

Narrative reporting and non-IFRS measures

Audit Committee Questions
Audit Committee Institute

The integrity of the financial statements and the systems generating the information reported in the financial statements receives a lot of attention from management, internal audit and external audit. The same is not always true for non-IFRS measures and various narrative reporting disclosures provided to investors and other stakeholders.

Assurance
asymmetry

Pressure to
meet analyst
consensus

Understanding
investor needs

Transparency
and
comparability

Tone,
balance and
consistency

Audit committee oversight essentials ...

It is essential for the audit committee to consider and assess the assurance asymmetry between the financial statements and any other information provided to investors and stakeholders – such as non-IFRS measures and narrative reporting pieces included in management's commentary sections, earnings releases, analyst presentations, etc.

Management should have processes in place to ensure the relevance and probity of all such financial information. The audit committee has an important role to play in ensuring such processes are fit for purpose and working as intended. ASX corporate governance guidelines place responsibility on the board for all corporate reporting, not just the financial statements. Also, ASIC has issued guidance on the disclosure of non-IFRS financial information (RG230).

The audit committee should seek to ensure that management considers the materiality of all information reported and assesses whether the assurance received over such information is appropriate in the circumstances. It is a reasonable assumption that if information is of value to investors then it should be reported to them and, conversely, if a company reports information then it is on the

basis that it believes that the information is of value to investors. In either case, there should be an expectation that such information is accurately reported and that it is not otherwise misleading.

Audit committees also have a role to play in ensuring that the tone of all the reported information is appropriate and that corporate reports, viewed in their entirety, are fair, balanced and understandable.

The factors an audit committee should consider when carrying out its oversight role in terms of narrative reporting and non-IFRS measures are, in many respects, very similar to those considered in the context of the financial statements. However, audit committees might specifically seek to assess:

- What information requires disclosure?
- The appropriate use of key performance indicators (particularly non-financial key performance indicators) and non-IFRS measures.
- The level of assurance needed for each type of disclosure or reporting.
- The tone, balance and consistency of reporting.

Key questions for audit committees to consider:

What information requires disclosure?

- Has management carried out appropriate consultation and investigation to fully understand regulatory, investors' and other stakeholders' needs?
- Is there a process in place to apply relevant materiality thresholds to determine whether certain information should or should not be disclosed in the annual report?
- Has the company's narrative reporting sections and its use of key performance indicators been properly compared to those of its peers and best practice pro-forma reporting to ensure that no significant gaps and/or irrelevant disclosures are present in any financial information?

Key performance indicators and non-IFRS measures

- Do all key performance indicators have meaningful names and is their context properly explained?
- Are any key performance indicators and non-IFRS measures clearly defined and reconciled to the most relevant IFRS amount?
- Are any adjustments to key performance indicators and non-IFRS measures clearly explained, together with the reasons why they are being made?
- Are comparatives presented, disclosing key performance indicators and non-IFRS measures consistently over time?
- Do all the non-IFRS disclosures comply with the ASIC Regulatory Guide 230?

What level of assurance is needed?

- Has management assessed the materiality of all information reported to investors taking into account the information most valued by investors and regulatory requirements?
- Is the level of assurance commensurate on management's assessment of materiality?
- Are effective processes and internal controls in place ensuring that information disclosed is complete, accurate and consistent?
- Are effective communication channels and processes in place by which relevant, timely and accurate information is brought to the attention of those responsible for preparing financial reporting disclosures?
- Is the extent of assurance provided by the internal and/or the external auditor on the narrative sections of the annual report appropriate in the circumstances?

Tone, balance and consistency

- Is the language used precise and does it explain complex issues clearly? Is jargon and boilerplate avoided?
- Is appropriate weight given to the "bad news" as well as the "good news"?
- Is an appropriate level of aggregation applied and tables of reconciliations supported by, and consistent with, the accompanying narrative?
- Are important messages, policies and transactions highlighted and supported with relevant context and not obscured by immaterial detail?
- Are cross-references used effectively and is repetition avoided?
- Are the narrative sections consistent with the (basic) financial statements reported?
- Are all significant matters appropriately disclosed and explained so that there are no hidden surprises?
- Are significant changes from the prior period, whether matters of policy or presentation, properly explained?
- Does the information reported enable readers to properly understand the company's performance, strategy and risk appetite?
- Are principal risks that the board is concerned about properly disclosed and explained?

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