The Journey to Better Business Reporting

Moving beyond financial reporting
to improve investment decision making

kpmg.com.au

Foreword

The world of business reporting has entered an exciting phase of development that should greatly improve communications to the markets and contribute to better capital allocation decisions.

Peter Nash
National Managing Partner
Audit

In this paper, we explore how some organisations are already improving reporting on strategy, performance and prospects so they can better meet the challenge they face in a post-financial crisis, capital constrained environment. We have used these examples to help develop our thinking about a roadmap for the journey to improved communication with the capital markets.

This journey should be of particular interest to chief executive officers, chief financial officers and board chairs as they face the challenge of convincingly telling their organisation's 'story' to the markets so they can obtain capital at a reasonable cost, enhance their corporate reputations and maintain their licences to operate.

Institutional investors, fund managers, analysts, and other capital markets participants who underpin their investment decisions with detailed modelling based on those 'stories' are also becoming actively involved in the journey to better business reporting. Legislators and regulators, business commentators, investor associations and other stakeholders are also increasingly interested and involved.

I would like to take this opportunity to thank a number of organisations who have assisted in the development of our thinking in this area by sharing their experiences as participants in the journey to better business reporting. The experiences shared by BHP Billiton, Microsoft, Novo Nordisk and United Technologies should provide valuable signposts for those who are following them on this path.

I trust you find this paper a new and useful contribution to the development of a business reporting framework that significantly improves the basis for capital allocation.

If you would like to discuss any of the ideas explored here, please contact your KPMG adviser or one of the professionals listed at the back of this publication.

Contents

Executive summary

Current reporting practices tend to be more effective in enabling the evaluation of historical financial performance than they are at providing insights into business strategies and performance prospects, and so are of limited use for those seeking to differentiate between competing investment opportunities. As a result of this shortcoming, the accounting profession – supported by leading corporations, investors, industry groups, legislators and regulators – has been pushing for the development of better business reporting.

The journey to improved communication with the capital markets begins firstly by improving and consolidating what is already reported. This involves moving beyond traditional, more narrowly-based financial disclosures to include relatively recent innovations including sustainability or corporate social responsibility (CSR) reporting.

The next step in the journey aims to overcome the limitations of today's reporting model by then incorporating forward-looking, strategic key performance indicators, and using management commentary as an opportunity to bring this together. We examine the real world experiences of several notable business reporting early movers, including Microsoft, Novo Nordisk, BHP Billiton and United Technologies and look at what can be learned from their efforts to date.

The end game is the development of a 'flagship' business report that fully integrates critical business performance information, traditional financial reporting, management commentary and sustainability reporting to allow external analysts, investors and others to make informed judgements about the entity's prospects. Current developments in this field include those made possible by technological innovations such as XBRL, web-based and real-time reporting. There are additional benefits from these developments, including efficiencies arising from automated information gathering and reporting systems, but there are also potential challenges around how to establish the credibility of the new information incorporated into the expanded business reports they make possible.

Perhaps the most important development in the business reporting space has been the establishment in 2007 of an umbrella global business reporting body, the World Intellectual Capital Initiative (WICI). WICI has developed a business reporting framework. An XBRL taxonomy has been built for that framework through WICI. Industry databases, focusing on common business model features and key performance indicators in an industry (e.g. software, mining and insurance), are also being established through WICI and loaded into the XBRL business reporting taxonomy. By using these tools as the starting point, individual businesses are able to implement enhanced business reporting.

There have also been significant business reporting developments in Australia, including the establishment of the Standard Business Reporting (SBR) initiative. The Australian Government set up this initiative to reduce the business-to-government reporting burden and agencies including the Australian Securities and Investments Commission, the Australian Prudential Regulation Authority and the Australian Tax Office are participating. Business reporting is a natural application for the SBR initiative, which will be fully implemented from July 2010.

The benefits of improved business reporting could include more efficient capital allocation, streamlined reporting processes, reduced reporting costs and enhanced organisational clarity in terms of business strategy and the business model. Australian entities can take immediate steps to begin realising these potential benefits by making business reporting-based improvements to their existing reports and evolving to a more comprehensive reporting strategy over time.

A vision for improved investment decision making

Our current reporting approach adheres to an accounting framework in financial reporting and offers inconsistent approaches to supplementary communication. It risks confusing investment decisions. Our current model also does not sit well with the clear, concise communication to the capital markets that enables informed investment decisions. This paper sets out our vision for business reporting and the road map to realising that vision.

So what is our vision for business reporting all about? Fundamentally, it is about improving the basis of capital allocation. The aim of the game is business communication for capital reward. It focuses on reporting the business strategy, performance in implementing it and insights into performance prospects. Financial and non-financial information will be fully integrated in the flagship business report, which will be delivered in real time and that will offer the capital markets true insights into the performance prospects of the company. Delivering information in this manner will enable the capital markets to better understand the strategy, align their models with business performance, and make efficient and forward-looking investment decisions based on business reports. The business reporting vision involves an alignment of the reporting strategy with the business strategy.

Reporting to the capital markets should be viewed as a communication opportunity. It is a 'fit-for-purpose tailoring exercise' where many strategic choices must be made as to what to report, to who, when and how, in what format and, probably most importantly, understanding why the organisation should report in this way. To 'feed' their models and decision-making processes, the capital markets need the right information to be delivered in the right format at the right time and with content that the markets believe in. Ultimately the aim of business reporting is about credible communication for capital. It is that simple – and that complex.

Our aim is to work with our clients, investors, regulators, the accounting profession, academics and other interested parties in agreeing and implementing a business reporting framework which significantly improves investment decisions.

The current reporting model

In his Ken Spencer Memorial Address, *Restoring Trust and Building Confidence,* in Melbourne on 2 March 2010, KPMG Global Chairman, Tim Flynn, made the following observation:

"Things have simply become too complex from my point of view. In fact, they are so complex and so voluminous that we run the danger of financial statements not maintaining their relevance to our most important user – the investor.

The real users of financial statements are shrinking. Companies do not use them to manage their businesses. In many cases, management does not use them to explain their financial results and I believe many investors simply cannot understand them.

Instead, companies focus on 'non-GAAP' measures in their press releases. A recent report from KPMG Australia showed that 84 percent of the top 100 Australian listed companies used a measure other than statutory profit to measure their performance. This showed that directors believe statutory profit does not provide all, and certainly not the best, information for investors to understand the operating performance of the company. We need to re-think financial reporting, remove the complexity and improve the transparency, and develop a disclosure framework, not increase the volume of disclosures."

The current reporting model – focused on IFRS-based financial reporting, supplemented by voluntary communications (referred to as 'management commentary' in this paper) and compulsory communications (continuous disclosures) – has significant limitations as a tool for evaluating the drivers of past financial performance, understanding future performance prospects, and differentiating between competing investment propositions in a capital constrained business environment.

The first half of Diagram 1 (below) summarises the current business reporting portfolio.

As Tim Flynn noted, our clients and the capital markets have become frustrated. We have seen the emergence of 'workarounds', including alternative financial performance measures such as 'underlying profit', and new financial reports such as 'summary financial reports' designed to highlight the key features of financial performance often buried in more voluminous financial statements. Annual reports containing audited financial statements have become divorced from the time horizon and information requirements of capital markets.

In addition, directors can be concerned when they are required to make compulsory continuous disclosures with financial statement implications (e.g. impairment and profit guidance) outside of their 'normal' reporting and assurance processes, and well before those matters are reported in audited financial statements.

Across organisations management commentary lacks a common framework and so there is little consistency between businesses. As a result, some businesses do it well, some do it badly – all do it differently. The capital markets must compensate for this lack of consistency as best they can, but in doing so the risk remains that the real story of business performance and prospects may not be fully understood.

Finally, as we emerge from the financial crisis, capital remains in short supply while investment requirements are dauntingly large. In some sectors (e.g. energy) there is likely to be a significant capital shortfall, making it imperative

Diagram 1

NOW

Current Business Reporting Portfolio

- Fragmented reports
- Complex and voluminous annual reporting
- Historical focus
- Not timely

to identify and finance only the best projects. In this environment, the current reporting model is also limited as a source of information for assumptions and inputs to the financial modelling that underlies the analysis of competing investment propositions.

These factors do not make for precise financial modelling and analysis and efficient capital allocation decisions. Modelling and decision-making becomes weighed down by extrapolation and assumption, makes greater allowance for uncertainty than is necessary and embraces more 'short termism' than would be the case if all businesses communicated their story to the capital markets in a consistent manner according to a common business reporting framework in near to real time.

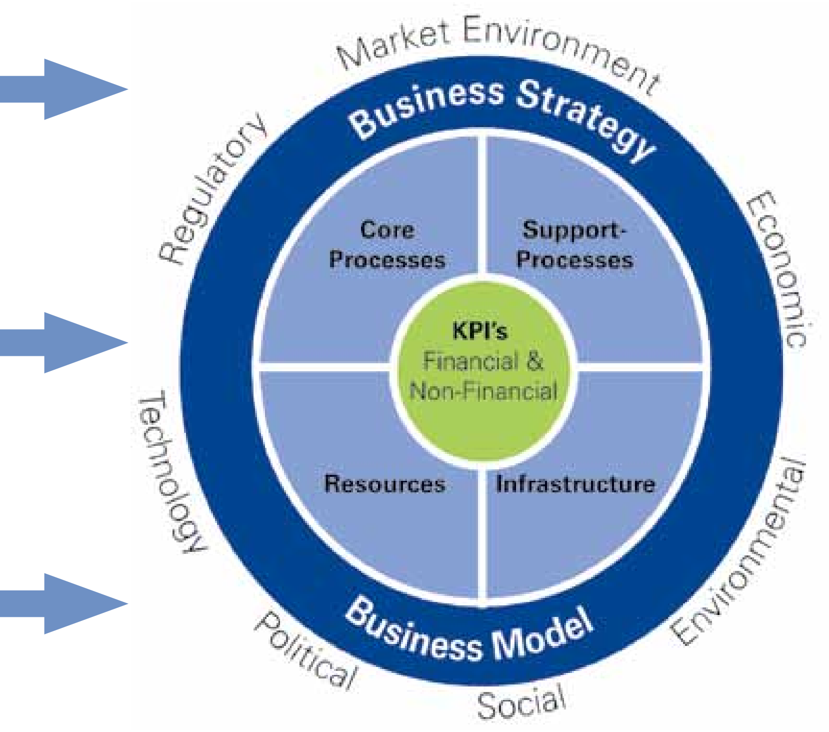
The second half of Diagram 1 (below) summarises the business reporting journey from the current business reports portfolio to a business reporting approach designed for efficient capital allocation.

In the context of the market environment (including economic, environmental, societal, political, technological and regulatory factors), the business strategy and business model put in place to execute the strategy are the focal points of business reporting. The business model comprises business processes (core and support), resources (e.g. people) and infrastructure (e.g. systems). Relevant KPIs measure progress towards the desired strategic outcomes and the performance of the business model. They comprise a balance of financial and non-financial measures across the whole business model. Accordingly, business reporting integrates strategic, financial and non-financial information, is future-performance focused, delivered in real time, and is fit for purpose.

NEXT

Business reporting for Capital Allocation

- Integrated strategic, financial and non-financial performace information
- Future performance focussed
- Fit for purpose
- 'Real time' information



Real world experience of early movers

The best way for new entrants to start on their business reporting journey is to reflect on the experience of early movers.

Early movers of business reporting concepts and report integration, such as Microsoft, United Technologies and Novo Nordisk, are increasingly reporting on the benefits that they are deriving from their business reporting journeys. They talk of the improved organisational clarity that comes from articulating the business strategy and business model given that reporting on these matters lies at the heart of enhanced business reporting. They also talk about the business process improvement that comes from consolidating multiple reporting processes for generating different reports into one reporting process for producing all reports, and the significant cost reduction which results. They share the ideal of a common reporting framework that will enable all businesses to tell their story to the capital markets in a consistent manner in near to real time.

It is too early to expect empirical evidence about the effects of business reporting on the cost of capital as, by definition and admission, no one has fully implemented the business reporting framework at this stage. Thus while it is too soon for anyone to report the 'right-sizing' of their cost of capital through business reporting, early adopters note positive comments from their investors and they expect their cost of capital will more closely mirror their strategy, performance and prospects over time.

According to Mr Todd Setcavage, Group Manager of Investor Relations at Microsoft, the genesis of Microsoft's Investor Central Portal is a desire to highlight information that is often buried in financial reports.

"There's a ton of valuable information deep within the 10Q or 10K or in earnings call transcripts that doesn't get exposed to investors. We wanted to make these valuable data points more broadly available, while at the same time embracing XBRL and showcasing technologies like Silverlight."

Microsoft®

Live data, regularly updated, on investor portal.

Benefit
Improved analytical capability for investors.

Microsoft

Mr Dennie Kimbrough, a Microsoft Investor Relations Manager, says the goal for Microsoft's website will be streamlining what is done today so people have everything they need in one location:

"Whether it's retail investors or institutional investors, they're all looking for the company's strategy and what we see as driving growth. We want to make it easier for them to analyse those things."

Mr Bob Laux, Senior Director of Financial Accounting at Microsoft, recently said:

"Microsoft has received good feedback on its Investor Central Portal, more so from smaller investors than larger investors. Smaller investors are able to dive deeper for their analysis. While larger investors are so far saying the portal is good, they still seem beholden to their own models. However, as we continue to add interactive tools to the portal, it will provide more utility to both smaller and larger investors."

Novo Nordisk

Novo Nordisk has been on its business reporting journey for close to a decade and reached the point of integrating its financial and non-financial reporting a couple of years ago. The next steps in their journey will include greater use of the business reporting framework and automating that reporting in a similar manner to Microsoft. They have found significant benefits in talking publicly about their journey and reporting strategy.

Novo Nordisk
Integrated consolidated financial and non-financial reports, both with independent assurance.

Benefit
Improved organisational clarity and reliability of non-financial information.

United Technologies

Mr John Stantial is Director of Financial Reporting for United Technologies. He says United Technologies has derived significant reporting cost reductions, reporting process improvements and strengthened organisational clarity from pursuing one reporting process for all reports. United Technologies expects that these benefits will be significantly increased in the future when reporting enhancements (e.g. business reporting) are automated and investor analytical capabilities improve. He was recently quoted in the *Journal of Accountancy* commenting on how XBRL is already changing his organisation's reporting processes.

"The entire quarterly reporting process takes an average of 845 hours. As data is extracted from the financial reporting system and is managed between multiple documents, nearly 20 percent of those hours are spent on the non-value activities of proofing, reading, checking and footnoting. Additionally, it is this manual aspect of the process that has the most potential for errors.

By not manually extracting the data and working in multiple documents, the effort to proof-read, review, check and add footnotes is not required. This eliminates 150–200 hours of labour from the quarterly reporting process, while concurrently strengthening the overall process controls.
So, there isn't a cost barrier, the tools are available, technical knowledge of XML is not required, the resource commitment need not be extensive, and there are a number of reasons to begin participating now.

But this is all reactive information. The benefits to XBRL come in the future when tagged information is readily available from all companies and can be accessed electronically for analysis, benchmarking, reporting uses and financial modelling. Not only can XBRL enhance external financial reporting, but it can also be applied internally for cost accounting, performance measurement, analysis and decision-making purposes.

Analysts and investors will be able to dramatically increase their breadth of knowledge with data readily available that does not require hours of manual manipulation. The data will be much more accurate and comparable; and context to the numbers will be accessible, ensuring they are used correctly."

BHP Billiton

It appears that companies such as BHP Billiton are trying to make it easier for the capital markets to see the critical information buried in their financial reports and management commentaries, or more appropriately reported in non-GAAP ways. They are trying to make it easier for the capital markets to understand their reports portfolios, and to easily navigate between and within their reports, so that investors and analysts can tap into the information they need to model companies' strategy, performance and prospects.

From the decision-making end of the capital markets reporting supply chain, a number of analysts have noted that they need different information to that contained in today's reporting, including annual reports and management commentaries, to do their work effectively.

They note that the business reporting framework, being focused on reporting the strategy, performance, and performance insights, will let them improve their models and analytical capability. This should allow more consistency in the way business stories are communicated to them.

bhpbilliton
resourcing the future

Summary review elevates highlights from detail. Logical and navigable reports portfolio on website.

Benefit
Capital markets know where to go to get information.

The business reporting framework

The business reporting framework adopted by WICI was summarised earlier as reporting the business strategy, performance in implementing it, and insights into performance prospects. The critical success factor in implementation of the framework by individual businesses is whether their business reporting enables the capital markets to understand the strategy, align their models with business performance, and make more informed and forward-looking investment decisions based on business reports.

An XBRL taxonomy has been built for the business reporting framework through WICI. Industry databases, focusing on common business model features and key performance indicators in an industry (e.g. software, mining and insurance), are also being established through WICI in conjunction with Gartner and loaded into the XBRL business reporting taxonomy. By using these tools as the starting point, individual businesses are able to implement enhanced business reporting focusing on a flagship business report (page 19).

The key components to be reported in relation to the business strategy in the flagship business report are the strategic objectives, business risks and their management, the business model (business processes, resources/people and infrastructure), and the KPIs covering each aspect of the business strategy that the capital markets will require to assess where a business is on the road to its intended destination. The components of the WICI business reporting framework upon which the XBRL taxonomy is built are summarised in the following table:

Table 1

Business Reporting Framework	Taxonomy Components
Market	**Corporate Overview**, including business and geographic segments **Business Landscape**, including industry analysis and technological trends
Strategy	**Description of Business** • development and description of business, segments, risks, legal proceedings • supplementary financial information
Performance	**Corporate Strategy** and related KPIs • strategy summary, vision and mission • SWOT analysis • overall corporate strategy, business unit strategies, business portfolio • goals, objectives and value drivers
	Business Model – Processes, Resources and Infrastructure and related KPIs
	Financial Performance, including summary (GAAP-based and GAAP-derived)
	Key Performance Indicators (KPI's), including strategic, process, resource and infrastructure. Corporate, industry-based and company-specific KPIs
	Environmental, social and governance KPIs
Performance Insights	**Management discussion and analysis / Management commentary**

Are we there yet?

This question is critical in the world of business reporting, which transcends the discrete (12 month) period focus of traditional financial reports as business reporting is focused on the longer-term business strategy and progress towards implementing it.

Most businesses know what their intended destination is (maybe a five-year total shareholder return target) and their road map (or strategy) to get 'there' (the business model - processes, resources/people and infrastructure). A key question is whether the intended destination and strategy have been explained to the capital markets with clarity and consistency.

There is a second key question. Have the KPIs identified internally as those critical to measuring progress towards the strategic objectives and performance of the business model been clearly explained and linked to the strategy up front in reporting to the capital markets? In other words, have the 'performance promises' been defined in a measurable and 'modellable' way?

If the answers to one or both of these questions is 'no', it would not be surprising if the capital markets keep asking, 'are we there yet?', and penalise you if they do not get a clear answer.

In addition, we all know that it often takes a long time to get 'there', even if the 'destination' is well known or even in sight. Explaining the destination is, in fact, the 'easy' part, even if this is often not done well. The harder part is explaining the road map and where you are located on that road map. The capital markets are much less likely to ask 'are we there yet?' if business reports show whether the measures of progress nominated up front indicate that you are where you expected to be on the road to the final destination, and provide insights about what might happen during the rest of the journey. This will make it safe and rewarding to report on KPIs measuring today's status towards the destination (e.g. total shareholder return), progress (e.g. people or risk management performance) and prospects (e.g. anticipated revenue levels in two years if the strategy is well executed) without fear of that information being misinterpreted in the capital markets.

The KPIs will include those which are standard in a particular industry (increasingly available from the WICI industry KPI libraries), and also those measuring the unique features of a business model and the competitive edges of a business. KPI information can also be provided for peers and competitors to further accentuate superior performance. Insights into past and future performance can be reported to the capital markets by reporting on the linkages between KPIs, such that the capital markets can develop scenarios and sensitivities in their models based upon alternative views of the internal and external environments, allowing them to extend their decision-making time horizons. Specifically, this reporting will provide a better basis for setting assumptions and designing modelling architecture, developing more accurate cash flow estimates, and selecting a discount rate based upon the unique features and competitive edges of the business model, all setting the scene for a longer term modelling horizon.

The industries with possibly most to gain through the implementation of business reporting are those with long lead times from large upfront investments (e.g. mining, pharmaceuticals, automotive) or complex business models and business risks (e.g. banks and other financial institutions).

Industry KPI libraries – basis for implementation by individual businesses

All industries compete with each other for capital, as do the businesses within industries. Australian businesses compete for capital in global capital markets. The development of relevant, measurable and consistent KPIs for industries and individual businesses means that the capital markets will have a better basis for allocating capital between organisations and between industries.

WICI industry projects co-opt industry leaders and leading industry analysts as co-developers, formulating a library of KPIs that can assist in forecasting financial results.

The WICI industry-based KPI applications of the business reporting framework take the potential benefits of adoption of business reporting to a new level. The emergence of the industry KPI taxonomies has brought consistent business reporting within and between industries a step closer. The intention of the industry KPI libraries is for companies beginning their business reporting journey to have a tailored starting point for their industry so that investors, analysts and others in the capital markets can have confidence about the consistency of corporate and industry-based information. Given that business reporting is designed to enable businesses to inform the capital markets about the unique features of their business models and competitive differentiators, it is important to look beyond the standard industry KPI library. Businesses need to report the KPIs unique to their own strategy, business model and competitive edges. The WICI XBRL business reporting taxonomy accommodates business-specific KPIs in addition to the industry library.

The library for the software industry is now complete. Those for the automotive, electronic devices, pharmaceuticals and chemicals industries are under development. A mining industry taxonomy is now under consideration.

Of course, it is not necessary to wait for an industry application to start the business reporting journey. The WICI XBRL business reporting taxonomy can be used by individual businesses in advance of an industry KPI library becoming available.


N
20
40
60
80
E
100
120
140
160
S
200
220
240
260
W
280
300
320
340

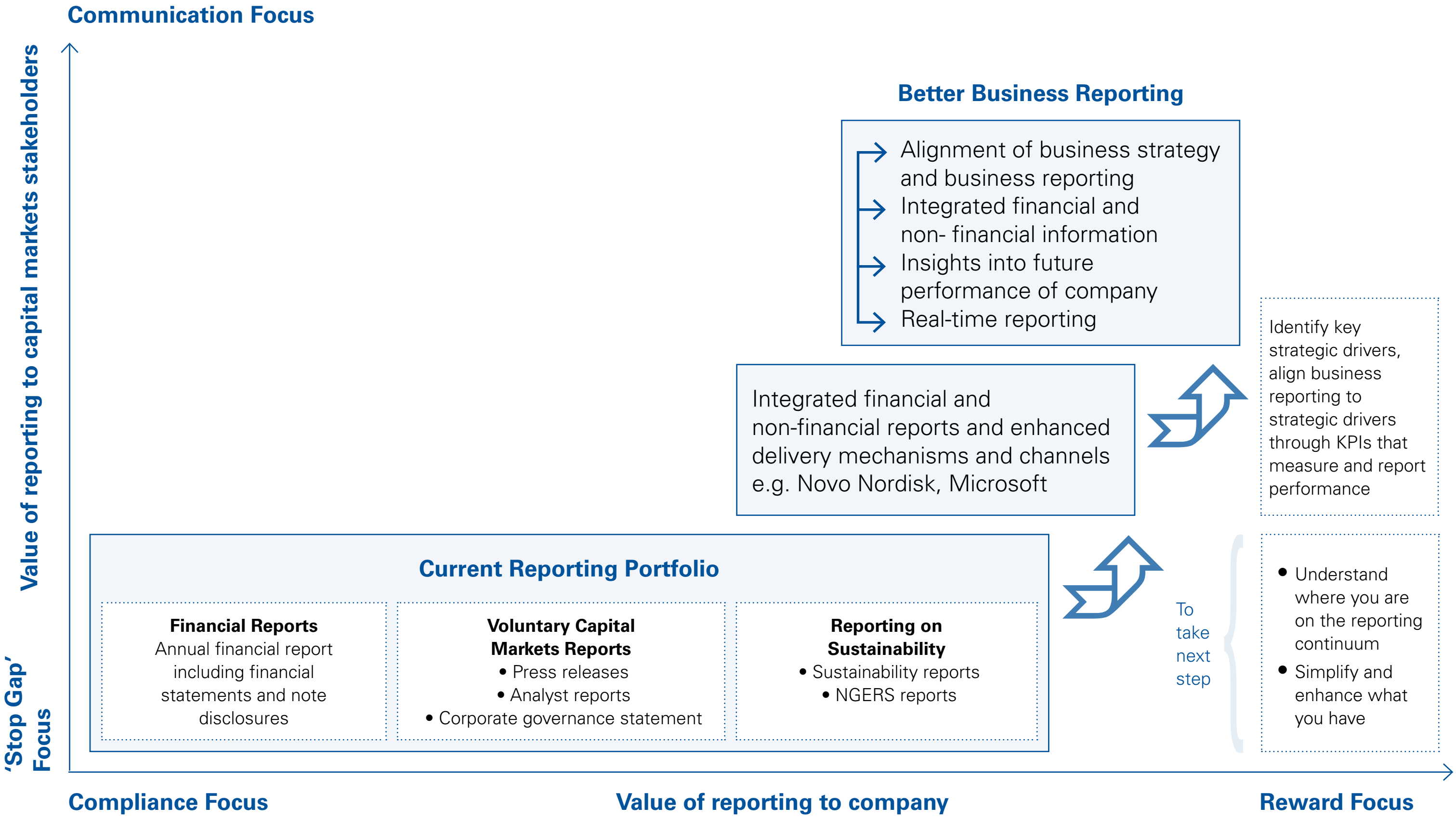
Steps in the journey

Early mover business reports bearing the hallmarks of prototype reports such as *Lintun*, and business reporting frameworks such as *WICIs,* appeared towards the end of the last decade.

Novo Nordisk, a global diabetes management leader based in Denmark, began its journey to integrated business reporting in the middle of the last decade. The journey is well documented on its website. Novo Nordisk has integrated its consolidated financial statements and consolidated non-financial statements in its annual report, with independent assurance on both. Microsoft has applied the business reporting framework – strategy/performance/performance insights – in a flagship business report based on live data distributed through its Microsoft Investor Central Portal using XBRL. BHP Billiton has developed a 'summary review' focused on financial highlights, and has included a clearly defined reports portfolio on its website, providing easy navigability around the portfolio.

Diagram 2

Steps in the business reporting journey



The work of these early movers pre-dates the industry KPI applications that are now making consistent and automated business reporting possible. In years to come, the number of WICI industry applications will grow, there will be critical mass in the number of companies using the business reporting framework, and the reporting of business-specific KPIs will be the norm such that the desired consistency of business reporting will have been achieved. The capital markets will naturally use these KPIs in their analysis and modelling. Businesses will have realised the capital allocation advantages of reporting the unique features of their business model and other performance insights.

Diagram 2 summarises the steps in the business reporting journey. It maps the value of reporting to a business against the value of reporting to the capital markets. The business reporting journey will involve a move from the compliance focus of the current reporting portfolio, through an integration of financial and non-financial reports with highlights summaries, to more holistic business reporting for capital allocation. The end game is a ‘communications for reward’ (capital, reputation, licences to operate) focus. At this time, there will be an alignment of the reporting strategy with the business strategy. Financial and non-financial information will be fully integrated in the flagship business report, which will be delivered in real time, most likely in XBRL. The capital markets will get true insights into the performance prospects for the company.

As noted previously, the XBRL business reporting taxonomy includes a specific section for the MD&A, anticipating an SEC mandate for the lodgement of that document in XBRL when it judges that the WICI business reporting framework and industry KPI applications provide a stable platform. In other parts of the world, automating the MD&A will provide a basis for the automation of the management commentary. This will establish a foundation for Australian businesses to obtain reporting cost reduction benefits such as those being derived by the early participants in the business reporting journey on a global basis, and for the capital markets to receive comparable business reporting between companies in near to real time. The reporting cost reductions possible by consolidating reporting processes and focusing on a flagship business report using the MD&A section of the XBRL taxonomy are significant.

In Australia, the Standard Business Reporting (SBR) initiative is making rapid progress. Business reporting is a natural application for the SBR initiative. Businesses will be able to leverage the benefits of the SEC mandates, particularly as they go through the preliminary ‘data cleansing’ phase required that will secure the integrity of the information included in business reports.

The early movers are deriving significant benefits and showing that there is competitive advantage in pursuing a business reporting journey. The ‘sustainability/‘CSR’ reporting movement is moving towards the capital markets. A key to realising a business reporting aspiration will be to build upon the current impetus being provided by regulation, early adopters and the sustainability/‘CSR’ reporting movement. More businesses are seeking to exploit the benefits of XBRL. These developments provide the catalyst to move from early adoption of business reporting to critical mass.

Standard Business Reporting (SBR)

SBR is an Australian Government initiative to reduce the business-to-government reporting burden.

Led by the Australian Treasury, the agencies participating in SBR are the Australian Taxation Office (ATO), the Australian Securities and Investments Commission (ASIC), the Australian Prudential Regulation Authority (APRA), all state and territory government revenue offices and the Australian Bureau of Statistics.

Some examples of reports SBR is targeting include the Business Activity Statement (ATO), financial statements (ASIC), and payroll tax returns (state and territory government revenue offices).

SBR is expected to save Australian business an estimated $800 million per year once fully implemented from July 2010.

Adoption of SBR will be voluntary and no legislative changes will occur as a direct result of the initiative.

A roadmap for improved capital allocation

Implications for legislators, regulators and standard setters

Business reporting has significant implications for legislators, regulators and accounting standard setters. In Japan, the business reporting movement is being driven by the Ministry for Economy, Trade and Industry (METI), with significant participation from the accounting profession. Business reporting is viewed as a critical next step for the development of Japanese capital markets. In the US, the Global Public Policy Committee is driven by the accounting profession, with significant participation from the capital markets. In Europe, the analyst community is leading the way. In Australia, the Society for Knowledge Economics and the accounting profession have taken lead positions. An Australian Public Policy Committee has recently been formed.

Implementation of business reporting does not rely on new legislation, regulations or reporting standards. Businesses can take immediate action by pursuing the benefits outlined in this paper and becoming involved in the rapidly expanding business reporting movement, which is being led by WICI. Reporting standards can follow as practice evolves. Regulators and legislators will be critical to facilitating change and removing obstacles to change. Of course, legislation or regulation could dramatically accelerate implementation if desired.

The global business reporting movement is on the move. Rapidly. The challenge for businesses now is to avoid getting left behind.

Australian businesses can take immediate steps to realise the benefits of enhanced business reporting. They can start small by making business reporting-based improvements to existing reports and evolving to a more comprehensive reporting strategy over time.

Businesses can undertake a diagnostic analysis of existing financial reports and supplementary capital markets communications, sustainability reports and report automation. This analysis can be used to develop a fit-for-purpose reporting strategy focused on improving the basis for capital allocation, streamlining reporting processes, reducing reporting costs and improving organisational clarity as to the business strategy and business model. A focus on sustainability and real time reporting as well as financial reporting and management commentary will be built into the reporting strategy as steps on the path to integrated business reporting focused on a flagship business report. In developing the reporting strategy, businesses will decide what to report (strategy, performance and insights into performance prospects); and how to communicate those reports to the capital markets (report formats, timeliness, use of technology).

Reporting of the business strategy in annual reports and management commentary tends to occur after such information is required by the capital markets. Meanwhile KPIs have tended to focus on outcome-based measures, financial and non-financial, rather than the more revealing aspects of performance and performance prospects. By way of contrast, reporting KPIs measuring how people have performed in achieving goals that are clearly linked to the business strategy should provide greater confidence in relation to whether the business strategy will be executed.

Businesses will need to consider whether all elements of the flagship business report are released together, and when and how they are refreshed, using all available reporting format and distribution channels. Report sequencing will be an important component of the reporting strategy, with a logical sequence being the reporting of strategy, then performance and then performance prospects, which will be accompanied by a strategy update. It is important to deal with these matters in the reporting strategy.

Businesses can experiment internally with the business reporting framework, XBRL business reporting taxonomy and industry KPI libraries as they calibrate their internal reporting processes and systems to deliver business reporting to the board and executive teams. Such reporting can be delivered externally when the capital markets are judged to be ready to use it effectively in their decision-making. Over a period the reporting strategy will become 'business as usual' through the ongoing reporting process and a development of a reporting team with the knowledge, skills and competencies to execute the reporting strategy effectively.

CFO performance reporting will always focus on the quality of the business reports produced for both internal and external audiences. It will also focus on the quality of the reporting strategy, the performance of the reporting processes, teams and technologies, reporting cost reduction targets, and the capital markets consequences of reporting initiatives.

First step – improve what you already report

Let's not obscure the critical information.

Adding to the already formidable reporting compliance burden would be an undesirable outcome of a business reporting journey. The reporting strategy must include ways to simplify what is already reported. Part of this will be achieved by consolidating reporting processes. Another part will be accomplished by taking a fresh look at what is already reported, finding opportunities to remove unnecessary detail. Finally, opportunities can be taken to introduce broader business reporting elements into existing reports, and to gradually evolve to a flagship business report. External and internal assurance can add value to these reporting improvements, both internally and in the capital markets.

Financial reporting will continue to be critically important to the operation of capital markets. It can evolve in conjunction with broader business reporting. A key purpose of financial reporting is to demonstrate the credibility of management and of the reporting process, and to report what actually happened. Independent assurance adds to trust in the information reported.

The 'look back' orientation of financial reporting also allows businesses to demonstrate whether they have delivered on past performance promises (the strategy) provided that the strategy and associated KPIs have been well articulated previously. For example, financial statement disclosures may include the KPIs identified in the 'strategy' element of a business report, and provide some insights into performance prospects by linking these KPIs to the more forward-looking aspects of financial statement disclosures (e.g. disclosures about capital management, accounting estimates and judgements and sensitivity analyses). To the extent that such information is included in financial reports it will automatically receive independent audit assurance.

Sustainability reporting has become important. It will continue to evolve as it becomes better understood by the capital markets and thus becomes more important to investment decisions through integration with financial reporting in broad-based non-financial reports, and ultimately business reports. Novo Nordisk has followed this path, including both a consolidated financial report with independent audit assurance and a consolidated non-financial report with independent review assurance in its integrated annual report.

Management commentaries can focus on the link between these critical financial statement and sustainability disclosures and the previously reported strategy, and provide insights about previous performance relative to KPIs and performance prospects (expected KPI levels) if the strategy is well executed. This is not forecasting.

Report automation technology exists and is in use in a number of areas (e.g. lodging returns with regulators). Reporting portals have been developed on the internet and as a result significantly improved linkages between and within reports have become possible. It is possible now to distribute business reports, improved financial reports, management commentaries and sustainability reports to the capital markets using technologies such as XBRL. In fact, as we have already explained, financial reporting in XBRL has been mandated by the SEC in the USA, and electronic lodgement of the MD&A will be mandated next. Microsoft and United Technologies are showing what is possible with report automation and are reporting the benefits. Australian companies can follow the approach of US companies in automating financial reporting, management commentaries, sustainability reports and, ultimately, business reports. Assurance on automation processes and systems can be obtained.

Such improvements to existing reporting will be important foundations for the continued evolution of business reporting. This evolution will assist capital markets to extend their decision-making horizons by being able to model short, medium and long term financial performance, including the effects of sustainability strategies and their impact on reputation and licences to operate. Significant cost savings and reporting process improvements will be possible if they are sought in the context of a 'fit-for-capital' reporting strategy. Value will also be derived from implementing an assurance strategy which is aligned with the reporting strategy, which may include independent assurance on business reports.

A 'flagship' business report can be tailored to meet stakeholders' needs

Whether the flagship business report is a physical report delivered to the capital markets, or is a database of information from which a number of reports to the capital markets are drawn, is a matter to be considered in setting the reporting strategy. It is most **unlikely** that the flagship business report will be today's annual report, or today's key voluntary report to the capital markets such as the 'analyst pack' or other forms of management commentary. In a fully automated reporting world, the options are endless.

Next step – implement the business reporting framework

The application of the business reporting framework will result in the development of a comprehensive flagship business report, which will be focused on reporting the strategy, performance and insights into performance prospects of an individual business. The flagship business report is a gateway to further 'drill-downs' of financial or non-financial information. Ultimately, this information will be able to be manipulated by investors and analysts to meet their particular needs (i.e. 'fit for purpose' reporting based on user needs).

All reports and report distribution channels will have a capital allocation purpose as well as meeting any compliance requirements (e.g. compliance with accounting standards or the Global Reporting Initiative). Linkages will be clear between reports in the portfolio (e.g. the flagship business report and the other reports extracted from the underlying data) and it will be easy to navigate between and within the reports (e.g. between the description of the business strategy and associated KPIs, between KPIs measuring strategic objectives and, say, people performance KPIs, and between KPIs measuring performance and KPIs measuring risk management). The flagship and all other reports will be produced through one reporting process and distributed to their audiences using distribution channels and technologies tailored to the decision-making formats, content and timing required by those audiences.

An approach taken by some companies (e.g. BHP Billiton) in their journey to such a portfolio is to introduce a 'summary report' which highlights and aligns the critical aspects of the financial statements and management commentaries. Such reports usually include certain non-financial KPIs which provide insights into critical aspects of financial performance, but which are often otherwise buried deep in financial reports, commentaries thereon, or in sustainability reports. In some instances, this information includes key aspects of sustainability reports. Alternatively, rather than create a summary report, Microsoft launched its Investor Central Portal with an aim of highlighting critical financial information that was previously buried deep in financial reports and earnings call transcripts.

The flagship business report will be comprehensive yet concise. It should cover all critical aspects of and insight into the business strategy, performance and prospects. It may evolve from the summary financial reports that highlight the critical aspects of financial reports, management commentary and sustainability reports that at present are often overloaded with detail and lacking in context. It is likely to be delivered in XBRL and be regularly updated with live data (as Microsoft is doing with its Investor Central Portal). Assurance over the reports portfolio will also improve capital market confidence levels in the reporting.

Are you ready to start the journey?

To determine your organisation's state of readiness to embark on or continue on the business reporting journey, it may be useful to ponder the following questions.

- Is there organisational clarity as to your business strategy, business model and key performance indicators measuring the strategy and model? How well do your executives understand the strategy and are they focused on the key value drivers and associated KPIs? Do they all tell the 'story' of the business in a consistent way?
- If you think about the key individuals in the capital markets who have the most influence on your capital position, how well does each of them understand your business strategy, business model and performance prospects? Are their financial models aligned with yours? Is your market value what you think it should be?
- What is the cost of your reporting process? Do you have multiple reporting processes? Do you have any other frustrations with your current reporting and reporting process?

Background

The business reporting movement has been around since the early 1990s. The 2000s decade could best be characterised as a period of research, the finding of common ground among the pioneers and building a business reporting framework, both overall and at the industry level. During this time different business reporting initiatives have appeared around the world.

The remarkable thing has been the common features of the conclusions they have reached, and a period of quite rapid convergence has been evident in the past year.

We have also seen developments in technology (e.g. XBRL, web-based reporting, electronic report distribution) that will deliver business reporting to the capital markets in real time in a consistent manner. There has also been a broadening of reported performance measures through the sustainability/corporate social responsibility (CSR) reporting movement.

These developments all contribute to an environment where the tipping point for business reporting has been reached. Swift execution at the individual business level is now possible. The time is right to focus on the implementation of business reporting.

While not a crowded place, the world of business reporting is now occupied by the accounting profession, leading businesses, some analysts and investor groups, industry groups, legislators, regulators and business commentators. It is quickly generating critical mass and a large degree of consensus through WICI.

The accounting profession has been researching and developing business reporting for around a decade. A number of business reporting frameworks have been put forward in recent years, and there is a lot of commonality between them. The common thread is a conceptual underpinning – reporting of the strategy, performance and performance drivers, and insights into performance prospects. For example, the Institute of Chartered Accountants in Australia's (ICAA) 2002 publication, *New Directions in Business Performance Reporting & Assurance,* was an early contribution to the case for change. It outlined what a business reporting framework might look like and discussed implementation considerations.

Towards the end of the last decade the Enhanced Business Reporting Consortium (EBRC) in the USA, which is spearheaded by the American Institute of Certified Public Accountants, created one of the early business report prototypes for the fictitious company *Lintun*. The 'Report Leadership' initiative in the UK did something similar, building the prototype Generico business report. These prototypes are worth considering as they are possibly a more holistic demonstration of the business reporting frameworks than has been publicly released to date by the early adopters.

The recently published, One Report – *Integrated Reporting for a Sustainable Strategy* by Robert Eccles and Michael Krzus outlines a number of case studies of the early adopters of business reporting. It focuses on the integration of financial and sustainability/CSR reporting.

Possibly the most exciting development has been the formation and public emergence in 2007 of an umbrella global business reporting body known as WICI, the World Intellectual Capital Initiative. It is a private/public sector collaboration aimed at improving capital allocation through business reporting. The founding members of WICI were the EBRC, the European Federation of Financial Analysts Societies, the Japanese Ministry of Economy, Trade and Industry (METI), the OECD, the Society for Knowledge Economics, the University of Ferrara (Italy), and Waseda University (Japan). The European Commission participates in WICI as an observer. Japan has formed its own WICI chapter. The EBRC acts as the WICI member body in the USA. WICI is aiming to establish an Australian chapter shortly along the lines of WICI Japan. KPMG has recently become an Observer within WICI.

WICI has now adopted a business reporting framework similar to that outlined in the 2002 ICAA publication. Through the EBRC, WICI has led the development of an XBRL taxonomy for its business reporting framework and has established a collaboration with the Gartner Group to develop key performance indicator (KPI) libraries for selected industries applying the business reporting framework and associated XBRL taxonomy. The ICAA has been working with industry bodies to define libraries of KPIs for several industries, including for a general office based service business, the financial services industries (banking and insurance) and extractive industries. The combination of WICI's XBRL taxonomy and the industry KPI libraries establishes the basis for individual businesses to introduce enhanced business reporting.

References

The Business Reporting Framework

World Intellectual Capital Initiative (WICI), The World's Business Reporting Initiative http://www.worldici.com/ <http://www.worldici.com/>

'One Report – Integrated Reporting for a Sustainable Strategy', Robert Eccles and Michael Krzus, 2010

'New Directions in Business Performance, Reporting & Assurance', Institute of Chartered Accountants in Australia, 2002

'Broad Based Business Reporting – The New Benchmark in Business Reporting', Institute of Chartered Accountants in Australia, October 2008

'Broad Based Business Reporting – Business Reporting in Practice', Institute of Chartered Accountants in Australia, September 2009

Standard Business Reporting, An Australian Government Initiative http://www.sbr.gov.au/ <http://www.sbr.gov.au/>

Business Reporting Examples

Microsoft Investor Central Portal http://www.microsoft.com/msft/IC/default.aspx <http://www.microsoft.com/msft/IC/default.aspx>

Novo Nordisk 2008 Annual Report and web site. website http://annualreport.novonordisk.com/how-we-are-accountable/default.asp <http://annualreport.novonordisk.com/how-we-are-accountable/default.asp>

BHP Billiton Summary Review http://www.bhpbilliton.com/bb/investorsMedia/reports/annualReports.jsp <http://www.bhpbilliton.com/bb/investorsMedia/reports/annualReports.jsp>

Lintun prototype, Enhanced Business Reporting Consortium http://www.ebr360.org/ContentPage.aspx?ContentPageId=81 <http://www.ebr360.org/ContentPage.aspx?ContentPageId=81>

Generico prototype business report – Report Leadership Initiative (November 2006) http://www.generico.co.uk/ <http://www.generico.co.uk/>

'Return on Investment in XBRL – Interactive data Cuts Reporting Costs Today', John Stantial, Director of Financial Reporting, United Technologies, Journal of Accountancy, 2007

The Business Reporting Case for Change

'Global Capital Markets and the Global Economy "A Vision from the CEOs of the International Audit Networks', November 2006

'Global Dialogue with Capital Markets Stakeholders - A Report From the CEOs of the International Audit Networks', January 2008

'Developments in New Reporting Models', Institute of Chartered Accountants in England and Wales, 2009

'Reaching the $20 Trillion – A Progress Report', a paper delivered by Michael Bray to the World Energy Congress in Rome, 2007

'Business Reporting & Communications – Promoting Adequate Investment in the Energy Sector', a paper delivered by Michael Bray to the World Energy Congress in Sydney, 2004

'Financing the Australian Energy Sector 2009 – the Impact of Climate Policy and the Global Credit Crunch', Australian Energy Alliance, 2009

'The Third Wave Breaks on the Shores of Accountancy', Robert Elliott, 1992

About the author

Michael Bray is a KPMG audit partner with 30 years experience providing audit and advisory services to a range of clients. He is chairman of KPMG in Australia's Better Business Reporting Group.

Michael is also the author of the Institute of Chartered Accountants in Australia (ICAA) publication *New Directions in Business Reporting, Communications and Assurance*. His long-standing interest in business reporting matters is reflected in his foundation membership of the ICAA's Broad Based Business Reporting Panel.

He is also the chairman of KPMG in Australia's Energy & Natural Resources Group and a director of the Energy Alliance of Australia.

Related publications

This is the first in a series of *Better Business Reporting* publications covering developments in areas including financial reporting, management commentaries, sustainable capital allocation and real time business reporting.

Other KPMG publications that may also be of interest include the following:

Integrated reporting - closing the loop of strategy, KPMG Europe LLP, 2010

Managing financial impacts and reporting of carbon emissions – A guide for CFOs, KPMG in Australia and the Group of 100, 2009

Underlying profits survey report, KPMG in Australia, 2010

Using IT to drive business innovation, KPMG in Australia, 2010

For further information or to obtain copies of these publications, please contact your KPMG adviser or one of the professionals listed at the back of this publication.

Contact:

Melbourne
Michael Bray
Partner
+61 3 9288 5720
mbray@kpmg.com.au

Penny Stragalinos
Partner
+61 3 9288 5108
pstragalinos@kpmg.com.au

Sydney
Anthony Jones
Partner
+61 2 9335 7238
arjones@kpmg.com.au

Shaun Kendrigan
Partner
+61 2 9335 8722
skendrigans@kpmg.com.au

Brisbane
Simon Crane
Partner
+61 7 3233 3153
simoncrane@kpmg.com.au

Adelaide
Paul Cenko
Partner
+61 8 8236 3288
simoncrane@kpmg.com.au

Perth
Brett Fullarton
Partner
+61 8 9263 7159
bfullarton@kpmg.com.au

May 2011. QLDN07587AUD.