# Corporate Reporting
## A Useful Tool for Business Decisions

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## Why Corporate Reporting?

The traditional task of the Professional accountants in business is evolving. The governance requirements are increasing, more regulations are being put in, and more emphasis is placed on documentation now, all of which is perceived by the business community as restrictions on the opportunity for expanding businesses.

The rising concerns of the stakeholders (particularly investors) on transparency and accountability has increased the focus, on both the role of the Board and its effectiveness in executing its responsibilities. Today Boards are under intense scrutiny from shareholders, regulators, politicians, media, employees and other stakeholders. When things go wrong, directors are in the line of fire, which is why directors have to focus on discharging their responsibilities thoughtfully and thoroughly.

The Organization for Economic Co-operation and Development (OECD) Principles of Corporate Governance (2004) stated:

> *"The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company"*

In Deen e Islam, our life is all about deeds and performance in this world, resulting in rewards and punishments (JAZA and SAZA) in the after life. The day of resurrection (Qayamah) would be day of judgment, when our deeds would be evaluated based on a report of what we did in our life. The life of corporations can be taken with the same analogy; similar to people going through their individual struggles.

Modern corporations have to follow similar rules – its deeds in the form of performance will earn it kudos and if they are according to the Shariah Barakat will fall on them.

The term "Corporate Reporting" refers to the presentation and disclosure of business transactions in a financial statement. Corporate reporting has never been easy, especially these days, with endless stream of new regulations and requirements coming up on a regular basis.

## Is it Legally Required to Make Annual Report?

It is interesting to note that there is no specific law requiring an entity to produce and publish annual report, however, there are various statutes, authorities and best practices that require the contents embodied in it.

According to the International Standard on Auditing (ISA) 720 the Annual Report is referred to as "An entity ordinarily issues on an annual basis a document which includes its audited financial statements together with the auditor's report thereon. This document is referred to as the "annual report".

## Auditor's Duty for Other Information

The auditor has no specific responsibility for determining whether or not 'other information' in Annual Report is properly stated or not. However, the auditor has to go through 'other information' because credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information. Under the Code of Corporate governance the auditors carry out a review of "Statements of Compliance with Best Practices of Code of Corporate Governance" (CCG) which is in a way a type of assurance on Other Information.

As per ISA 720 the other information includes:

- Report by management or those charged with governance on operations;
- Financial summaries or highlights;
- Employment data;
- Planned capital expenditures;
- Financial ratios;
- Names of officers and directors and
- Selected quarterly data.

## Is IFRSs a Good Tool for Decision Making by Operational Management?

IFRSs and Code of Corporate Governance are important tools for promoting transparency and accountability in the Corporate Reporting. Financial disclosures have increasingly improved through provisions of IFRSs, resulting in to improved transparency for the stakeholders, despite the fact that operational management still prepares a different set of management accounts for the purposes of their decision making.

Annual Report is one of the important medium through which stakeholders obtain knowledge about a company for their economic decision making. Other information in the Annual Report helps external stakeholders to help make their economic decisions. Annual report tells how well the company did financially and operationally and explains the scope of its business mission and management philosophy. The Annual Report should be such that the reader can see inside-out of the company not only the positive aspects but also the negative performance.

## What Code of Corporate Governance says for Annual Report?

Corporate and Financial Reporting Framework of the CCG requires directors to annex the following statements with the Directors' Report, prepared under Section 236 of the Ordinance:

- The financial statements, prepared by the management of the company, present its state of affairs fairly, the result of its operations, cash flows and changes in equity;
- Proper books of accounts of the company have been maintained;
- Appropriate accounting policies have been consistently applied in preparation of financial statements and accounting estimates are based on reasonable and prudent judgment;
- International Financial Reporting Standards, as applicable in Pakistan, have been followed in preparation of financial statements (any departures there from has been adequately disclosed and explained);
- The system of internal control is sound in design and has been effectively implemented and monitored; and
- There are no significant doubts upon the company's ability to continue as a going concern.

CCG requires that 2/3 directors should be non executive. In my view, it is not logical to bound Non Executive directors to certify and take so much exposure and liability. In few countries these confirmations are expected from CEO and CFO under a separate statement called Responsibility Statement.

The CCG also requires, wherever necessary the following information to be annexed to the Directors' Reports:

a. If the company is not considered to be a going concern, the fact along with the reasons;

b. Significant deviations from last year in operating results of the company and reasons thereof;

c. Key operating and financial summarized data of last six years;

d. If the company has neither declared dividend nor issued bonus shares for any year, the reasons thereof;

e. Where any statutory payment on account of taxes, duties, levies and charges is outstanding, the amount together with a brief description and reasons for the same;

f. Significant plans and decisions, such as corporate restructuring, business expansion and discontinuance of operations, shall be outlined along with future prospects, risks and uncertainties surrounding the company;

g. A statement as to the value of investments of provident, gratuity and pension funds, based on their respective audited accounts;

h. The number of board and committees' meetings held during the year and attendance by each director;

i. The details of training programs attended by directors;

j. The pattern of shareholding with the aggregate number of shares held by:

   I- Associated companies, undertakings and related parties (name wise details):

   II- Mutual funds (name wise details);

   III- Directors and their spouse(s) and minor children (name wise details);

   IV- Executives;

   V- Public sector companies and corporations;

   VI- Banks, development finance institutions, non-banking finance companies, insurance companies, takaful, modarabas and pension funds; and

   VII- Shareholders holding five percent or more voting rights in the listed company (name wise details).

Above are not necessarily or compulsorily required because it says "wherever necessary", therefore I suggest SECP to make them as a part of annual report instead of making it as a part of Directors' Report so that the responsibility remains with the Operational Management, CFOs and & CEOs. In my view it is practically difficult to get approved these disclosures from BOD particularly when time is short in finalizing statutory accounts and preparation for BOD meeting.

Although above disclosures are recommended for

directors' report, but the CCG is silent about the term 'annual report' and its contents, however at some places it specifically requires to disclose in annual report. For example:

- Names of the Executive, non executive and independent director(s);
- Details of the aggregate remuneration separately of executive and non executive directors including salary/fee, benefits and performance linked incentives etc;
- Names of members of the committees of the board; and
- All trades in the shares carried out by its directors, executives and their spouses and minor children to be reported in Annual Report.

## Investors' View

Stakeholders especially investors equate high quality annual reports with high quality management.

The financial statements prepared under IFRS are not, sufficient to meet the needs of investors to assess the quality and sustainability of corporate performance. The current reporting status quo is unsatisfactory. Investors are aware of this issue, so are the regulators. The corporate reporting debate is gathering pace worldwide that whether this information should be in the form of legal requirements, guidance or be provided through good practices.

Investors are becoming increasingly vocal about reporting that passes regulatory muster but fails to provide a fully transparent view of a company's health and prospects. The pressure is on for companies to report on a broad set of non-financial measures that can help investors to better judge the corporate performance.

Today companies are eager to put emphasis on balancing the conflicting interests of shareholders and defining the role of independent directors and management on how to avoid decision failure and ensuring effective outcome in boardroom negotiations.

I would like to share few extracts of the speech delivered by Secretary General OICCI Mr. M. Abdul Aleem FCA CEO & General Secretary of the Overseas Investors Chamber of Commerce and Industry (OICCI) at the ICAP - ICMAP BCR Award Ceremony held on October 8, 2012.

> *"The standard of corporate reporting is quite high in Pakistan and is improving further with the passage of time. Quality Corporate Reporting covering all aspects of corporate governance gives a good feel about the legislation in the country to a potential foreign investor. In a 2011 survey conducted among OICCI members, comprising of foreign corporate investors based in Pakistan, the feedback was positive on the quality of corporate governance*

*and positive support extended by regulators like SECP and SBP. However, good investment friendly policies and high level of corporate reporting in itself is insufficient in attracting and retaining foreign investment. What is needed is a consistent and transparent application of policies supported by sound security, energy and other necessary infrastructure. "*

Keeping the concerns of the investors in mind, the corporate reporting should focus on the investor's need which is why many companies have a separate section on their websites for investor relations.

## Donors' View

Donors usually like to ensure that funds donated are utilized properly and for the purpose for which they were donated. I would like to quote here few highlights of the speech delivered by Mr. Nadeem Mustafa Khan FCA Regional CEO of Health Services, Asia Aga Khan University Hospital (AKUH) at the ICAP - ICMAP BCR Awards Ceremony.

*"The annual report doesn't directly cater to the needs of donors. This is where corporations can consider opportunities for fund-raising using this document. No one is propagating that "Cases for Support" become a norm here but the report can touch on areas where donors and other funding agencies can be attracted. And definitely the report should touch on topics of interest for potential donors. After all the report is a statement of the company to the reader particularly the users, the disclosures should have a feel for inspiring "Trust". When trust comes, passions follow and the extraordinary occurs.*

On trust, a famous story told in a book "Freedom at Midnight" about the Quaid-e-Azam speaking at the rally in pre-partition India in English to an audience who barely understood any English. When a reporter asked one of the persons at the rally the reason for his excitement although he could not understand anything the Quaid said, his response was spontaneous "whatever he says, he tells the truth". It is an example of the ultimate trust.

## Lender's View

The corporate report has a unique significance for lenders because they want to see the security of the financing amount sanctioned as well as the timely recovery of loans and markup. The lenders not merely look at cash flow statement & liquidity ratios, but are also interested to see the credibility of the data appearing in the Financial Statements. The perception and purpose of lenders is entirely different form the shareholder. The lender is also interested in futuristic information. Here I would like to quote extract the speech of Mr. Hassan Bilgrami, Past President ICMAP and CEO BankIslami Pakistan Limited delivered at BCR Award Ceremony on October 8, 2012:

*"From the lenders perspective five areas are of great concern namely, the accounting standards, the accounting estimates used, the quality and applicability of the disclosures, business strategy and reliability of the forward looking statements and lastly the code of corporate governance application.*

*We know the accounting rule that where investment in a company exceeds 20 % the equity method is used, whereas practically the investee company has no control on the cash flows of the investee company and there is no bearing on the viability of the investee company but at the same time it distorts the financial ratios. For accounting estimates, if we look at depreciation, the reported useful life of assets are very high in some cases e.g. sugar and textile companies. Borrowing rates are not disclosed with regards to quantum of the borrowings. A good balance sheet can cover all sorts of disclosures but if the underline business strategy is not correct the financial statements are of no value. The competitive positions of the company within the industry and globally or regionally is not reported in annual report.*

*The corporate governance code does not tell us how to run the business, or what the correct succession planning of the business is, or what the segregation between the management and the ownership is.*

*The greatest damage due to the code is that it has diminished the line of ownership and management and needs to be looked upon in light of the local environment. It's very unusual that performance of CFO is evaluated by BOD whereas he/she reports to CEO."*

## Purpose of Disclosure

The principal aim and purpose of disclosing information in the annual report should be clearly defined at the outset of the preparation process. These may include:

- Explain the resources available to the company that help to attain the objectives and how are they managed;
- Describe the principal risks and uncertainties that may affect the company's long-term value or prospects;
- Disclose the significant relationships with stakeholders that are likely to influence the performance of the company and its value;
- Disclose quantified data relating to trends and factors likely to affect the company's future prospects;
- Spell out any uncertainties underpinning forward-looking information;
- Communicate targets relating to those key performance indicators (KPIs) used to manage the business;
- Demonstrate the linkage of other content areas within your reporting to your longer-term objectives and the strategies to achieve those objectives;
- Share the Management's ability to respond successfully to changes in the external business environment;
- Share the corporate values through effective Communication;

## Best Corporate Report Awards In Pakistan

The aim of the Best Corporate Report (BCR) Awards is to encourage and give recognition to excellence in annual corporate reporting. Instituted and presented for the first time in 2000, BCR Awards seek to promote corporate accountability and transparency through the publication of timely, informative, factual and reader friendly annual reports. The details are available on ICAP website at:

http://www.icap.org.pk/web/links/0/bestcorporatesustainabilityreportawards.php

This type of competition was initiated by the South Asian Federation of Accountants (SAFA) in 1997. ICAP and ICMAP are members of SAFA Accounting bodies. For the last 12 years the Joint Committee of ICAP and ICMAP has been organizing the BCR award Competition. Significant improvements have been witnessed in Pakistan in presentation of annual reports since then. The disclosures made in annual reports in Pakistan are at par and in some areas better than disclosures made by companies of developed world.

The criteria for judging reports as devised by a subcommittee of the Joint Committee of ICAP and ICMAP and reviewed by it on a regular basis in order to keep pace with the international best practices and the local reporting frameworks. The Criteria not only comprise of mandatory requirements of the Companies Ordinance, the Code of Corporate Governance and IFRS but also encourages to adopt best practice being followed all over the world.

The voluntary disclosures recommended are based on:

- International Auditing Standard on Other Information ISA 720;
- IFRS Practice Statement - Management Commentary prescribed by International Accounting Standard Board. (The Management Commentary is a narrative report accompanying, but not part of the financial statements. It is recommendatory but not mandatory. It is not IFRS);
- Best Practices around the world; and
- Experience and intellect of the BCR Committee Members which include representatives of capital market, audit professionals and operational managers.

## Eligibility to Participate

Till 2011 Annual Reports containing Auditors' Report any qualification/ disclaimer of opinion /adverse opinion or emphasis of matter (EMP) paragraph were not considered for this competition. Exemptions were given to those reports where EMP was due to situations which were beyond management control. From 2012, all Annual Reports are now considered for this competition; however, annual reports not containing a clean audit report would be eligible subject to a deduction of maximum of 5 marks.

## Forward Looking Information

From 2012 a new item has been added to the reporting requirement which is very significant from the point of view of all external stakeholders particularly capital market i.e. forward looking information. It requires that "Forward looking information in narrative or quantitative form including projections or forecasts about known trends, uncertainties or the other factors that could affect the entity's liquidity, capital resource, revenues and the results of its operations, and explanation as to how the performance of the entity meets/exceeds or why it fell short of forward-looking disclosures made in the prior period.

Companies worldwide are increasingly being encouraged to place an emphasis on providing a more forward-looking orientation in their reporting whether through regulatory requirements, guidance or evolving good practice.

Some argue about need of futuristic information and show concerns that the publication could compromise competitive advantage as one may have to provide potentially competitively-sensitive information and that the quality of information provided could provoke legal and regulatory sanctions. Others ask question "does this mean that we have to publish profit forecasts?"

If we look at our capital market, it moves up and down based on future expectations. For example, let's see P/E ratio of Engro Food, it is about 25 to 30 whereas average P/E of our Capital Market is 8. The reason of its high P/E is that investors give too much weightage to forecasted revenues as the historic data is not useful for future investment decisions. The reporting of Risk Management is also a step in same direction of guessing futuristic scenario.

## Seven Pillars of Effective Communication

PWC Guide issued in 2007 suggests that forward-looking information can be provided without specific reference to profits, looking instead to the broader picture of the company shown by contextual information. It also suggests following seven pillars for effective communication of the future which will be providing investors with the forward-looking orientation increasingly demanded worldwide:

1. Explain the resources available to your company that help to attain your objectives and how they are managed.
2. Describe the principal risks and uncertainties that may affect your company's long-term value or prospects.
3. Clarify the significant relationships with stakeholders that are likely to influence the performance of your company and its value.
4. Provide quantified data relating to trends and factors likely to affect your company's future prospects.
5. Spell out any uncertainties underpinning forward-looking information.
6. Communicate targets relating to those key performance indicators (KPIs) used to manage your business.
7. Demonstrate the linkage of other content areas within your reporting to your longer-term objectives and the strategies to achieve those objectives.

## Voluntary Disclosures

Other important voluntary disclosures which are not specifically required by the law in Pakistan or by IFRS, but ICAP-ICMAP BCR Criteria require entities to include the following information:

1. Stakeholders' Information requires 6 years data for Cash flow statement, Vertical and Horizontal analysis and Ratios. (It is to be noted that while CCG doesn't suggest any specific ratios, it only requires KEY OPERATING and FINANCIAL DATA). The Vertical and Horizontal analysis provided in our local reports is unique and not usually found in developed countries. These are very simple tools for analyzing financial statements.
2. Comments on 6 years results of the analysis carried out through ratios, vertical and horizontal analysis and summary of cash flow. In some countries it is often reported under the head of Business Performance.
3. Risks, including strategic, commercial operational and financial risks, Plans and strategies for mitigating these risks and potential opportunities; and the significant relationships that the entity has with stakeholders, how those relationships are likely to affect the performance and value of the entity, and how those relationship are managed properly.
4. Description of energy saving measures taken by the company during the year and how the company is planning to overcome the escalating energy crisis
5. Description of the entity's most significant resources, including an analysis of liquidity, cash flows, financing arrangements, human capital, capital structure including inadequacies in the capital structure and plans to address such inadequacies, significant changes in financial position, liquidity and performance compared with those of the previous period.
6. Investors' relation section on the website of the company.
7. Encouraging timely authorization of Financial Statements by Board of Directors within 30 days, whereas companies are required to hold AGM in 4 months.
8. Organization Chart with functional and administrative reporting.
9. Profile of Directors and their engagement in other companies/ entities as CEO, Director, CFO or Trustee
10. All members of Audit and HR Committees to be non-executive Directors, (whereas for HR committee, the code requires *majority* non executive Directors preferably one independent director)
11. CEO performance review

**For the year 2013, following voluntary disclosures are included in the criteria:**

1. Strategy to overcome liquidity problem and the company's plan to manage its repayment of debts and recover losses
2. Key sources of estimation uncertainty
3. Efforts made to mitigate the adverse impact

of industrial effluents by adapting techniques, creating awareness and providing training etc. to the surrounding communities.

4. Preparation of Cash Flow Statement based on Direct Method is encouraged.
5. Analysis of variation in results reported in quarterly accounts
6. Video presentation of CEO placed on company's website detailing financial position and performance of the company, major products launched, projects accomplished during the year and planned for next year including an overview of future prospects of the company
7. Policy and procedure for stakeholders' engagement and the frequency of such engagements during the year (both formal and informal). Dialogue may be with:
    a. Institutional Investors
    b. Customers & Suppliers
    c. Banks and other lenders
    d. Regulators
    e. Media
8. SWOT Analysis
9. Share Price Sensitivity Analysis
10. Policy for safety of records of the company
11. Disclosure of Policy for actual and perceived *conflicts* of interest relating to members of the Board of directors and a disclosure that how such a conflict is managed and monitored
12. Disclosure of IT Governance Policy
13. Whistle blowing policy and procedures enabling staff to raise concerns about possible improprieties in financial and other matters, without fear of reprisal, in confidence, and a disclosure of the number of such incidences reported to the Audit Committee during the year
14. Report of the Audit Committee
15. Risk and Opportunity Report

## Disclosures that later became part of the CCG

It will not be wrong to say that ICAP and ICMAP are ahead in Corporate Governance reforms: BCR criteria had already incorporated the following few reporting requirements into their criteria for Best Report Awards 2012 which later were also included in CCG 2012:

- Risk, plans and strategies for mitigating these risks and potential opportunities;
- Future prospects;
- Human resource management policies including preparation of a succession plan;
- Salient features of the Audit Committee's and other Board Committees' TOR and attendance in meetings held;

- All members of Audit and HR Committees to be non-executive Directors (for HR committee code requires majority non executive Directors); and
- Criteria to evaluate Board's performance and Formal orientation at induction and regular continuous professional development Programs of BOD.

## Few Concerns

Despite moving rapidly towards transparency and disclosures there are still certain concerns which are discussed below:

### a. Go Green and Sustainability

From the point of view of Go Green and Sustainability, there are apprehensions that use of paper; printing and other associated cost has significant environmental impacts. Paper usage contributes towards deforestation (cutting trees – trees are the main source of absorbing carbon dioxide), air pollution (Greenhouse gases are emitted during paper manufacturing), water usage in paper manufacturing and water pollution (discharge of waste water during paper manufacturing), paper waste and energy consumption in paper manufacturing and transporting. Printing industry uses excessive amount of energy from heating and lighting to powering equipment and final delivery, energy is used at all stages of the printing process.

### b. Paper Less Environment

Growing awareness of paper less environment, many feel that although annual report is a means of disclosure, users should use web and the website should become the greater focus in the present and in near future.

### c. Off Balance Sheets Items

The readers of Corporate Reporting need to appreciate the impact of Off Balance Sheet items. These items are assets, or liabilities or financing activities that are not reported in Financial Statements. Examples of off balance-sheet items include leases, separate subsidiary companies or contingent liabilities (such as a letter of credit). They may also involve loan commitments, futures, forwards, and other derivatives.

d. **Sustainability Reporting**

CCG requires BOD to consider Report on CSR bringing a new era in the eve of corporate reporting in Pakistan. This initiative encourages the corporate world to focus beyond single bottom line financial performance to triple bottom line:

- economic;
- environmental; and
- social performance.

A separate award from 2010 is announced by the Evaluation Committee. The Criteria of this award is based on Global Reporting Initiative (GRI), an international standard on Sustainability Reporting which has also been adopted by the International Federation of Accountants (IFAC).

Sustainability Reporting in India has been made mandatory for all listed companies for year ending Dec 31, 2012. In Pakistan SECP has also issued draft guideline and sought comments on Sustainability Reporting from Stakeholders. It is expected that a round table would shortly be organized by SECP to take views of variety of stakeholders.

## Way Forward

There is still a long way to go, for additional information. The BCR Committee is contemplated to consider following criteria for 2014:

i. Summarized financial information of quarterly/half-yearly reports;
ii. Product-wise data both for sales value and sales volume;
iii. Directors' report also in Urdu language;
iv. Availability of financial information in XBRL;
v. Details of term loans;
vi. Disclosure of date of meeting of Analyst briefing.
vii. All members of the audit committee to be financially literate and at least one member to have expert knowledge of finance and accounting;
viii. Head of internal audit to have direct access to Audit Committee; and
ix. Audit Report should also cover the following:
   a. Statement on Audit Committee's review to ensure that internal controls are well conceived properly administered and satisfactorily monitored;
   b. Statement to indicate audit committees role in ensuring compliance with Laws, Regulations and timely settlements of Statutory dues;
   c. Statement on Audit committee involvement in selection of appropriate accounting policies that are in line will applicable accounting standards and annual review;
   d. Statement of Audit Committee involvement in the review and recommend to the board of directors, annual and interim financial releases;
x. Statement of Executive Director's responsibility to establish appropriate system of internal control and that the Director's have reviewed the adequacy of the system of internal controls;
xi. Establishing effective anti-fraud programs and controls;
xii. Disclosure of general description of the company's policies and practices relating to social and environmental responsibility of the entity; and
xiii. Disclosure of company's policy on ensuring participation of shareholders in the Annual General Meeting and providing reasonable opportunity for the shareholder participation in the AGM.

The members are encouraged to send their recommendations.

## Recommendations to SECP

In order to further strengthen transparency and accountability, SECP may include corporate reporting criteria of ICAP and ICMAP as a part of CCG.

## Conclusion

ICAP and ICMAP have indeed taken a major step in the corporate reporting in Pakistan. The Capital Market should appreciate the importance of Corporate Reporting over the past decade. They should understand that it is an opportunity to inspire all stakeholders particularly potential investors, lenders and donors, and use of the corporate report as a weapon of good will and building trust-that will advance Pakistan's image.

***Note:*** *The views expressed herein are those of the author's and do not necessarily reflect the views of the Institutes.*

## Profile of the Author

*Abdul Rahim Suriya FCA, FCMA is the Past President of ICAP and an elected member of the Council for last 16 years.*

*He has over 27 years experience in Accounting, Auditing, Corporate Finance and Operational Management, is running his own audit firm A. R. Suriya & Co., Chartered Accountants for last 5 years, prior to which he served 18 years in Spencer Pharma including last 5 years as an Executive Director. He was a member of International Accounting Education Standard Board from 2002 to 2008. He is currently a SAFA Board Member. He is the Chairman of Best Corporate Report Award Evaluation Committee of ICAP and ICMAP and CPD Committee, ICAP. He has also authored a book on "A Guide to Business Decision Making" in 2008. He is also a visiting faculty at IBA, Karachi. Besides that he is a professional trainer on the subject of Finance for Non-Finance Executives. He has recently presented paper "Corporate Reporting – a means of Corporate Governance and Transparency "at CPD programmes in Lahore, Faisalabad, Islamabad and also presented the same paper in SAFA summit held in Lahore on November 10, 2012. The presentation may be downloaded at http://arsuriya.com/file/code-corporate2012.pdf*