



Corporate reporting

From compliance to competitive edge

Today's business information and reporting is under fire from companies, investors, government and regulators alike. In this paper, we give our views on why it is falling short, what's driving change, where insight is missing and how companies can take action.

Management teams today are constantly having to re-evaluate their business strategies in light of significant economic uncertainty and changing market dynamics. Investors too are having to keep a very sharp eye on their investment strategies. Understanding the issues and having a clear strategy in place to respond to the changing dynamics – whether they are caused by financial crises, more global competition or resource scarcity – is essential to survival.

No wonder, then, that the ability to access the right information for decision making is high on the agenda for all those with an interest in business performance – from management teams and the board, to investors, policy makers and regulators.

But nobody wants just more information; it has to be relevant, insightful and reliable. Financial reporting, while providing the backbone of information, is by its very nature backward-looking and months out of date by the time it emerges. Relying on this alone to understand the quality and sustainability of company performance is a dangerous game.

A narrow compliance-driven approach to reporting... is starting to look risky.

We expect the most radical changes...to come from [companies]



As businesses start to challenge aspects of the business, including the resilience of the business model, information needs and reporting are also in the firing line.

For management, taking a narrow, compliance-driven approach to external reporting, that does not show a response to the changing context for business, is starting to look risky. Stakeholders are looking for evidence of management quality and credibility in reporting, and asking: “What does this reporting say about the company, its management, governance, ambition and prospects?”

Already fewer people are asking us: “Why should I improve the information I report?” And more are asking: “How can I get the quality information I need to run the business, compete and communicate effectively with my stakeholders? How much change is needed? Where and when do I start?”

To help answer these questions, the findings from our comprehensive review of company reporting (see pages 4-8) highlight areas ripe for improvement, and suggest others that require more fundamental change.

You can also look at those companies who are innovating to help shine a light onto what’s important.

There’s no doubt that regulation will continue to have an impact on the level of disclosure and structure of reporting, but its immediate impact on transparency is less clear. Regulation does, however, tend to increase everyone’s attention on certain areas, and this, in time, drives real improvements in the quality and coherence of key information reported.

The speed of reporting change is something that each company will determine for themselves, depending on management’s ambition and appetite for the task. But one thing that will be difficult to ignore is the need to be receptive to the growing external pressures from stakeholders, which are unlikely to abate in the foreseeable future.



Innovation is building momentum for change

Forward-thinking companies, investors, government and regulators are all driving change

We are entering a period of significant innovation in reporting. Markets, regulators, companies and an ever broadening group of stakeholders are demanding change. Significant steps are already being taken to meet the challenge.

We believe that emerging practices from forward-thinking companies have the potential to transform corporate reporting in the next decade.

The work of the Financial Reporting Council (FRC), the International Integrated Reporting Committee (IIRC) and the Department for Business, Innovation and Skills (BIS) is all raising awareness of the need for change and providing mechanisms to achieve it by experimenting with the structure and content of reporting.

Recent initiatives are clearly encouraging innovation.

- **The FRC Financial Reporting Lab** is bringing management and investors together to innovate and shape reporting to better meet their needs.
- **A two-year IIRC pilot programme** focused on innovation to better integrate reporting is attracting significant interest from companies, investors and other key stakeholders. The idea is that the process of companies experimenting and innovating with the principles and content of the IIRC integrated reporting framework will go beyond simply informing the development of the framework; it will also demonstrate the benefits for companies and investors and define emerging best practice¹.

- **The BIS consultation on a proposed new reporting framework** aims to address the length and complexity of current reporting to make key information easier to find. It proposes to divide the annual report into: a Strategic Report with key messages about the company (including its strategy, results, risks and remuneration); and an Annual Directors' Statement, published online, giving the detailed information that underpins the Strategic Report. The deadline for this consultation is the 25 November 2011¹.

- **Innovation among leading companies** – a recent example is Puma's trailblazing environmental profit and loss account, which put a cost on its use of carbon and water across its entire operations (including the whole of its supply chain). Puma's management sees this as essential information to inform its future strategy – from product development to the shape of its business model. It is also the first phase of its plan to innovate across all its reporting and take stock of its social and economic impact in a similar way.

While these initiatives take different approaches and focus on different areas of the reporting model, they all have the same ambition: to create a reporting model that delivers the information needed to understand the quality and sustainability of business in the 21st century.

The ambition: to create a reporting model that delivers the information we need to understand the quality and sustainability of business today

¹ For PwC's Straight away guidance on this topic, email info@corporatereporting.com

What company reporting is like today

How are companies responding to this dynamic reporting environment? Is improvement widespread, or is it limited to a small number of more forward-looking companies?

To understand how effective reporting is today, we assess companies' reporting against our integrated reporting model (see page 5 'Integrated reporting – what we mean').

We analyse how effectively companies communicate the quality and sustainability of their performance and future prospects. We look at how well they explain: their strategic priorities; their approach to governance and risk; how the business model works; and their performance – both financial and operational.

Context is also crucial, so we ask how well a company presents the critical links and dependencies between the various information sets and how complete and coherent the overall picture is.

This year, our review of the narrative reporting practices of the FTSE 350² shows a general trend of improvement in quality and effectiveness (see graphs below), but that this improvement is not universal.

Our overall reporting effectiveness measure shows that some companies in both the FTSE 100 and 250 achieve very high standards of reporting. The best reporters in the FTSE 250 are as good as those in the FTSE 100. But no single company in either group achieved the highest quality across all areas of its narrative report.

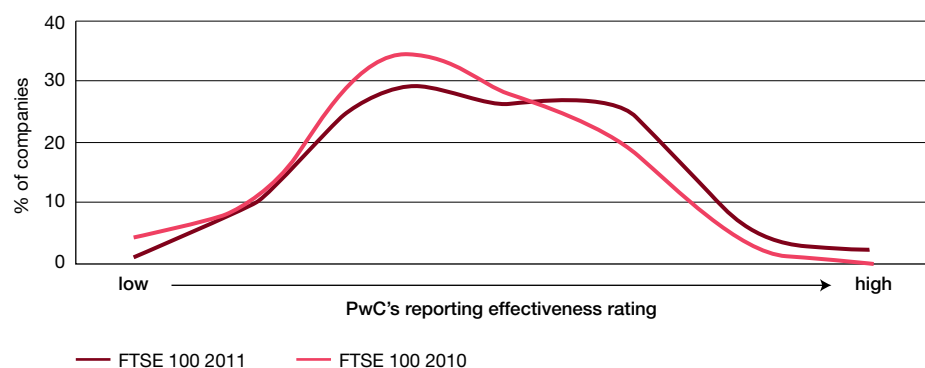
Among FTSE 100 companies, we have seen slight, but continued, signs of improvement across the whole spectrum of reporters. This is illustrated by a reduction in the percentage of companies at the lower end of the effectiveness scale in the first graph, as well as an increase at the higher end.

In the FTSE 250, where arguably they need to shout louder than their FTSE 100 competitors to attract investor attention, it is encouraging to note an overall move up the scale from low/medium to medium/high (see second graph). However, the proportion of FTSE 250 companies with low reporting effectiveness is still hovering around 25%, perhaps reflecting a core group of companies that continue to adopt a compliance 'bare minimum' approach.

There is a significant effectiveness gap between the best and worst reporters. Indeed, the leading companies appear to be moving further ahead of the pack. This may indicate that the opportunity to embrace change and turn it to competitive advantage is yet to be spotted by many companies.

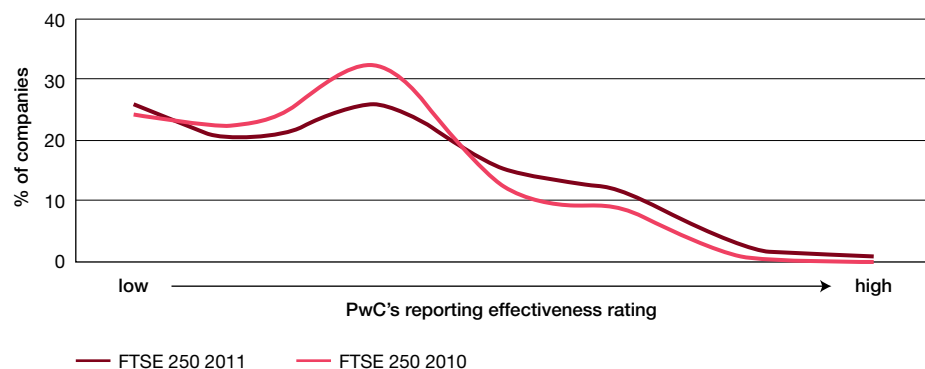
How effective is FTSE 100 reporting?²

The bell curve shows the proportion of companies at each stage of the journey towards effective reporting



How effective is FTSE 250 reporting?²

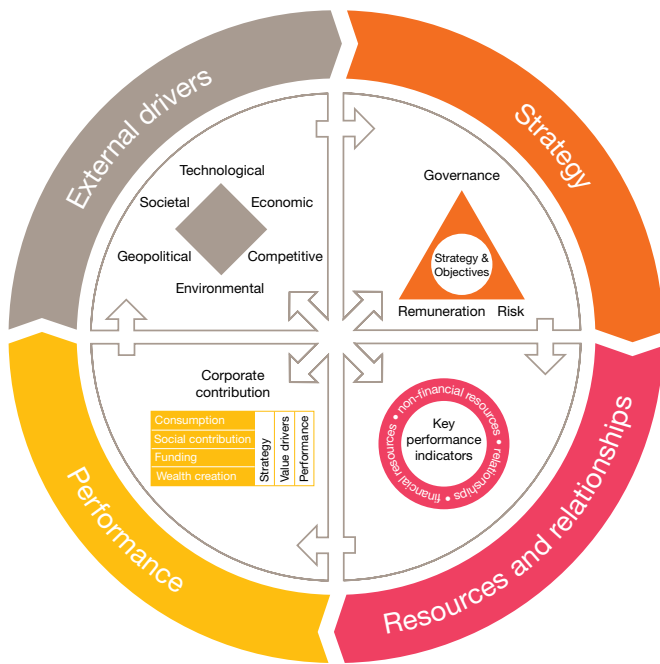
The bell curve shows the proportion of companies at each stage of the journey towards effective reporting



2. We reviewed 298 reports for periods ended between 1 April 2010 and 31 March 2011 – 100 in the FTSE 100 and 198 in the FTSE 250. Each report was examined against more than 80 data points related to our integrated reporting model. Investment trust companies were excluded from the analysis, as their more standardised reporting would skew the results.

Integrated reporting is achieved when it shows how governance connects with remuneration and risk, when strategy is designed to exploit a changing market environment, and when strategic priorities align with key resources, relationships and key performance indicators

Integrated reporting – what we mean



For further insight into the PwC integrated reporting model contact us for a copy of *Integrated reporting: What does your reporting say about you?* or for detailed examples of effective reporting in particular areas, email: info@corporatereporting.com

‘Integrated reporting’ is the talk of the town yet it is very difficult to find two people who can agree exactly on what it means. In our view, integrated reporting is more than just a collection of statements covering corporate strategy, business and financial results, environmental, social and governance issues.

To us, an integrated report provides a strategic picture of a business that explains how a business creates and sustains value now and in the future. It recognises that meaningful reporting must include stewardship of more than just financial capital and will include stewardship of intellectual, natural, social or other forms of capital, where these are material to the business.

An integrated report may also report on the risks and opportunities across a company’s entire operations, including their suppliers, customers and other critical elements beyond the legal entity itself. This kind of report should offer a more complete, and joined-up, picture of a company’s performance and prospects.

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This illustration of our integrated reporting framework shows how the key elements flow and are interconnected.

So what else is different about ‘integrated reporting’? The IIRC, in its discussion paper, outlines some key differences with the current model (see table).

How is Integrated Reporting different?

	Current model	Integrated Reporting/ Future model
Focus	Past, financial	Future, connected, strategic
Timeframe	Short term	Short, medium and long term
Detail	Long and complex	Concise and material
Compliance	Rule bound	Responsive to circumstances
Presentation	Paper based	Technology based
Trust	Narrow disclosure	Greater transparency
Thinking	Silos	Integrated
Stewardship	Financial capital	All capital (human, intellectual, social, natural etc)

Source: IIRC

What has improved?

Research findings from our analysis of FTSE 350 companies

84%	Discuss future market trends	25%	Explain what the future means for strategic choices
94%	Include strategic priorities	16%	Base reporting on strategy
97%	Report principal risks	45%	Clearly explain the impact of risks and their mitigation
74%	Discuss managing key resources/relationships	33%	Clearly define their business model
93%	Explicitly identify KPIs	35%	Align KPIs to strategy
78%	Report non-GAAP measures	27%	Clearly explain underlying revenue drivers
74%	Give sustainability-related KPIs	15%	Link sustainability to strategy
92%	Have narrative consistent with segment notes	7%	Communicate across reporting model by segment

Some elements of FTSE 350 corporate reporting are improving. What are the catalysts for change? Where have the improvements occurred? And where do the challenges remain?

Regulatory changes are having a marked impact on corporate reports. For example, revisions to the UK Governance Code now require companies to provide information on their business models³. Even though this change was not fully effective for the period covered by our review, our study found that 33% of the FTSE 350 now provide an explicit description of their business model, indicating early adoption of this disclosure.

Alongside rules and regulations themselves, stakeholders and regulators are also helping to improve reporting practices by encouraging companies to address key areas. The Financial Reporting Review Panel's (FRRP) focus on risk reporting³ earlier this year has had a noticeable effect on disclosure, with 45% (up from 18% last year) now clearly explaining the nature of their principle risks, their impact on the business and how they are mitigated.

What about quality?

But the overall impact of regulatory change and pressure so far has been steady rather than spectacular: the content is now broadly there, but the quality of information reported still

has a long way to go. For example, while 97% of companies now report principal risks and uncertainties, 60% report generic risks that are not specific to the company and its business model, priorities and markets. Similarly, while 33% of companies include an explicit description of their business model, and most of these reference key resources and relationships as a critical part of these business models, only 7% support the statement with detailed commentary or measures.

Missing insights

Lack of depth and insight in the descriptions of many key contextual elements of the business is a tell-tale sign of either a compliance-minded response to legislation, or that the benefits of a more informative approach are not yet appreciated.

Insight is missing, for example, on future external trends and factors likely to have an impact on performance. While 84% provide a forward-looking orientation to their market discussion, only 25% this year (and 13% last year) back this up with a more detailed, quantitative narrative.

3. For PwC's paper on this topic, please email info@corporatereporting.com



well it hangs together – both within and between different sections. Encouragingly, our review shows some progress, albeit from a low base, towards companies providing a more integrated picture⁴. For example, 35% of companies (compared to 25% in 2010) now clearly align KPIs with strategic priorities. But challenges remain: only 16% clearly integrate strategic themes and intent throughout their reports; and one in five (19%) demonstrate a link from external drivers and opportunities to the company’s strategic choices.

Sustainability issues feature in 97% of company reports, but only 15% fully integrate related priorities into their overall strategy – an area now attracting interest from a number of stakeholder groups. Two-thirds of companies fail to outline any links between risk reporting and other aspects, such as strategic priorities, external trends, and performance.

A clear message from these findings is that regulation can provide the foundation for developments in reporting, but does not immediately deliver better quality reporting or transparency. However, regulation does appear to have an indirect positive impact by increasing everyone’s attention on those areas, which ultimately improves quality. When KPI disclosures were first required, for example, they very often appeared in isolation from strategic priorities. Yet, over time, stakeholder focus has challenged this gap and we’ve seen it gradually close.

Fundamental improvements to reporting will therefore only happen, when management and other key stakeholders challenge the content. Commitment, not checklists, will bring about real improvements in the quality and relevance of information provided in company reports.

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Performance measures tell a similar story: 93% of companies (up from 88% last year) explicitly identify their KPIs, yet only 22% clearly define and provide a rationale for them.

Segment reporting, also the subject of regulatory attention and a key area of investor interest, shows variable quality. Some 92% of the FTSE 350 provide a consistent view of segments from their narrative through to their numbers, yet only 63% define segment priorities and 47% explain how these priorities contribute to overall group goals.

There are variations too in the quality of reporting on performance. Only 27% clearly explain the underlying drivers of revenue and profitability (eg, price vs volume, organic vs acquired) and 36% (up from 12% last year) provide a detailed set of measures to monitor progress in delivering strategic priorities.

And integration?⁴

After content and quality of information, the final piece of the jigsaw for effective reporting is how

4. For PwC’s paper on this topic, please email info@corporatereporting.com



Blaming the medium, not the messengers

A limited view of the annual report could be a mistake, particularly if other online reporting doesn't fill the gaps

If our findings point to challenges around the quality and alignment of key information within annual reports, one explanation could be the changing role of the annual report as a communications medium in the digital era of instant news and commentary.

For many, the annual report fulfils a regulatory requirement, carries a traditionally historic focus, and sits on the website alongside any number of interim announcements and links to analysts' reports.

Our experience with companies confirms that this limited view of the annual report is common. Typical views include: 'it's a regulatory filing document', 'it's too unwieldy to change', and 'we tell investors extra information in our presentations'. Some companies, however do seem to see how to use all the different channels in effective ways.

To assess whether the medium is really to blame, we also reviewed the preliminary announcements and presentations of the entire FTSE 350. Our findings make for interesting reading. Far from providing additional or better quality information, these other year-end communications often have the same gaps as the annual report.

This suggests that the issue may be less about the medium and more about the quality and availability of information and management's appetite for transparency.

Traditional financial performance measures dominate FTSE 350 preliminary presentations to investors, but some other aspects of the reporting model are barely discussed. For example, only 10% cover risks and 12% discuss environmental or social-related risks and performance, far lower proportions than address these areas in their annual reports. The vast majority of companies provide no extra information in their preliminary results than in the annual report. For example, while, 71% provided information on strategy, only 15% of these provided more insight than they provided in the annual report. Similarly 66% provide insight into external drivers, yet only 16% include more information, often in the form of forecast trends in markets.

Our conversations with investors have highlighted that they still attach tremendous importance to the annual report as a key source of information, so it may be risky to assume that they don't use it.

In our view, communicating effectively and consistently across all mediums, especially the annual report, makes a difference to the way stakeholders perceive your organisation. But, as we know, that's much easier said than done. Management teams with an appetite for better quality information for their own decision making are likely to make the best progress towards more effective communication with their external stakeholders.

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The way forward



The key to companies turning their reporting into a source of competitive edge, lies in the action taken internally.

The external benefits that come from communicating relevant information to the markets are important, but not always tangible or measurable. The intangible benefits might include: no issues raised by regulators; increased confidence and trust across all stakeholders; enhanced corporate reputation (lower reputation risk); and productive dialogue with stakeholders.

But arguably, the most fundamental benefits spring from the discipline imposed on a company by shining a light on its internal workings. Companies are telling us that the real catalyst for improvement is finding ways of accessing better information to support management decision-making, board review and employee awareness.

Certainly 'integrated thinking' is a central tenet of the IIRC's discussion paper, and uncovering opportunities to optimise management processes appears to be a key motivator for

companies participating in the IIRC pilot programme. Coherent external reporting will follow, but the first goal is a better managed company.

Our engagement with companies, users and regulators highlights a growing recognition that improving the effectiveness of reporting cannot be achieved through compliance and clever presentation. The current debate is rightly focused on the need for reliable, quality information that reflects the reality of a business today and exposes its future prospects.

The financial crisis has placed a premium on information disclosure, risk management, scenario planning and good corporate governance. Seen in this light, experiments in the FRC Reporting Lab and the IIRC's pilot programme, together with the BIS consultations, are practical forces for improving how businesses are managed as well as mechanisms for better corporate reporting.

We believe there are compelling options for every company to improve their reporting.

Where are you on the reporting journey?

We believe there are compelling options for every company looking for a way forward with its reporting. The right options will depend on where each company has got to on its reporting journey. Some might choose to get involved in influencing the future, joining the debate, experimenting and innovating. Others will want to wait and see, responding when reporting practices are more fully formed.

In our view, there is no excuse for inaction. Options for companies considering positive action on reporting are outlined in the chart below.

How can you take reporting forward?

Differentiate

Think beyond current reporting. Go for competitive edge with integrated reporting, eg:

- Report on your stewardship of all forms of capital – human, social, natural etc as well as financial
- Think beyond the accounting definition of ‘control’, consider risks and opportunities across your entire operations
- Pick up cutting edge ideas from the companies signed up to the IIRC pilot programme
- Take a longer-term perspective with your reporting
- Provide your content with a forward-looking orientation
- Combine financial, operational, governance and environmental information in a concise and coherent way

Innovate

Challenge today’s reporting. Experiment with content, structure and integration, eg:

- Explore what a Strategy Report (BIS) might look like and how you could pull the information together
- Understand investors’ bug bears and find innovative ways to address them – sign up to the FRC Reporting Lab?
- Challenge the content of your annual report and whether it is ‘material’
- Innovate with your annual report to create a clearer narrative flow
- Experiment with structure and channels – place standing data on-line?

Fix

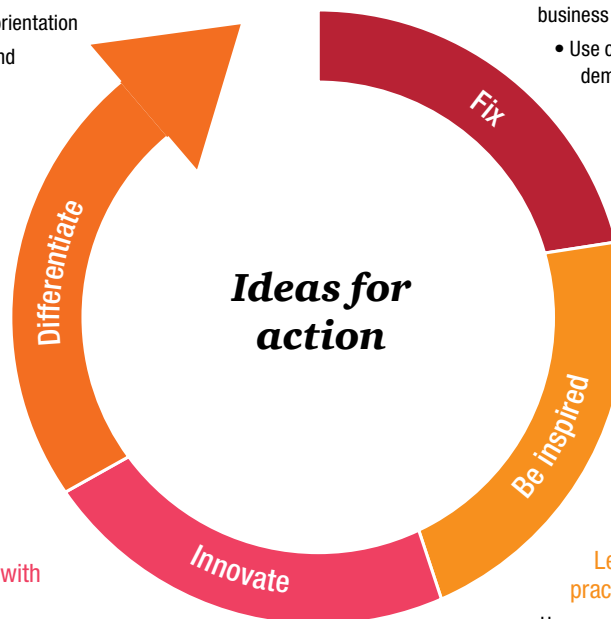
Keep up with current practice and new requirements. Focus on quick wins and fill any significant gaps, eg:

- Keep up with industry reporting trends and what other companies in your peer group are doing
- Look for ways to avoid repetition and reduce length to improve narrative flow
- Consider whether your risks descriptions can better reflect your industry and specific circumstances
- Consolidate existing content to build a picture of your business model – is any key information missing?
 - Use clearer sign-posting and cross-referencing to demonstrate links between key information
 - Explain why your ‘key performance indicators’ are key

Be inspired

Learn from emerging and best reporting practices, eg:

- Use your strategy to underpin your reporting
- Demonstrate a clear link between your strategic priorities, KPIs and remuneration
- Discuss the group’s risk profile and how it has changed
- Explain the drivers shaping the market in which you operate and how they influence your strategic choices
- Embed business model and corporate responsibility into your discussion of strategy and performance
- Provide more operational/non-financial KPIs to support your discussion of key resources and relationships
- Check out the Building Public Trust Awards winners reports or good practice examples on www.corporatereporting.com



Further insights

Contact us for a copy of or a link to any of these publications, email: info@corporatereporting.com



Reporting hot topics

Highlights the reporting issues most in the spotlight and where insights are missing in current reporting



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World Watch – governance and corporate reporting magazine

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Corporate Reporting blog

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