In today’s business world, questions are being asked about institutions, companies and professions. These questions often center on trust. Can I rely on the reported financial results? Are audit committees and auditors truly independent? Are accounting and auditing standards consistently applied?

Trust is the precious commodity that makes financial systems around the world work. But it is seemingly in short supply. To restore trust, each participant in the system needs to consider how it provides confidence and, thereby, trust to the capital markets. There are five crucial links in this chain: the company, the audit committee, the auditor, the standard setters and regulators, and the investors.

THE COMPANY
Quality financial reporting starts with the company. Without a strong CFO and controller, an effective finance function and active internal audit department, the financial reporting process can fall short. We only need to look at the number of adjustments proposed by auditors around the world to understand that preparers can and should take greater responsibility for getting their financial statements right.

Preparers do make errors, and sometimes it is intentional. This is fraud. The reason for the intentional misstatement does not matter. It is never acceptable to intentionally misstate a company’s financial results. It serves no one in the capital markets well, and it contributes mightily to a loss of trust.

The EY 2016 Global Fraud Survey shows that a worryingly large proportion of finance executives say they can justify actions to meet financial targets that will misstate reported figures. In total, 16% of respondents globally said they would be prepared to change assumptions in determining values and reserves.

THE AUDIT COMMITTEE
The second important link in the chain is the audit committee. Effective audit committees enhance quality and investor confidence. To be effective, committees need to challenge and support the company’s management and its auditor. They also need to demonstrate independence from management.

I have personal experience of the value of a strong and independent audit committee. Some years ago, I was the audit partner on a public company. In the course of a periodic review, EY identified that the company had recorded revenues on product that had not shipped. I advised the company to adjust the revenues, but the CFO and CEO resisted.

An audit committee meeting was held and the matter was explained in detail. The CEO called on the audit committee to reject EY’s advice and to report the revenues in the period. There was complete silence and then the audit committee chair said: “The audit committee accepts the auditor’s recommendation and the company will correct its reported revenues prior to filing its periodic reports.”

This example also shows the importance of an auditor being skeptical, following his or her instincts, and standing firm against considerable pressure – which brings us to our third link.
THE AUDITOR
Auditors are the foundation of strong financial reporting. A quality audit, overseen by a professional and independent auditor, helps to maintain confidence. It has a ripple effect, boosting both the local and global economy and promoting growth, employment and prosperity.

Auditor independence, like audit committee independence, is vital to confirm there is no undue influence and to provide trust that the system works fairly and effectively. It is something that requires consistent reinforcement and monitoring by both firms and regulators.

THE STANDARD SETTERS AND REGULATORS
The move to both independent standard setting and regulatory oversight has been a key change in the past 15 years. There are now, in many jurisdictions, independent regulators who oversee the work of auditors, and, of course, securities regulators who oversee the companies. These changes, together with the combination of many new standards and ever-evolving requirements, are putting more pressure on management and the auditor.

The ultimate regulator is, of course, government. Individual governments or political and economic alliances, such as the European Union, can have a profound effect on financial reporting in parts of the world. In this context, there is an emerging trend away from globalization of standard setting and regulation. In effect, we have increased “protectionism” of standard setting and regulation of the profession and the financial reporting chain.

One example is the EU legislation on auditor rotation that came into force in June 2016. This has not been taken up in the US, which appears unconvinced by the approach. The US not moving to International Financial Reporting Standards is another example. We see “gold plating” by countries of standards that create country-specific rules. This fragmentation of standards causes sub-optimal outcomes for companies, audit committees, auditors and, importantly, investors, either in financial reporting or in the quality or type of assurance on financial reporting.

THE INVESTOR
The final link in our chain is the investor. Investors are increasingly global, and they want to be able to compare companies globally. To determine if they should invest in, say, British Airways, Korean Air or American Airlines, they’d like to compare the financial results. But this can’t be done easily because these companies aren’t using the same accounting standards or methods.

There may be some doubters, but investors generally value an independent audit. A recent survey by the Investor Advisory Group of the US Public Company Accounting Oversight Board spoke volumes on this point. Respondents to the survey — who were investors with assets under management of US$13.4t — were asked whether they relied on audit opinions. The result was that 94% said they relied “extensively” or “a good bit” on the audit opinion.

Investors are looking for more, however. They want different sources of information in addition to the financial statements. For example, investors have long been calling for something beyond the traditional “pass/fail” auditor’s report.

As a response to this demand, some jurisdictions have moved to the long-form, ISA 700 auditor’s report with “Key Audit Matters.” Unfortunately, the result has been increasing divergence around the world — for example, such a report is not accepted for companies subject to US SEC requirements.

So, for the same company listed in the UK and the US, an investor who reads the UK report will get considerably more information on the Key Audit Matters and how the auditor addressed them.

This does not serve the investing portion of the financial reporting chain. It is something that all participants should be working on so as not to confuse or devalue the audit and reporting effort of companies.

CONCLUSION
Our five links in the chain each have difficult roles that are made even more complicated by the dynamic environment in which they operate. The world we live in is one of uncertainty and upheaval, including geopolitical crises, economic shocks and compliance with ever-changing laws and regulations.

We are facing a period of unprecedented change, but one thing remains the same — the importance of a sound financial reporting system. Confidence and trust in the capital markets are needed to facilitate prosperous businesses and thriving economies and citizens. All professionals in the financial reporting chain must do their individual part, and work together for the public interest.

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