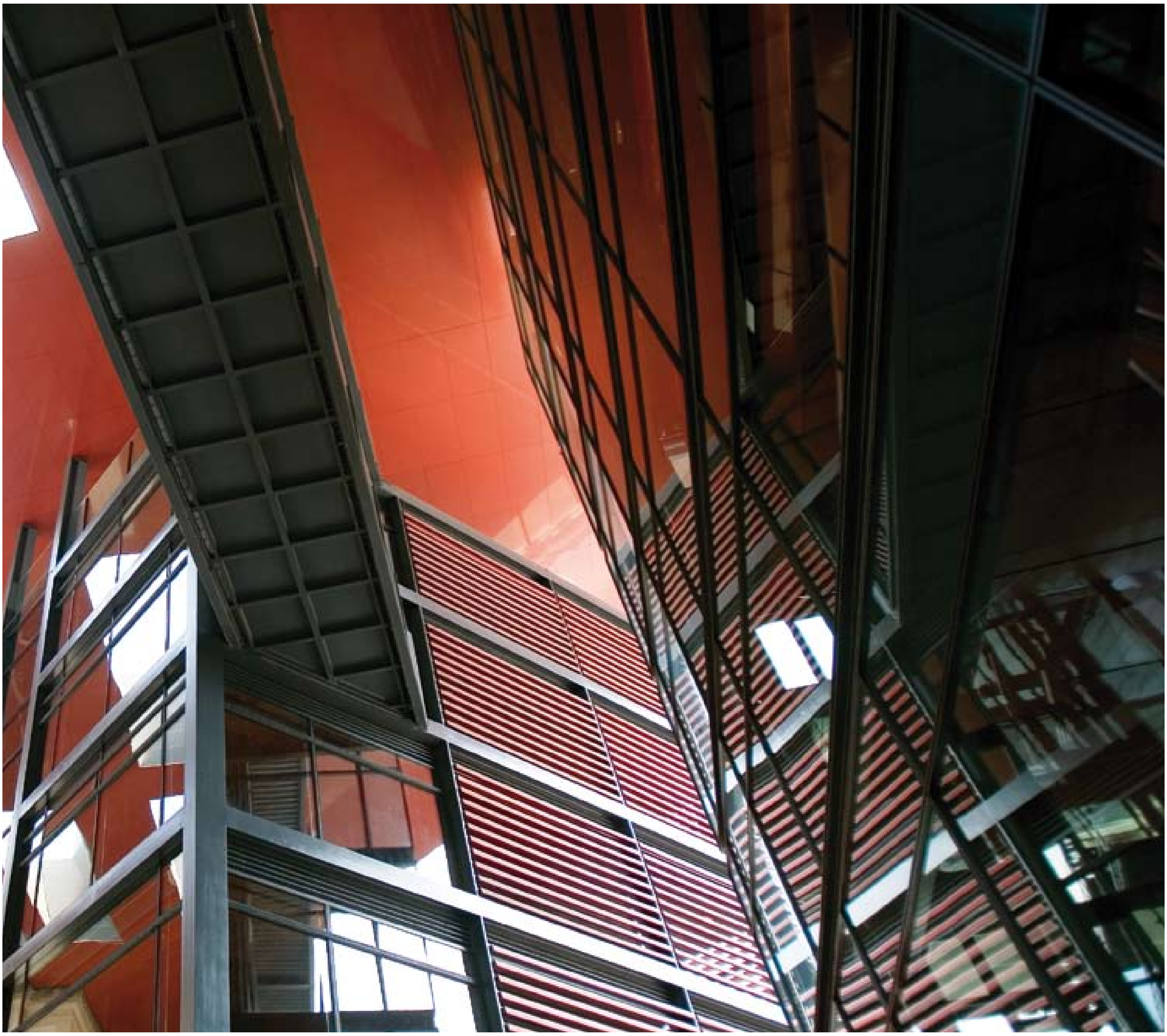
Corporate reporting – a time for reflection

A survey of the Fortune Global 500 companies' narrative reporting

April 2007



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What do companies say?

Fresh from a round of intensive research in the global investor community, a PricewaterhouseCoopers team turned its attention to the key informational reports issued by the world's largest companies – the Fortune Global 500. The team wanted to discover what information those companies release to the public in their primary communications in narrative form. Numbers are critical, of course, but alongside the financial statements issued by companies there is typically narrative around market dynamics, strategy and the drivers of value. What do those narratives actually say? It's a question worth answering. The answer could help both companies and investors.

Key messages

The survey's key messages are simple. Companies do provide what some call 'contextual and non-financial information' about their performance and prospects – but top reporters provide a great deal more than average ones. From the investor community's perspective, there is plenty of room for improvement. From the companies' perspective, enriching their narrative presentations and accompanying metrics offers the opportunity to provide a view 'through the eyes of management' that investors would highly value.

Does that mean creating bulkier reports, with more cost and more effort that may be better applied elsewhere? Our commentaries throughout the survey propose that, while adhering to regulatory requirements, companies have enough latitude to make choices. They can delete routine but superfluous disclosures. They can provide insights and related numbers that management already uses to operate the business. Taking a top-down, investor-centric approach may be the future where corporate reporting is concerned. To that end, it's important to know the broad situation today. That is what you will find in these pages.

Company-investor dialogue

If this survey and others to come from PricewaterhouseCoopers prove effective, corporate executives and senior investors will understand that the future of the corporate reporting framework rests to some real degree in their hands. Standard setters and regulators build that framework. The accounting profession contributes to its development. But companies and investors are fundamental stakeholders in what it is and how effectively it serves its purposes. They need to talk the issues through in a new dialogue. Together they may be able to influence the 21st-century framework through which companies report and investors listen and respond.

PricewaterhouseCoopers, April 2007

Preface: Corporate reporting – a time for reflection

There is significant potential to enhance the quality of companies' reporting by taking a more top-down, investor-centric approach to determining what information is reported externally.

The corporate reporting model has been the topic of a slow debate for a decade or more. That debate is now quickening as a number of factors have made themselves felt – among others, growing resistance to the complexity of financial reporting, the standard setters' closer focus on measurement and the proposed convergence towards a single set of global accounting standards. This survey report offers insights that we believe should colour the debate about the scope of the reporting model necessary to meet the needs of both preparers and users in today's global capital markets and in the digitally enabled markets of the future.

The research effort first focused on assessing the narrative contextual and non-financial information reported by the Fortune Global 500 companies (G500) against a comprehensive information set. This was codified on the basis of PricewaterhouseCoopers' global capital markets research to provide a framework for the key features of many companies and the information needs of investors. Second, the survey addressed the extent to which the G500 reported certain information points cited as important by investors in the research we have conducted on investor needs.

The current reporting model has been dominated for decades by financial information. While financial information is obviously and critically important, it provides only one part of the picture of overall business performance, and has a built-in bias towards recording the short-term results of companies, giving too little emphasis to their longer term value potential. This fact has been understood by both preparers and users of financial information, and most companies and investors now go to significant lengths to capture and analyse a broader information set. Yet in our view the existing model is less efficient than it could be.

The key question posed by the results of this survey is whether preparers and investors can address that inefficiency by developing a better corporate reporting framework which will improve communications, supplement and complement the financial reporting model, and provide a more consistent picture of the key building blocks of performance. Without being overly prescriptive, and allowing for the specific needs of different industries and companies, the result should be capable of assisting the presentation of a cohesive data set which investors value. Advances along these lines, driven by a careful and collaborative process of change, will go some way to address the concern that the current reporting model is in danger of becoming suboptimal.

A broader information set

While the evolution of financial reporting has entered a period of accelerated change, it continues to provide less than the full range of information sought by many investors. Discussions around the basic conceptual framework of accounting and reporting are currently in progress as part of the convergence process, and we should be encouraged by the commitment from all sides to embrace a more principles-based model. While such moves will have a place in any development of the reporting model, there is significant potential to enhance the quality of companies' reporting by taking a more top-down, investor-centric approach to determining what information is reported externally.

There is a further issue. Unless collaborative efforts are made to address the overall framework of information needed for corporate reporting, new areas of performance information – for example, around environmental impacts – are likely to complicate an already complex picture by being bolted onto the existing financial model without due consideration of their strategic context.

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Even the most technically able within the corporate and investor communities are finding it difficult to decipher the performance message of many financial reports.

Alignment of external reporting with internal management information

Even the most technically able within the corporate and investor communities are finding it difficult to decipher the performance message of many financial reports. Further, the data required to address the technical complexities of the external reporting model may not be aligned with the information set being used to manage the business. Sophisticated users of the current corporate reporting model typically pay attention only to parts of the information conveyed by companies (compiled at great cost to those companies) and have little choice but to turn to non-company sources to continue populating their analytic models.

This survey highlights the point that, regardless of the communication channel used by companies (analyst briefing, annual report, regulatory filing), there appear to be important elements of contextual information which some companies do not report externally. While multiple sources of information will always be used by investors, shouldn't what they regard as important information initially come from the company itself? Furthermore, are company executives missing opportunities to communicate the fundamentals of value? Does this expose the business to undue volatility risk, which may arise from the assumptions investors will have to make if companies do not provide a broader information set? These problems could be mitigated by greater transparency.

Consistency of the reported information set

While much effort is being committed on a global basis to create consistency around financial reporting, there has been little focus on creating consistency across the other key elements of information, the contextual and non-financial elements. These areas have tended to fall under the jurisdiction of individual countries and, not surprisingly, there is substantial variation in these requirements. In part, this divergence reflects differing cultural and societal expectations, but given the importance of contextual and non-financial information to investors, is this a sustainable position in a global economy? While much of the information discussed in this report should not be in the domain of detailed reporting standards, collaboration in developing a framework for reporting may over time facilitate a more efficient flow of information from preparers to users.

A 'win-win' solution? Preparer and user collaboration

We hope that the findings in this survey report will help to fuel the debate about how the reporting model can best be developed to get the right information set to the market in the most efficient manner.

It is our belief – and our observation among leading companies – that contextual narrative reporting helps to cut through the complexity and partial opacity of today's financial reporting. The 'win' for companies is to tell the company's story through management's eyes and using management's key performance indicators. A related win is to give a larger place to long-term value creation and reduce the focus on short-term financial gains. The win for investors is increased transparency, which permits them to make better-founded investment decisions. Achieving these coordinated wins depends very much on a new and sustained dialogue between companies and investors – a dialogue which standard setters, regulators and auditors can facilitate, but should not dominate. Ultimately, the two key forces in the capital markets – companies and investors – need to reach consensus on the content of reporting.

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01 Highlights and executive summary

Volume of narrative reporting

149	the average number of pages in primary filings
60%	of pages in primary filings comprise narrative information

Understanding management’s strategy for creating value

56%	of narrative reporting relates to explaining performance outcomes
50/50	split of qualitative and quantitative narrative reporting
10%	of companies report on capital employed in the business
6%	of companies report the cost of capital

Lead indicators and forward-looking information

10%	of quantified narrative reporting relates to forward-looking information
15%	of companies report specific key performance indicators
60%	of companies report general highlights of the business

Critical disclosures and accessibility

30%	of companies provide some form of revenue or operating profit ‘bridge’ reconciling year-on-year performance
65%	of companies report segment information consistently across the narrative and financial disclosures
67%	of companies report segment information in financial statements on both a business unit and a geographic basis
71%	of companies report segment information solely on a business unit basis in their narrative reporting

What is narrative reporting?

In this survey narrative reporting is shorthand for the critical contextual and non-financial information that is reported alongside financial information so as to provide a broader and more meaningful understanding of a company’s business, its market position, strategy, performance and future prospects – including quantified metrics.

Volume of narrative reporting

Calls for companies, including the world's largest – the Fortune Global 500 – to provide increased transparency arise from a number of sources. Companies worry that they already produce weighty corporate reports, a position borne out by the findings of this survey (on average each primary filing comprises 149 pages). With 60% of these documents dedicated to narrative, contextual and non-financial information, companies need to be sure that this information meets investor needs. Here, the goal should be to provide information with strategic value that supports an understanding of the sustainability of the business and its performance. But getting this critical information right should not mean bulkier reports; it is more a matter of both preparers and users challenging the quality and scope of the information currently provided, not only thinking about what may be missing, but, in this age of 'information overload', considering what may be superfluous.

Understanding management's strategy for creating value

Current narrative reporting tends to focus on performance outcomes (such as changes in turnover and customer retention), which our survey found comprises 56% of scored reporting. However, this is just one important element of the value chain of a business and the information set that our research shows investors need. Perhaps more important are the front-end elements of the value chain, which explain how management intend to create value. In this context, investors value information explaining a company's markets (for example, changing customer demographics), which comprises 10% of scored reporting, an outline of its strategy (such as objectives around improving customer penetration), representing 18%, together with discussion of the key risks, resources and relationships needed to implement strategy (for example improved processes to engage with customers), which comprises 16%. This information is even more valuable when it includes quantified metrics and comparative data showing relative performance against competitors, as well as goals and targets – all of which the highest scoring companies in our survey are providing. Furthermore, as we would expect, the survey results show that industry-specific factors are critical to a more comprehensive and informed view of a company's growth, performance and prospects. Interestingly, few companies communicate measures around capital employed (10%) or the cost of capital (6%) – perhaps leaving investors to make their own assumptions about a company's risk and return profile.

Lead indicators and forward-looking information

Valuing a company is the role of investors, but it is important for management to provide a broad information set, which builds a picture of the medium- to long-term prospects of the business. Fundamentally, this has to flow from the company's market position and strategy. In building this picture some companies provide high-level goals and targets, but they are in a minority (10% of scored quantified reporting). It is interesting to speculate whether some of the current capital market 'short-termism' is in part driven by the current reporting model and the lack of forward-looking information evident from this survey. Were management to explain its expectations and set out the scenarios that might unfold, perhaps investors would be better informed and more engaged. In addition, this picture can be enhanced by reporting key performance indicators (KPIs) to help reinforce the drivers of value and progress in delivering strategy. Here our survey shows that 15% of companies specifically define their KPIs and use them to report on progress towards strategic medium- and long-term operating objectives.

Critical disclosures and accessibility

Gaining a real understanding of performance requires some key elements of information and a depth of analysis that gets below the surface. Growth is one element. How have revenues and profit grown year-on-year? How much is due to organic growth rather than acquisitions? What has been the impact of price and volume changes? And what part have currency movements played? The survey indicates that some companies and industry groups report on these factors in more depth than others; on average, 30% provide some year-on-year analysis. A second critical area is segment reporting, in terms both of its granularity and the consistency of analysis and explanation. Here the survey results show that 65% of companies present their segmental information consistently between the narrative explanations and the financial disclosures. A balance between narrative about each business unit (currently the dominant approach at 71% of surveyed companies) and each major geographic region, for which risk and return profiles are of interest to investors, would also provide more insight for investors into management's performance across the business.

A note to executives: Using the survey findings as a basis for internal discussion

How does your company compare to the Fortune Global 500 in its communication of corporate performance? What issues raised in this publication provide the greatest challenges or attractive opportunities for improved engagement with your shareholders? To facilitate self-assessment, Section 05 offers a structured approach to exploring these questions.

02 Introduction and survey methodology

The survey asks a simple but far-reaching question: what is communicated by the narrative elements of the corporate reports of major global companies?

While this question is not entirely new – there has been global debate in recent years about the scope and quality of information in corporate reports – this survey-based approach to the non-financial and contextual information of the Fortune Global 500 companies' (G500) corporate reporting provides new insight on a broad scale.

Understandably, much attention is given to the audited financial statements and related notes of G500 companies. But that is not where investors and other users of corporate information can hear the voice of management and, in theory, 'look through management's eyes' at the company's performance, markets, strategies, prospects and much else. Such contextual information appears predominantly in presentations to analysts and in the narrative portions of regulatory reports, both of which are often made available via the investor relations area of companies' websites. This survey looks at how much contextual information, of what kinds and quality, is currently delivered by the management of the world's largest companies. Also, it looks at certain related elements in the financial statements and notes—for example, the granularity of reporting on business segments.

Investors need reliable, varied and timely information, according to our investment community research. They expect a considerable level of transparency from management, within the framework of applicable standards and regulations and acknowledging the need for discretion about some competitive factors. However they see fit, sophisticated investors analyse the information they receive as a basis for investment decisions. The 'efficient allocation of capital' – that much-cited phrase in discussions of capital markets – takes place inside the heads of investors before it becomes a market reality. Company-provided information is only one source of insight; information from other sources will be factored in. The object of the exercise for management is to provide enough informational building blocks to populate investors' analytic models, realistically influence how investors perceive the company, and reduce their need for sources of information beyond the company's span of control. The object for investors is to grasp in depth the financial condition, performance and likely future of the company from any and all sources of information they regard as useful and reliable.

This survey – the first in a series – focuses on the narrative reporting and certain aspects of related financial reporting in three publicly available documents: the primary filing (e.g. the Annual Report, Form 10-K); the investor briefing on the annual results (e.g. presentation to analysts) and the supplementary filing (e.g. Form 20-F). We did not review Corporate Social Responsibility reports or other environmental, social and ethical reporting, except to the extent that it was included in the documents listed above. The documents all dated to years ended between January 2005 and December 2005 for the listing of Global 500 companies published by *Fortune* in 2005. Companies not assessed were those that experienced mergers or acquisitions after publication of the listing or for which the primary source document was not publicly available.

Two views into the survey sample were developed, by industry sector and by geography, as shown in Exhibit 1 (the grouping by geography reflects commonalities in narrative reporting requirements):

Exhibit 1: Two views into survey sample

Geographic clusters

US	172
Japan	80
Europe, Australia & Canada	192
Rapidly developing capital markets	35
Not assessed	21
	500

Industry groups

Automotive & Industrial Products	123
Energy, Mining & Utilities	72
Consumer, Retail, Pharmaceutical & Healthcare	101
Financial Services	109
Technology, Infocomm, Entertainment & Media	74
Not assessed	21
	500

For further information on demographics and method, please see the Appendix.

Differing narrative reporting requirements

Historically, most jurisdictions have created guidance for the narrative reporting that accompanies financial statements. Many have now adopted or are in the process of adopting the US Securities and Exchange Commission (SEC) practice of mandating certain disclosures. The goal of much of the regulation is that reporting should be clear, comprehensible and complete – in a word, transparent. However, specific mechanisms adopted to achieve this aim vary widely, from the SEC's detailed rules on the content of Management's Discussion and Analysis to the broader disclosure frameworks in place in many other reporting jurisdictions. Those broader frameworks tend to identify the type of content to be included in narrative reporting rather than defining the content itself.

What we looked for

The survey had two main areas of focus:

1. The narrative information provided by the G500 was first assessed against a framework for corporate reporting focusing on the breadth, depth and linkage of contextual reporting – the ‘Big Picture’.
2. The survey then assessed four critical areas of information cited as important in the research we have conducted on investor needs:
    - The drivers of revenue growth and margins, past and future
    - Uses of capital
    - Reporting of segment performance
    - Reporting of key performance indicators

In addition, we looked at the volume of narrative reporting provided in each of the three documents surveyed.

Assessing the ‘Big Picture’

To determine the breadth, depth and linkage of narrative information in the primary filing, investor briefing and supplementary filing, the survey benchmarked the information reported against four critical building blocks of information that all industries and companies have in common, as shown in Exhibit 2.

Exhibit 2: Critical information building blocks

Market Overview	Strategy & Structure	Managing for Value	Performance
• Competitive environment • Regulatory environment • Macro environment	• Goals & objectives • Governance • Risk framework • Organisational design	• Financial assets • Physical assets • Customers • People • Innovation • Brands & intellectual assets • Supply chain	• Economic • Operating • Environmental, social & ethical • Segmental

The information building blocks have been determined through more than 10 years of research conducted among investors and corporate management. The overall information set is what both of these participants in the corporate reporting process believe to be important for a thorough understanding of business performance.

The assessment process used in this part of the survey resulted in a score for each company’s key risks, resources and relationships[1] across the four building blocks, compared to a defined maximum achievable score.

For example, a qualitative discussion of the market challenges around a people topic, such as the scarcity or availability of skilled labour, would achieve a score; adding quantitative historical and forward-looking information about the demographics of the potential labour force would increase that score to the maximum achievable for People in the Market Overview category.

No company was likely to achieve maximum scores for all elements and categories because its industry, distinctive strategies and other factors dictate which elements it regards as most important to report.

The survey’s assessment of the Big Picture focused on narrative reporting; it did not address reporting in the financial statements or notes. Further, the scoring process did not consider narrative communications such as product descriptions, photographs and other types of content, which have their legitimate place in corporate communications but, in our judgement, need not be scored to reach a credible assessment of a company’s use of narrative reporting to inform investors on business performance.

Assessing the four critical areas of information

The specific information points within narrative and related financial reporting, identified by our research as highly significant to investors, were surveyed largely by means of a simple sequence of questions. To take segment reporting as an example, the initial survey question was: ‘Does the company have a segment note in the financial statements?’ If yes, the sequence continued: ‘How is the segment information presented: by business unit, by geography or by both?’ Similar questions were asked with respect to segment reporting in the narrative reporting, concluding with the question of consistency between financial and narrative reporting: ‘Does the segment analysis provided in the narrative report align with the segment note contained in the financial statements?’

1 Defined here as Financial Assets, Physical Assets, Customers, People, Innovation, Brands and Intellectual Assets, Supply Chain, Environmental, Social and Ethical and an Overview element encompassing high-level reporting of the group as a whole.

03 The 'Big Picture'

Narrative reporting provides the opportunity to communicate contextual information about many key issues: the sustainability of a company's performance, strategy and tactics, key risks, resources and relationships, the competitive arena, the innovation pipeline and much more. While certain narrative elements may be driven (depending on territory) by regulatory requirements, how G500 companies interpret the requirements and the degree to which they may supplement required information with voluntary disclosures and discussions can vary widely from company to company.

Balance and context

What we looked for

To assess how thoroughly the G500 communicate the Big Picture through narrative reporting,[1] the survey looked for the following points of information across nine key elements of the information set (described in the footnote on page 9):

- Description of external markets (market overview)
- Strategies and structures adopted to compete in those markets
- Key risks, resources and relationships managed to deliver on those strategies (managing for value)
- Performance outcomes

What we found

Exhibit 3: Companies' narrative reporting focuses predominately on performance

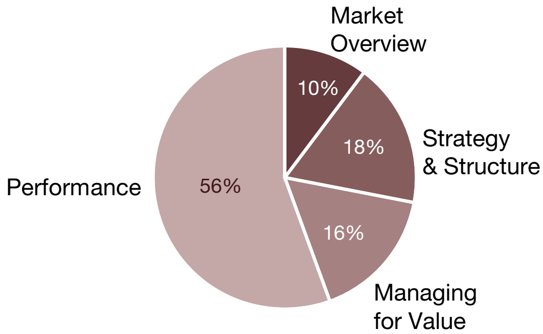


Exhibit 3 shows that more than half of the narrative reporting scores (56%) relate to explaining performance outcomes. A further 10% of the total scoring focuses on communication of the market opportunities and challenges faced by companies, 18% on articulating strategies, priorities for action and how success is measured, and the remaining 16% on how companies manage their risks, resources and relationships to achieve their objectives. This balance of reported information differs little across the industry groups and geographic clusters reviewed.

1 This phase of the survey considered only the narrative reporting in the three documents reviewed, excluding financial statements and notes.

Exhibit 4: Companies most commonly report quantified information for performance only

	Qualitative	Quantified	
		Current and historical trend	Benchmarks, goals and targets
Market Overview	✓		
Strategy & Structure	✓		
Managing for Value	✓		
Performance	✓	✓	

The more detailed snapshot in Exhibit 4 shows that across the four broad categories of the information set the average G500 company provides qualitative narrative reporting, meaning that it discusses markets, strategies, risks, resources and relationships, and performance outcomes. In the last of these categories – performance outcomes – the average company also reports some quantified data around current performance and historical trends. However, quantified data on benchmarks, goals and targets is virtually absent.

Exhibit 5: Highest-scoring companies provide benchmarks, goals and targets

	Qualitative	Quantified	
		Current and historical trend	Benchmarks, goals and targets
Market Overview	✓	✓	
Strategy & Structure	✓		✓
Managing for Value	✓	✓	
Performance	✓	✓	✓

Exhibit 5 shows that the highest-scoring companies commonly support qualitative statements with quantified current-period data and historical trend reporting. Benchmarking, goals and targets are often quantified as well, particularly with reference to strategy and structure and to reporting the performance outcomes. The divergence between reporting clusters is slight. This finding for the leading companies in the survey is reinforced by good practice examples, identified in our ongoing corporate reporting research (see www.corporatereporting.com).

PwC commentary

Investors can build a cohesive Big Picture of a company when an overview of its markets and an outline of its strategy are coupled with (1) discussion of the risks, resources and relationships needed to implement strategy and (2) key performance indicators. Our research shows that investors consider such contextual information vital as they assess current performance and prospects.

Our sense from the survey is that if corporate reporting is perceived as a compliance exercise, then this will colour the scope and quality of the contextual information provided by the average company. In the US the primary narrative element, Management's Discussion and Analysis, is governed by regulation and has a history of detailed SEC oversight. As a result, management may indeed be more likely to view narrative reporting through a legal lens. Additionally, the current legal environment in the US is generally thought to impede a more generous provision of information and perspectives. In Europe and other territories where narrative reporting requirements show signs of converging around a broader set of corporate reporting principles, regulators are tending to provide companies with frameworks for reporting contextual information, rather than closely defined rules. Many companies have embraced this approach to corporate reporting and offer cogent examples of how companies can provide a transparent view of their performance and prospects.

Note on Exhibits 4 and 5

In Exhibits 4 and 5, the shaded squares indicate that the survey did not assess quantified current and historical trend information for Strategy and Structure. Reporting on strategy and structure is considered, for purposes of the survey, to be an inherently forward-looking activity rather than a backward-looking, historical view. Companies reporting the results of implementing their strategies in current and prior years would achieve a score under Performance.

03 The ‘Big Picture’

Industry-specific reporting

What we looked for

We looked for Big Picture narrative reporting focused on those particular risks, resources and relationships that PricewaterhouseCoopers’ research has shown to be important to companies and investors in specific industry groups (see Exhibit 6). For each industry group’s focus areas, the maximum and average scores were calculated for each of the four building blocks of the information set shown in Exhibit 2.

What we found

Narrative reporting by industry group naturally reflects the importance placed by management and investors on industry-specific risks, resources and relationships, as illustrated in Exhibit 6. For example, Financial Services companies focus on financial assets and customers, with the highest-scoring company in this sector providing 62% of the information needed for a maximum achievable score. As another example, in the Energy, Mining and Utilities group, where physical assets are an important resource, the highest-scoring company provides 80% of the information needed for a maximum achievable score concerning performance outcomes for those assets, such as capacity utilisation and productivity. In certain areas, however, there are noticeable information gaps. For example, reporting in the Technology, Infocomm, Entertainment and Media sector on people (an important resource in the sector, according to our research) on average lacks information about issues such as the availability or scarcity of skilled workforce.

PwC commentary

Adapting the generic Big Picture communication of a company’s growth and performance to specific industries is key to long-term improvements in reporting. The survey findings make clear that industry groups do convey some elements of the Big Picture, but many opportunities remain to enrich reporting at this level to achieve a comprehensive, balanced and integrated narrative about key industry-specific factors of proven interest to investors.

Exhibit 6: Important areas for industries

Industry groups	Key risks, resources and relationships
Automotive & Industrial Products	Physical Assets, Innovation, Supply Chain
Energy, Mining & Utilities	Physical Assets, Environmental, Social & Ethical
Consumer, Retail, Pharmaceutical & Healthcare	Customers, Innovation, Supply Chain
Financial Services	Financial Assets, Customers
Technology, Infocomm, Entertainment & Media	People, Innovation, Brands & Intellectual Assets

Forward-looking orientation

What we looked for

We looked for qualitative and quantified information. We assessed the nature of quantified information between current year data, historical trends, benchmarks against defined peer groups and quantified forward-looking information such as market trends, targets for performance and quantified objectives.

What we found

Exhibit 7: Quantified forward-looking information is a small part of the information set

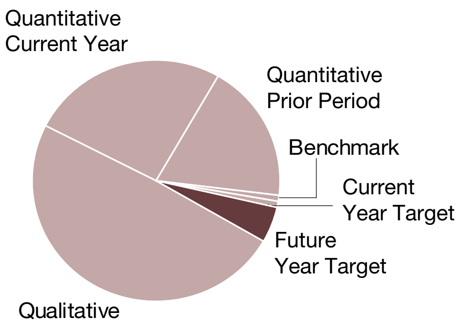


Exhibit 7 draws a strong distinction between quantitative and qualitative information provided by G500 narratives. Fully half of the scored information is qualitative in nature. In the quantified information reported (excluding financial statements), 10% is forward-looking – for example, communicating targets relating to the key performance indicators used by management to measure progress against strategy. Quantified benchmarks are even rarer.

PwC commentary

Valuing companies is the role of investors. But management needs to provide the components of information that enable investors to understand the company's own expectations of future performance and the drivers likely to generate expected results. Communicating the components of information can be improved by applying a forward-looking orientation to the overall discipline of corporate reporting and, more specifically, by providing the company's view on market trends and prospects, strategic priorities and indicators of success (including a candid and relevant account of the risks and uncertainties that might impact on that success).

Corporate leaders often raise the concern that communicating expectations equates to providing profit forecasts. That need not be so, provided that the focus is on the information set referred to above. Clearly, local regulations must be respected, but forward-looking information can be provided without specific reference to expected profits. Of course, management needs to be comfortable with the underlying assumptions. It also helps the user's understanding when preparers provide some sensitivity analysis as to the likely impact of changes to those assumptions.

In our experience, companies can find the right balance between the benefits of disclosing forward-looking information and the desire to withhold competitively sensitive information. Some companies – such as those in the consumer goods sector – achieve market success through dramatic launches of innovative products. It is management's decision as to whether effective product strategy includes forward-looking disclosures on such innovations.

Neglecting this aspect of corporate reporting can have unfortunate results from the company's perspective. Our research indicates that investors want to be able to assess and price the long-term prospects of the company and how those correspond with actual short-term performance. The short-term emphasis is considered by many preparers to be a long-standing but burdensome feature of their investor relations. A richer yet realistic set of forward-looking information in narrative reporting can help to strike a better balance between the long-term value view and short-term results, reducing investors' reliance on other sources of information about the company's prospects.

Ideally, investor relations would centre on this balance between long-term value creation and short-term evidence that the company is capable of sustained profitability. Reporting key performance indicators that show progress towards the company's clearly explained objectives is a sensible solution to the dilemma of needing to encourage investors' confidence in the company without overcommitting to a single future scenario.

04 Critical areas of information

Effective corporate reporting should comprise a number of key informational building blocks. Sophisticated investors use the information sets that underpin these building blocks to populate their investment models. This section of the survey report looks at four particular areas of information that investors say are critical:

- The drivers of revenue growth and margins, past and future
- Uses of capital
- Reporting of segment performance
- Reporting of key performance indicators

In addition, this section looks at the volume of narrative reporting.

The drivers of revenue growth and margins, past and future

What we looked for

The survey looked at whether companies provide an analysis of their revenue and operating profit growth by any of the following metrics: price, volume, currency, acquisitions or disposals. That analysis could be provided in a graphical format (see Exhibit 10) or otherwise quantified in the narrative reporting.

What we found

Exhibit 8a: Reporting revenue analysis: US consistently above average

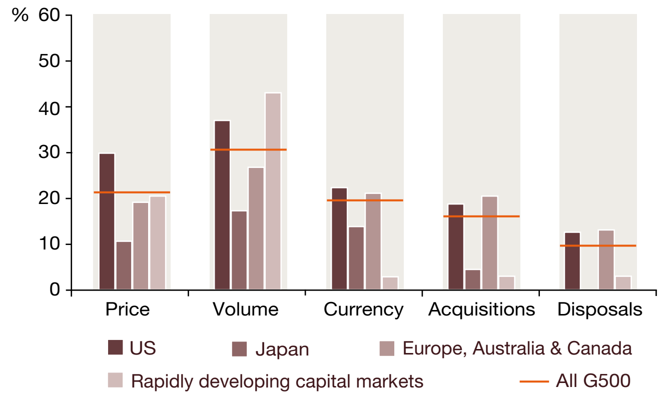


Exhibit 8b: Operating profit: less transparent than revenue

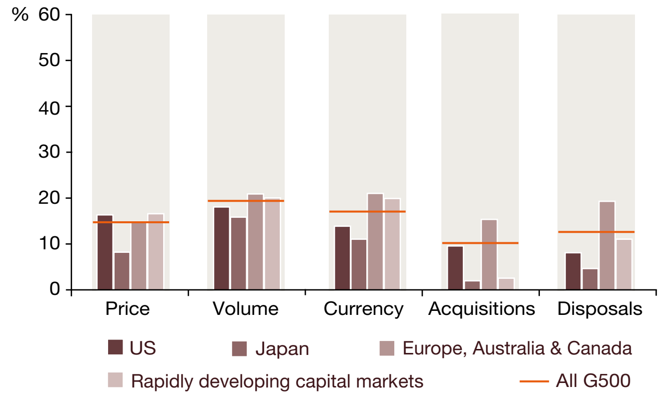


Exhibit 9a: Revenue analysis: reflects industry dynamics

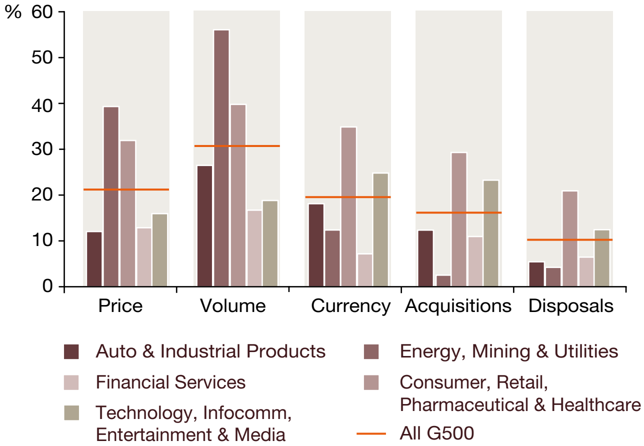
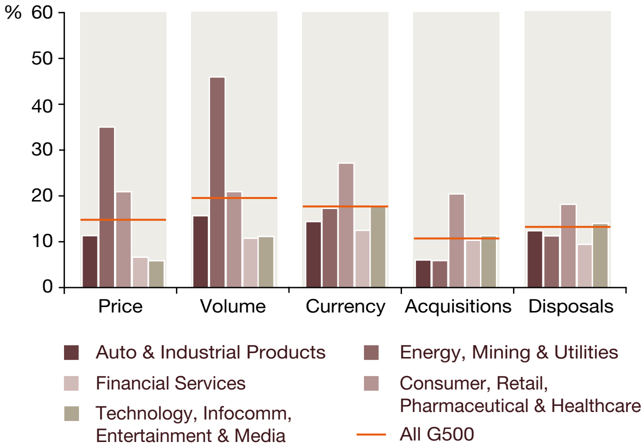


Exhibit 9b: Operating profit analysis: consistent with revenue picture



For at least some of the criteria shown in Exhibits 8a–b and 9a–b, 30% of all of the companies include in their primary filings an analysis of revenue or operating profit changes, while investor briefings and supplementary filings include markedly less analysis.

On a geographic basis (Exhibit 8a–b), generally speaking the US provides the greatest amount of narrative analysis of revenue, but the picture on operating profit indicates a better showing for Europe, Australia and Canada, with developing markets matching disclosure on price, volume and currency. Diversity between the geographies is less than that across the industry groupings.

There are differences in the extent of analysis provided across the industry groups (Exhibit 9a–b). The Energy, Mining and Utilities group stands out for price and volume disclosure, reflecting the nature of these businesses; for example, nearly 60% of those companies provide details of volume impacts on revenue. In contrast, the Financial Services sector provides the least substantive narrative concerning revenue and operating profit analysis.

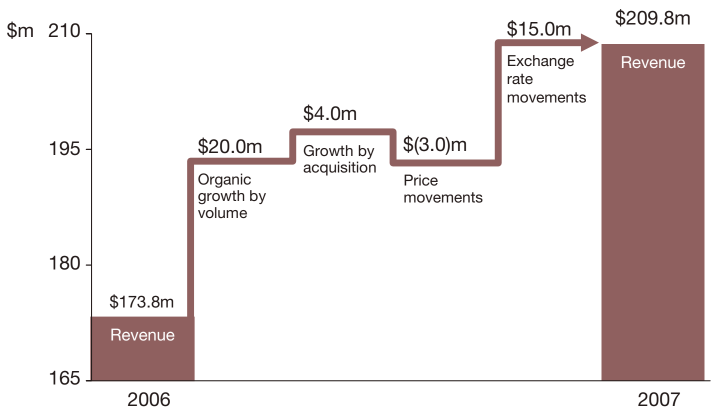
PwC commentary

Our research in the investor community indicates that the factors driving change in companies' revenues and margins are of particular interest to investors and other stakeholders. When companies disclose the major drivers clearly, investors are well served.

As things stand, some of the core components of revenue, operating profit and sources of growth are invisible to investors. How much is due to organic growth rather than acquisitions? Is organic growth a result of realising price increases or is it more to do with volume changes? Providing more granularity in this critically important area would help investors better understand and interpret the underlying economics of performance.

In certain parts of the world companies have experimented with the use of revenue and operating profit 'bridges' (see Exhibit 10) as a way of communicating this important information.

Exhibit 10: Illustrative presentation of a revenue 'bridge'



04 Critical areas of information

Uses of capital

What we looked for

The survey reviewed whether companies are reporting total capital employed (information needed to assess the level of returns achieved) and the weighted average cost of capital (information needed to determine whether the returns are adequate to compensate for the riskiness of the investment).

What we found

This category of information is not widely communicated in any of the three information sources reviewed. In primary filings less than 6% of G500 companies report cost of capital and approximately 10% report capital employed. Investor briefings and supplementary filings show lower levels of reporting in these areas.

In this sparse context, there are nonetheless slight differences by geography, with Europe, Australia and Canada reporting both measures around twice as frequently as other geographies. By industry, capital reporting is most common in the Energy, Mining and Utilities sector, reflecting the capital-intensive nature of the industry and the regulatory reporting of such measures that many are required to give. Virtually no Financial Services companies report the capital measures we looked for, although we recognise the importance that regulatory capital measures (such as Tier 1 and Tier 2 capital) play in this sector.

PwC commentary

The investment community research we have undertaken shows that investors need sufficient information to determine the quality and sustainability of future cash flows and to assess whether value is being created or eroded by the company relative to the cost of capital.

The current reporting model does not include such measures. It takes into account the returns paid to some company stakeholders, such as employees and debt holders, but fails to take into account a charge for the returns that equity investors expect to receive on their investment.

However, management can actively communicate these broader capital measures. Where there is no such communication, investors typically make their own assumptions, consider the views and supplementary data of those they regard as reliable sources, and draw their own conclusions about risk and return profiles. Should the company take the lead here, or is it satisfactory to allow these assumptions to be made without specific company input?

Reporting of segment performance

What we looked for

The survey considered the following questions to assess the consistency and relevance of segment information:

- To what extent do the companies provide segment information in either the financial statements or narrative reporting?
- What basis is used for determining the segments to be reported – business unit, geography, or both?
- Are the narrative reporting and financial statements elements of segment reporting consistent in the naming and description of segments as well as in the financial data reported?
- What metrics are reported at the segment level in the financial statements?

What we found

Extent of segment reporting

With the exception of the rapidly developing capital markets, segment reporting is widely provided. Some 80% of the companies in the other geographic clusters provide a segment note in the financial statements, and some 80% provide narrative segment reporting. However, a significant minority of companies provide only financial statement segment analysis with no supporting narrative to explain it.

Basis for determining reportable segments

Financial statement notes on segment performance tend to present information on both a business unit and a geographic basis (67%), particularly in Europe, Australia and Canada, where International Financial Reporting Standards (IFRS) requires both. This picture is reversed in the narrative reporting, where 71% of the G500 report on the basis of business units only.

Exhibit 11: Segment reporting: majority of geographies demonstrate consistency between financial statements and narrative reporting

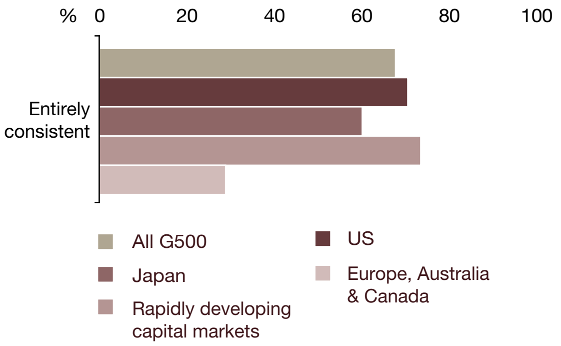
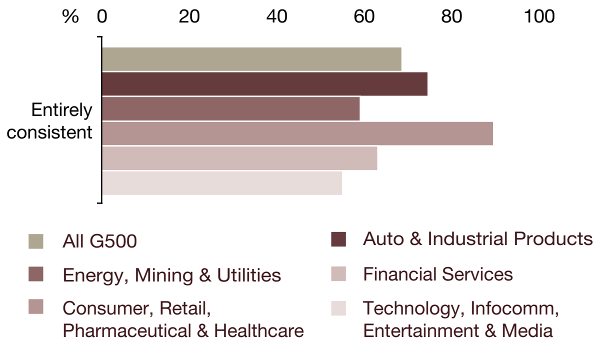


Exhibit 12: Consumer, Retail, Pharmaceutical and Healthcare stand out



Consistency of segment reporting (Exhibits 11 and 12)

Sixty-five percent of companies providing segment reporting in both their financial statements and their narrative reporting are consistent in how the segments are defined and financial data is presented and discussed. The level of consistency falls, however, when comparing the segment reporting in the investor briefing to the financial statement notes in primary filings. By geography, the rapidly developing capital markets group – although a relatively small proportion of the overall population, with varied financial reporting frameworks – shows the lowest level of consistency between segment financial statements notes and narrative presentation. By industry, the Consumer, Retail, Pharmaceutical and Healthcare industry group shows the greatest consistency in this respect, and the Technology, Infocomm, Entertainment and Media group shows the least.

Specific segment metrics

The requirements for, and reporting of, specific performance measures on a segment basis differ across reporting frameworks. Some measures, such as revenues, segment results and total segment assets, are consistently required, and they are provided by most G500 companies. Other segment information is scarce, particularly around property, plant and equipment and cash flow, for which information is reported by only 10% of the G500.

PwC commentary

Investors have told us in our research that a good understanding of performance by segment is fundamental for assessing which areas of a business are most productive and where value is or is not being added. Providing segment reporting in one form or another is widespread, but the information provided is not always clear and inconsistencies are fairly common. Narrative reporting exists to help explain the financial statements, and consistency is vital between segment reporting in the financial statements and explanations of those numbers elsewhere. The recent move under IFRS towards the US model of reporting segments ‘through the eyes of management’ should help to align external reporting with the management information used internally.

Companies show a decided preference for narrative reporting around business units only. In discussing segment performance, companies can also consider the value to investors of explaining differences in performance between geographic regions. Information such as the cash-flow implications of differing tax regimes or the risk associated with varying geopolitical environments can help investors build a deeper understanding of the challenges and opportunities a company faces in the markets management chooses to operate in.

While some specific segment metrics are widely reported, others are not. In particular, our research in the investment community shows that investors would value more disaggregation in segment reporting as well as contextual information, key performance indicators and cash-flow metrics on a segment basis.

04 Critical areas of information

Reporting of key performance indicators

What we looked for

The survey analysed whether the G500 report on measures explicitly defined as key performance indicators (KPIs) or similar measures — the in-house metrics developed and routinely used by management to measure progress towards the fulfilment of strategic objectives — as distinguished from general highlights which are reported by many companies, but which typically avoid specifying KPIs.

What we found

Exhibit 13: KPI reporting: slightly higher incidence in Europe, Australia & Canada

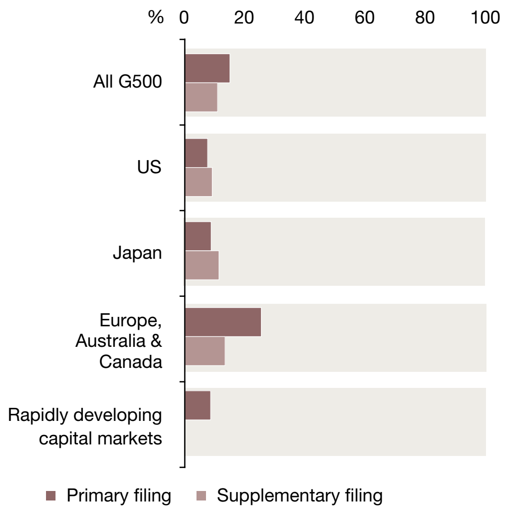
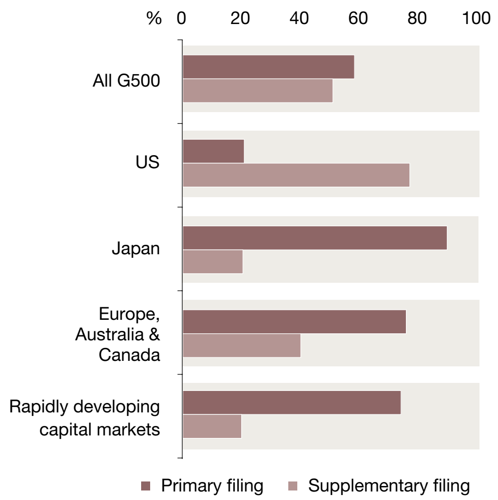


Exhibit 14: General highlights: widely reported in all geographies although choice of reporting channel differs



Although the central role of KPIs may prompt many readers to think that they would be a normal and even routine part of narratives, the survey shows that only 15% of the G500 actively identify and report on measures defined as KPIs (Exhibit 13). There is little divergence from this result among the industry groups. In Europe, Australia and Canada, there is marginally more KPI reporting, perhaps reflecting a move towards more guidance and regulatory requirements in this area of narrative reporting – for example, the implementation of European Union Directives mandating inclusion of KPIs in a company's review of its business.

As Exhibit 14 makes clear, 'highlights sections' are a more routine and accepted communication, typically delivered through a combination of brief narrative and quantitative information. Some 60% of G500 companies include a general highlights page in their primary filings, separate from discussion, if any, of explicitly defined KPIs. Again, this result is broadly consistent across the industry groups.

The findings in Exhibit 14 for the US will attract attention. Only 20% of US companies report highlights in the primary filing, usually a standard format Form 10-K. However, in the most common supplementary filing, a less prescriptive annual report, nearly 80% provide highlights.

PwC commentary

According to our research in the investor community, key performance indicators are valued by investors as pointers towards management's focus in running the business. Although the majority of companies do report highlights, there is typically no explanation as to whether they are the KPIs that management uses to assess strategic progress. There is arguably scope for using the highlights space, which is often the first page of a corporate report, to convey explicit management-defined KPIs or other important measures. Sufficient detail could also be provided elsewhere in the reporting to add further weight to these critically important measures.

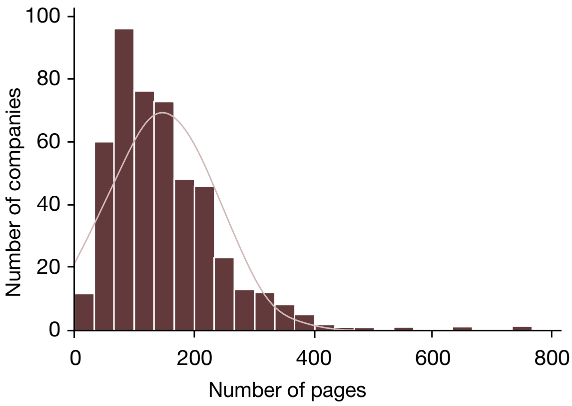
Volume of narrative reporting

What we looked for

The survey looked at the average length of companies' reporting documents and at the balance between regulatory financial statements and narrative reporting.

What we found

Exhibit 15: Primary filings: typically fewer than 200 pages, but significant outliers exist



G500 companies' primary filings average 149 pages, with financial statements accounting for almost 40% or, on average, 59 pages. Investor briefings average 33 pages, and supplementary filings average 108 pages. There is a wide dispersion around those averages; the highest number of pages recorded for a primary filing is 752, in a Form 10-K issued by a US healthcare company.

Of the industry groups, financial services companies issue longer-than-average reports, almost certainly due to the highly regulated markets in which they operate and the high volume of disclosures, particularly around financial instruments.

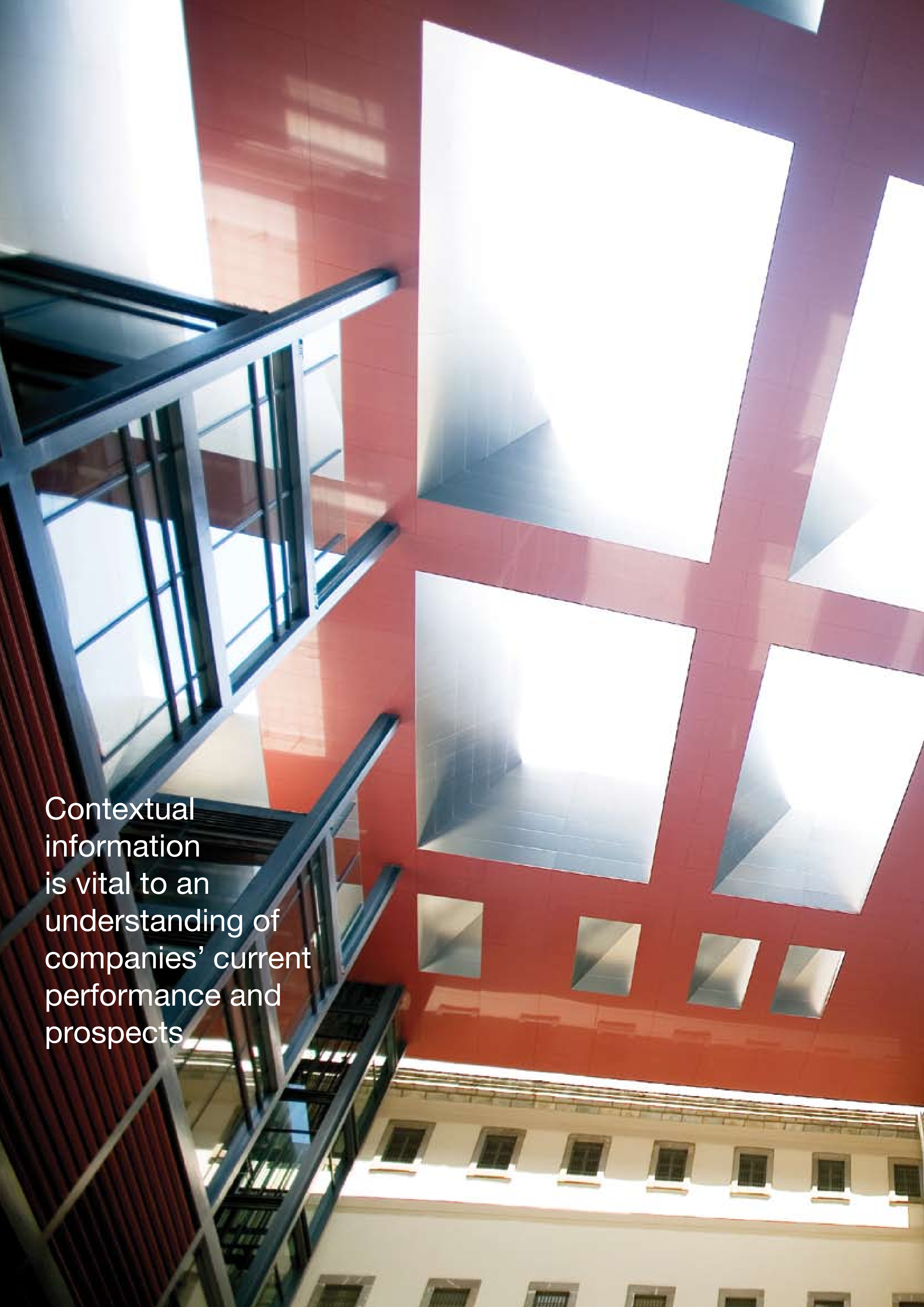
From a geographic perspective, companies in Europe, Australia and Canada also issue relatively long documents, perhaps reflecting the extended disclosures required in the transition to IFRS that many of these companies were experiencing in the survey period.

PwC commentary

There are many pressures on companies to provide disclosures about various aspects of their business. Companies would argue that they produce weighty corporate reporting documents, and this G500 survey supports that point of view. But voluminous corporate reports take time to prepare and time to understand. There is a balance to be struck between quality and quantity of information, and that balance must be found in the context of whatever regulation and standards are applicable, with a view to clarity and transparency of reporting.

On average, 60% of the primary filing is dedicated to narrative. This finding suggests that companies are clearly investing tremendous time, cost and effort in the preparation of extensive narrative. Findings presented earlier in this survey report have already indicated that qualitative discussion tends to dominate the contextual information, with quantified points mainly reported for performance outcomes. By broadening the information set to provide the Big Picture, companies could make better, more varied and more informative use of their investments in narrative reporting.

We believe that there is scope for management to streamline reports and to be more cost-effective through the provision of more focused analyses of the quality and sustainability of performance. Calls for a richer set of contextual information and better disclosures need not mean bulkier reports. An alternative approach is to improve the processes around identifying information that is superfluous to investors and recognising and reporting information that really matters. Less can be more, when there is good linkage among key topics, aided by convenient navigation and signposting that help users find what they are looking for. There is also scope for greater use of company websites to provide supporting detail and downloads.


Contextual information is vital to an understanding of companies' current performance and prospects

05 Assessing your own company's practice: How do you measure up?

How can executive leadership and boards effectively assess their company's current reporting practice to confirm that all is well or to uncover reporting opportunities that make strategic sense? Based on the findings of this global survey, the following questions may provide worthwhile guidance as corporate leaders review their company's reporting practices.

1. If you were an investor, could you evaluate your company's long-term potential based upon your external communications?
2. Are you helping investors to understand the Big Picture by providing sufficient contextual information to assess the sustainability of your company's performance and growth?
3. Is it easy to understand the trends in your revenues and operating profits and the drivers that cause them?
4. Are you taking the opportunity to explain how value is created and how you measure value creation?
5. Is there sufficient detail in segment disclosures to provide a true understanding of the components of your business?
6. How consistent is your segment reporting across different communication vehicles?
7. Do you explain how you measure success in your strategic objectives by means of defined key performance measures? Do you display these measures prominently in your communications?
8. Wherever possible, have you created a forward-looking picture of the business, against which short-term financial performance can be understood?
9. Have you identified any surplus information in your reporting that could be reduced or eliminated to improve the clarity of your messages?

As a result of PwC's ongoing engagement with the corporate and investor communities, we are able to propose solutions to some of the reporting challenges faced by preparers – solutions that may be possible within current reporting regimes.[1] The proposals are detailed in a document entitled Report Leadership, and a summary of some key proposals is set out here. Readers interested in seeing these issues brought to life can do so at www.reportleadership.com

Effective communication

- **Structure:** Clear and logical organisation helps readers retain more of the story and to be convinced by it.
- **Messaging:** Reporting should focus on key points so that readers can't miss them.
- **Navigation:** Helpful navigation ensures that readers will find the information that companies go to such trouble to collect, analyse and publish.

Modelling the future

- **Value creation:** The accounting profit does not necessarily tell investors if the returns generated represent a substantial achievement.
- **Forward-looking orientation:** Historical performance data is a starting point, but a rear-view mirror is not an apt instrument for judging a company's future potential.
- **Business environment:** Management's interpretation of the marketplace and its future challenges and opportunities is a critical factor in the development of investors' cash-flow models.
- **Strategy:** Many strategic statements lack the detail needed to understand the priorities for action, the resources that must be managed, and how success is measured.
- **Key performance indicators:** Without KPIs, investors' perceptions of performance may be at odds with management's own view and investors' ability to model the future will be diminished.

Rethinking the financials

- **Revenue and costs:** Providing sufficient granularity around revenue and costs is essential if investors are to understand and interpret the underlying economics.
- **Segment disclosure:** Current levels of disclosure are typically not enough to let investors evaluate performance on a differential basis.
- **Pensions:** Investors want to appraise the chances of increased cash contributions or other significant actions that may be needed in future.
- **Analysis of net debt:** Investors want to be able to understand and reconcile net debt movements on a year-to-year basis.

1 The approach summarised here has been developed in the context of IFRS reporting, the information requirements of the IASB's Management Commentary Discussion Paper, and similar narrative reporting guidelines. However, many of the suggested solutions to reporting challenges are likely to be possible under other narrative reporting and financial reporting regimes. Although the solutions proposed focus on the annual report, they are adaptable in other areas of corporate reporting. For most companies outside the US, the annual report remains the primary document of record. Many US companies supplement their primary filing (Form 10-K) with a separate annual report. Investor briefings are also a key tool for companies to engage with the capital markets. For all of these vehicles, the approach presented here is likely to be suitable and to represent a step forward for many companies.

Appendix: Survey population and source documents

Profile of Fortune Global 500 companies

The total number of the Fortune Global 500 surveyed was 479. The remaining 21 either had no publicly available primary filing on their websites or had undergone mergers/acquisitions since publication of the Fortune Global 500 list.

	Automotive & Industrial Products	Energy, Mining & Utilities	Consumer Retail Pharmaceuticals & Healthcare	Financial Services	Technology Infocomm Entertainment & Media	All
US	33	16	59	34	30	172
Japan	36	10	7	11	16	80
Europe, Australia & Canada	49	29	33	58	23	192
Rapidly developing capital markets	5	17	2	6	5	35
Total	123	72	101	109	74	479

The following concentrations of industries in reporting clusters are worthy of note:
Japan – Automotive & Industrial Products
Rapidly developing capital markets – Energy, Mining & Utilities

Which countries are in each geographic region?

The regional groups were composed on the basis of geography rather than financial reporting regime, because most of the survey questions related to narrative reporting rather than financial reporting. Narrative reporting tends to be driven by the capital market where a company is listed or the company law requirements of its territory, rather than by financial reporting regimes.

US	172 companies	All US companies, plus those that use US GAAP and list on a US exchange even if domiciled elsewhere. The companies in this group report under US GAAP.
Japan	80 companies	Eighty-three percent of the surveyed companies in this category report under Japanese GAAP; a further 17% use US GAAP.
Europe, Australia and Canada	192 companies	This grouping includes Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Spain, Sweden, Switzerland and the UK, as well as Australia and Canada. These countries are grouped together as they are primarily influenced by the ongoing convergence towards IFRS and by capital markets with converging reporting regimes. Sixty-two percent of the companies in this group report under IFRS; 20% use a European GAAP. The latter companies can be expected to move towards IFRS as it becomes mandatory in those territories. Seven percent currently report under US GAAP, while the remainder use Australian or Canadian GAAP.
Rapidly developing capital markets	35 companies	Included in this group are Brazil, China, Hong Kong, India, Malaysia, Mexico, Russia, Saudi Arabia, South Korea, Taiwan, Thailand and Turkey. These countries are grouped together because they are not primarily influenced by either US GAAP or IFRS reporting requirements, nor are they influenced by a particular capital market reporting regime. A broad mix of GAAPs is used by these companies, although 28% use Korean GAAP.

Which industries are in each industry grouping?

Industries are grouped as follows, on the basis of similar key risks, resources and relationships.

Industry groups	Number of companies	Industries	Key risks, resources and relationships
Automotive & Industrial Products	123	Automotive, Aero & Defence, Chemicals, Engineering & Construction, Forestry Paper & Packaging, Industrial Manufacturing, Metals, Transport & Logistics	Physical Assets, Innovation, Supply Chain
Energy, Mining & Utilities	72	Energy, Mining, Utilities	Physical Assets, Environmental, Social & Ethical
Consumer, Retail, Pharmaceutical & Healthcare	101	Consumer Products, Retail, Pharmaceutical, Healthcare	Customers, Innovation, Supply Chain
Financial Services	109	Banking & Capital Markets, Insurance, Investment Management & Real Estate	Financial Assets, Customers
Technology, Infocomm, Entertainment & Media	74	Technology, Infocomm, Entertainment & Media	People, Innovation, Brands & Intellectual Assets

What did the survey encompass?

All of the information surveyed related to year ends between 1/1/2005 and 31/12/2005, and comprised narrative reporting and specific elements of financial reporting presented in the relevant publication.

Primary filing	Number of companies	Investor briefing	Number of companies	Supplementary filing	Number of companies
Annual Report	286	Annual results slide presentation	279	Annual Report	101[1]
Form 10-K	129	Earnings press release	94	Form 20-F	61[2]
Combined Annual Report / Form 10-K	28	Written transcript of annual results briefing	28	Annual Review	30[3]
				Company fact book	19[4]
Other	36	Other	15	Other	64
No publicly available information	21	No other publicly available information	84	No other publicly available information	225
Total	500	Total	500	Total	500

Notes:
1 Mainly US.
2 Mainly Europe, Australia and Canada and Japan.
3 Mainly Europe, Australia and Canada.
4 Mainly Japan.

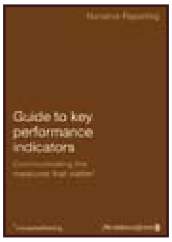
A cohesive picture of a company is easily built when an overview of its market and an outline of its strategy are coupled with a discussion of the resources and relationships needed to implement strategy and the outcomes of key metrics of success.

Further information

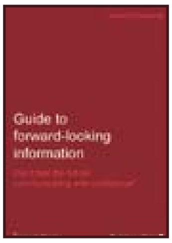
Contact

If you would like more information on the survey or our publications, please send an email to info@corporatereporting.com or contact your local PricewaterhouseCoopers office directly.

The following publications can be downloaded from www.corporatereporting.com



Guide to key performance indicators



Guide to forward-looking information

Report Leadership

Report Leadership is a multi-stakeholder group that aims to challenge established thinking on corporate reporting. The contributors to this initiative are the Chartered Institute of Management Accountants (CIMA), PricewaterhouseCoopers LLP, Radley Yeldar and Tomkins plc.

They believe that corporate reporting should be more accessible and informative. The aim is to develop simple, practical, yet effective ways to improve narrative and financial reporting.

You can help shape how the Report Leadership project evolves by giving your comments, actively participating, or adopting the elements that appeal to you.

Please provide any feedback, register your interest, and keep up to date with developments at www.reportleadership.com.

PwC's corporate reporting website: www.corporatereporting.com

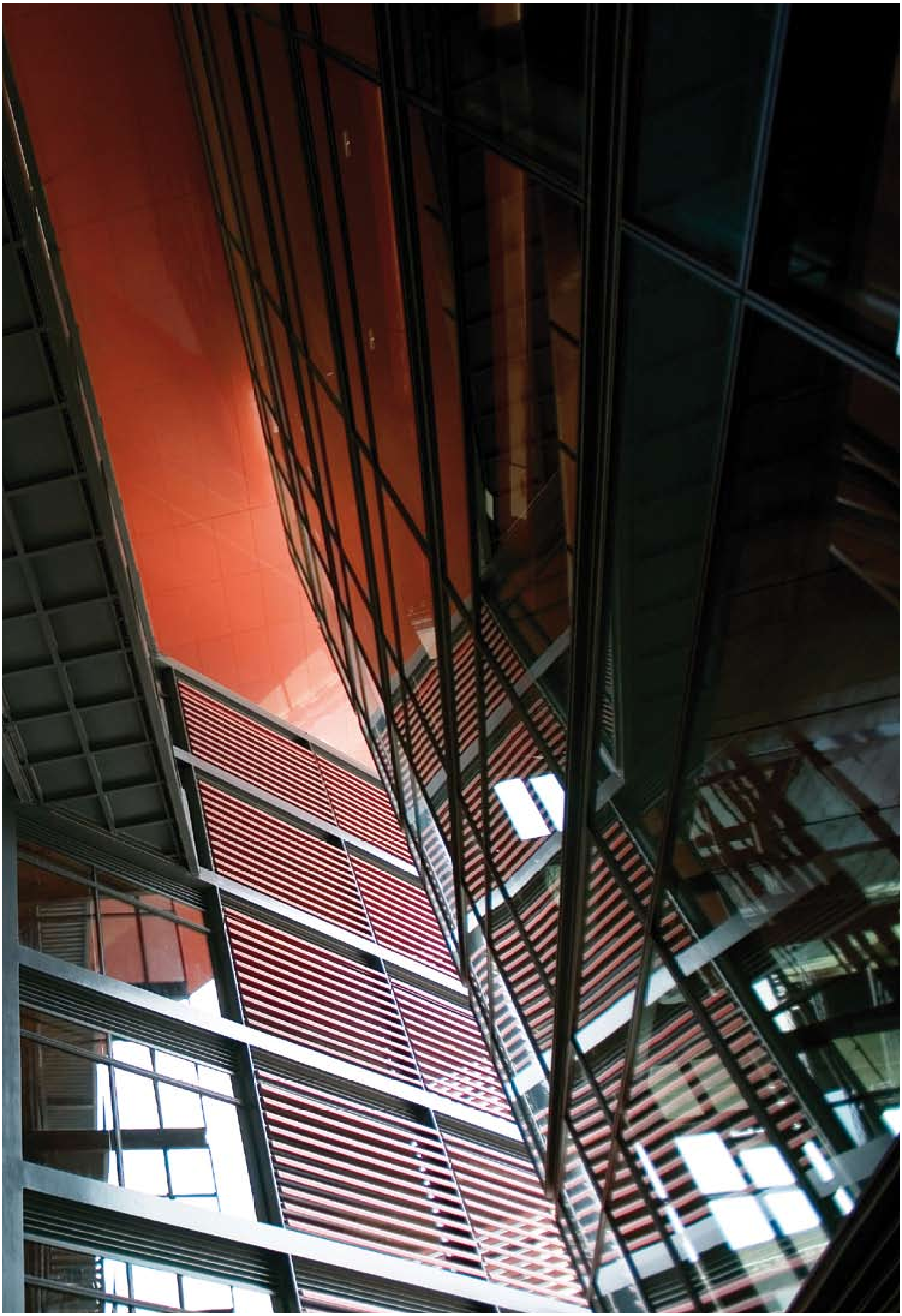
How are companies worldwide responding to the narrative reporting challenge?

Corporatereporting.com contains over 40 real-life examples of what good reporting actually looks like from companies across the globe.

Each example contains detailed commentary and guidance on how to improve the transparency of financial and non-financial information.

What information is important in your industry?

The site contains over 25 industry-tailored frameworks, developed from over a decade of extensive global industry research and analysis, which provide practical guidance to help you embrace increasing demands for broader corporate reporting.



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