

# The future of auditing and corporate reporting

PwC is committed to playing an active role in the key policy debates that will shape the future of auditing and corporate reporting. One example of this commitment being put into practice is the following article jointly authored by John McFall, the Chairman of the House of Commons Treasury Select Committee revenue, and Richard Sexton, PwC's Head of Assurance.

The financial crisis demonstrated that company reports leave something to be desired if they are to alert investors to problems that may lie ahead. Justifying the status quo by arguing that there was a high level of compliance with the existing model just does not pass muster. The trouble is that the corporate reporting model is broken.

Recent market events have exposed reporting's shortcomings with painful clarity. It failed to help flag up systemic risk in the banking system. It appears to tolerate situations where companies fail days after issuing robust annual reports. It relies on technical disclosures running to hundreds of pages and leaves board directors feeling detached. Indeed, the Financial Reporting Council recently announced a review into the complexity and relevance of corporate reporting.

Companies should be telling a clear story and providing real insights into what is important. The existing reporting construct fails on both counts. There is no joined-up picture on critical areas of business activity. Financial information largely ignores the wider context and sits in isolation.

Accounting standards and regulatory requirements leave us with information that is hard to penetrate and is increasingly technical and academic. Some of this may be necessary, but the annual report risks being distanced from the day-to-day management information on which the business is run.

Reports must be reframed to explain all the critical aspects of performance reporting along with the dynamics of a company's business model and the risks and business relationships on which it depends. Whether assets and liabilities are on or off the balance sheet makes only a small contribution to the reader understanding the dynamics of the business, its competitive landscape and market environment.

In today's challenging operating environment, who can deny that we need a category given over entirely to how a company is funded and how the associated risks are managed?

An effective model would do much to highlight issues that should be on the minds of boards and management. It would look at the critical alignment of strategy and key performance indicators along with the tone, culture and behaviour of the business, remuneration and risk,

and their linkage to the overall dynamic of the business model. It should also consider climate change and broader aspects of sustainability.

Ensuring that the right information is reported in an accessible way is, of course, only part of the story. The audit model, part of a governance and regulatory model conceived decades ago, warrants as much of a rethink as the rest of the system.

Although audit failure did not contribute to the global market turmoil, events have reinforced the need to rethink how audit firms' skills and experience can be best used. Audit quality has improved significantly in recent years, but the audit remains focused on historical financial information and the complexity of the reporting system means a disproportionate amount of time must be committed to technical reporting issues.

This must not be seen as a green flag for more hours and bigger audit fees. Yet it is high time for a reassessment of how and where auditors are required to spend their time. Can auditors play a role in helping monitor systemic risks? Could they contribute to the operation of new regulatory mechanisms, given their

extensive knowledge of global business and markets? What more can auditors do to assist our understanding of corporate governance, remuneration and its impact on culture and risk-taking, and of the dynamic of the business and the scope of the risks and relationships to which it is exposed? None of these factors fall within their current remit.

It would be naïve to think that a response to all this can be found overnight. But we should waste no time in establishing a progressive programme of activity over the next two years to consider how the reporting and audit model can be strengthened to enhance regulatory and investor understanding. As a major public policy opportunity it should command the attention and sponsorship of global leaders and the active involvement of all market participants.

We have a rare opportunity to confront these issues and build trust and confidence back into the system. We must seize the moment – or risk sleepwalking into the next crisis.

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