ecoDa and Forvis Mazars webinar - 13 November 2024

How do Corporate Governance frameworks influence the quality of corporate reporting in Europe?

SUMMARY NOTE

Speakers:
- David Herbinet - Head of Audit & Assurance at Forvis Mazars
- Anne-Hélène Monsellato, Independent board member
- David Risser, Managing Director at Sodali & Co

Moderator: Béatrice Richez-Baum, Director General – ecoDa

This webinar on Corporate Governance and Corporate Reporting, organized by ecoDa and Forvis Mazars, explored the relationship between corporate governance frameworks and corporate reporting quality. Panelists highlighted the critical role of corporate reporting in ensuring financial stability, investor protection, and supporting the green transition, emphasizing the need for effective governance frameworks across the EU. They discussed the positive impacts that the 2014 EU audit reform had, in particular on audit committee activities. The panelists suggested that the EU focuses on the implementation of existing frameworks rather than introducing new requirements, and called for the development of guidance to clarify the expectations for the monitoring of the effectiveness of internal control over corporate reporting. They noted the importance of board composition and external board evaluation to reinforce the quality of oversight, the need to strengthen the role of internal audit, and agreed that lessons could be learned from audit quality indicators and from regulation in the financial services sector. Finally, they recommended that companies focus on a robust double materiality assessment in preparing for their sustainability reporting, with strong internal controls and internal audits both playing a key role.

This webinar on Corporate Governance and Corporate Reporting, organized in partnership by ecoDa and Forvis Mazars, complemented an external study commissioned by DG FISMA to assess the effectiveness of corporate governance frameworks in relation to corporate reporting quality.

Corporate reporting is crucial for financial stability and investor protection. Starting in 2024, companies will be required to disclose, and obtain assurance on, sustainability (ESG) information in addition to their financial statements. Corporate governance plays a key role in ensuring the robustness and reliability of corporate reporting, alongside statutory audits and supervision.

However, in the EU, there are almost as many corporate governance frameworks as there are Member States, as governance codes reflect the diversity of cultural and economic backgrounds.
Panelists emphasized the importance of quality corporate reporting to improve transparency over value creation and for value protection. It serves as a tool for a successful Capital Market

Union and supports the green transition. Additionally, it enhances trust and transparency, contributing to financial stability and proper capital allocation. Efficient corporate reporting can also help reduce administrative burdens.

The EU corporate governance framework is complex, combining laws, best practices, and "soft law". The varying levels of requirements across the EU result in a diverse landscape, influenced by differences in shareholder rights, stakeholder engagement, and approaches to long-term value creation.

All panelists agreed that the best approach to achieving more harmonized practices would be to first ensure the effective implementation of existing rules rather than introducing new requirements.

All panelists agreed that the 2014 EU audit reform positively impacted corporate reporting, putting an emphasis on the financial statement preparation process, internal controls over financial reporting and external audits, strengthening the independence of statutory auditors, and highlighting the role of the Audit Committee throughout the process. Additionally, for Public Interest Companies, audit regulators are expected to now assess the performance of audit committees.

While such a formalised approach is a useful benchmark, the EU should prioritize the effective implementation of existing EU and national frameworks and establish the right enforcement mechanisms to ensure compliance. This applies to the proper conduct of audit tenders, as well as the pre-approval process of non-audit services in all PIEs. It was considered that the existing EU law provisions which require that audit committees monitor the effectiveness of the company's internal control, internal audit and risk management systems regarding the financial reporting should be clarified with the issuance of guidelines and expectations, to reduce the disparities in application within EU Member States, at a time where in the US and 20 years now, the Sarbanes-Oxley Act introduced a systematic approach to internal controls over financial reporting (applying the COSO framework), covering aspects such as control environment, risk assessment and monitoring functions beyond control activities, with material weaknesses required to be disclosed and the overall assessment being subject to reasonable assurance.

The EU regulation stopped short of requiring an Internal audit function. Internal audit (and internal control functions) often face challenges related to time and resources, and internal auditors may sometimes feel isolated within the organization. Building a trusted relationship between the board and internal audit is essential. Achieving this requires the right skills and talent within the internal audit function.

Effective governance also depends on the practical functioning of boards and audit committees. Board composition and evaluation were identified as key factors for quality oversight. The suitability of board members should go beyond a basic fit-and-proper assessment, incorporating a forward-looking strategic approach to directors' skills and experience. Board members must demonstrate their ability to understand the company's business model and its risks to effectively monitor internal controls. A number of countries have adopted a requirement for regular external board evaluations, including a review of individual directors' contributions. Board composition is closely linked to corporate culture and the ability to constructively challenge management. Both culture and composition of governance form the foundation of a strong internal control framework.

External auditors are currently not required to provide any assurance on the effectiveness of internal control over corporate reporting, even though their audit approach must consider internal control, to varying degrees, as part of their risk assessment for the purpose of their audit. However, their procedures are not sufficient for them to provide any assurance on the effectiveness of internal control over corporate reporting, as it is not systematic and does not cover the full internal control structure. Key Audit Matters could refer to the effectiveness of certain key internal controls but are not used for this purpose in practice. Implementing robust internal controls over information reported directly improves audit quality, helping auditors focus on high-risk areas.

Additionally, Audit Quality Indicators, particularly those focused on individual engagements, can contribute to stronger governance. There are valuable lessons to be learned from the financial sector, where the Senior Manager Certification Regime helps set clear expectations of management, and where trilateral interaction between the auditor, the regulated firm, and the regulator can drive meaningful governance improvements.

Finally, when asked about the European Commission's recent announcement on an omnibus regulation to reduce red tape and reporting burdens, the panelists noted that there might be some confusion regarding the concept of double materiality. It should be made clear that companies need to focus on the issues with the greatest impact, being those that could jeopardize their resilience and operating licence, with appropriate input and oversight from governance to determine which topics are material to the company.

Recording: https://www.youtube.com/watch?v=qdUFc-MYUoA