Anglo-Saxon unitary model. Keeping the board apart from executive management helps clarify roles and responsibilities, they believe, and promotes greater accountability. While most countries prefer to keep the roles of chairman and chief executive separate, the nature of the modern board calls for active involvement and regular dialogue with senior executive

officers and places a premium on effective communication.

The report also includes an up-to-date survey of board and top management remuneration, a model for improving board effectiveness, and best practice ideas for self-evaluation. Guidance is also provided on how to effectively manage the work of board committees, leverage CSR and deal with ethical dilemmas.

**The report is available in English at [www.pwc.dk/da/board-forum/assets/chairmans\\_agenda.pdf](http://www.pwc.dk/da/board-forum/assets/chairmans_agenda.pdf)**

## UK

# Spotlight on risk reporting

The Financial Reporting Council (FRC) released in September its report on *Effective company stewardship: Next steps*. This is the FRC's feedback on its previous consultation document issued earlier in the year in which it sought views from companies, investors, auditors and other interested parties. It represents a further step forward in the FRC's efforts to improve the overall transparency of the reporting process and the accountability of those involved in the financial reporting chain.

The FRC has said it will take action to ensure company narrative reports focus primarily on strategic and major operational risks, rather than indiscriminate lists of risk that all companies face. At the same time, the FRC is considering what changes may be needed to the Turnbull Guidance and the UK Corporate Governance Code, to implement the recommendations. The

outcome of the Sharman Inquiry on going concern and liquidity risk will also be taken into account (see page 45).

Proposals put forward in the report include:

- Extending the audit committee's remit to include consideration of the whole annual report to ensure that the report, viewed as a whole, is fair and balanced
- Amending auditing standards to ensure that auditors always report the outcome of their review of the whole annual report, rather than, as at present, only when they encounter information that is inconsistent with the financial statements
- Establishing a new Financial Reporting Laboratory to remove roadblocks to effective reporting and promote innovation (see page 45).

The FRC hopes that by putting an emphasis on the reporting of risks that could undermine the company's strategy or long-term viability, investors will have the information they need to help them decide how to allocate capital.

Commenting on the proposals, Pauline Wallace, head of public policy and regulatory affairs at PwC in the UK, said: "We support any measure that will improve the quality and transparency of the audit and of corporate reporting. We welcome many of the measures announced by the FRC, including consideration of a wider remit for audit committees and a broader role for auditors reporting the outcome of their review of the whole annual report."

**[www.frc.org.uk](http://www.frc.org.uk)**

## Strong support for ‘comply or explain’ principle

**Responses to the European Commission’s green paper, *The EU corporate governance framework*, show strong support for the ‘comply or explain’ principle and for a flexible approach to corporate governance.**

Consultation between April and July 2011 drew more than 400 responses from companies, investors, professional advisers, public authorities and representative bodies. The paper’s 25 questions covered three broad areas – the ‘comply or explain’ principle, board effectiveness, and shareholder engagement.

Analysis of the commission’s summary of responses, published in November 2011, shows strong support for the current practice of ‘comply or explain’, which requires companies to state how their corporate governance approach measures up to national codes. While many called for improvements in the quality of information provided, most saw no need for additional regulation at EU level to supplement or strengthen national rules and governance codes in this or any other specific areas.

On board composition and effectiveness, there was a 50-50 split on the question of separating the functions and duties of

the chair and CEO. Around 75% are against the idea of an EU measure to limit the number of mandates held by non-executive directors, with most preferring to deal with the matter at local or company level. There was strong support for mandatory disclosure of remuneration policies, an annual remuneration report and details of key executive and non-executive directors. While most want companies to disclose their policy on board diversity, a majority are against the idea of requiring boards to ensure a gender balance.

Questions addressing shareholder engagement focused on ways of improving communication and active long-term participation. Most were in favour of a European mechanism to help companies identify their shareholders and promote dialogue on corporate governance issues. Use of the internet to establish investor forums and facilitate cross-border voting to help improve shareholder cooperation was a popular response. However, there were calls for greater clarity on the rules for ‘acting in concert’. Most respondents believe that minority shareholders’ rights are well enough protected under the current arrangements.

There was little support for the idea that EU corporate governance regimes should take into account the size of listed companies, and strong opposition to the idea that EU regulation should be applied to unlisted companies.

*“Any system of corporate governance needs to be calibrated to the nature, scale and complexity of the organisation. We believe that the necessary flexibility is most appropriately built into corporate governance arrangements through a ‘comply or explain’ regime in relation to the best practice codes designed and applicable at a member state level,” said Ian Dilks, PwC global leader of Public and Regulatory Affairs. “However, we do not believe that there is a need for additional legislation or regulation at EU level in the area of corporate governance generally, but rather a focus on promoting and encouraging good practice, including in large private companies that do not fall within the remit of national codes, to follow the spirit of the codes in their disclosure.”*

[www.europa.eu](http://www.europa.eu)

## CANADA

### New executive compensation disclosure rules in force

The Canadian Securities Administrators (CSA) has introduced new disclosure rules on executive compensation for public companies. The tougher requirements are designed to provide investors with better information on key risks, governance matters and compensation practices.

A key requirement is for companies to disclose whether their board of directors adequately considered the risks associated with their compensation policies and practices. Companies must also provide more information on the qualifications of the compensation committee, and fees paid to external compensation consultants. The changes include tighter grounds for exemption from disclosure of executive performance



goals. Amendments to Form 51-102F6 *Statement of executive compensation* came into force for companies with year-ends on or after 31 October 2011.

“Greater transparency on the compensation policies of public companies will allow investors to make

better informed voting and investment decisions, and will help them determine whether management’s incentives are aligned with their interests,” said Bill Rice, chairman of the CSA.

[www.securities-administrators.ca](http://www.securities-administrators.ca)

## SOUTH AFRICA

# New Companies Act focuses on transparency and good governance

A new Companies Act has come into force in South Africa to encourage greater transparency and high standards of corporate governance. The new law puts the behaviour of preparers of financial statements, auditors, directors and board committees in the spotlight.

### New committees

Certain companies are required by the act to have an audit committee elected by shareholders at the annual general meeting. It also requires certain companies to appoint a social and ethics committee to monitor the company's social and economic development, good corporate citizenship, the environment, health and public safety, consumer relationships and labour and employment.

The act also has an impact on the audit profession, since audits are no longer required for some companies and independence requirements are more onerous than before.

### Director pay and performance

Directors' duties and liabilities have been extended to 'prescribed officers' of a company – those who have general executive control over a significant portion of a company's business.

Previous legislation required disclosure of directors' remuneration in aggregate, but the new act requires each director's and prescribed officer's remuneration to be disclosed in the financial statements of all companies required to have an audit.

In addition to the common law duties of directors, standards of directors' conduct have now been codified. These standards, for example, require directors to exercise their powers and perform their role with the degree of skill and diligence that may reasonably be expected of a person in their position. Directors may be held liable for any loss, damages or costs sustained by the company as a result of any breach of their duty of skill and diligence.

The act permits non-board members to be members of board committees, unless otherwise legislated. Such members are required to comply with the prescribed standards of directors' conduct and bear the same liability as board members, but are not allowed to vote on a matter to be decided by the committee.

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*“Enhanced transparency and good governance is further highlighted by the requirement for the first page of all financial statements to display prominently the name and professional designation, if any, of the individual who prepared, or supervised the preparation of, the financial statements,” said Brendan Deegan, national assurance leader for PwC in South Africa. “Although there have been some initial teething difficulties, the act is generally welcomed as a positive step forward in cementing South Africa and Africa as an investment destination.”*

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## RUSSIA

# Closing the governance gap

The Russian government has demonstrated a consistent commitment to improving corporate governance by proposing a number of initiatives to make governing bodies in state-controlled companies more professional and accountable.

The move follows a decision in spring 2011 to replace senior state officials on boards of directors with business professionals. Russia's president, Dmitry Medvedev, approved guidelines requiring the government to establish adequate compensation and independent performance evaluation criteria for its representatives acting as directors on the boards of state-controlled companies.

The guidelines also require mandatory liability insurance to be in place for

government representatives. The long-discussed bill on clarifying the liability of corporate governing bodies, was recently approved on first reading by the State Duma (the lower house of Russia's parliament), and introduces further steps for improving governance. The bill proposes amendments to current legislation, including:

- Clarifying the definition of unreasonable and negligent behaviour by members of boards of directors and management boards (as opposed to the more general 'duty of care' and 'duty of loyalty' principles used in countries with advanced corporate governance legislation) and their liability for companies' losses incurred as a result of unreasonable and/or negligent behaviour

- Clarifying the board of directors' and management board members' liability by mandating that companies have signed contracts in place setting out their respective rights, obligations and liability
- Establishing a legal basis for liability insurance for members of boards of directors and management boards

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*“If they are made law, these initiatives could serve to improve corporate governance in Russian companies,” said Alexander Chmel, Partner with PwC Russia. “They would close the gap between Russian practice and international best practice by making domestic governing bodies more professional and accountable while also serving to protect stakeholders' rights.”*

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# More board focus on stakeholder concerns



**Directors serving on the boards of leading publicly-traded companies are increasing their focus on executive compensation, risk management and succession planning in response to concerns expressed by shareholders, regulators and other stakeholders.**

The *Annual corporate director survey* was conducted by PwC in the US. Responses from over 800 corporate directors – 67% of whom held positions on the boards of companies with more than \$1bn in annual revenue – indicate a clear recognition of the challenges they face in meeting increased investor demands and regulatory pressure.

“Board members are serious about embracing change and are focused on identifying areas of risk and opportunity,” said Don Keller, partner in PwC’s Centre for Board Governance. “Our survey found that directors are willing to address, and communicate about, the concerns of key stakeholders.”

## **Executive compensation**

Directors expressed concern about shareholders’ views of executive compensation levels, with 72% saying they would reconsider executive compensation, even though they received support from a majority of shareholders in the say-on-pay vote required for the first time, for most companies, in 2011.

To prepare for the say-on-pay vote and to address investor concerns, two-thirds of respondents indicated that they had made changes to their approach from prior years, with 45% using simpler language in their Compensation Discussion and Analysis (CD&A) and

31% adding an executive summary to the CD&A.

## **Emphasis on risk**

With constant changes in risk, whether financial, environmental or IT security risks, only 19% of directors rate their board as effective at monitoring plans to reduce corporate risk. They recognise the competitive advantages to be gained through the use of emerging technologies and at the same time note the dangers posed by increasingly sophisticated cyber attackers.

Recognising the complexity of securing company and customer data, nearly half of directors surveyed (46%) believe their board’s ability to oversee strategic use of IT is less than effective, and 38% want to spend more time on IT.

## **Succession, diversity and gadgets**

Succession planning, board diversity and the use of gadgets were revealed as hot topics on the minds of directors.

Directors would like the board to spend more time thinking about the future leadership of the company, with 59% saying they would like to spend more time and focus on succession planning.

The increased focus on diversity, driven by globalisation and an increase in purchasing power of women and minorities, has many boards assessing their composition. The directors polled indicated that racial and gender diversity are the most difficult to address. Nearly two-thirds (65%) found it difficult to increase racial diversity on the board, and 55% found it difficult to add gender diversity.

The use of mobile computing devices in the boardroom is gaining attention, with a large majority having, or wishing they had, started using tablets or smart phones to receive board papers. Notably, it was those directors who had served on the board for more than five years who weren’t in favour of board gadgets.

[www.pwc.com/us/directorsurvey](http://www.pwc.com/us/directorsurvey)

# What works best?



Two new publications on board practices from PwC in the US provide insight from directors and governance leaders around the world on how companies’ boards are dealing with demands for improved governance.

The need for information on leading governance practices is high as new demands are placed on companies and their boards by economic uncertainty. Scrutiny of boards’ responsibilities by shareholders, regulators, legislators, and others is fostering the continued refinement of leading governance practices.

The 4th edition of *Audit committee effectiveness – What works best* covers many areas of interest for audit committees, including: financial reporting and disclosures; risk management and internal control; culture and compliance; oversight of management and internal audit; relationship with external auditors; errors and investigations; and committee composition.

*Board effectiveness – What works best*, is now in its second edition. It includes chapters on strategy, corporate ethics, monitoring company performance, and communicating with stakeholders, as well as other key boardroom issues.

**The publications can be downloaded from [www.pwc.com/us/en/corporate-governance](http://www.pwc.com/us/en/corporate-governance).**

## AUSTRALIA

# Regulator calls for clarity on executive pay

The Australian Securities & Investments Commission (ASIC) has called for better disclosure on executive pay. Based on a study of 60 annual reports for the 2010 financial year, the regulator identified the need for improvement in four key areas: the board's policy on the nature and amount of remuneration for key executives; the terms and conditions of incentive plans; why certain performance conditions were chosen;

and clearer description of non-financial performance conditions in short-term incentive plans.

"We encourage company directors to prepare this year's reports with the overriding objective in mind of explaining the relationship that exists between the company's performance and the remuneration of its executives," said Belinda Gibson, ASIC deputy chair.

The call comes alongside the introduction of the so-called 'two-strikes' rule, effective from July 2011, empowering shareholders to vote off a board if a remuneration report receives 25% or more 'no' votes at two consecutive annual meetings. Investor groups including the Australian Shareholders Association have welcomed the ASIC's move, and have criticised the length and complexity of remuneration reports.

## UK

# Addressing board gender diversity

**The UK Financial Reporting Council (FRC) is strongly encouraging companies to report voluntarily on their boardroom diversity policy, including gender, and any measurable objectives they have set and progress made in delivering their policy and objectives.**

The FRC's stance, announced in October 2011, precedes formal amendments to the UK Corporate Governance Code. A summary of the policy and progress made will need to be disclosed annually, with the first disclosures due in the 2013 corporate governance statements.

The FRC believes that by taking action ahead of the revised code coming into force, companies can demonstrate that the UK's 'comply or explain' code-based approach to corporate governance can deliver a flexible and rapid response more effectively than detailed legal regulation. The FRC will also update the code to include diversity of the board, including gender, as one of the factors to be considered when evaluating board effectiveness.

Consultation with business and others began in May 2011, with the FRC requesting views on possible amendments to the code. The consultation was based on recommendations from a government-sponsored independent review undertaken by Lord Davies, to explore ways of increasing the number of women on the boards of listed



companies. The vast majority of respondents supported the amendments proposed. The report, *Women on boards*, proposed a business-led approach, with ten practical recommendations.

The government has announced that it will hold in reserve the possibility of statutory quotas if the business-led approach does not result in significant change. The European Commission is also taking a stand, warning that regulation will be forthcoming if companies fail to take credible self-

regulatory action by March 2012 to redress the balance voluntarily (see *World Watch*, Issue 2, 2011).

The new code provisions on diversity will start to apply for financial years beginning on or after 1 October 2012. This will coincide with the timing of proposed government regulations requiring companies to disclose information about the percentage of women at different levels of the organisation.

[www.frc.org.uk](http://www.frc.org.uk)

## Regulator moves to rein in executive pay

A new rule issued by the Financial Supervisory Commission (FSC), requires Taiwan's listed companies with capital of at least NT\$10bn to set up a remuneration committee, and hold at least one meeting of the newly-formed committee before 31 December 2011. The change is heralded by some as a sign of positive change in Taiwan's corporate governance regime.

The new rules were prompted by calls to limit excessive senior executive pay in the wake of the financial crisis. Lobbying by groups including the Taiwan Corporate Governance Association (TCGA) and Hong Kong-based Asian Corporate Governance Association (ACGA) are credited with helping to bring about the new rules.

Under the new requirements, listed companies had until 30 September 2011 to set up a remuneration committee to carry out regular reviews and determine the compensation of directors, supervisors, and managers. Smaller

listed companies have until the end of the year to comply.

Each remuneration committee must have a minimum of three members appointed by the board. Committee members should be experienced professionals, and hold formal meetings at least twice a year. In addition, companies that appoint independent directors to the board must have one of those chairing the committee.

PwC Taiwan partner Alan Lin welcomed the FSC's moves as an opportunity for companies to strengthen corporate governance beyond the area of executive compensation.

In March, the FSC extended existing regulations to ensure that all listed companies with paid-in capital of at least NT\$10bn appoint independent directors. Previously, the requirement applied only to financial institutions, investment trusts, securities firms and listed companies with paid in capital of at least NT\$50bn.

The move reflects long-standing concerns over the power of directors and board composition, which was highlighted during a wave of leveraged buyout transactions earlier this year.

Voting behaviour at shareholder meetings, the prevalence of family members on company boards and the relative absence of institutional investment in listed companies are further areas of regulatory focus.

*“The new compensation committee mandate should be viewed as an opportunity to strengthen the link between the compensation and the performance management framework from the ground up,” he said. “The compensation committee’s work should therefore go beyond questions of legality to consider the overall compensation strategy and rationality to achieve ‘internal equity’ and ‘external competitiveness’.”*

## US

## Dodd-Frank compensation provisions delayed by SEC

**Proposed rules on several provisions of the Dodd-Frank Act focused on executive compensation are still to be issued by the US Securities and Exchange Commission (SEC).**

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was enacted in July 2010 to address weaknesses in corporate governance and executive compensation disclosures. (See *World Watch*, Issue 1, 2011.)

The Dodd-Frank Act called for hundreds of new rules, with many of these to be issued by the SEC. The provisions below were expected to be introduced in the April to July 2011 time frame. That timetable was revised to between August and December 2011. Releases are now expected in the first half of 2012. These will cover:

- **Pay for performance** – requires companies to disclose in their proxy statement a clear description of elements of compensation and the relationship between executive compensation paid and the financial performance of the company. This information is expected to take into account any change in the value of the company's stock and dividends and any distributions.
- **Employee and director hedging** – requires companies to disclose in their proxy statements whether any employee or director is permitted to hedge or offset any decrease in the market value of company stock that is granted as part of compensation or held directly or indirectly by the employee or board member.
- **Recovery of previously awarded compensation** – calls for publicly-

listed companies to implement and disclose a policy to ‘claw back’ incentive-based compensation if the company has to restate previously issued financial statements. The amount of the clawback is the excess incentive compensation paid to executives based on the erroneous financial statements.

These provisions of Dodd-Frank will require companies to make additional disclosures or provide for recovery of amounts awarded as executive compensation. While companies understand that additional disclosures cost more, new rules in this area could create more uniform disclosure on executive compensation. This could level the playing field to help investors understand executive pay packages, and compare them across companies.

INTERNATIONAL INTEGRATED REPORTING COMMITTEE

# New framework for integrated reporting proposed

Business and investment leaders have called for a new approach to corporate reporting in a landmark discussion paper: *Towards integrated reporting – Communicating value in the 21st century*, published by the International Integrated Reporting Committee (IIRC).

The paper sets out a rationale for ‘integrated reporting’, offering initial proposals for the development of an International Integrated Reporting Framework and outlining the next steps towards its creation and adoption. The senior stakeholders involved – from the corporate, investor, accounting, securities, regulatory, and standard-setting communities – believe it will provide more comprehensive and meaningful information about all aspects of an organisation’s performance and position, presented in a clearer, more concise and user-friendly format.

The aim is for reporting to show the links between an organisation’s financial performance and the social, environmental and economic context within which it operates. It is also intended to provide a meaningful assessment of the long-term viability of an organisation, meeting the information needs of investors and other stakeholders and supporting the effective allocation of capital in all its forms – human, intellectual, natural and social, as well as financial capital.

The proposed integrated reporting framework recognises that for meaningful reporting to occur, resource use and the risks and opportunities associated with business have to be considered across the supply chain and cannot be restricted to the accounting definition of control. This creates significant challenges for how companies report, but there are already examples of companies breaking the traditional reporting mould for competitive advantage – see, for example, the case study on page 10 on Puma’s environmental P&L account.



Sir Michael Peat, chairman of the IIRC, said: “All matters that are important in assessing an organisation’s performance and position, past and prospective, need to be reported but not by making annual reports ever longer and more complex – they are too long already. The information needs to be provided clearly and concisely with the connections between financial, environmental and social impacts demonstrated and the clutter removed. This is what Integrated Reporting seeks to achieve.”

Ian Powell, UK chairman and senior partner at PwC, added: “At a critical time when companies are struggling with economic uncertainty and a lack of confidence in business prospects – and our profession is under the microscope – it is

important to recognise that the relevance and value of reporting and audit need to be viewed with an eye on the future needs of the capital markets.”

The IIRC discussion proposals are complementary to the report PwC launched at the end of May 2011 – *Tomorrow’s corporate reporting – a critical system at risk*. This report highlighted the behavioural and structural challenge of changing the reporting system and includes a “roadmap for change” (see *World Watch*, Issue 2 2011, page 6).

**The deadline for providing feedback on the IIRC’s paper is Wednesday 14 December.**

[www.theiirc.org](http://www.theiirc.org)

## Pilot programme for integrated reporting gets started



More than 50 leading companies have signed up to take part in the IIRC's integrated reporting pilot programme, with more expected to join soon. Coca-Cola, Microsoft, HSBC, Akzo Nobel, Volvo and Aegon were among the international participants at a kick-off meeting in Rotterdam on 17-18 October, marking the start of the two-year project to develop an integrated reporting framework.

The companies represent a wide range of sectors – including leading names from automotive, IT, food, utilities, pharmaceuticals, healthcare, retail, oil & gas, professional services, banking and financial services. Companies across Europe are represented, alongside participants from the US, China, Canada, Australia, South Africa, Japan and Brazil.

“The IIRC has experienced a magnificent response by companies from around the world to participate in the pilot programme. These companies are now part of the creation of what the integrated reporting (IR) framework should be, and that is very exciting,” said Paul Druckman, chief executive officer at the IIRC. “Different companies implement IR in different ways, and these participating companies, representing various sectors, will help demonstrate how this can be done.”

The IIRC pilot programme will see the companies exchange knowledge and share experiences that will feed into development of the IR framework, which aims to address key corporate reporting challenges.

[www.theiirc.org](http://www.theiirc.org)

## Report urges companies to learn from innovative corporate reporters

Most company reports fail to paint the full picture of the key risks and opportunities facing the business, and the gap is growing between the best and least effective reporters, according to PwC research.

The report – *From compliance to competitive edge* – looks at how the 350 largest UK listed companies communicate with their stakeholders. While companies are meeting the basic regulatory requirements, analysis reveals that many companies are leaving themselves open to questions about the quality and sustainability of their performance and future prospects. Less than half (45%) clearly explain the potential impact of key business risks or how they intend to buffer their effects. A mere 16% were found to base their reporting on their strategy throughout their accounts, and only 35% clearly align their key performance indicators with strategic priorities.

Reporting on company business models is a further cause for concern. Two-thirds of companies do not clearly define their business models in their annual reports. These companies appear to be confused about the definition of a business model, focusing on responding to emerging regulation (required from next year under the UK Governance code), rather than making its relevance clear and linking it to the other company information provided.

But there are positive signs of improvement in some areas of corporate reporting, with clear evidence that regulatory changes are having an impact. The vast majority (97%) now include some information on principal risks, 84% discuss future market trends, and 93% explicitly identify key performance indicators. And the proportion of companies offering a clear explanation of business risks, while still a minority, has more than doubled since PwC's 2010 survey.

The report encourages companies to look for improvement beyond regulatory compliance and take inspiration from the more innovative reporters, which appear to be moving ahead of the pack. “We believe that emerging practices from forward-thinking companies have the potential to transform corporate reporting,” said Charles Bowman, partner on PwC's UK assurance leadership team. “Management teams have a real incentive to improve – they are looking for ways to access better information that supports their decision making and gives them a competitive edge. Coherent external reporting follows from effective management processes; it cannot be achieved by regulatory compliance alone.” See also page 8.

### Research findings from PwC analysis of FTSE 350 companies' reporting

84%	Discuss future market trends	25%	Explain what the future means for strategic choices
94%	Include strategic priorities	16%	Base reporting on strategy
97%	Report principal risks	45%	Clearly explain the impact of risks and their mitigation
74%	Discuss managing key resources/relationships	33%	Clearly define their business model
93%	Explicitly identify KPIs	35%	Align KPIs to strategy
78%	Report non-GAAP measures	27%	Clearly explain underlying revenue drivers
74%	Give sustainability-related KPIs	15%	Link sustainability to strategy
92%	Have narrative consistent with segment notes	7%	Communicate across reporting model by segment

# CDP finds link between sustainability and financial performance

The Carbon Disclosure Project (CDP) Global 500 report examines the carbon reduction activities of the world's largest public companies. The 2011 report, *Accelerating low carbon growth*, produced by PwC, reveals a strong correlation between higher financial performance and good climate change disclosure and performance.

Companies included in the 2011 Carbon Disclosure Leadership Index and Carbon Performance Leadership Index provided approximately double the average total return of the Global 500 between January 2005, and May 2011. There is clearly a correlation between strong business planning, performance and reporting on climate change and strong financial performance. Inclusion in these indexes seems to be indicative of businesses that proactively manage their business risks, are more environmentally efficient, and are starting to decouple the link between financial growth and carbon emissions.

The research found a big jump in the number of companies that are integrating climate change into their overall business strategy, at 68% in 2011 up from just 48% last year.

## Executive reward and responsibilities

The report found that 93% of companies have a board member, or senior executive who has responsibility for climate change; 62% have board-level responsibilities and financial incentives for achieving climate-change objectives.

Alan McGill, PwC partner in Sustainability and Climate Change, said: "We're seeing the highest levels of board oversight and engagement on climate change strategy ever, with significant increases in the levels of monetary incentives linked to achieving targets. Companies are linking action on climate change to their employees' work and wallets, from the boardroom to the office floor. It's a shift we could not have imagined 15 years ago."



## Commodity pricing and supply chain

With the unprecedented moves in the commodities market over the last year and as climate change exacerbates resource availability and pricing, investors are expected to put more pressure on companies to report clearly on their exposures to medium and longer-term risks associated with their supply chain.

*"Businesses and consumers cannot be insulated from the impact of climate change being felt in countries far removed from the factories and shop shelves," said Mr McGill. "Companies in the Carbon Disclosure Leadership Index are looking at their supply chains, and their business models, and considering how to grow their businesses in an environment that is going to become more resource constrained."*

## CDP criteria changes

Against tighter criteria in this year's report, only 37% met CDP's verification reporting criteria, a 23% drop on last year. The tightening of criteria is a very clear statement by CDP and its stakeholders about the importance of data quality in building trust in carbon reporting.

"Setting higher standards on verification builds the quality and reliability of the information for consumers and investors," said Mr McGill.

## Setting emissions targets

Companies are more engaged in managing greenhouse gas (GHG) emissions this year than before – 74% disclosed that they have an emissions reduction target (compared to 65% in 2010). Global 500 companies reported reductions of over 4% in 2010 – if all businesses showed a similar level of ambition, the Intergovernmental Panel on Climate Change's targets for emissions reduction could be reached.

"Industries are responding differently to the climate change issue," said Jonathan Grant, PwC director in the Sustainability and Climate Change team. "Energy and power companies cite concerns about extreme weather events and the potential impacts on infrastructure. They reported that fuel and energy taxes and regulations may stimulate the demand for renewable energy and biofuels." He added that retail and consumer goods companies are typically focused on potential climate impacts on their supply chain and changing consumer behaviour. Many highlight the transition towards a growing market for sustainable, locally-sourced, low-carbon products.

# Global sustainability ratings change corporate behaviour

**Around 10% of companies in the Dow Jones Sustainability Indexes (DJSI) were replaced by new companies when the indexes were updated recently. The indexes are among the most-recognised global sustainability ratings offered by Dow Jones in collaboration with Sustainable Asset Management (SAM), a global investment company focused exclusively on sustainability investing.**

The annual review is based on the Dow Jones Global Total Stock Market Index of investable stocks. The DJSI/SAM data collection relies on a comprehensive questionnaire that contains long-term economic, environmental and social criteria, publicly-available information and media and stakeholder analysis. Following a best-in-class approach, only the best performing companies in 57 industry sectors that fulfil key

sustainability criteria better than their peers are included.

The DJSI has facilitated the unbiased integration of sustainability assessment into company valuations and investment decisions. The best-in-class approach has increased competition among companies for inclusion in the indexes. Some companies have even directly linked the yearly listing to executive bonuses.

## Implications for businesses

When the indexes are published, companies receive their numerical score in each criteria, along with the industry's best, average and lowest scores. This gives each company an indication of its strengths and weaknesses compared to its peers. The assessment offers a strategic view of sustainability and shows how to link sustainability to business performance.

SAM has gradually increased its focus on industry-specific criteria, acknowledging that sector-specific sustainability opportunities and risks play a key role in companies' long-term success. Companies have to continually advance long-term value creation, improve impact measurement and align sustainability considerations with overall business operations and strategy to be included in the index.

*“The global reach and recognition of the DJSI has helped move sustainability up the corporate agenda,” said PwC partner Thomas Scheiwiller. “But inclusion in the DJSI should not be a goal in itself. The ultimate ambition should be improving processes and operations in a structured and sustainable way – better ratings will naturally result from these efforts.”*

## CORPORATE SUSTAINABILITY

# New move promises ‘gold standard’ for sustainability

**The Global Initiative for Sustainability Ratings (GISR) sets out to develop a generally-accepted performance-ratings standard that will help capital markets and consumers identify true sustainability leaders.**

Ceres and the Tellus Institute, the two non-profit organisations who pioneered the Global Reporting Initiative (GRI), launched GISR in June 2011 to tackle perceived inconsistencies and inefficiencies in the current ratings system. While numerous sustainability ratings providers have helped develop awareness of sustainability in the capital markets, the absence of a commonly accepted standard is holding back progress, according to GISR. Conflicts of interest between commercial ratings providers and the companies they are rating, together with ‘survey fatigue’ among companies faced with multiple information requests from a range of rating agencies, means that some companies are ‘cherry picking’ results

that show them in the best light and avoiding less flattering findings.

“We need a new powerful instrument to steer capital – financial, human, social and natural – towards sustainability leaders and away from the laggards,” said Mindy Lubber, the Ceres president. “With global sustainability crises from climate change to water shortages, resource pressures and population growth more evident every day, it’s time to build a ratings system that distinguishes between those companies that clearly see and act upon sustainability opportunities and risks and those that don’t.”

GISR will take the same non-commercial, independent path taken by the GRI. Founding partners in GISR include TIAA-CREF, a Fortune 100 financial services provider, investment management firm Calvert Group, and business and financial news organisation Bloomberg. They aim to bring together a broad coalition of stakeholders that will develop GISR as a non-profit framework

characterised by technical excellence, transparency, dynamism and integrity.

The initiative has a two-phase workplan for the coming year. First, it will systematically evaluate the quality of existing ratings programmes, examining both process and content. Second, the group will design a best-practice ratings framework as a benchmark for use by raters and ratings users. The two activities will be conducted through an independent and non-commercial process. Once the new ratings framework is ready for the market, its founders expect that GISR will become a stand-alone, non-profit organisation similar to GRI.

The ultimate goal is for the GISR system to become embedded in the listing requirements of stock markets, in disclosure requirements of securities regulation, in the contractual relationships between asset owners and managers, and in government procurement programmes.

# Management commentary fails to impress



According to analysts and investors, the Management Discussion and Analysis (MD&A) does not meet their expectations for the provision of disclosure information. They rate other forms of communication, such as conference calls and one-on-one meetings that allow for interactive dialogue with management, more highly for extracting the information they need.

These views were expressed by more than 400 analysts and investors from around the world in a survey undertaken in spring 2011 by the Rotterdam School of Management, Erasmus University (RSM) and PwC.

### More consistency needed

Over half of those interviewed (59%) would like to see regulators requiring more mandatory content in the MD&A and 57% would welcome a consistent presentation format such as the International Accounting Standards Board's (IASB) *IFRS practice statement management commentary*.

*“When it issued the new non-binding rules, the IASB expected this would encourage jurisdictions to adopt it as their own,” commented Professor Erik Roelofsen, RSM researcher and PwC director. “To date we have seen few countries that have taken meaningful steps in this direction, while analysts and investors would clearly applaud it.”*

A further majority (59%) would prefer to see financial and non-financial information sitting side by side in the same report. In fact, approximately 40% of respondents would like to see more non-financial information in the MD&A.

In general, analysts and investors are unimpressed with the information provided about sustainability, productive capacity and legal structure. Just a few are satisfied by the information that is provided on strategy, financing and risks.

Remarkably, 46% of respondents presume the MD&A is audited, which is rarely the case in practice.

The MD&A could also improve if more information was quantified and

presented more clearly and consistently. ‘Tables speak louder than words’, is what most appear to believe. Words like ‘significantly’ or ‘as expected’ meet with the annoyance of analysts, according to Professor Roelofsen.

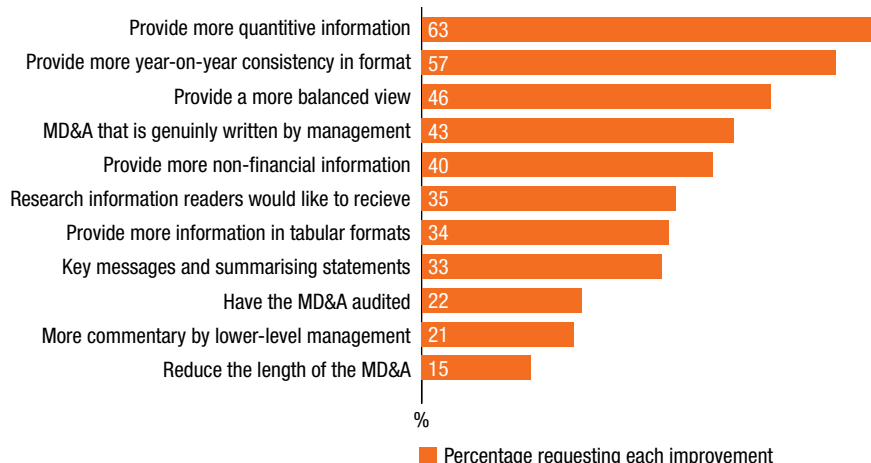
“Many firms use long narrative disclosures and continually change the presentation formats of their MD&A, making it difficult for users to find the information they need,” added Professor Roelofsen. “Analysts prefer a number in a table and that table should preferably look the same year-on-year.”

### Preferred information sources

Written commentary is welcomed to keep management accountable for their targets and forecasts. As it is simultaneously available to everyone, it prevents any selective disclosure issues that would prevent analysts or investors from making informed decisions about their transactions.

Overall, the conference call appears to be the most popular source of management commentary. One reason analysts and investors favour this medium is because it allows insight to be gleaned from the Q&As rather than information provided by management up front. Equally, many prefer one-on-one meetings with management for the very reason that it allows them to ask questions without sharing the answers with others.

### Analyst and investor views on how to improve the MD&A



Source: PwC & RSM

## CPAs urge action on integrated reporting



CPA Australia has urged the government to “actively pursue developments in integrated reporting” as a matter of national interest. The country’s largest professional accounting body recommends targeted funding for the Australian Accounting Standards Board (AASB) to support its work on integrated reporting, in line with the IIRC’s integrated reporting framework initiative.

The call comes in a CPA Australia report assessing the imperatives for governance and corporate reporting in the years following the global financial crisis. *The social responsibility of corporations – Recent trends and future developments in the promotion of responsible business* is an updated review of an influential 2006 report on corporate ethics by the Corporations and Markets Advisory Committee (CAMAC), an independent statutory body that advises the government on corporate law and financial markets matters.

CPA Australia argues that the global financial crisis has accelerated the need for government policy to actively promote and support developments in corporate reporting and responsible business practices. The report recommends government funding for a number of focused initiatives, including state of the environment (SoE) reporting, a Global Reporting National Index, and the establishment of a sustainability commission to set sustainability targets for Australia.

[www.cpaaustralia.com.au](http://www.cpaaustralia.com.au)

## Sustainability reporting needs more connection



**Companies are increasingly reporting on sustainability issues in their annual reviews, but are failing to link this information to the business strategy and financial performance, according to a recent survey.**

The survey, *How sustainable is your reporting*, was undertaken by PwC Australia to investigate the quality and maturity of reporting by the top 30 companies listed on the Australian Stock Exchange (ASX). This included looking at how well environmental, social and governance (ESG) performance data is integrated into corporate reports.

“Integrated reporting is starting to emerge,” commented Kerryn Schrank, senior manager at PwC in Australia. “However, the extent to which the reported ESG data and information is seamlessly integrated, supports the overall business strategy and is linked to the financial performance, still leaves room for improvement.”

The survey found 20% of companies disclose ESG data in their annual reviews, whereas 70% reported this data in a separate sustainability or corporate responsibility report. Of these, just over half disclosed associated performance targets.

“These results indicate that Australian companies are making progress on the journey to disclose ESG performance data to their stakeholders,” added Ms Schrank. “Setting targets assumes a clear strategy on how the company wants to perform. These should be aligned to the strategic goals of the company, but this is not always the case.”

Two thirds of companies disclosed their material sustainability issues, but less than 30% actually disclosed the process undertaken to identify these issues, including stakeholder engagement. This makes it hard to evaluate whether companies regularly engaged with the stakeholders to understand their sustainability concerns and expectations and how this influences what is being reported.

Almost two thirds of companies obtained external assurance over all or some of their disclosed ESG performance data. This gives a strong indication of companies’ maturity in having auditable ESG performance data. Overall, the results suggest Australian listed companies are moving towards providing more meaningful ESG performance data to their stakeholders. However, they are missing the opportunity to demonstrate how this is translating into business value.

# New carbon standards to help cut emissions

The Greenhouse Gas Protocol has launched new carbon accounting and reporting standards that focus on emissions from both the supply chain and product use. The standards and tools are voluntary and are intended to help measure and manage greenhouse gas (GHG) emissions to help companies cut emissions, waste and costs across their business.

Released in October, the *Corporate value chain* (Scope 3) and *Product life cycle* standards were developed by the World Resources Institute (WRI) and the World Business Council for Sustainable Development (WBCSD) as part of the GHG Protocol Initiative.

The new standards focus on emissions generated by a company's extended supply chain and product use (collectively known as Scope 3). This can represent the largest sources of emissions and costs for many companies – and the greatest opportunities for reductions and savings. Examples of extended supply chain activity include: purchased goods and services, business travel or waste generated in operations

or losses on transmission and distribution of electricity and other utilities. Downstream examples may include transportation, distribution and product use as well as downstream leased assets and franchises.

Customers, organisations, government agencies, and other stakeholders are increasingly calling for data around these emissions.

*“We expect these standards to be of particular interest to the aerospace and defence, automotive, industrial products, information technology, retail and consumer, and utility sectors,” said Malcolm Preston, global sustainability and Climate Change leader for PwC, which provided significant input to the development process. “Value chain and product life-cycle reporting will allow stakeholders to better assess an organisation’s emissions across their entire value chain, which will help optimise purchasing decisions and product efficiency.”*

The standards are designed to make carbon emissions reporting more consistent, relevant, accurate and complete. They will help businesses that need to:

- Establish strategies for measuring and reducing their emissions
- Develop and implement processes and systems for reporting
- Collaborate with suppliers, customers and other stakeholders and businesses to manage emissions.

These new standards are already gaining widespread traction. For example, the Consumer Goods Forum, representing over 400 retailers with a combined US\$3 trillion dollars in sales, has recommended them to members that choose to measure and report Scope 3 greenhouse gas emissions. The Sustainability Consortium and the Global e-Sustainability Initiative, a consortium of leading ICT companies, are both using the standards as a basis for their own guidance and tools.

[www.pwc.com/en\\_GX/gx/sustainability/carbon-accounting-in-the-value-chain-new-standards-represent-a-leap-forward.jhtml](http://www.pwc.com/en_GX/gx/sustainability/carbon-accounting-in-the-value-chain-new-standards-represent-a-leap-forward.jhtml)

## IFAC & ISACA

# Reaping the benefits of XBRL



A new guide from the Professional Accountants in Business (PAIB), the International Federation of Accountants (IFAC) and the Information Systems Audit and Control Association (ISACA) is helping organisations understand how best to use XBRL and the benefits that can be gained from its use.

XBRL (eXtensible Business Reporting Language) has been around for ten years. Yet few organisations have gained

the benefits beyond where it is mandated by stock exchanges, securities regulators and government agencies. This applies particularly to large organisations that remain to be convinced of the advantages XBRL can bring to their corporate reporting.

The paper, *Leveraging XBRL for value in organisations*, provides guidance on how to leverage the value of XBRL through effective implementation. It includes a discussion of non-financial reporting, noting the inherent ability of XBRL to communicate a wide array of data, supporting a range of key performance indicators (KPIs).

The paper gives examples to illustrate how XBRL can be used by both preparers and users of business information. It also considers strategies for addressing its use within the organisation, including:

- Implications for governance – setting strategies and managing change
- Risks, security and privacy concerns
- Implications for internal control and assurance

Examples include how a large, internationally-recognised business has used XBRL to achieve better data management, improved internal processes, and enhanced business data integrity across its sophisticated organisational structure.

“Many organisations have yet to realise the benefits of XBRL,” said Eric Cohen, PwC’s XBRL global technical leader. “This paper can serve as a starting point to help companies consider and leverage XBRL’s value.”

[www.ifac.org](http://www.ifac.org)

# Fresh approach to ecosystems reporting



New research from the Global Reporting Initiative (GRI) offers a fresh take on environmental reporting. *Approach for reporting on ecosystem services — Incorporating ecosystem services into an organisation’s performance disclosure* proposes a new approach for developing sustainability indicators to help companies report the impacts they have and their reliance on ecosystem services.

Many companies already measure and report their impact on ecosystems – defined as biological environments including plants, animals, soil and water – by reporting items such as the levels of gas, chemical and waste emissions and effluents. Ecosystem services (ES) is a term used to capture the benefits derived from ecosystems, such as food, pharmaceutical products, timber, soil fertility, pollination, and freshwater. Viewing ecosystems as service providers will enable companies to monitor dependencies as well as impacts, says the report.

Potential reporting indicators for ecosystem services emerging from the research include:

- Nature and amount of natural resources harvested, produced, traded and/or consumed (eg, crops, fish, timber, fibre) by the organisation in relation to safe ecological limits

- Volume of water consumed related to total water availability in areas that the business operates in
- Economic cost to the organisation of climate-related disasters such as flooding

The GRI worked with the United Nations Environment Programme World Conservation Monitoring Centre (UNEP-WCMC) and consultancy CREM on the research. The publication adds to international work addressing how companies use ‘natural capital’ – ecosystem goods and services – in their operations. Related initiatives include The Economics of Ecosystems and Biodiversity study (TEEB), the World Business Council for Sustainable Development (WBCSD) *Corporate ecosystem valuation* (CEV) guide and The University of Cambridge *Natural capital leaders platform* report (issued in June 2011). The GRI publication represents a move towards incorporating ecosystem services information into sustainability reporting and ultimately into ‘integrated reporting’, where it is material to the business.

[www.globalreporting.org](http://www.globalreporting.org)

## Reporting on climate change

It is almost two years since Malaysia announced a voluntary and conditional carbon intensity reduction of up to 40% by 2020 based on 2005 levels. Since then, various efforts have been made to achieve this goal, including the establishment of the National Climate Change Policy and launch of a Corporate Sustainability Programme by the local stock exchange, Bursa Malaysia.

PwC Malaysia recently conducted a study of several leading companies to assess what the corporate sector has done so far to support Malaysia’s reduction commitments and make their own climate-change disclosures. These findings were later compared against their counterparts in Indonesia, China, Thailand and Singapore.

The analysis showed that 65% of the top 20 Malaysian companies in the sample reported on climate change – significantly higher than their counterparts in the other four countries. However, reporting quality can still be improved. Most companies report on their policy and awareness initiatives, but there aren’t enough disclosures on actual emissions and targets.

- 80% of top Malaysian companies report on total CO<sub>2</sub> emissions, but only 20% set targets to measure their performance.
- The focus on renewable energy is low, with only 20% reporting their usage or even researching the possibilities of using renewable energy in their operations.

Ng Yin Ching, advisory services associate director at PwC, said: “While Malaysia’s 40% target for carbon intensity reduction remains ambitious, it is encouraging to see the private sector in Malaysia putting the climate change challenge onto their boardroom agenda and taking steps to address it.”

For more information, visit the website or contact [yin.ching.ng@my.pwc.com](mailto:yin.ching.ng@my.pwc.com)

[www.pwc.com/my/en/publications/pwcalert90-climate-change.jhtml](http://www.pwc.com/my/en/publications/pwcalert90-climate-change.jhtml)

# New EU strategy 2011-2014 published



**The European Commission's new strategy for corporate social responsibility (CSR), issued on 25 October 2011, promises legislation to promote an across-the-board improvement in disclosure of social and environmental performance.**

Defining CSR as "the responsibility of enterprises for their impacts on society", the commission recognises that a growing number of European enterprises are now providing social and environmental information. But it notes that only 2,500 of the EU's 42,000 large companies currently publish CSR or sustainability reports and promises to introduce legislation under the Single Market Act covering "the transparency of the social and environmental information provided by companies in all sectors".

The commission warns that with non-financial disclosure requirements in some countries going beyond existing EU legislation, compliance costs may be an issue for companies operating in more than one member state. The paper highlights developments in

internationally-accepted frameworks, including the GRI, and the IIRC's work on integrated financial and non-financial reporting as key goals.

Work is already under way on an impact assessment of the commission's legislative options, which will include a competitiveness proofing and SME test. A policy to promote a common life-cycle based methodology for measurement, benchmarking and disclosure of environmental performance is also in the works.

A workplan for developing and implementing the EU's CSR strategy will be published by the end of 2011. In the meantime, the commission has called on business leaders in all sectors to make public statements before mid 2012 of their commitment to introducing responsible business conduct among EU enterprises. A major review of progress is promised before mid 2014.

[www.ec.europa.eu/enterprise/newsroom/cf/itemlongdetail.cfm?item\\_id=5511](http://www.ec.europa.eu/enterprise/newsroom/cf/itemlongdetail.cfm?item_id=5511)

## Call for clarity on human rights

**Proposed federal legislation will expose the extent to which companies are managing the risks of human rights violations among their supply chains.**

The proposed legislation, HR 2759, the *Business Transparency on Trafficking and Slavery Act*, will require companies to disclose in their annual reports to the Securities and Exchange Commission (SEC) their efforts to identify and address the risks of forced labour, slavery, human trafficking and the worst forms of child labour.

The bill was introduced on 1 August 2011 and is in the early stages of its legislative journey. If it passes into law it will apply to all companies with annual worldwide gross receipts of over US\$100m that file annual reports to the SEC, whether publicly-traded or private.

The Act would also require a company's suppliers to certify that materials used in the manufacture of their products comply with the law, in the countries where they operate.

Companies would be required to make disclosures stating the extent to which:

- Policies and internal accountability standards are in place
- Product supply chains are verified
- Suppliers are audited, including whether independent and unannounced
- Management and procurement systems of suppliers are assessed
- Employees are trained and suppliers' recruitment practices comply with company standards
- Remediation is provided to victims

As well as disclosures being made public through annual reports submitted to the SEC, companies will need to disclose the information on the home page of their website via a link to their policies. This step will make companies increasingly transparent about their efforts to eradicate violations of human rights.

# Guide to sustainability frameworks



**A new FEE guide to the most widely used sustainability frameworks calls for a common methodology for selecting relevant environmental, social and governance (ESG) indicators.**

The Federation of European Accountants (FEE) has issued an analysis of the five most influential sustainability reporting guidance documents used by companies to identify and use ESG indicators, key performance indicators and reporting principles. In the absence of a globally recognised standard, the FEE identifies a “need for a commonly agreed methodology on how to use the various guidance documents to meet stakeholders’ needs”.

While the FEE guide does not present such a methodology, it recommends four equally important criteria for choosing ESG indicators: relevance, materiality, consistency and reliability. Taking this approach will help reporters include all relevant and material KPIs, whichever framework is followed.

The frameworks summarised in the report are:

- Accounting for Sustainability (A4S) – The Prince’s Accounting for Sustainability Project – *Connected reporting framework*, which has links with the International Integrated Reporting Committee’s proposed integrated reporting framework
- Deutsche Vereinigung für Finanzanalyse und Asset Management (DVFA) – *KPIs for ESG*
- Global Reporting Initiative (GRI) – *Sustainability reporting guidelines*
- European Academy of Business in Society (EABIS) – *Sustainable value*
- United Nations Conference on Trade and Development (UNCTAD) – *Guidance on corporate responsibility indicators in annual reports*.

[www.fee.be/publications/default.asp?library\\_ref=4&content\\_ref=1392](http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1392)

## Stock exchange issues sustainability reporting guidelines

The Singapore Exchange (SGX) has introduced a voluntary guide to sustainability reporting for its listed companies, which is the first of its type from an Asian securities exchange. Aimed at newcomers to the practice, the guide outlines general principles to help companies draw up their approach to sustainability reporting.

Singapore’s revised corporate governance code identifies the consideration of sustainability issues, including environmental and social factors, as a key aspect of the board’s strategic role. But most Singapore companies do not yet produce sustainability reports, with SGX citing cost concerns, scope and lack of information as possible causes. The guide aims to start listed companies on their way.

“*The sustainability reporting guide* is the first step for listed companies who are new to sustainability reporting. A few are already practising and reporting fully on sustainability matters,” said Magnus Böcker, SGX CEO. “Among them are even some award-winners. With time, more SGX companies will join the ranks of those with international acclaim.”

In keeping with Singapore’s international outlook, the guide encourages companies to consider adopting internationally accepted reporting frameworks, and the Global Reporting Initiative (GRI) *Sustainability reporting guidelines* in particular. While sustainability reporting remains voluntary in Singapore, SGX recognises that growing local and global interest may lead to mandatory requirements in the future.

# GRI is considering initial comments on its G4 guidelines

The Global Reporting Initiative (GRI) is considering the comments it has received on its initial consultation on the fourth generation of the GRI sustainability guidelines. The feedback will be an important part of the development process and covers fundamental issues, such as the reasons for sustainability reporting, minimum content of a GRI sustainability report and reporting formats.

The GRI is one of the stakeholders involved in the development of a broader integrated reporting framework with the International Integrated

Reporting Committee. G4 is intended to be a useful building block for those moving towards more integrated reporting and aiming to give stakeholders a more holistic view of their performance.

The GRI has been running a series of workshops and events to enable people to provide feedback. A first draft of G4 is being developed by a working group and will be available for public comment in 2012. The final draft is expected to be ready for approval by GRI's governance bodies in late 2012, before the planned launch in 2013.

*"G4 needs to reflect stakeholders' needs," said Nelmara Arbex, GRI deputy chief executive. "This is why GRI develops its guidelines through a multi-stakeholder process. Public comment periods are crucial parts of this development, and workshops are a great way to gather feedback. We encourage people to sign up for events and have their voices heard!"*

For information on events and workshops around the world, see the GRI website.

[www.globalreporting.org](http://www.globalreporting.org)

## INTERNATIONAL ORGANISATION FOR STANDARDISATION

# ISO and GRI sign cooperative agreement

The International Organisation for Standardisation (ISO), the world's largest developer of voluntary international standards, and the GRI signed a Memorandum of Understanding (MoU) to increase their cooperation on 5 September 2011. One of the objectives of the GRI's G4 guidelines is to harmonise with the other main sustainability and reporting frameworks, including ISO 26000, which gives guidance on social responsibility.

The GRI was one of the 42 public and private sector organisations that participated with the representatives of 99 ISO member countries in its development. Following the launch of the standard, GRI published a document on how to get the best out of ISO 26000 in conjunction with its guidelines – *GRI and ISO 26000: How to use the GRI guidelines in conjunction with ISO 26000*.

The MoU is intended to leverage the activities of the two organisations related to sustainable development and reporting by business. The increased collaboration will include sharing information on ISO standards and GRI programmes, teaming up with other partners, participating in the development of new and revised documents, and joint promotion and communication.

[www.iso.org](http://www.iso.org)

## PPR GROUP

# Counting the environmental impact

The cost of producing group luxury sport and lifestyle brands is to be reported in an environmental profit and loss account (EP&L) by 2015, according to the brands' owner PPR Group.

Having taken the lead with its Puma brand (see page 10), the initiative will be implemented across brands such as Gucci and Yves Saint Laurent to give an across-the-board analysis of the environmental impact and monetary

valuation linked to production and sales of all the group's luxury sport and lifestyle brands.

"An EP&L helps to reveal the cost of business to nature and in order to manage and reduce our environmental impacts, we need to measure them," said Jochen Zeitz, chief sustainability officer, PPR. "A group EP&L will help us pinpoint and understand our issues so that we can set clear targets against

them to operate on a more sustainable level across all areas of the business."

PPR is ramping up its sustainability resource to support the brands during the group EP&L implementation stages. The addition of an energy management specialist and conservation and ecosystem services specialist will help identify opportunities to reduce the carbon footprint.

ACCA

# Global reporting standards gain popularity

Support for global standards for accounting, audit and non-financial reporting is on the rise, with standards such as IFRS now viewed more positively than before the economic crisis, according to a recent survey of CFOs and investors.

According to the survey respondents – 163 CFOs and investors from the US, Europe, Asia and the Middle East – the financial woes of the past few years have served to improve their perception of global standards. Over half (52%) now support IFRS, with a majority believing the benefits outweigh the costs of implementation. More than 40% of respondents said that IFRS has improved access to capital, with about a quarter saying adoption has lowered costs.

The survey, *Towards greater convergence – Assessing CFO and investor perspective on global reporting standards*, was undertaken by the Association of Certified Chartered Accountants (ACCA) in the summer of 2011. The findings were published in October. The ACCA is urging the US Securities and Exchange Commission (SEC) to take note of the findings ahead of delivering its verdict on IFRS.

“The growing support among CFOs and investors for global standards must be considered by the SEC as it considers its decision about whether the US should adopt IFRS,” commented Helen Brand, chief executive of ACCA. “We believe a positive answer from the SEC would give a tremendous boost to the cause of financial reporting and, more importantly, the world economy.”

The research found increasing familiarity with global standards is breaking down resistance to their implementation. In addition, 60% of respondents see international standards as facilitators of more consistent regulation.



When asked for their views on the value of global standards for audit, investors voiced the strongest support, with 44% seeing benefits from a move to International Standards of Auditing (ISAs) in terms of quality and cost. Among CFOs, only 27% were supportive, with 49% saying they see little or no benefit.

### **Appetite for non-financial reporting**

Rising demands from investors and customers for greater disclosure is fuelling an appetite for global standards in non-financial reporting. Far more CFOs (37%) believe standards will improve non-financial reports, such as those on corporate social responsibility and environmental risk, than the

9% who think otherwise. Further, respondents see global standards on non-financial reporting as a tool that could contribute to the better management of environmental risk.

There is also a clear recognition of the potential benefits of integrated reporting, with more than two thirds of those surveyed saying there is much to be gained – both in terms of better decision-making (39%) and a more accurate picture of overall performance (28%) from the presentation of financial, governance and sustainability information in an integrated report.

[www.accaglobal.com](http://www.accaglobal.com)

# New standards still some way off

The International Accounting Standards Board has a number of priority projects on its convergence agenda with the US Financial Accounting Standards Board that are proving difficult to conclude. Despite having a target date of June 2011 for completion of these projects, final standards are still some way off.

## Lease accounting

The reform of lease accounting has been through a long process, with an exposure draft issued in August 2010. The IASB's objective was to issue a final standard by June 2011, but the IASB encountered a number of problems during 2011, leading to their decision in July 2011 to re-expose the document. It seems likely that the basic proposition – that all leases should be on balance sheet for lessees – will survive. However, the boards are still debating a number of important details, such that it is difficult to predict the nature or timing of the final standard with any confidence. The exposure draft is now scheduled for the first half of 2012, with a final standard by the end of 2012. A likely application date seems to be 2015 at the earliest.

## Revenue recognition

The story with revenue is similar. Again, the target was to issue a standard by June 2011, but it was not to be. The IASB issued a new exposure draft in November 2011, with a view to delivering a final standard by the end of 2012. The core revenue recognition model and scope have not changed from the June 2010 exposure draft, although various proposals on how to apply that core principle have now



been included. Again application looks likely to be around 2015.

## Financial instruments

The development of a standard to replace IAS 39, *Financial instruments: Recognition and measurement*, is also a major project for the IASB. IFRS 9, *Financial instruments* (the new standard), is being developed in stages. The first part – dealing with classification and measurement of financial assets and liabilities – is in place. The second and third parts – on impairment and hedge accounting – have been issued as exposure drafts but are still not finished.

The question of impairment of financial assets has been very much in the spotlight recently in connection with holdings by banks and insurers of Greek government debt.

The current situation is that the IASB continues to work on trying to convert the proposals on impairment and hedge accounting into further parts of IFRS 9. These are difficult technical challenges.

Hedge accounting is being split into two aspects: general hedge accounting and 'macro hedge accounting', with the former, which applies to most companies, being finalised first. Macro hedge accounting is something that primarily affects financial institutions.

There are three other projects relating to financial instrument accounting. One is the measurement of fair value, on which IFRS 13, *Fair value measurement*, was issued in May 2011. This applies to any items that are measured at fair value, not just financial instruments. The second is a project on asset and liability offsetting. The IASB has decided not to make any substantive changes other than to enhance disclosures to allow users to understand the differences between IFRS and US GAAP on the offsetting of derivative contracts. And finally, the IASB did some work recently on the distinction between debt and equity. However, this is not currently scheduled for any further work.

[www.ifrs.org](http://www.ifrs.org)

# Disclosure reductions and increases

At the request of the IASB, the Scottish and New Zealand Institutes of Chartered Accountants recently published *Losing the excess baggage – reducing disclosures in financial statements to what's important*. Weighing in at a wonderfully ironic 138 pages, this report tries to establish a high threshold before

disclosures are necessary, and seeks to approach materiality in a different way.

This is certainly a topical issue. The forthcoming revenue standard, for example, includes very extensive disclosures and this has been true of many new or revised standards recently.

The IASB has recognised this – in the new agenda consultation (see page 15), they float the idea of a presentation and disclosure framework.

One of the challenges is to reduce the level of disclosure while keeping accounting information relevant and useful.

# Investors want clarity and depth of insight

Companies' segment reporting lacks clarity and depth of insight, according to PwC research, which means that investors often don't have the evidence they need to assess whether management is making the right resource allocation decisions to meet current and future challenges and opportunities. Investors say that segment reporting is the "biggest gap" in the information set provided by companies today.

*"Investors look to alternative sources of information to help them assess group performance and future potential," said Alison Thomas, former analyst, and PwC corporate reporting director. "The bottom line is that share valuations and capital availability can suffer. Investors see segment reporting as an essential building block for all valuations' analysis. It is the area that offers the greatest opportunity for management teams to show how their approaches and skills differ from those with competing offerings."*

Ms Thomas adds that when you ask investors what they want from corporate reporting, two themes come up again and again. First, investors want to know what evidence there is that management is spending capital wisely. Second, they ask whether management is providing sound data – financial (underlying performance, cash, capital returns, etc) and non-financial (KPIs, market trends, risks, etc) – so that investors can make confident forecasts about the company's prospects. In most cases, such analysis only makes sense if each business segment is analysed separately.

Our survey shows that 43% of FTSE 350 companies go deeper than high-level summaries to provide segment-specific insights – either by business, product, service or geography – into external market drivers. However, 37% fail to provide any insights into their company's priorities by segment and 42% do not explain how strategy execution and value creation differ by

segment. Only 19% offer any information on business risks affecting specific segments of their business.

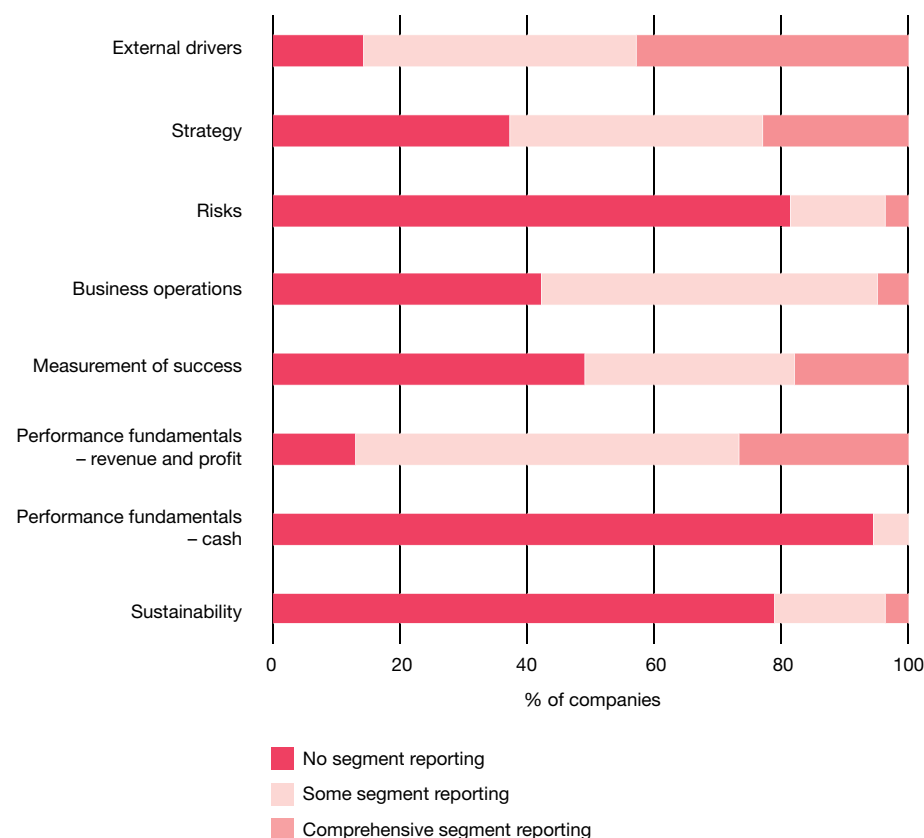
The lack of cash flow information by segment is striking – reported by only 6% of companies. Just over half of companies disclose some KPIs by segment as evidence of operational performance for the business unit.

While 87% offer high-level information by segment on underlying drivers of revenue or profits (such as volumes, pricing, currency, acquisitions), perhaps by including it in narrative discussions, only one third of these companies comprehensively quantify their impact on performance.

When segment information fails to give investors the information they need to analyse performance for forecasting purposes, Ms Thomas reports that it raises uncomfortable questions about the quality of management information used internally for decision-making. Inconsistencies between descriptions of segments within the annual report and accounts do not help. In the survey, 8% of companies provided segment information in the narrative that was at odds with the operating segment performance presented in the financial statement notes. Differences mainly arose in the underlying financial numbers or the segmentation presented.

## Segment reporting by FTSE 350 companies

Results show a greater focus on reporting external drivers and financial performance by segment. But there is room for improvement in other areas of the PwC integrated reporting model, where a group level focus is more prevalent.



Source: PwC

## Standards setters plan stronger regional focus

The Asian-Oceanian Standard-Setters Group (AOSSG), representing 25 national standards-setting organisations, has set out its vision for continued IFRS adoption in the region.

In *A driving wind for IFRS from Asia-Oceania*, the AOSSG details its work to date and future plans. Much of the AOSSG's work so far has focused on improving communications between its member organisations and representing their views in consultations with the International Accounting Standards Board (IASB). Future plans include intensifying AOSSG engagement with the IASB at the same time as it expands membership and promotes further understanding and consistent application of IFRS across the region.

The AOSSG was established in 2009 to represent the region's jurisdictions in a global standards-setting debate largely dominated by US and European participants. Its 25 national members cover diverse economies – including Dubai, Iraq and Saudi Arabia in the Middle East, Australia and New Zealand in Oceania, Singapore, Vietnam, Indonesia and Malaysia in Southeast Asia, as well as Japan, China, Hong Kong and India.

Around 80% of AOSSG members are in the process of implementing IFRS and are facing challenges including difficulties in application and practice, a lack of technical expertise, lack of support from the community, financial constraints and language barriers. The AOSSG says it would consider assisting the IASB in post-implementation reviews in order to identify and address implementation issues.

A key goal for the AOSSG is to become a major regional voice in global standards-setting, shifting the focus of debate towards issues facing the emerging economies it represents. It is therefore eager to cooperate with the IFRS Foundation's liaison office, due to be set up in Tokyo in 2012.

[www.aossg.org/docs/About\\_Us/Vision\\_Paper.pdf](http://www.aossg.org/docs/About_Us/Vision_Paper.pdf)

# Pressure to extend the IFRS timeline



**A recent announcement in Japan that companies would be given a five to seven year preparation period from the date of any decision to make adoption of IFRS mandatory, implies a one to three year delay from the existing IFRS roadmap.**

The announcement was made by Japan's financial services minister, Shozaburo Jimi, at a recent meeting of the Business Accounting Council (BAC) hosted by the Financial Services Agency (FSA). Under the existing roadmap, IFRS is scheduled for adoption by 2015/2016.

Shozaburo Jimi's views do not constitute a formal announcement by the BAC or the FSA. The BAC continues to deliberate whether or not to adopt IFRS, and the timetable to be followed. A formal announcement is expected in 2012.

The discussion around a delay in mandatory adoption comes amid pressure from Japan's business community to extend the deadline in the aftermath of the March 2011 earthquake and tsunami, to ease the additional burden that would be placed on companies impacted on by the disaster.

Voluntary adoption of IFRS has been permitted for listed companies in Japan since 2009, and many companies have

already started preparing for the planned transition to IFRS. The reaction to Shozaburo Jimi's words from most leading companies has been to either continue with preparations as previously planned (keeping the option to adopt IFRS voluntarily in the 2015/16 time frame), or perhaps most commonly, to keep momentum going but over an extended period of time to allow for a steadier paced build-up towards adoption of IFRS.

*“The consensus among the business community seems to be that mandatory adoption of IFRS is still coming,” said Hitoshi Kiuchi, the leader of Accounting Consulting Services at PwC in Japan. “The reluctance to lose momentum in transition projects, despite the announced delay, applies particularly to those companies that have taken the opportunity to align their transition to IFRS with other business initiatives, such as system and process change.”*

While the most likely adoption scenario seems to be a slightly delayed timeline along the lines of that put forward by Shozaburo Jimi, the US situation is still being closely monitored and the path ultimately chosen by the US could result in further changes to Japan's roadmap.

## NEW ZEALAND

# Backtracking on sector-neutral standards

**Recent proposals to financial reporting requirements in New Zealand will result in fewer companies there preparing their annual reports under International Financial Reporting Standards (IFRS).**

The introduction of a tiered approach to accounting is similar to that being proposed in the UK and elsewhere. However, what separates the proposals being put forward by the External Reporting Board (XRB) is that there is currently one set of sector-neutral standards in use by listed and unlisted companies, public sector and not-for-profit entities, based on IFRS. Under the proposed new financial reporting framework, public sector and not-for-profit entities will have to report under accounting standards based on International Public Sector Accounting Standards (IPSAS).

These proposals represent the most significant change in financial reporting since the New Zealand decision to adopt IFRS in 2005.

Although the tiered framework will have little impact on domestic listed companies, others such as large subsidiary companies with an overseas parent will have the option of moving to a reduced disclosure framework. Smaller subsidiaries of overseas companies will need to look at the new requirements more carefully as some may find the requirements for local GAAP financial statements or an audit no longer exist.

“Although some entities will welcome the introduction of reduced disclosures, or not having to produce general purpose financial statements, those companies could find themselves

disadvantaged,” commented Michele Embling, PwC partner in New Zealand. “Banks and others in the financial reporting supply chain will still want to see transparent reporting of an entity’s financial health if they are to invest in it.

“We are generally supportive of the proposed changes as it is clear that the current ‘one size fits all’ approach to accounting standards in New Zealand is not sustainable in the long term, particularly when the underlying standards (IFRS) are developed for the capital markets, rather than the public sector.”

[www.pwc.com/nz/en/ifrs/ifrs-in-brief-september-2011-for-profit-entities.jhtml](http://www.pwc.com/nz/en/ifrs/ifrs-in-brief-september-2011-for-profit-entities.jhtml)

## INDIA

# Following the XBRL lead

The Ministry of Corporate Affairs (MCA) has mandated the use of XBRL for the filing of audited financial statements by certain Indian companies, to include those listed on any stock exchange in India and entities with a specified amount of capital and turnover.

The MCA made the announcement in March 2011, with a deadline for implementation of November 2011. “The short deadline for companies to prepare for implementation is causing concern among affected companies,” commented

Debdas Sen, executive director at PwC in India. “Since the MCA’s mandate affects a large number of companies, this concern is quite widespread.”

The Ministry has also mandated that for the first year of implementation the XBRL financial statements will need to be certified by a professional, such as a chartered accountant, company secretary or cost accountant.

“Indian regulators are following the lead of their counterparts in countries

such as the US and UK, which have already recognised the reduced manual effort and greater accuracy that XBRL can bring to corporate reporting,” continued Mr Sen. “XBRL also has the potential to become the standard for internal financial reporting. By reducing the time for data collation and reconciliation, XBRL can leave more time for data analysis.”

[www.mca.gov.in/xbrl/sitemap.html](http://www.mca.gov.in/xbrl/sitemap.html)

## MALAYSIA

# IFRS adoption on track

The Malaysian Accounting Standards Board (MASB) has issued an exposure draft detailing its proposed IFRS-compliant financial reporting framework and has reaffirmed its plan to fully converge with IFRS on 1 January 2012.

“Accounting professionals and non-private entities are advised not to delay their preparations to converge with IFRS,” said Mohammad Faiz Azmi, MASB chairman

and PwC partner. “In fact, non-private entities should have already developed and implemented a formal transition plan. On an individual level, all accounting professionals must make a personal commitment to be conversant with the new IFRS-compliant framework.”

Malaysia’s existing framework is virtually the same as the IFRS framework except for IAS 41, *Agriculture*, IFRIC 15, *Agreements*

*for the construction of real estate*, different effective dates and additional transitional provisions in a limited number of standards. The MASB said it will deal with entities affected by IAS 41 and IFRIC 15 separately. For all other entities, the MASB does not expect a significant impact to arise from full convergence with IFRS.

[www.masb.org.my](http://www.masb.org.my)

# Review proposes new rules for foreign companies

**New rules on foreign companies and new criteria to allow an audit exemption for small companies feature in proposed reforms to Singapore's regulatory regime, issued by the Ministry of Finance (MoF) and the Accounting and Corporate Regulatory Authority (ACRA).**

ACRA's recommendations on the regulatory framework for foreign entities include a streamlining of registration requirements and procedures to make registration easier. At the same time, foreign entities will have to provide more financial information, bringing their requirements into line with those of locally-incorporated companies.

Small companies will qualify for the exemption if they meet two of three criteria: a turnover of less than S\$10m; gross assets of less than \$10m; and no more than 50 employees. Dormant



companies that are not part of a group will also be exempt.

The proposals were published for consultation in June 2011 following a major MoF review of Singapore's Companies Act. New rights for indirect investors also feature among the report's

217 recommendations. Nominee companies and investors using the Singapore Central Provident Fund will be allowed to appoint multiple proxies to attend, speak and vote at general meetings, subject to qualifying criteria.

[www.mof.gov.sg](http://www.mof.gov.sg)

## NIGERIA

# Nigeria adopts IFRS

**From 1 January 2012 all listed and significant public interest entities in Nigeria will be required to report under IFRS. While many of these entities have already commenced their conversion process, it remains a daunting reality for those tasked with financial reporting in Nigeria.**

The time frame for IFRS adoption in Nigeria has been relatively short. Although some speculated initially that IFRS adoption would be delayed as a consequence, the staged adoption roadmap has not been amended since it was officially announced by the Nigerian Accounting Standards Board (NASB) in 2010. The NASB has since been replaced by the Financial Reporting Council (FRC) as the

country's standard setting body through the signing into law of The Financial Reporting Council of Nigeria Act 2011.

In Nigeria, a number of laws and regulations covering financial reporting overlap and are inconsistent with one another. Regulatory bodies, such as the Central Bank of Nigeria and the National Insurance Commission, also place financial reporting requirements on regulated entities, often prescribing formats and disclosures in financial statements that may not conform with IFRS. However, with the recent establishment of the FRC, the enforcement of IFRS is now vested in one body – the act aims to bring all financial reporting, auditing and corporate governance regulations together under one umbrella.

Other challenges Nigeria faces with its IFRS implementation include: the shortage of sufficiently skilled accountants and auditors; the integration of IFRS into tertiary education courses; and the inadequate technical knowledge of users of financial statements. Another major concern remains the tax considerations of the conversion. The tax effect of IFRS adjustments, as well as some accounting profits and losses (such as fair value movements) are not currently specifically dealt with in the tax legislation.

To help understand more of the detail behind the challenges, PwC has produced a publication summarising the key differences between IFRS and Nigerian GAAP. For a copy, please email Berna Buys ([Berna.buys@za.pwc.com](mailto:Berna.buys@za.pwc.com)) or Tony Oputa ([tony.oputa@ng.pwc.com](mailto:tony.oputa@ng.pwc.com)).

# Recommendations on going concern and liquidity risk disclosure



**The Sharman Panel of Inquiry, established under the Financial Reporting Council (FRC) to consider going concern and liquidity risks, has published its preliminary report and recommendations.**

The Inquiry was borne out of concern over the quality of information that companies provide on their financial health and their robustness to trading difficulties encountered as a result of the financial crisis. Its aim was to consider what lessons companies and auditors could learn from the economic woes and to recommend measures that could improve the existing reporting regime and guidance available to them.

The main recommendations from the inquiry were:

- The purpose of the going concern assessment and disclosure process in accounting standards and the Corporate Governance Code should be harmonised and clarified.
- The going concern assessment should focus on solvency risks as well as liquidity risks, whatever the type of business.
- The going concern assessment should include stress tests of liquidity and solvency.

- A move away from the current model where the company only highlights going concern risks when there are significant doubts about the entity's survival, to one which integrates the directors' going concern reporting with the directors' discussion of strategy and principal risks.
- A move away from the current 'three category model' for auditor reporting to an explicit statement in the auditor's report that the auditor is satisfied that, having considered the assessment process, the auditor has nothing to add to the disclosures made by the directors.
- The FRC should establish protocols with other authorities in the UK to allow the review of circumstances and learning of lessons when significant companies fail.

The panel also considered whether banks should be treated differently. It is now asking for views on whether there should be a separate disclosure regime for banks and their auditors in relation to going concern matters and whether they should be subject to a separate financial reporting and auditing regime.

The FRC's preliminary recommendations are open to comment until 31 December 2011. The FRC expects to finalise its recommendations early in 2012.

# Reporting formats ripe for experiment

An environment where corporates and investors can come together to develop pragmatic solutions to today's reporting needs has been launched in the UK.

The Reporting Lab is the brainchild of the UK Financial Reporting Council (FRC). Its aim is to foster dialogue between preparers and users of corporate reports and encourage debate on how the effectiveness of reporting can be improved.

The FRC explains that those who prepare corporate reports express frustration with the "complexity and overlapping requirements of the current regime" and want to improve the reporting framework to achieve a "significant step change in disclosure practice".

Experimentation is encouraged. Companies can use the Lab to test new reporting formats with investors, and investors can indicate areas where management can add greater value through the information they provide. The FRC is optimistic that lab users will develop practical, evidence-based innovation in corporate reporting and audit committee reports.

The FRC is acting purely as a facilitator for the lab, the agenda being driven by its participants. However, a steering group has been established to oversee the lab's activities. It will contribute ideas for discussion and high-level direction on its projects, as required.

Projects suggested to date include: improvements to the notes to the accounts, a review of the effectiveness of elements of narrative reporting and governance information, and materiality of specific disclosures.

**Further information can be found at [www.frc.org.uk](http://www.frc.org.uk)**

# Material information frequently disclosed in one-on-ones

In a survey of more than 400 analysts and investors from around the world, almost half said they believe that companies frequently disclose material information in one-on-one meetings.

Although one-on-one meetings are common practice between company executives and investors/analysts, there is a blurred line over whether the information disclosed could be construed as price-sensitive. Some 47% of analysts and investors questioned in the RSM global analyst and investor survey agreed (or slightly agreed) with the suggestion that “companies frequently disclose material information in one-on-ones”. However, there was no clear distinction between the responses from sell-side and buy-side.

Regulation on the release of corporate information varies from country to country and it is hard for regulators to enforce the rules. Partly, this is due to the lack of clarity around what is inappropriate behaviour, but also because they have limited knowledge of what goes on behind closed corporate doors. In the US for example, there is strict regulation around the release of corporate information, and this is reflected by the number of US investors (8% lower than globally) who say they have received material information. The percentage in Asia is 10% higher than average – which could be attributed to investors’ dependence on one-on-one meetings because of a generally lower level of transparency in public disclosure in the region.

Regional differences exist around the question of transparency: that is, when companies hold one-on-one meetings and who with. Although 48% said they are in favour of more transparency, Asian respondents were the most vocal, with 55% wanting more. European analysts and investors expressed the least, with 40% in favour, while US/Canadian respondents sat in the middle, with 48% in favour of more transparency.

The survey was conducted by the Rotterdam School of Management, Erasmus University and PwC between 28 March and 1 April 2011.

## CRUF

# What’s keeping investors awake at night?



A panel of investors and analysts has given its view of the current reporting framework and described where they think ‘quick fix’ improvements can be made to help users get a fuller picture of a company’s financial health.

The panel was made up of members of the Corporate Reporting Users’ Forum (CRUF) – a discussion forum of professional analysts and investors from

both buy-side and sell-side, speaking at the 13th annual Meet the Experts conference in London. Among their recommendations were:

### **Segment information**

Management should consider whether there is anything else it uses to assess business performance that could be disclosed. For example: revenue components, operating profit (or similar), operating cash flows, Capex, working capital, debt/capital employed.

### **Net debt reconciliation**

Consistency of definition and application is needed. Investors want to know how debt financing has changed over time, whether increases in cash are attributable to increases in debt. They also want a clear definition of what’s in net debt as this often provides added insight, for example on debt-related derivatives.

### **Maturity schedules for debt**

These disclosures are frequently too high level. Investors would like to see an

explanation of maturity amounts within the next year and for each of the next five years. Investors would also like to see clarity over the reconciliation of the maturity schedule amounts to the balance sheet.

### **Pensions disclosures**

CRUF panelists would like to see more focus on key expense drivers and planned cash flows such as: longevity assumptions; discount rate and duration of obligations; hedging; regulatory and other influences on expected cash flows. A single table to show changes in plan assets and obligations and their accounting is their preferred layout to show what’s going on within the financial statements.

### **Quality of disclosure**

Investors want to know: what’s the story being told? Where is the business? Where is the cash? What are the tax impacts? And what’s management’s view of risk?

[www.meet-the-experts.org](http://www.meet-the-experts.org)

# Financial Reporting Council stresses 'true and fair'

The 'true and fair' view has long been an important foundation of UK accounting standards and law. It was exported to Europe, found its way into the EU 4th directive, was then re-imported into the UK and is now set out in the Companies Act 2006. Hence UK directors and auditors both sign off in terms of 'true and fair'. The IFRS literature refers to 'fairly present' but the two are regarded as synonymous for all practical purposes.

Despite this, the notion of 'true and fair' is not so well established or understood outside the UK. Arguably, it is not as well established within IFRS as it is within UK GAAP. With that in mind the Financial Reporting Council has issued a paper that confirms that the true and fair requirement remains of fundamental importance in both UK GAAP and IFRS.

The paper concludes that the FRC expects preparers, those charged with governance and auditors always to stand back and ensure that the accounts as a whole do give a true and fair view, and to be prepared, albeit in extremely rare circumstances, to consider using the true and fair override.



# IFRS still up in the air

The US Securities and Exchange Commission (SEC) continues to deliberate over whether US entities should transition from US GAAP to IFRS. The publication of two new papers provides evidence that the SEC Staff is still gathering insight to support the final decision. However this recent activity throws further doubt on whether a decision will be forthcoming before the end of 2011.

The papers were published by the SEC's office of the chief accountant on 16 November 2011. The first summarises

the differences between the US GAAP and IFRS frameworks, noting that key differences still exist between the two frameworks. The second paper analyses how IFRS is applied in practice. It found diversity in how different territories apply IFRS, and a need for more robust disclosures from some reporters.

The SEC had been expected to announce its decision by the end of 2011 on: if, when and how the US might adopt IFRS. Although some form of decision is still expected, rumours now abound on whether adoption will take the form

of a 'condorsement' approach (somewhere between convergence and endorsement) rather than a straight switch to international norms. That is, US GAAP would remain as the reporting framework under the US Financial Accounting Standards Board's remit, with IFRS standards not on the IASB's work plan being incorporated into the framework over time.

The papers can be downloaded from [www.sec.gov/spotlight/globalaccountingstandards.shtml](http://www.sec.gov/spotlight/globalaccountingstandards.shtml)

### AUDITOR REPORTING

# Standard setters act on investor call for better auditor reporting

Investors in a number of jurisdictions have become more vocal during the financial crises in seeking more informative reporting from auditors (see p38, World Watch Issue 2, 2011). While the audit and audit opinion are valued, many argue that much of today's standard audit report is not useful or informative. It is seen as being primarily boilerplate description and liability-limiting language.

Investors observe that auditors have a wealth of information and insight into companies and their financial reporting as a result of the audit, but it is not shared with investors – even though the audit is for their benefit.

As a result, audit standard setters on both sides of the Atlantic have issued a series of consultation documents that explore options for significantly enhancing today's audit reporting.

- In May, the International Audit and Assurance Standards Board (IAASB) released its much anticipated consultation paper – *Enhancing the value of auditor reporting: Exploring options for change*.
- In June, the US Public Company Accounting Oversight Board (US PCAOB) joined the auditor reporting debate with a concept release – *Possible revisions to PCAOB standards related to reports on audited financial statements* – and held a roundtable in September.
- In August, the UK's Financial Reporting Council released its proposed next steps in its plans for effective company stewardship, which include enhanced reporting by audit committees and auditors.
- The European Commission's October 2010 green paper on audit policy sought input on questions about auditor reporting and the draft legislation includes proposed audit reporting requirements (page 49).

Common to all of these consultations is recognition of a need for greater transparency about the judgements



made by management and auditors in the course of preparing and auditing financial statements in order to address the 'information gap' investors perceive.

The IAASB paper explores the following options for enhancing auditor reporting:

- Possible changes to the format and structure of the auditor's report.
- Clarification of the auditor's responsibilities for other information in documents containing the audited financial statements.
- Introducing auditor commentary on matters significant to users' understanding of the audit or the audited financial statements.
- Introducing an enhanced corporate governance reporting model, including broader reporting by those charged with governance and enhanced auditor reporting.
- Other assurance or related services on information not within the current scope of the financial statement audit.

The US PCAOB paper explores similar, but narrower, options for change but also includes the concept of Auditor Discussion & Analysis (AD&A), which would be a supplemental narrative report that provides the auditor's views on aspects of an entity's financial reporting – for example judgements, estimates, issues, 'close calls', etc – entirely separate from the conventional audit report.

The UK FRC believes that auditors can and should provide increased insight into the audit process to reassure users of financial statements that all material matters have been properly disclosed. The FRC has, however, concluded that the better course is for audit committees to provide the information that investors and other users are seeking.

Each of the standard setters is trying to increase auditor transparency and relevance to financial statement users, while not compromising audit quality. With responses now being analysed, the way forward is expected to emerge in 2012.

# Major changes proposed for the audit market



**Widely-leaked proposals, now issued as draft legislation, look set for a lengthy discussion period during 2012.**

The European Commission (EC) has published draft legislation setting out major changes to the statutory audit arrangements of EU companies that could significantly affect the structure of the audit market. The proposed reforms were drawn up in response to the EC's pledge to introduce new rules to improve market transparency and accountability in the wake of the financial crisis.

Key proposals include:

- The mandatory rotation of auditors after a six-year period (or nine years in the case of voluntary joint audits)
- Greater separation of audit and non-audit services, including the introduction where certain size criteria are met of 'audit only' firms
- Removal of artificial barriers to entry for smaller audit firms
- Wider recognition of auditing qualifications throughout the EU to ensure the free movement of suitably qualified professionals

- Greater transparency of the way audit committees select audit and non-audit services
- Improved communication between auditors and financial regulators
- Detailed specification of the content of audit reports.

The proposed legislation covers most of the areas set out in the EC green paper, *Audit policy: Lessons from the crisis*, issued in October 2010. The paper attracted a record number of responses – from companies, investors, governments and regulators – with clear support for proposals on greater audit transparency, a redefined role for the auditor, and improved EU-wide coordination of audit oversight. But there was little support for some of the more radical reforms, including audit firm rotation, joint audits and restricting non-audit services. (see *World Watch*, Issue 2, 2011, p37).

Member states and MEPs will start debating the proposals early in 2012. A lengthy period of consultation is expected as the Council of Ministers and the European Parliament decide whether to pass the proposals into EU law. See PwC opinion, page 16.

## PCAOB

# Proposal for firms to name engagement partner in audit report

**Proposed new amendments to US Public Company Accounting Oversight Board (PCAOB) standards would see engagement partners and others named in audit reports. The changes follow consultation with US investors on ways to make the audit process more transparent.**

The PCAOB's move is not unique in the US – the Federal Reserve already requires external auditing firms to give details of the engagement partner on certain financial statements.

The PCAOB decided against a proposal requiring the engagement partner to sign the audit report in response to concerns that to do so might minimise the firm's role in the audit. But the auditor must give details of third-party accounting firms and key individuals that took part in the audit.

Consultation on the proposed amendments closes on 9 January 2012.

[www.pcaobus.org](http://www.pcaobus.org)

*“This proposal would increase transparency of public company audits by providing investors with information about certain key participants in the audit,” said James Doty, PCAOB chairman. “This would bring disclosures about US audit engagement partners more in line with those provided for many engagement partners abroad.”*

# Investors call for assurance on key performance measures

Investors want auditors to provide assurance on performance measures that are often not audited, according to new PwC research *Audit today and tomorrow*, published in July 2011.

PwC interviewed investors and analysts in the UK to hear first-hand what they think about the audit and the role of auditors, at a time when there is intense debate about the future audit framework and regulators are weighing up what changes may be needed. The findings bring a fresh perspective and show what users value from the audit and what they feel is missing.

Assurance on industry metrics, such as same-store sales, upcoming contracts data and core or underlying earnings is

in particular demand from investors. The majority also want to see auditors report on companies' preliminary results, which they say would provide more timely assurance at a critical stage in the reporting cycle of a business.

"The views of investors and analysts are critical to the audit profession's aim to underpin trust and confidence in the capital markets," commented Richard Sexton, PwC UK board member responsible for reputation and public policy. "They clearly value the audit process, but in calling for more timely assurance, investors and analysts have laid down the gauntlet. If we want an assurance and reporting model that adds value to the capital markets, then analysts, investors, regulators,

companies and auditors will all need to be engaged in the debate."

In the wake of the financial crisis, investment professionals believe audit committee reports could become more helpful if the 'lid was lifted' on the talks between auditors and audit committees, which currently take place behind closed doors. Ideally, investors want greater transparency around these talks, but some cautioned that this transparency should not jeopardise the frankness of discussions between the auditor and the audit committee.

[www.pwc.co.uk/eng/publications/audit-today-tomorrow-investor-survey.html](http://www.pwc.co.uk/eng/publications/audit-today-tomorrow-investor-survey.html)

# Market for large company audits referred to Competition Commission

The UK Competition Commission is conducting a market investigation into statutory audit services provided to large companies in the UK. The Office of Fair Trading (OFT) made the referral on 21 October following a six-week public consultation.

Market concentration, barriers to entry and audit switching will be the main focus of the detailed study aimed at uncovering any adverse effects on competition, according to the OFT.

The referral was made at the same time as the European Commission was finalising its draft legislation proposing reforms to the EU audit market (see page 49). Uncertainty over the timing of European initiatives and the likelihood of a two-year EU legislative process contributed to the OFT's decision. Competition Commission investigations must be concluded in two years or less.



"We see this market investigation as an opportunity to show that this is a fair and competitive market," said Richard Sexton, PwC board member for reputation and policy. "We also believe that the evidence that will come out of this review will help to inform the ongoing European debate on the provision of audit services.

"Large companies are sophisticated, demanding and discerning buyers of professional services. Their operations are often complex and international and

require an audit firm that has sector expertise and can operate on a comparable international basis.

"It will be important for the commission to listen to the views of business through the course of this market investigation and to take account of the potential unintended consequences of any intervention, particularly where they could impair audit quality, add costs and complexity to business, and damage the competitiveness of the UK economy."

## Plan to learn from ISA implementation experiences



**The International Auditing and Assurance Standards Board (IAASB) has released a plan for a post-implementation review of the clarified ISAs.**

The Clarity ISAs released in March 2009 were the culmination of a comprehensive review and redrafting of the ISAs and ISQC 1. Approximately half of the ISAs were substantively revised. The overall aim was to improve the clarity of the standards and make them easier to understand so that they could be applied more consistently.

The IAASB now plans to find out if the ISAs are meeting these objectives. Many national standard setters, such as India (see next article), and audit networks have adopted and implemented the Clarity ISAs. Audit inspection regulators are also beginning to review audits that have been performed in accordance with the Clarity ISAs.

“With extensive uptake of the clarified ISAs throughout the world, in already more than seventy-five countries, now is the time to gain a deeper understanding of how the clarified ISAs are being used and implemented,” said Arnold Schilder, chairman of the IAASB.

The plan describes phase 2 of the IAASB’s review, which will begin in 2012. It will gather information about the use of the ISAs to see if any changes are needed to improve the consistency of practitioners’ understanding of the ISAs.

The input received will also help inform the IAASB’s priorities in 2014 and its next three-year, strategic planning cycle in 2015-2017.

The plan sets out the key areas of focus for the review, its timing and the approach. The IAASB intends to seek input from stakeholders that are most directly involved in the audit process, including larger firms, smaller firms, public sector auditors, professional bodies, national standard setters, and audit inspection groups. The IAASB recognises, however, that there are other stakeholders who may be interested in providing feedback, and encourages and welcomes their feedback as well.

In 2009 and 2010, the IAASB conducted the first phase of its review programme by obtaining pre-implementation views from a number of countries and firms about their experiences of introducing the clarity ISAs into their national standards or firm audit methodologies. The results of the survey were reassuring – most welcomed the new format and the added rigour of the revised standards. There was some anxiety about how the Clarity ISAs could be applied in a cost-effective way in smaller entities, and also about implementing all aspects of the new group audit standard, ISA 600.

**To offer input from your experiences of implementing the clarified ISAs, contact IAASB staff member BeverleyBahlmann@ifac.org**

## Towards international clarity

**The Institute of Chartered Accountants of India (ICAI) is continuing its efforts to ensure standards issued by the Auditing and Assurance Standards Board (AASB) mirror as closely as possible those released by the International Audit and Assurance Standards Board (IAASB).**

The ICAI is a founder member of the International Federation of Accountants (IFAC) and actively contributes to the development of International Standards on Auditing (ISA) in a bid to harmonise with global standards. To date, the ICAI has issued 36 Standards on Auditing (SAs) based on the IAASB’s Clarified ISAs. The latest standards to be issued are the revised standards on *Audit conclusions and reporting*, which came into effect from 1 April 2011.

*“The ICAI, as a founder member of IFAC, has taken giant strides in keeping pace with the rest of the world,” said Harinderjit Singh, PwC partner in India and a former member of the Central Council and chairman of the AASB. “The focus on achieving global professional standards in India is evident from the input to the Clarity Project. The challenge now is to focus on the implementation of these new standards.”*

The SAs are substantially based on the corresponding ISAs with minimal differences. However, certain areas, such as access to auditor’s working papers, assessment of professional competence of the other auditor and definition of ‘public sector’, continue to differ. “Certain differences with the ISAs are inevitable, given the unique statutory environment and the phase of the profession’s development in India,” continued Mr Singh. “It may be too early to evaluate the ICAI’s success in implementing the clarity standards in India, but it is certainly a step in the right direction.”

# Diary dates

Date	Key upcoming events	Location/Contact	Sponsors/Organisers
12-13 December 2011	ICGN 2011 Autumn Mid-Year Conference	Miami, USA www.icgn.org	International Corporate Governance Network
15 December 2011	8th Transatlantic Corporate Governance Dialogue	Washington DC, USA www.ecgi.org/tcgd/index.php	European Corporate Governance Institute, Brookings Institution, Columbia University
3-6 January 2012	Global Conference on Business and Finance	Honolulu, Hawai www.theibfr.com	The Institute for Business and Finance Research
10-12 January 2012	9th International Conference on Environmental, Cultural, Economic and Social Sustainability	Vancouver, Canada www.onsustainability.com	Common Ground Publishing
13 January 2012	IFRS Foundation Trustees Meeting	Singapore	International Accounting Standards Board
25-29 January 2012	World Economic Forum Annual Meeting	Davos, Switzerland	World Economic Forum
15-18 February 2012	2012 International Conference on Governance and Accountability	Sarawak, Malaysia www.icga2012.com	Asia-Pacific Centre for Sustainability
14 March 2012	Responsible Business Convention 2012	London, UK www.bitc.org.uk	Business in the Community
20-22 March 2012	24th XBRL International Conference	Abu Dhabi, UAE www.Xbrl.org	XBRL International
29 March 2012	Investing in a Sustainable Future	New York, USA www.ftconferences.com	Financial Times
13 April 2012	IFRS Foundation Trustees Meeting	London, UK www.ifrs.org	International Accounting Standards Board
21-22 May 2012	2nd International Conference on Accounting and Finance	Singapore www.acc-finance.org	Global Science and Technology Forum

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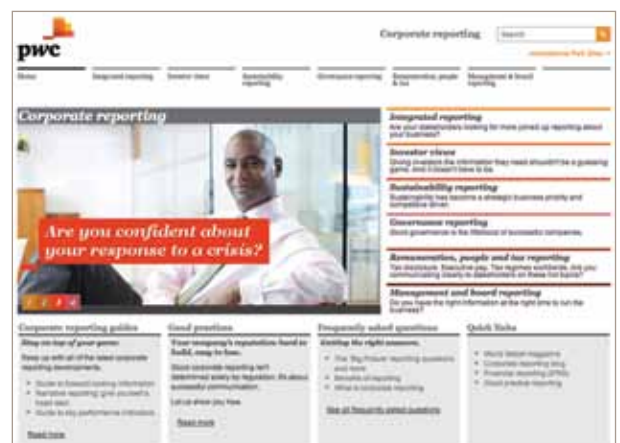
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