Integrated Reporting & the Future of Auditing

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Disruptive technologies and innovations have caused dramatic changes throughout numerous industries, most notably in the expectations and requirements of businesses operating on a global scale. Additionally, requirements from both financial and non-financial stakeholders continue to increase in both complexity and time sensitivity; users of organizational data require that it be produced and distributed in a timely and cost-efficient manner. In order to produce and report the information required by increasingly important non-traditional stakeholders, accounting and financial professionals must evolve and adapt to a rapidly changing and evolving marketplace. Systems and processes associated with auditing and forensics must be improved upon and integrated into the real time requirements of the market. In essence, accounting and finance must evolve into a more strategic function, and embrace a role as a strategic business partner.

INTRODUCTION

The global business landscape has been, some would argue, irreversibly disrupted and continues to be affected by several mega trends that do not appear to be diminishing. Entire industries and organizations have emerged to fill and address the voids in current market offerings. Examples routinely cited include Tesla, Facebook, Twitter, and the creation of touch-screen phone and computer industry that was spearheaded by Apple. In addition to competitive pressures, it is important to also remember that the global regulatory environment has also become more complex and multi-faceted following the financial crisis of 2007-2008. Regulators, particularly of firms operating in finance and consumer facing organizations, have become increasingly interested and opinionated concerning ongoing operations, future performance, and financial results. Organizations and individuals alike, have been tasked with reporting on, and managing, the expectations of a wider range of stakeholders. These parties include shareholders, environmental groups, regulators, consumers, and even partner corporations that are often utilized as partners. That said, it is interesting to note that, despite that rapidly evolving nature of the business marketplace, and the effect that such changes have had on business at large, the internal audit function has remained relatively unchanged. This places organizations and accounting professionals at a disadvantage in the marketplace. This research piece reviews the current academic literature focusing on the evolving and changing nature of the accounting function and proposes a framework for developing a more strategic and engaged accounting function. Accounting and financial professionals must become more involved in the managerial decision making process, and a broader audit function is central to this strategic and engaged accounting function.

A NEW MODEL OF BUSINESS

Prior to drilling deep into the specific actions and steps required by organizations to adapt to a new business environment, it is important to understand and analyze what changes are driving this change. Put simply, doing business as usual, in a traditional manner, is not a methodology and managerial practice that will generate continuing success. As both shareholder and non-financial stakeholders become increasingly interested, not only in current performance, but in future operations and directions of the organization, it is critical that business respond. Several competing methodologies and types of business organizations have arisen as possible solutions to incorporate the needs of shareholder groups into business management and reporting, and a specific reporting framework appears to represent an effort among existing corporations to address these needs.

Benefit and Flexible Purpose Corporations

Benefit corporations, as well as flexible purpose corporations, offer a way in which business leaders can meld together traditional financial metrics and goals with longer-term, sustainability-oriented, and strategic objectives of the organization. One high-profile example of organizations that have embraced the benefit corporation model include Ben & Jerry's, as well a multitude of other organizations, and a full list of organizations embracing this business model can be found in the *B Corp Best for the World List* www.bcorporation.net. Additionally, and arguably more importantly, the b-corporation model is becoming increasingly embedded within the legislative and regulatory framework. At the time of this writing, over 35 states have legislated the concept of a b-corporation into law. The key essence, and distinguishing feature of a b-corporation revolves around how specifically goals and objectives are linked to sustainability and built into operations and evaluation.

One key issue with sustainability and other non-traditional goals associated with management and performance, involves the way in which such goals are pursued. Often, such goals are added-on, inconsistently enforced, and generally not regarded as core to organizational goals. B-corporations, in contrast to this approach, embed and align such longer-term goals directly into the corporate charter and evaluative tools used to engage and rank organizational performance. Specifically, the business question is whether or not the emergence of benefit corporations and other such alternative business models will influence business decision making in a substantive manner (Andre, 2012). Generally, these specific goals and objectives are also embedded within internal and external reporting, i.e., the reporting and monitoring of such metrics and objectives becomes equally as important as financial results. Such integration represents a convergence of sustainability, corporate governance, and accounting professionals. Interestingly enough, it appears that organizations that have embraced a more comprehensive or holistic model of business performance and evaluation achieve superior financial results.

These benefits are not exclusively accrued to organizations that embrace the b-corporation model, or any of the other flexible purpose, or "grey," corporate models that have debuted in the marketplace since the financial crisis. Overall, it is clear that organizations that have embraced the so-called conscious capitalism model have achieved superior financial results versus both the marketplace at large as well as competitors (Simpson, Fischer & Rhode, 2013). This linkage between academic theory and marketplace performance demonstrates that not only is the emergence of stakeholder theory prominent in academic studies, but it also appears to be demonstrating that it is at home in the market. That being said, is it important to understand that a critical step in the development and proliferation of an more comprehensive financial reporting process is the development of a standardized template. That template appears to be integrated financial reporting.

Integrated Financial Reporting

Integrated reporting (IR) has been a development several years in the making, and this framework has been embraced by organizations, institutions, and shareholders in a wide variety of firms and industries. The broad-based implementation appears to represent the favorable nature in which the market views the development and spread of IR. Such a methodology, that is different and inherently more complex than current financial reporting, requires that organizations embrace changes and developments both from an internal point of view and as an external construct. It links together such disparate trends as corporate governance, sustainability, strategic thinking and planning, and a more proactive and engaged finance and accounting function.

Specifically, the rise of integrated financial reporting represents an opportunity for accounting and finance professionals to leverage existing skill sets and competencies to play a more strategic role in organizations. Drilling down to the specific concepts that are most applicable to accountants and other financial professionals, it appears that information technology, quantifying sustainability, ranking governance, and creating a system of reporting that can be applied to a broad range of activities reside within the areas of strength for accounting professionals. Integrated financial reporting, as defined by Bendt, Bilolo, and Muller (2014), represents a new frontier in how organizations interact with both internal and external shareholders, and accounting and finance professionals must seize the emerging opportunities in the marketplace. Governance, represented by Governance Metrics International, is clearly becoming an increasingly important aspect of how organizations are judged and evaluated in the marketplace, and it is imperative that financial reporting and accounting professionals integrate such shifts into work products and services. Put simply, stakeholders and users of financial information expect organizations to report both on current operations as well as on future prospects in a real-time manner. Additionally, it is critical that, while organizations are reporting on a more real-time basis, quality does not suffer in the process, and such a conundrum presents an opportunity for accountants and financial professionals.

TRENDS INFLUENCING THE FUTURE OF AUDIT

Trends and paradigms related to business models will, undoubtedly, have an effect on financial reporting and operations, and there are two trends in particular that appear to be especially important as they relate to auditing an forensics. Sustainability, which until relatively recently was considered a rather amorphous concept related to regulatory concerns, is increasingly becoming a more important aspect of business and managerial decision making. Simultaneously, with the increasing usage of technology in every aspect of business operations, it appears that analytics, especially analytics that enable managers to look forward, will play an ever-increasing role in the strategic planning of an organization. Both trends will shape, not only business strategy at large, but also the role of the accounting function within organizations.

Sustainability

Lastly, and perhaps most important of all, is the dual rise of sustainability and analytics as core competencies for both organizations as well as for financial professionals. Sustainability, moving from somewhat of an add-on measure, or something that is merely to comply with regulatory requirements, to a full-fledged business theme, represents both opportunities and challenges. Obviously, organizations that operate and employ sustainable measures have reduced carbon footprints and lower energy costs, both of which help reduce the likelihood of fines and other penalties from regulators. A less apparent benefit, however, is the competitive advantage that arises from embracing a more ecologically oriented and sustainable business model. Akin to organizations such as Wal-Mart and SouthWest that have achieved positions of market dominance due to a low cost model of operations, it is reasonable to foresee that organizations with lower costs, over time, might very well be able to translate sustainability into a competitive advantage. That said, there are significant challenges that lay ahead of such initiatives the least of which relates to, specifically, to track and evaluate such measures. Building and reporting on sustainability standards is a unique opportunity for organizations to both report on innovative information as well as more specific ways in which accountants can integrate such measures into financial reporting (D'Aquila, 2012). Since every organization is unique, and every industry has its own set of competitive pressures and forces, it is critical that financial professionals and business decision makers be equipped with the correct information. This, among other trends, appears to have directly led to the increase in important of analytics as a business tool.

Analytics

Analytics have been long recognized as powerful tools that enable management to analyze past performance, benchmark against the competition, and assist in planning for the future. Until fairly recently, however, the utility of analytics and other statistical analyses was limited to breaking down historical information. Financial statements, the core of the accounting and finance professions, are backward looking and can be 6-12 months out of date by the time they are published. Linking together internally generated information, related to both operations and external financial reporting, is a clearly defined market need, as well as an area in which accounting professionals can leverage existing skills (Cokins, 2014). Specifically, there is a gap between information that is currently generated and analyzed by organizations, and what types of data are published to external stakeholders. This gap, between the information actually occurring and being analyzed, and when the data was reported upon and made available to end-users, presents an opportunity for both organizations and accounting professionals. Harnessing the advances in technology, it is simpler and faster to analyze information in real time, construct and present summarizations of the raw data flowing into and out of the organization, and use such information to make timelier and better informed business decisions.

THE FUTURE OF AUDITING AND FORENSICS

Auditing and forensic accounting have long played an important role in both the accounting field and in the area of business management generally. Auditors provide reasonable assurance that the financial statements issued by organizations are prepared and presented in adherence with generally accepted accounting principles (GAAP). Forensic accountants, on the other hand, play a critical role in both due diligence as well as in divorce, bankruptcy, and other civil matters. In light of the changes outlined above, as well as market forces linked to the need for real-time data and information, it is clear that both subsets of the accounting profession need to evolve.

A More Proactive Audit Function

Sample sizes, stratifications, and random selections have long been the hallmark of audits, both internal and external. Based on these quantitative methodologies, coupled with testing of internal controls, tracing of internal documents, and staff interviews, auditors have formed an opinion on both the effectiveness of internal controls as well as the likelihood of material misstatements. In light of the two trends mentioned previously, sustainability and analytics, it is clear that such an approach cannot be brought forward into the future. With an amorphous concept, such as sustainability initiatives, with a wide variety of metrics and guidelines, it is critical to obtain as much quantitative and verifiable information as possible. Linked to this is the increased usage of analytics software throughout organizations – why should auditors be restricted to a sample selection when, via learning and leveraging the appropriate software packages, it may be possible to test virtually every transaction? As both business decision makers and external stakeholders demand and expect information to be available in a real-time manner, it is imperative that the audit profession keep pace with the changing marketplace.

Building on this point it is important to recognize that the internal audit function is an integral part of the internal management accounting function, and that in order to produce the timely and quantitative information demanded by stakeholders, the entire accounting team must be engaged. Internal audit requires the creation and tracking of quantitative metrics, and it is logical to conclude that internal audit and forensics should play a more active role in managerial decision making. Tracking, developing, and updating metrics on a real-time basis is a goal that involves the entire internal finance and accounting function, and internal audit, in addition to performing periodic tests to detect fraud and misstatements, should also play a role in developing metrics to make such testing simpler and more reliable. Regardless of the specific steps of metrics developed by individual organizations, it is clear that organizations must produce, and verify, larger amounts of quantitative data and deliver it to stakeholders. Involving internal audit in this process will ensure a more consistent work product, simpler and less contentious external audits, and a more dynamic accounting function overall.

Continuous Fraud and Forensics Testing

Leveraging, once again, the growing importance of analytics in business decision making, it is apparent that forensic examination and fraud investigation need not be limited to periodic, and limited, time frames, and scopes. If technology enables management to monitor internal operations on a continuous and on-going basis, it is also possible, and reasonable, for forensic accountants and investigators to have access to information on a real-time basis. Whether this is enabled using an existing feed from existing ERP and risk management systems, the installation of new systems, or the purchase of specific data tools is less important than the end result of the initiative. While cost, and cost benefit analyses are always a factor concerning new projects or ideas, it is important to realize both the benefits of doing so, as well as the potential costs of not providing accounting professionals with the tools they need to perform duties and analyses in real time. Forensic analysis and fraud examination, in addition to being of assistance in resolving matters related to taxes, business bankruptcy, and asset valuation, can also be of assistance in evaluating internal operations as well as potential business partnerships or mergers. This approach, although somewhat innovative and outside of the traditional scope of forensics and fraud investigators, provides an opportunity for growth for professionals as well as an opportunity for organizations to more effectively leverage existing talents within the organization.

THE PATH FORWARD

The idea of a more vigorous and engaged forensic division of the accounting function, or the creation and development of entire organizations centered on a more engaged subset of the professions is a clear reflection of market forces. In addition, this train of thought is reinforced by existing research and academic literature. Specifically, as it pertains to the value that internal audit systems and forensic professionals can bring to the table, it is important to acknowledge the unavoidable fact that financial statement misstatement and fraud are increasingly acknowledged as risks to both operations and reputation. Interestingly enough, and perhaps most nascent at this time in the marketplace as well as in the existing research, is the role that accounting systems can have in managing the risk of shareholder activism. A more strategic accounting function must, by default, integrate the needs of both internal and external stakeholders in both periodic reporting as well as continuous operations (Nixon & Burns, 2012). In spite of this inherent limitations, it is clear that such a dynamic accounting function is necessary in the rapidly evolving business marketplace. Although shareholders large and small are increasingly supportive and interested in the financial returns generated by activist investors, and many have become well-known market commentators, it is important to understand what exactly activism does to operations. An activist campaign usually beings with an accusation that current management and directors are not allocating capital and personnel to the most lucrative internal projects. At the core of this criticism is, by default, the accounting, finance, and financial information systems.

Activist campaigns of note, during the post financial crisis era, have generated market- moving headlines in organizations such as eBay, Apple, Pepsi, Coca-Cola, and HP. While it is noteworthy that the activist campaigns have appeared to have generated a positive financial benefit, it is also as important to acknowledge that the opportunity cost of engaging with activist investors on a continuing basis is high. Business decision makers who are not engaged in making business decisions, but rather preparing for and meeting with activist investor groups, simply cannot be expected to generate high quality decisions. In that light, it becomes clear that the future for fraud investigation, forensic accounting, and auditing personnel in general need not be limited to merely examining financial statements after the fact. Possibilities for future growth include the need for standardization and metrics within the growing field of sustainability accounting, utilizing the growth in analytics to create and track such metrics, and giving management to information it needs to most effectively manage the business. This convergence provide a clear roadmap for how such professionals can move up the organizational value chain. Important to both the importance

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