Is more less?
Exploring a new world of corporate reporting

Part 1: Plotting the course

Audit & Assurance
Exploring a new world of corporate reporting

We’re concerned. And we know many of you are, too. To begin with, we question whether stakeholder confidence in corporate reporting has improved over the past decade.

While balance sheets and income statements continue to provide value, the overwhelming volume of information available and the corresponding complexity of the overall investment environment now frustrates many stakeholders.

Some examples:

The management discussion and analysis arguably has become the most useful and relevant source of information. Even so, it has also become long and repetitive; uses too much “boilerplate” language; and is littered with sometimes-obscure risks. The compensation discussion and analysis is useful, but it too has become complicated and may not be of highest value to many.

Meanwhile, forward-looking information is highly valued, but little is shared with investors even though it may be available. Worse, many companies feel compelled to disclose marginal information, which further increases the volume of information produced, thereby increasing overall complexity in the corporate reporting process with very little return.

When does the push toward more information no longer achieve the core objective of actually informing stakeholders?

Join the conversation

Over the coming months, we’re going to be evaluating the existing accounting and regulatory compliance framework with an eye toward identifying and eventually recommending improvements in practice and design. And we’d like your input.

As leaders of our profession, we believe we have a responsibility to tackle issues that impact public companies, their shareholders and any other stakeholders trying to make sound investment, and other, decisions. Thoughts on these issues will be collected and shared in three installments in this series – Is more less? Exploring a new world of corporate reporting – as follows:

• Beyond the status quo: How stakeholders can be better informed within the current model.
• Looking to the future: Evaluating recently introduced frameworks and other proposals for potential changes in stakeholder communication.
• Raising the game: Other ways to enhance the quality of information and provide more assurance over other critical data that is released publicly, as well as how the accounting profession can be of more assistance.

In this first part – Plotting the course – we focus on establishing context for the discussion and posing many of the questions we’re looking to answer. We can all agree that more information is being made available. But does that additional information better serve stakeholders in their understanding of a company’s financial performance and prospects? If it does, what information specifically? And what could we do without?

We invite you to explore this new world with us. Please reach out to one of the Deloitte corporate reporting leaders identified at the back of this document or write to us at corporatereporting@deloitte.ca.
Can we talk?

Two dramatically different trends are taking hold in the business world.

With the rise of blogs, 140-character “stories” on Twitter and “infographics” that summarize entire topics with a few words and pictures in otherwise shrinking newspapers, there is a growing emphasis on shorter and simpler communications.

It’s a stark contrast to what seems to be happening in corporate reporting. While corporate reporting is still the market’s most important source of investment information, conversations we’ve had with various professionals suggest the volume and complexity of today’s financial environment makes it more difficult than perhaps it should be for stakeholders to make decisions efficiently and confidently.

Imagine it this way: you’re trying to decide between competing versions of a new tablet computer, and the sales material for each describes not only what the devices can do but also how every component in the manufacturing supply chain could have been made, was supposed to have been made and was, in fact, made. Or think pharmaceutical advertising, which requires manufacturers to identify every conceivable side effect of a given medication, no matter how rare.

Corporate reporting is now a lot more like this. Compliance first, clarity and usefulness second.

Why? Much of the challenge is due to significant increases not only in the complexity and types of mandatory disclosure but also – and perhaps more importantly – in the sheer volume of information generated by analysts and other market observers. Between the fear of litigation and the potential impact of “social” information sharing (over which companies have no control), is it surprising things have become so complex?

We hope you’ll work with us to find the answers.
More regulation, less protection?

Regulation is typically aimed at protecting those least able to protect themselves. In the case of corporate reporting, that means especially those stakeholders (investors) who likely do not have financial backgrounds sufficiently deep to parse highly technical financial language. But as the number of rules and regulations that govern the form and content of reporting requirements rises, is the objective of informing and ultimately protecting stakeholders still being achieved?

Many protective measures are, of course, built into the system. However, many stakeholders often have no choice but to rely on large, professional investment firms, experts with greater levels of financial sophistication, greater access to senior executives of the companies in which they invest and the sophisticated financial tools to summarize, analyze and evaluate complicated information. These bodies operate like journalists – they break down large data sets into digestible elements that the investing community then evaluates to determine whose stocks to buy or sell and when.

We talked to a number of analysts, institutional investors and directors on the boards of Canadian companies about the state of corporate reporting in Canada. These discussions covered a number of issues. Importantly, everyone agreed that the sheer volume of disclosures is obscuring focus on key issues critical to effective decision-making.

For instance, some information provided in various forms of financial disclosure is considered highly useful by large investors. But some of what is required and therefore reported period after period was also determined to have limited utility in promoting genuine understanding of a company’s financial performance and future prospects.

Nor is it simply a quantitative matter of too much regulation: multiple stakeholders are involved in generating corporate information and add to the complexity. Regulators put basic requirements in place, and that naturally instills a bias in preparers toward full compliance and disclosure. Preparers then layer on litigation risk and put protective disclosures ahead of the clarity of the language used. Directors, meanwhile, are often put in the position of arbitrating between auditors, lawyers and management’s views on the materiality of disclosures. For example, auditors are often required to report immaterial disclosure deficiencies to audit committees and boards. Boards then need to decide what might be considered material or worthwhile to disclose versus what is clearly trivial.

Suffice it to say, the buy-in of all of these participants will be needed to find an effective solution to current challenges.

Icebreakers

Who is the audience for information included in financial reports?
Has consideration of their needs been lost over time?
When does too much of a good thing (i.e., disclosures, information requirements) result in financial reporting that no longer achieves the core objective of informing stakeholders?
More information, less comprehension?

Broadly speaking, two categories of information are available to stakeholders and the investor community (see Figure 1):

- **Inside out**: Reports and other information that companies prepare themselves and deliver to the market, including financial statements, annual reports, management discussion and analysis (MD&A), compensation discussion and analysis (CD&A), annual information forms (AIFs), press releases and analyst conference calls.

- **Outside in**: All other information generated outside the company and its control but nevertheless able to impact the company's market value, such as analyst reports, news stories, blogs and other forms of market speculation and analysis.

More than any other information type, financial statements continue to be a primary resource for stakeholders, principally because the statements are subject to an independent opinion concerning whether or not they are materially misstated and because they are prepared in accordance with a highly codified set of rules. Since 2011, financial statements in Canada are generally prepared in accordance with International Financial Reporting Standards (IFRS).

Implementing IFRS's principles-based framework created renewed opportunity for companies to better tell their financial story. A few years into these standards, however, we're seeing instead an inclination to compliance for its own sake, an end rather than the means to an end, and not least because the perceived penalties for not complying and identifying all risks (either in the form of litigation risk or regulatory action) are greater than the rewards for doing it better.
Meanwhile, financial statements and other information produced by a company are rooted in historical fact – and are often two to three months old by the time they are audited. While a company’s historical financial performance is one indicator of its future, it is not the only, or often even the most important, one. Winning new business, securing new customers, developing new products and pursuing innovation can all impact a company’s future performance.

Consider the MD&A.

Prepared in accordance with National Instrument 51-102F1, Management Discussion and Analysis (NI 51-102F1), the MD&A is not subject to audit and, as such, the information and disclosures are not independently verified. In our discussions with boards, investors and analysts, the MD&A – although among the most useful disclosure documents – has become less useful than intended.

There is significant opportunity within the confines of NI 51-102F1’s rules and guidelines to provide real clarity into financial results, impacts of significant transactions, risk factors and management’s outlook for the future. However, companies often resort to repeating information included in the financial statements and to using boilerplate risk and forward-looking information. Under this approach, the MD&A often fails to enhance a stakeholder’s understanding of a company’s financial picture or its future prospects, relative to what was intended.

Similarly, other elements of the financial statements – the explanatory notes thereto – often tend to lose their usefulness past a certain threshold of highly detailed and complex information. There is often a level of complexity within these notes that results in genuine confusion for stakeholders, even the professionals, and little ability to fully understand what has transpired during the year. Overall, the sheer volume of information required can hinder, rather than enhance, transparency of financial results and positions.

Icebreakers

What are your most valuable sources of information in understanding and analyzing a company and its performance?
Where do you go to find the information you need?
What other types of information would you want to be provided with that you don’t currently have access to?
Perhaps more challenging still are the many other forms of information and media that can impact a company’s value but that are completely outside a company’s control. Here we mean things like independent trends and outlook discussions, competitive analysis, blogs, various forms of activism, ratings reports and so on. Under the current framework, public companies can see dramatic shifts in shareholder value (i.e., the underlying stock price) due to rumour, speculation, competitor activity or other industry changes. By its nature, this information is not subject to verification or corroboration by an independent source.

Thirty years ago, it wouldn’t have mattered as much. A relative layperson could read a set of financial statements and, combined with periodic news and industry information, get what was needed from it. But with today’s complexity and the speed at which information now spreads, that’s simply no longer the case.

On one hand, this is a function of the ongoing democratization of media, where the evolving landscape has given everyone (who wants one) a voice and a platform. On the other hand, not everyone with a voice and a platform has genuine expertise or even necessarily the purest of intentions. There is too much noise in the system. What, then, is a public company to do?

Icebreakers

What information produced outside of companies do you find most influential? Industry trends? Other analysts? Media? Blogs?

Should companies make a point of addressing this kind of information, perhaps even subjecting it to independent assessment?

And, if so, should they restrict the exercise only to their criticisms or should they also include their praises?
We can get there from here

A certain measure of complexity will always be in play, but when everyone gets everything, no one is served. Fortunately, many initiatives to enhance transparency and usefulness and to reduce the burden of compliance are already underway.

One model attracting attention is the International Integrated Reporting Council’s International Integrated Reporting Framework, which defines an integrated report as “a concise communication about how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term.”

It is not the only model that’s been proposed. Several organizations have also produced studies and offered both general and specific recommendations for improvement. But challenges remain.

Indeed, we believe many avenues to better inform stakeholders in the corporate reporting process are worth exploring. For instance, could one small step be the re-ordering of the financial statement notes to include first those matters that management deems to be the most important for its stakeholders rather than simply following the statement caption order? Could technology be more effectively used to drill down into financial details of interest to stakeholders and potential investors? Could real-time attestation be used on important company metrics that impact shareholder value?

We hope you will endeavour to answer these and other questions with us.

Icebreakers

Do forward-looking information and indicators better serve stakeholders than historical information? Can some of this be shared?

What role can auditors play in moving to a different frame of reference?
Be the change you want to see

Admittedly, the questions are often as complex as the problems they are looking to solve.

That, however, is no reason not to ask them, nor especially not to try and answer them. But, to do so, we need your voice, and we invite you to take advantage of our platform. Like decisions, recommendations are made by those who show up.

For now, we’ll leave you with this hypothesis: “If corporate reporting were redesigned in such a way that stakeholders are able to gain access to everything they need – no more and no less – then public companies will be more effective not only at demonstrating the value their companies create but also at delivering useful information to the market, which will in turn be more effective at making investment decisions.”

The next question, then, is arguably the most important:

“How are we going to do it?”
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Designed and produced by the Deloitte Design Studio, Canada. 17-4954H