Room for improvement

The KPMG Survey of Business Reporting, second edition

KPMG International

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Welcome to KPMG's Survey of Business Reporting

In the second edition of the report, we present the main findings from a global analysis of the content of 270 larger listed companies' reports, in an effort to highlight weaknesses and identify good practices in the presentation of corporate information. Our aim is to contribute to the debate among companies, investors, regulators, standard setters, auditors and others about what is right and wrong with corporate reporting around the world today, and help chart a course toward improved communication between companies and their shareholders. Capital markets rely on relevant information presented clearly and accurately, so the clarity and usefulness of corporate reports have an important role in ensuring they function efficiently and help support a healthy economy.

Our view is that financial reporting plays a central role in this communication, but it cannot present a complete picture of business performance and prospects on its own. Investors must assess the underlying health of the business, its potential for growth, and the long-term sustainability of its earnings. Annual reports provide much less information to support these assessments, although objective information could be provided to give this broader insight.

This imbalance of information can lead to short-termism. Current year earnings may be valued more highly than longer-term business prospects, simply because the value created is more visible. As a result, businesses that are investing in their long-term prospects may find it difficult to compete for capital with those that are instead prioritizing short-term earnings.

Addressing this will require something greater than merely tweaking financial reporting standards; indeed, this could undermine their conceptual integrity. Instead, the answer lies in the presentation of a broader range of business-focused information that addresses the operational performance of the company, allowing investors to form their own assessments of business prospects. The annual report is the right platform for this discussion, providing the backstop to other, more timely, performance communications.

We hope you find our analysis to be a useful contribution to this debate.

Mark Vaessen
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KPMG International

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KPMG in the UK

Main findings — the 'must dos' for improvement

1

Give investors the information they need

Annual reports can do more to look beyond past financial performance to provide objective information on current performance levels, details of strategy and progress in implementing it. They should provide more insight into how key business resources are being managed to meet the longer-term needs of the business.

Report content

42 percent of the average report is devoted to the financial statements, but only **14 percent** addresses business strategy

Looking forward

Only **7 percent** of reports provide information on order-book or sales run-rate to explain how the baseline performance of the business has changed

2

Keep the report content clear and relevant

Narrative discussions of corporate performance are often repetitive, anecdotal and fail to reflect business priorities, while the length of financial statements is often driven by national practices rather than the specific circumstances of the business.

Plenty of space

The average annual report is **204 pages** long. Reports don't need to get larger to be more insightful

Different views of 'concise'

Financial statement length varies significantly between countries — from **60 pages** in Russia to **140 pages** in Italy

3

Provide a longer-term view using operational KPIs

Better reporting of non-financial key performance indicators can help to balance short-term discussions of financial performance with a longer-term view of business success. The right objective operational performance measures provide insight into business prospects but they are not widely used. To support a longer-term view of performance, companies should select measures that align closely with the specific factors that drive success for their business, such as the strength of the customer base.

A healthy business

Only **11 percent** of reports come close to covering performance information on **six key areas** of business health

Track record

Only **9 percent** of reports provide a **5-year** track record of operational performance

4

Provide practical KPIs that align with strategy

Some companies are already providing simple measures that explain some of the most significant aspects of business performance. These measures can help investors assess the commercial success and prospects of the business.

Winning customers

Only **17 percent** of reports tell you whether the business is winning or retaining customers

Building presence

Only **15 percent** of reports show how brand or market share is developing

Building capability

Only **8 percent** of reports show whether the business is building or retaining its know-how and expertise

5

Provide deeper analysis of strategy

Descriptions of business model and strategy could be more tightly focused. Many business model descriptions focus on only a few aspects of the company and strategy discussions tend to highlight short-term incremental performance improvement rather than the long-term, corporate direction.

Short term

44 percent of reports do not look beyond short-term initiatives when discussing strategy

Missing the point?

73 percent of reports do not discuss customer-focus as a key business objective

Part of the story

Only **58 percent** of companies identify knowledge and expertise as a key part of their business model

6

Focus risk analysis on what's important for the future

The quality of risk discussions is variable. Many risk discussions appear to have been published in order to comply with regulations rather than to help investors understand how the most important risks are being managed. Common issues were failure to focus on the risks that are most relevant to business value, and not addressing risks relating to growth strategies.

Risk overload

Risk disclosures in four countries identified an average of **over 20** 'key' risks each, suggesting a lack of focus on the most important matters

A static view

Only **11 percent** of reports show how the risk profile has been managed over time

Strategic risks

Less than **10 percent** of companies identify risks in relation to each of strategy selection, product relevance and change management

Methodology

The survey looked at 270 annual reports from larger listed companies in 16 countries. It includes at least one company from each of 15 non-financial industry sectors in every country, except where there were no relevant companies in that country. Financial services companies were excluded from this survey due to the considerably greater reporting requirements required in this industry.

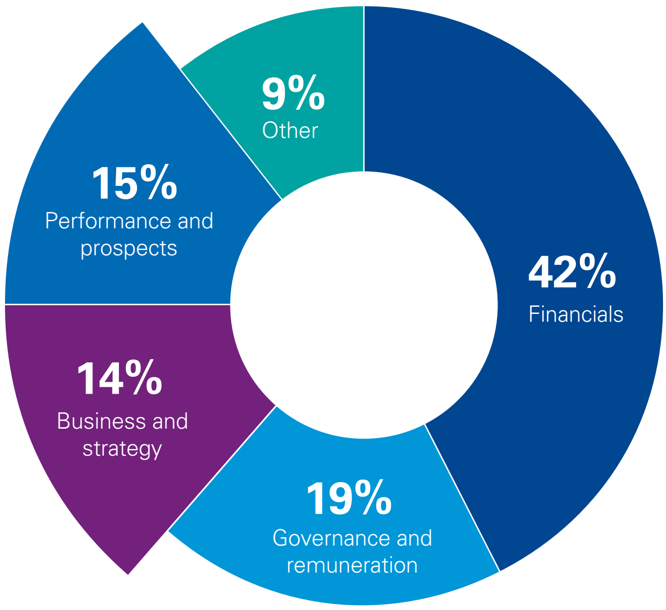
The analysis is based on information in KPMG member firms' reporting database derived from reviews of companies' narrative reporting content. The data captured includes the qualitative and quantitative information provided in relation to business model, strategy, performance and risk. Many performance disclosures are embedded in the text of the annual report. These disclosures are also included to the extent that they contain meaningful performance information (vague statements, such as 'the business performed well,' are not captured). On average, 100 information points were collected for each report.

The database also includes information on the overall structure of reports. The definition of an annual report varies between countries. In some countries, disclosures commonly found in annual reports are made in a separate document (for example, proxy filings). For comparability, these additional disclosures are also included in the report page count. Many companies also produce separate sustainability reports. Because material sustainability disclosures should generally be included in the company's annual report, the survey does not look at separate sustainability reports.

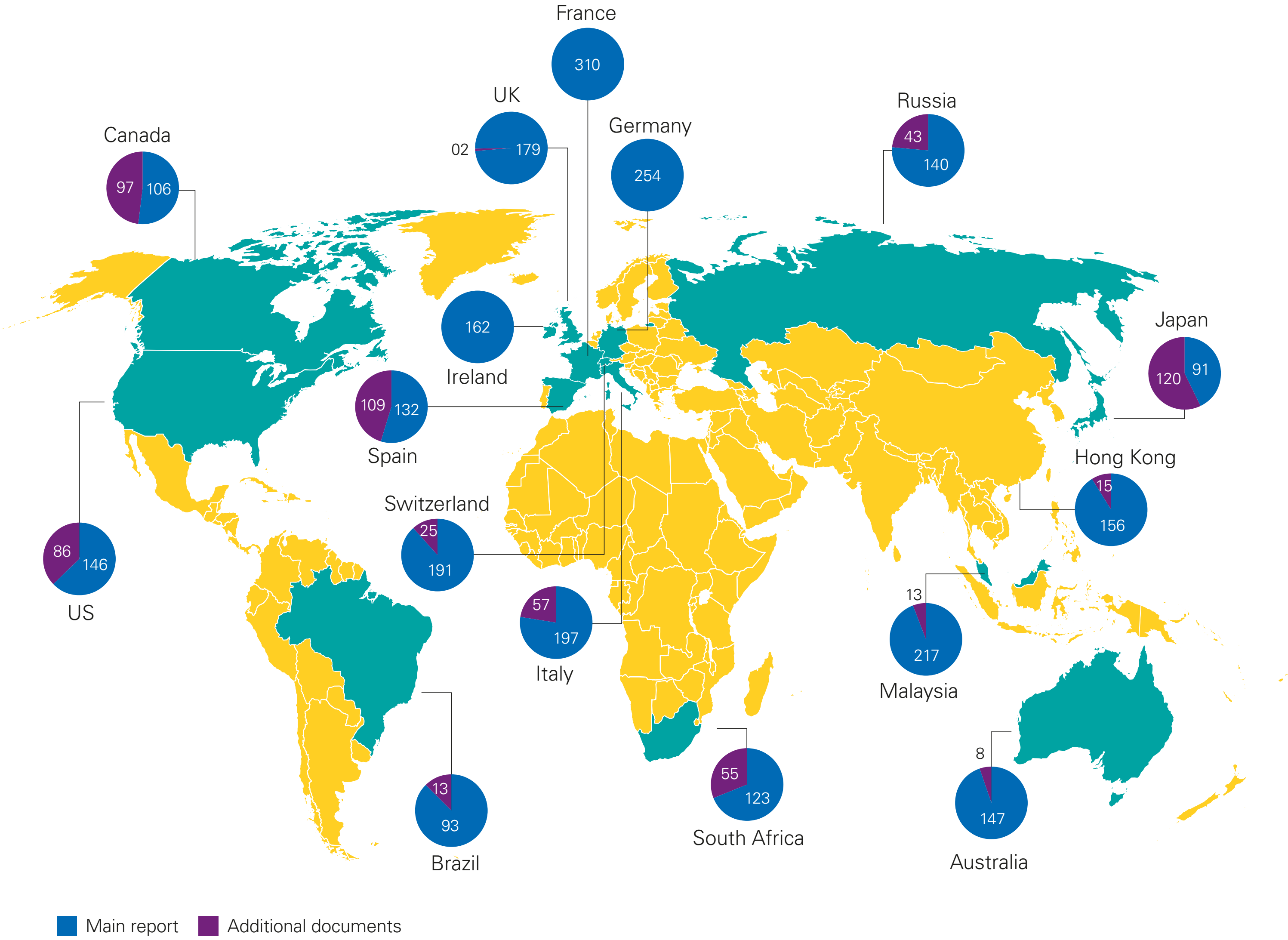
The annual report

Corporate reports don't need to grow larger to be more insightful. The average length of the reports surveyed was 204 pages, which should be enough to cover everything of significance, if space is allocated appropriately. But, on average, 42 percent of the annual report comprises the financial statements, almost three times more than the amount of space devoted to either the discussion of the company's business model and strategy on the one hand, or its performance and prospects on the other.

Annual report content



Average annual report length



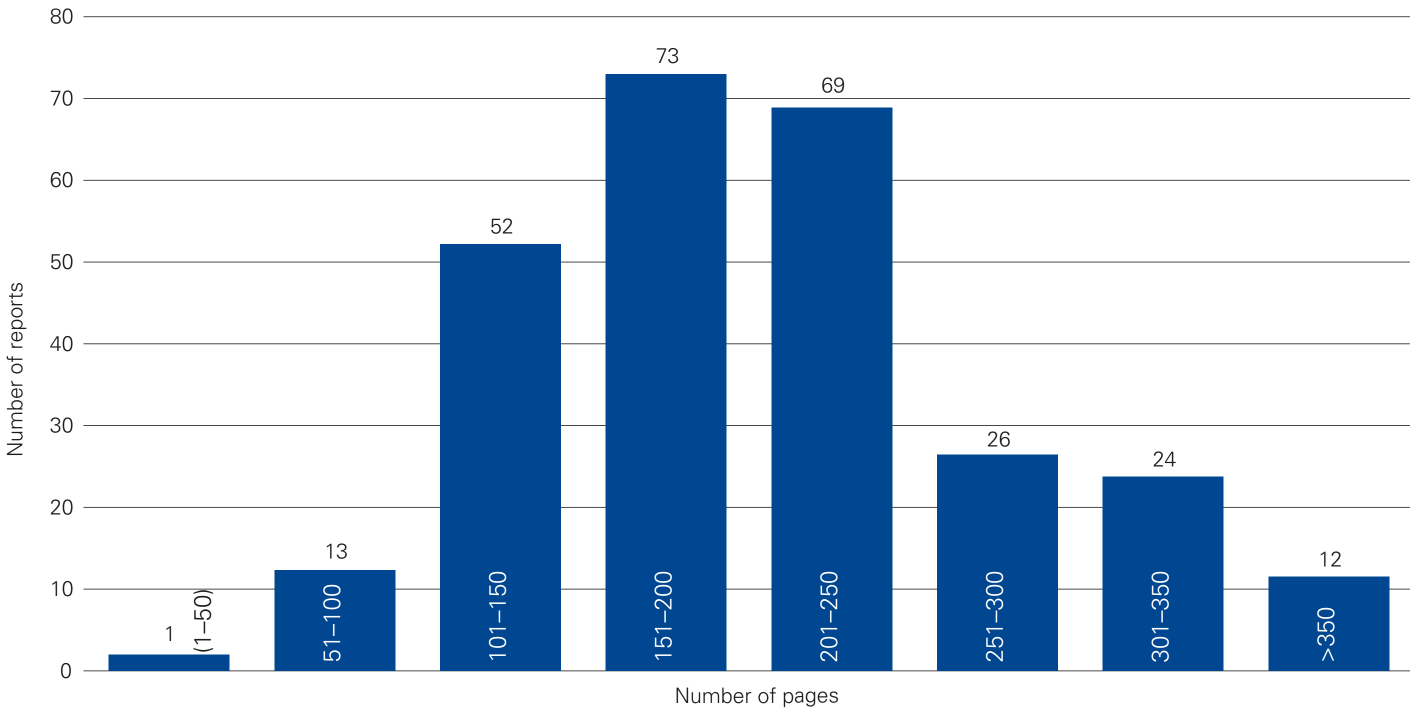
There is a considerable variation in the length of reports, with almost a quarter of them less than 150 pages and about the same proportion 250 pages or more. National practices have a big role to play in report length: reports for French companies averaged 310 pages and for Australian companies 155 pages.

Our survey of annual reports reveals a number of issues that work against clear and concise reporting: points are sometimes repeated several times in different sections of the report; report narratives focus on listing changes in key performance indicators (KPIs) that could be better presented in tabular or graphical form, particularly in relation to financial performance, rather than explaining why they occurred; and case studies are often used as a substitute for providing performance information, but they do not address the performance of the whole, or even a part, of the business. These and other factors make it hard for investors to find what they need from annual reports.

The financial statements have an essential role in annual reports. They provide an objective way to understand and benchmark a company's performance, its current ability to generate earnings, and a basis for assessing the stewardship of the business. They will remain a central source for investors' assessments, even though they cannot provide a comprehensive picture of business prospects.

The financial statements in the annual report vary widely in length from one country to another, reflecting national regulations, holdovers from previous generally accepted accounting principles (GAAP), and whether there is pressure to reduce clutter and improve clarity, as in the UK. Companies in a number of countries have complained that their annual reports (including their financial statements) contain too much information. Standards setters, including both the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB), have taken note of these concerns in their disclosure initiatives, which aim to improve the presentation and disclosure of information in financial reporting. Similarly, regulators are encouraging companies to focus on improving their disclosures.

Length of annual reports



Performance

Many companies have expressed frustration with what they consider to be an excessive emphasis by investors on short-term earnings performance. Yet investment valuation methodology is underpinned by an assessment of the long-term earnings prospects of a business. One reason for this discrepancy is related to corporate reporting practice. Most of the relevant, reliable information available to investors is focused on historical financial performance. If companies want their investors to take a longer-term view of their prospects, they will need to provide more high quality information to enable them to do this.

We believe that better reporting of non-financial KPIs can help to redress this imbalance. Specifically, operational KPIs can provide important insight into the development of the business and its longer-term prospects.

Forecast information is top of many investors' wish lists for changes in corporate reporting. Yet, from the corporate side, there is concern that management should not be seen to take responsibility for factors beyond their control. There is also a concern that publishing financial forecasts will place further emphasis on short-term financial performance. Nevertheless, 25 percent of companies provided short-term forecasts in their annual reports.

We recognize these concerns and do not think that forecasts should be seen as a substitute for giving investors the information they need to form their own views about the company's prospects. Even so, carefully explained forecast information can play a deeper role. It can provide a 'clean' base from which investors can project performance. And it can act as a catalyst for a more forward-looking discussion of historical performance that connects with the forecast and its underlying assumptions.

An alternative to providing forecast information is to align the presentation of historical information more closely with future performance. Forty-seven percent of reports use non-GAAP measures, such as underlying earnings before interest, taxes, depreciation and amortization (EBITDA). But only 30 percent address current baseline performance by providing information on areas such as the order book or changes to the cost base.

Operational performance

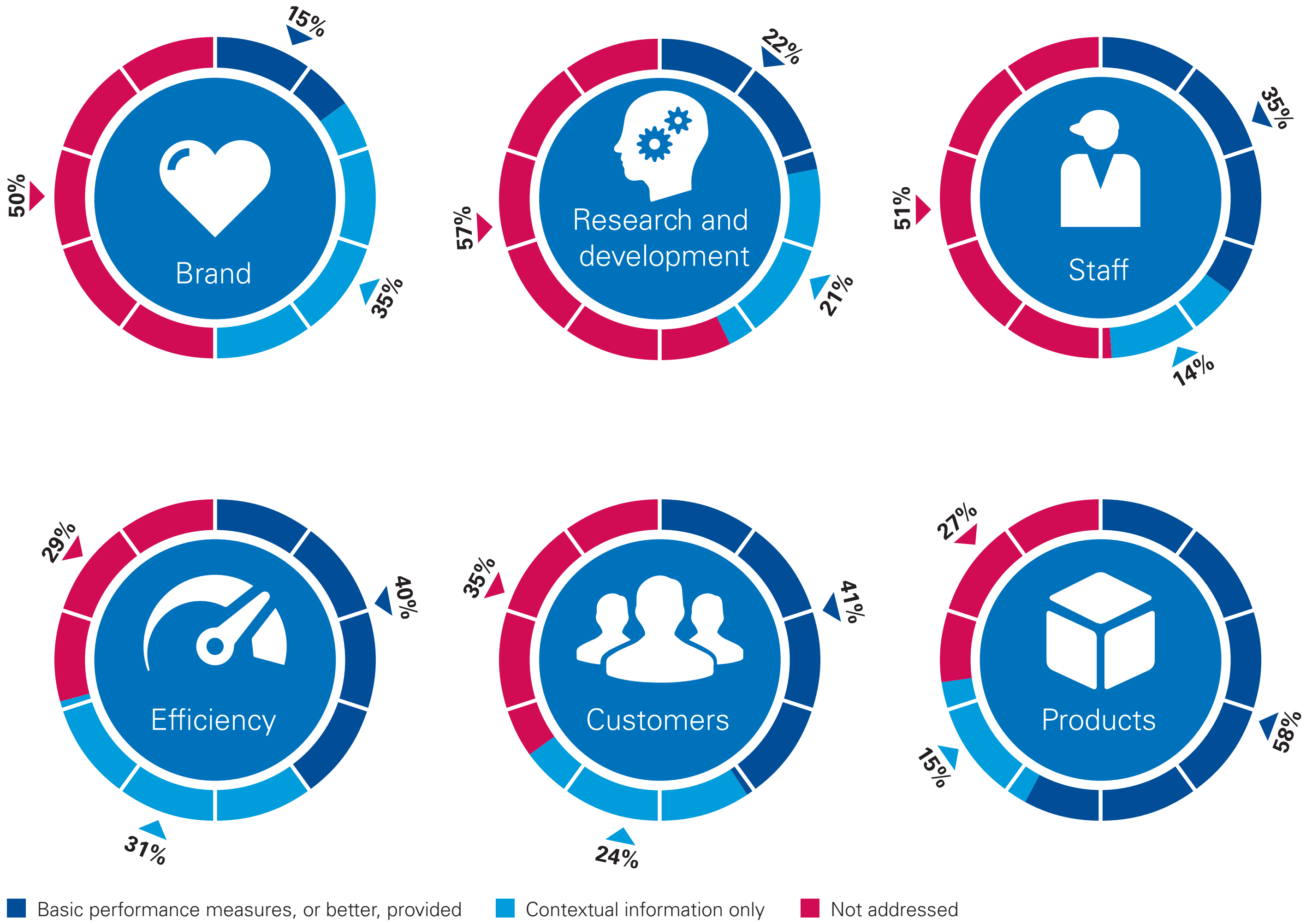
We looked for a range of measures covering each of 36 aspects of performance across six areas that would be relevant to understanding the performance and prospects of most businesses. This included any objective information that might provide insight into the performance of the business. In addition to quantitative KPIs, therefore, we also identified narrative indicators where they provided a complete (i.e. non-selective) view of performance, such as product or intellectual-property development pipelines.

Most companies provided at least some performance information in no more than two or three of the six areas. In our view, the operational performance in each of these areas should be an important part of most businesses' performance stories, but even the most addressed aspect of performance (product-based) was covered by only 58 percent of companies, while the least addressed area (brand) was covered by just 15 percent of companies. In fact, only 11 percent of reports addressed five or more of the areas, leaving readers with only a partial view of the operational health of the business.

Where we did identify information on a performance area, it was often one of the less insightful measures. So, there are opportunities for reports to improve not only the scope but also the relevance of performance information provided. We discuss these measures on the following pages.

The next six sections explain in more detail the six areas of operational performance outlined in the chart.

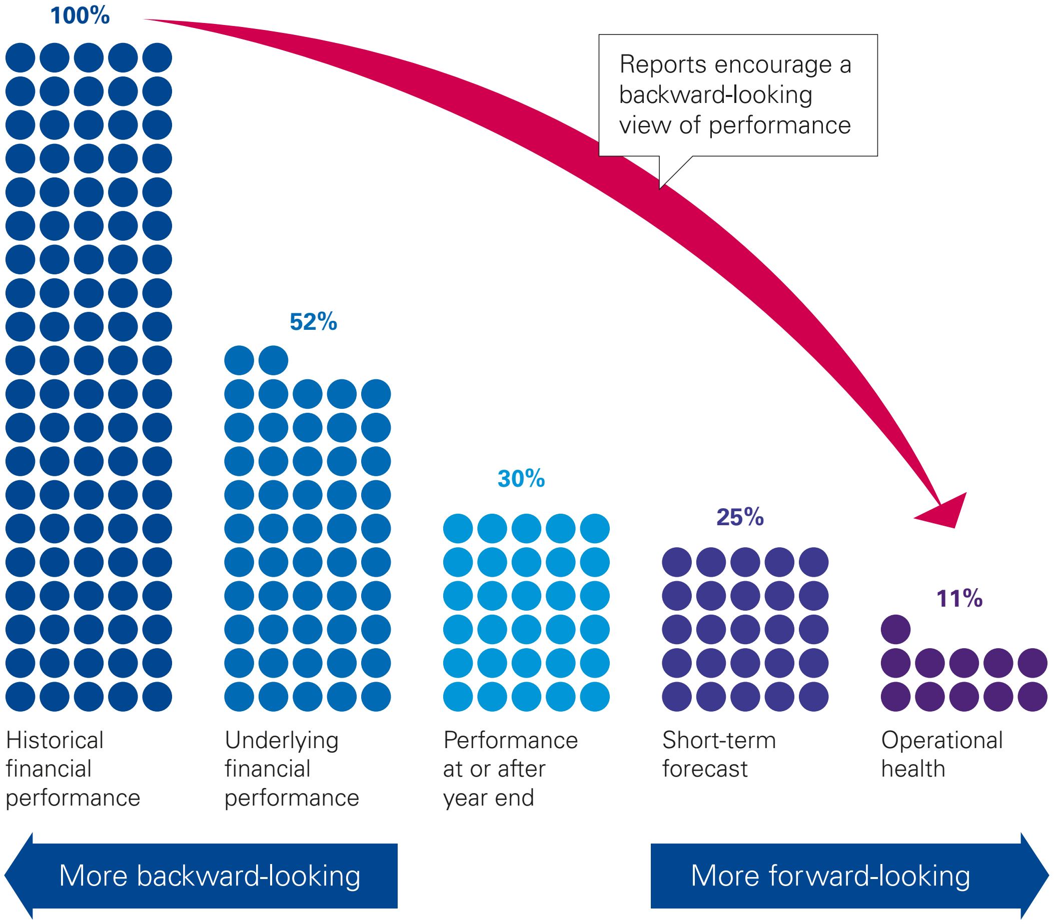
Companies reporting an operational performance measure



Fifty-two percent of reports use non-GAAP measures, such as underlying earnings before interest, taxes, depreciation and amortization (EBITDA).

... only 30 percent address current baseline performance by providing information on areas such as the order book or changes to the cost base.

Percent of reports addressing each aspect of performance

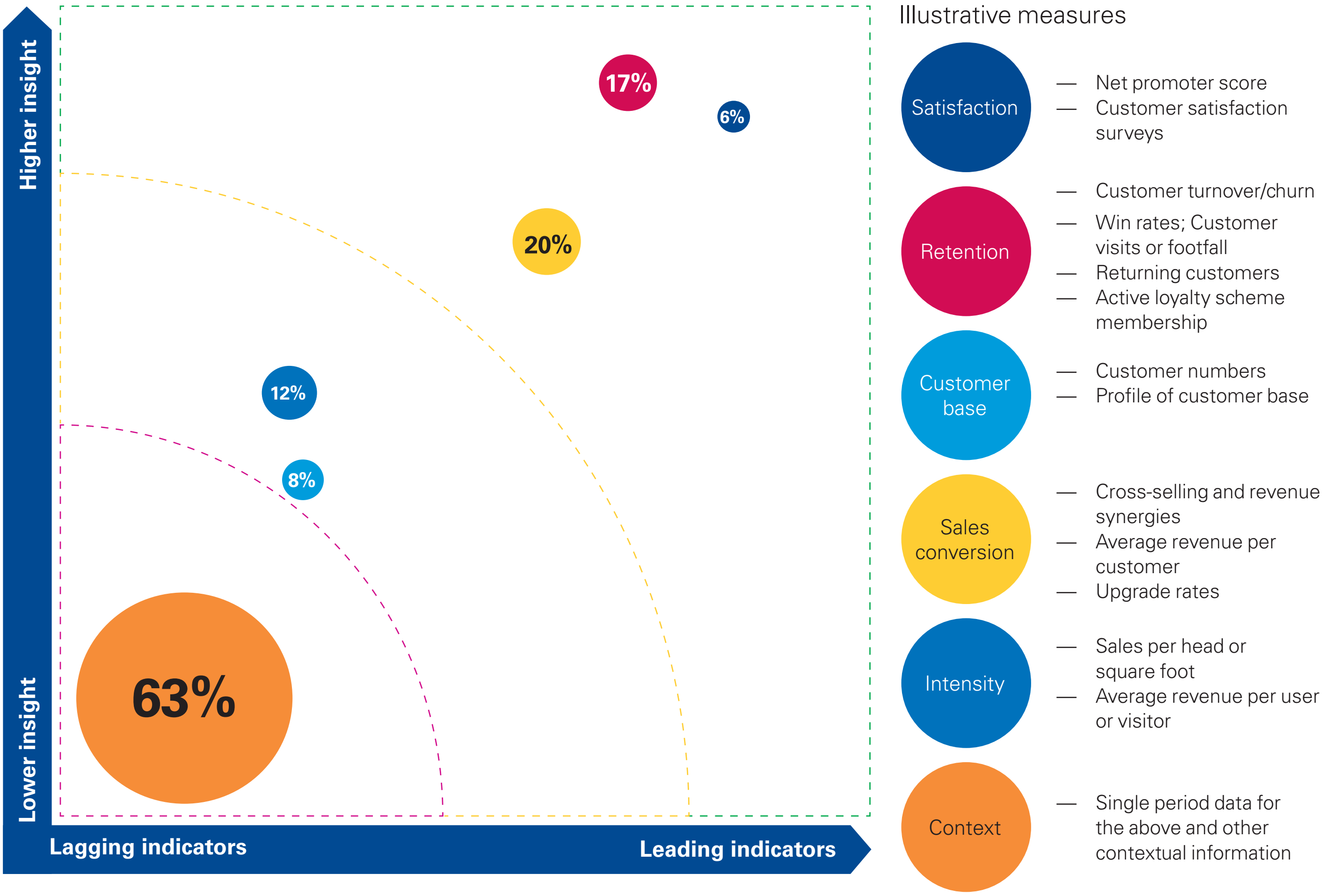


Customer and sales performance

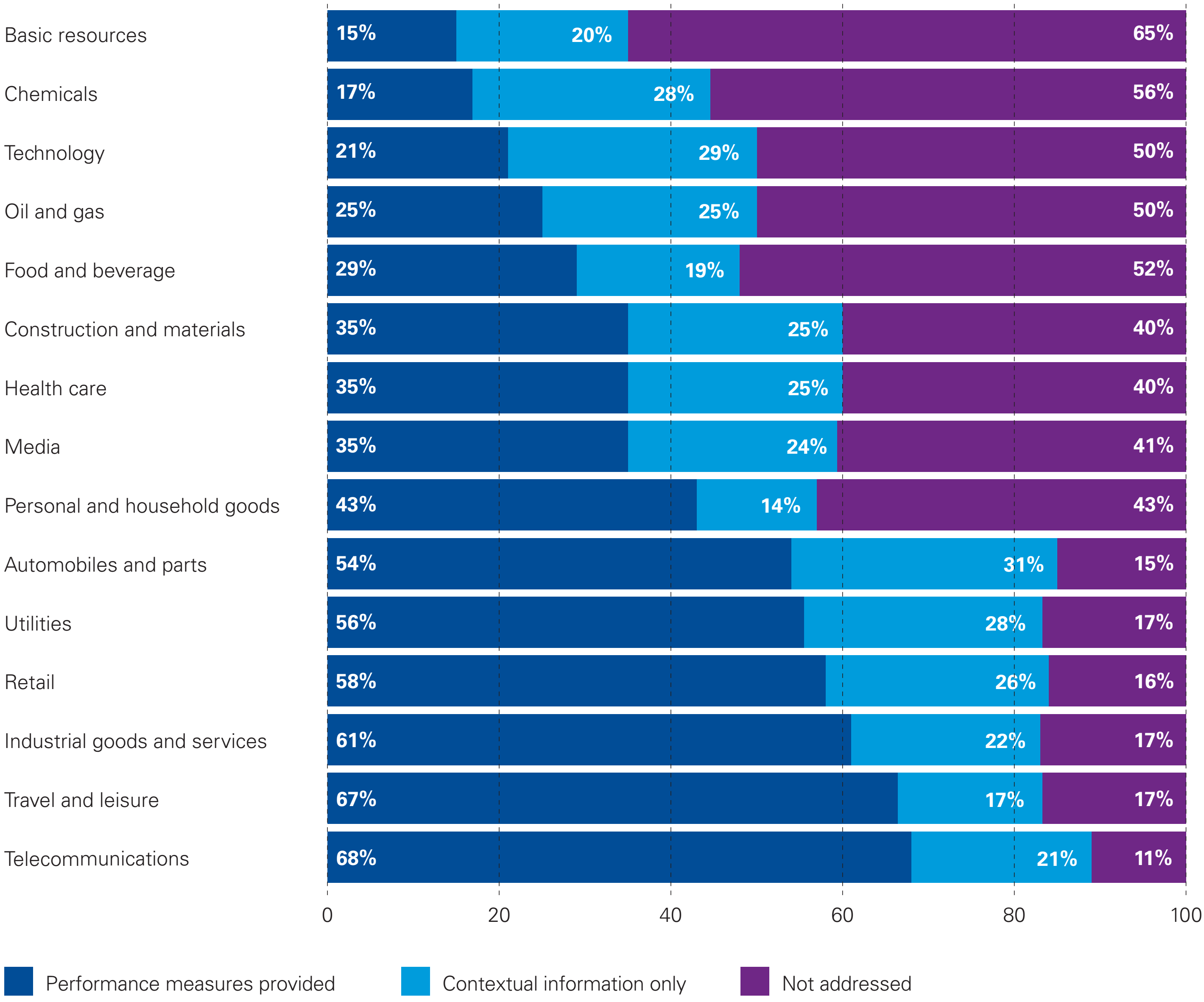
The majority of reports provide some discussion of sales performance based on the financial statements, but it is often difficult to see whether a company has had a 'good year' in customer-facing terms based on the discussion of financial revenues alone. In fact, we found only 41 percent of companies were providing additional performance information that went beyond contextual or single-period information in this area. This is unfortunate as customer-focused measures are particularly valuable as leading indicators of revenue prospects.

A wide range of measures can help communicate customer and sales performance. Measurements of customer retention and satisfaction, in particular, can provide a leading indication of the company's prospects in this field, but only 6 percent provide a satisfaction measure. Customer retention rates are common in the telecoms sector, with 53 percent of companies reporting on them, but they should be relevant to many more businesses.

Customer and sales performance insight



Companies reporting a customer/sales performance measure

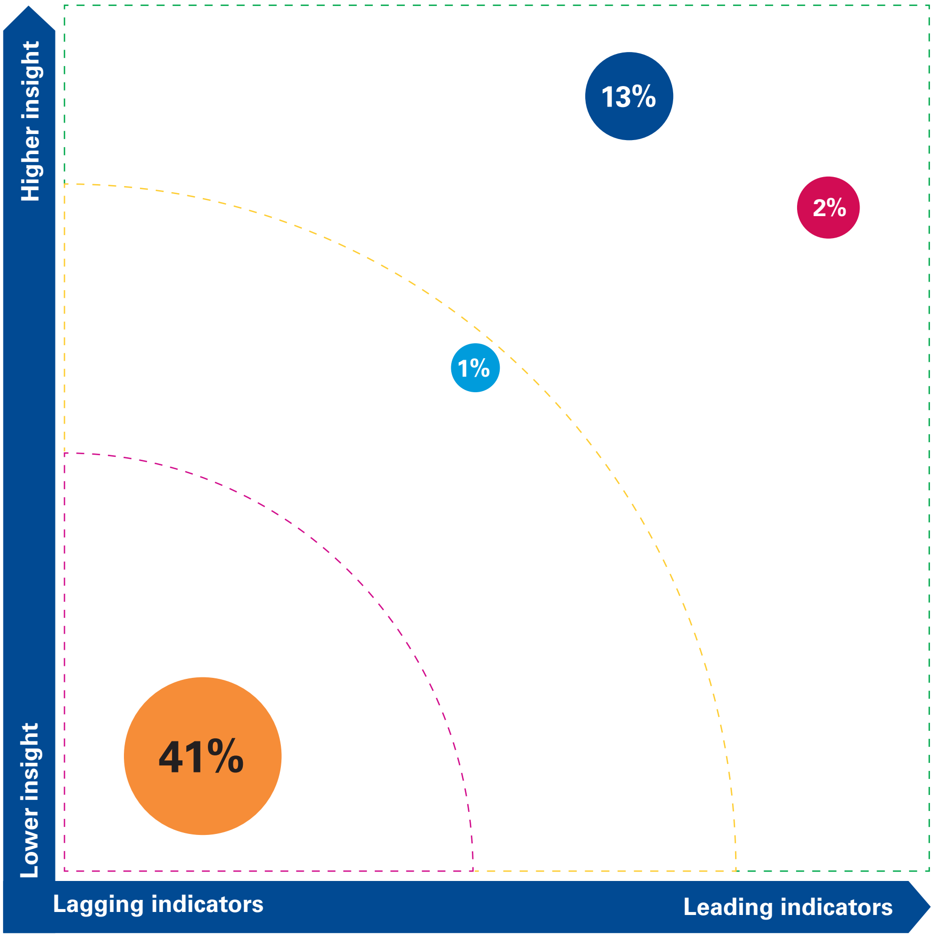


Brand and market share

The use of market-related data could help support a more outward-facing discussion of performance. But only 15 percent of reports provided measures showing how the brand or market share was developing. We think this is an opportunity lost, because the use of market or brand performance information can help the report address the business' own performance in the context of the market as a whole.

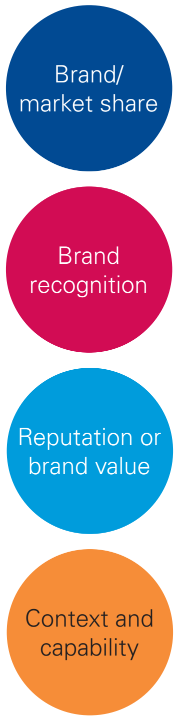
Where it is provided, brand performance is often given over a single period, but this isn't enough to support a discussion of whether the health of the brand has been enhanced in a sustainable fashion. In fact, six out of seven reports don't tell you whether the health of the brand or market position is improving.

Performance insight — brand and market



Illustrative measures

A range of brand and market measures can help to communicate performance in managing the health of the brand. Some measures may be derived externally (e.g. market share), but their inclusion in the report allows management to provide its perspective on performance.



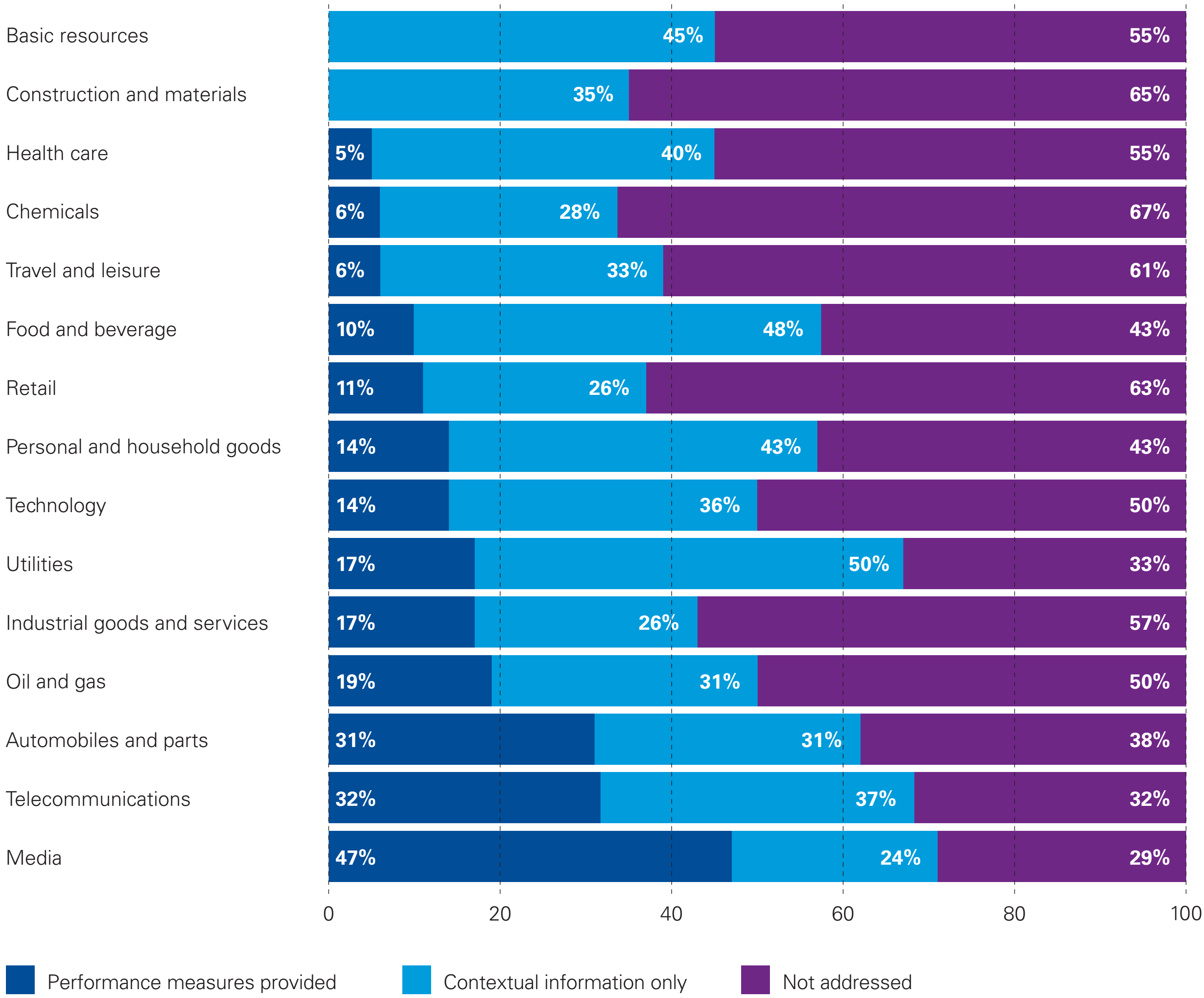
Brand/ market share
- brand share of market
- overall market share

Brand recognition
- brand rankings
- brand recognition scores across markets

Reputation or brand value
- brand valuation

Context and capability
- single period data for the above and other contextual information

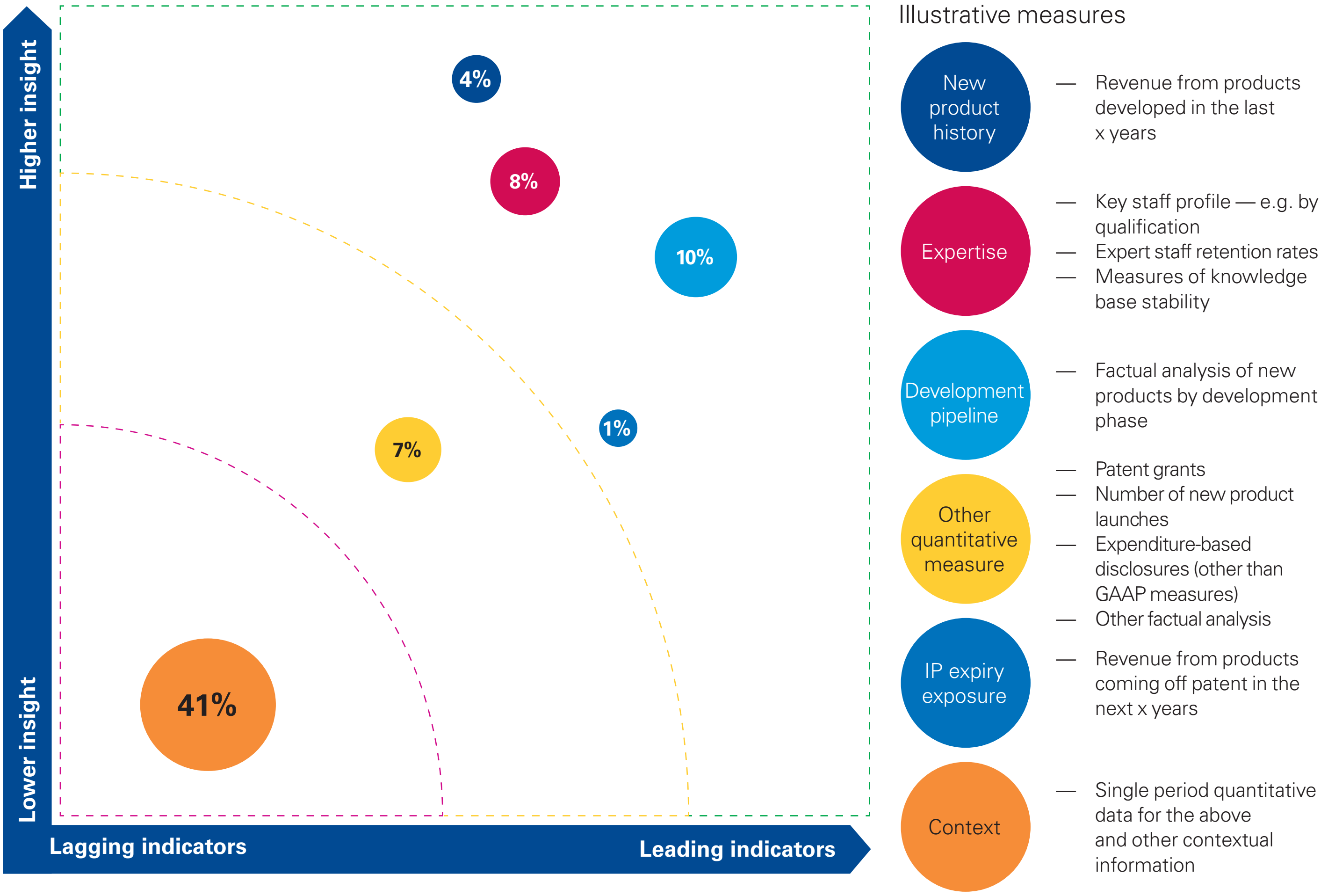
Companies reporting on brand and market position



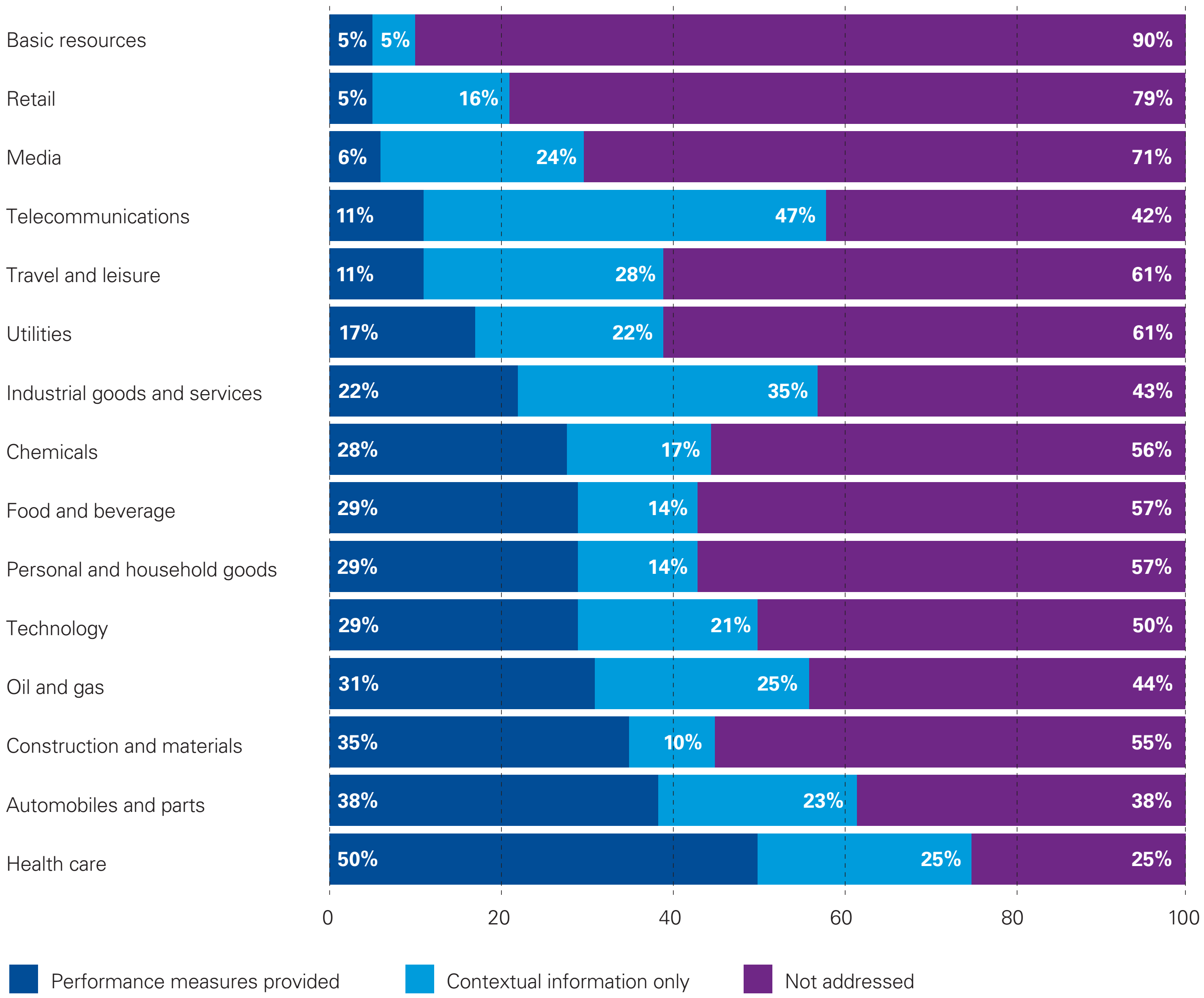
Intellectual capital

Intellectual capital is one of the areas that companies seem to find it hardest to report on, but there are some notable exceptions that demonstrate what can be achieved. Over half of the companies identified knowledge and expertise as an important part of their business model, but only 22 percent of annual reports provided performance information related to non-brand intellectual capital that went beyond basic disclosures of expenditure. One reason for this is that intellectual capital reporting is often limited to R&D while other key areas of expertise and know-how are not addressed. The measures needed to communicate intellectual capital performance to investors should not need to be complex or commercially sensitive. There are a range of higher-level objective measures that can be used: from the retention of key expertise to total revenue earned from new products.

Performance insight — intellectual capital



Companies reporting on intellectual capital performance



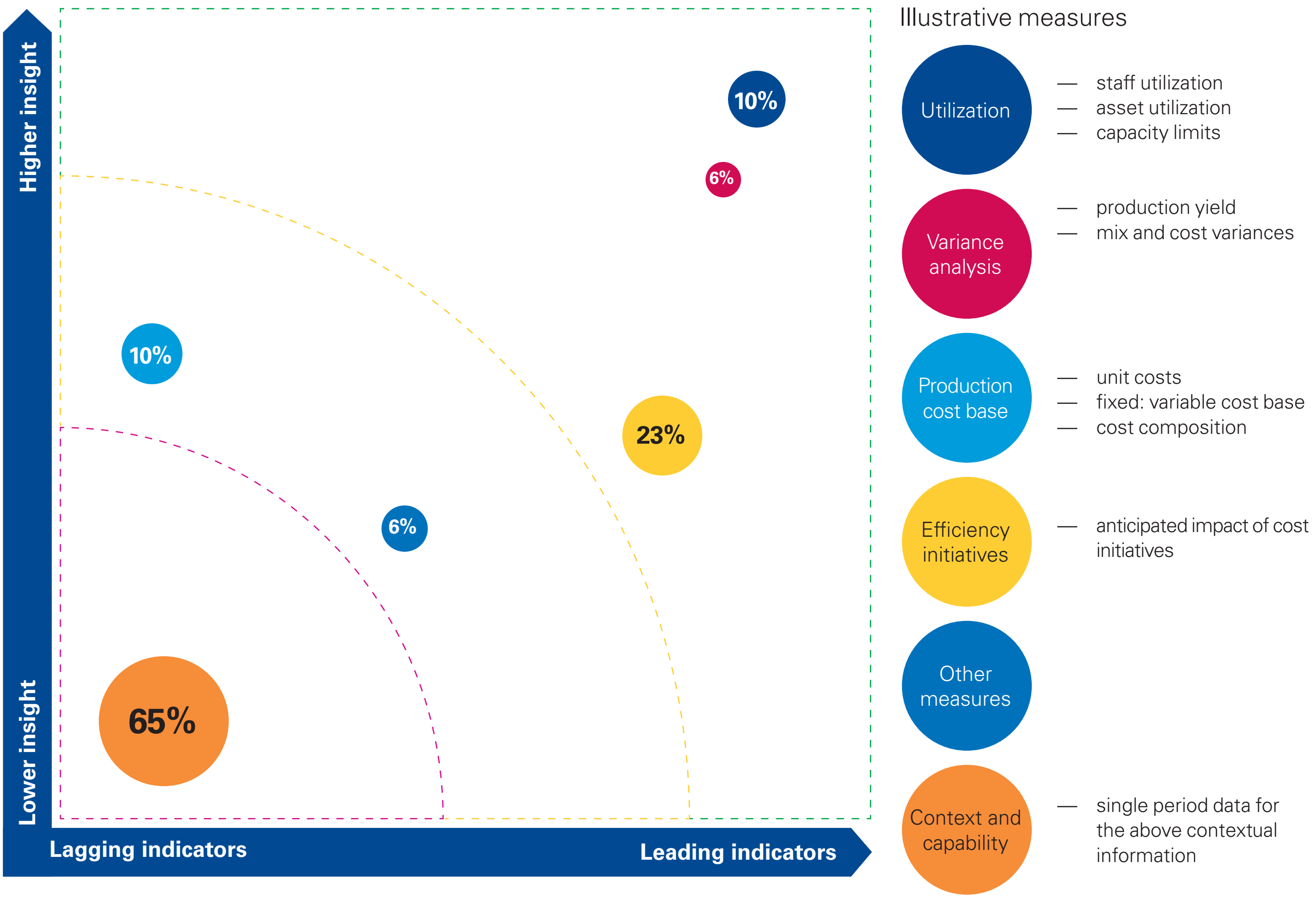
Operational efficiency

Efficiency reporting can play a key role, not only in measuring business success, but also in providing insight into the underlying cost base of the business. While 71 percent of reports addressed operational efficiency, only 40 percent described whether it was improving, and few are providing the most insightful measures of performance, such as utilization rates and variance analysis, which can be particularly relevant where businesses are in a high-growth phase.

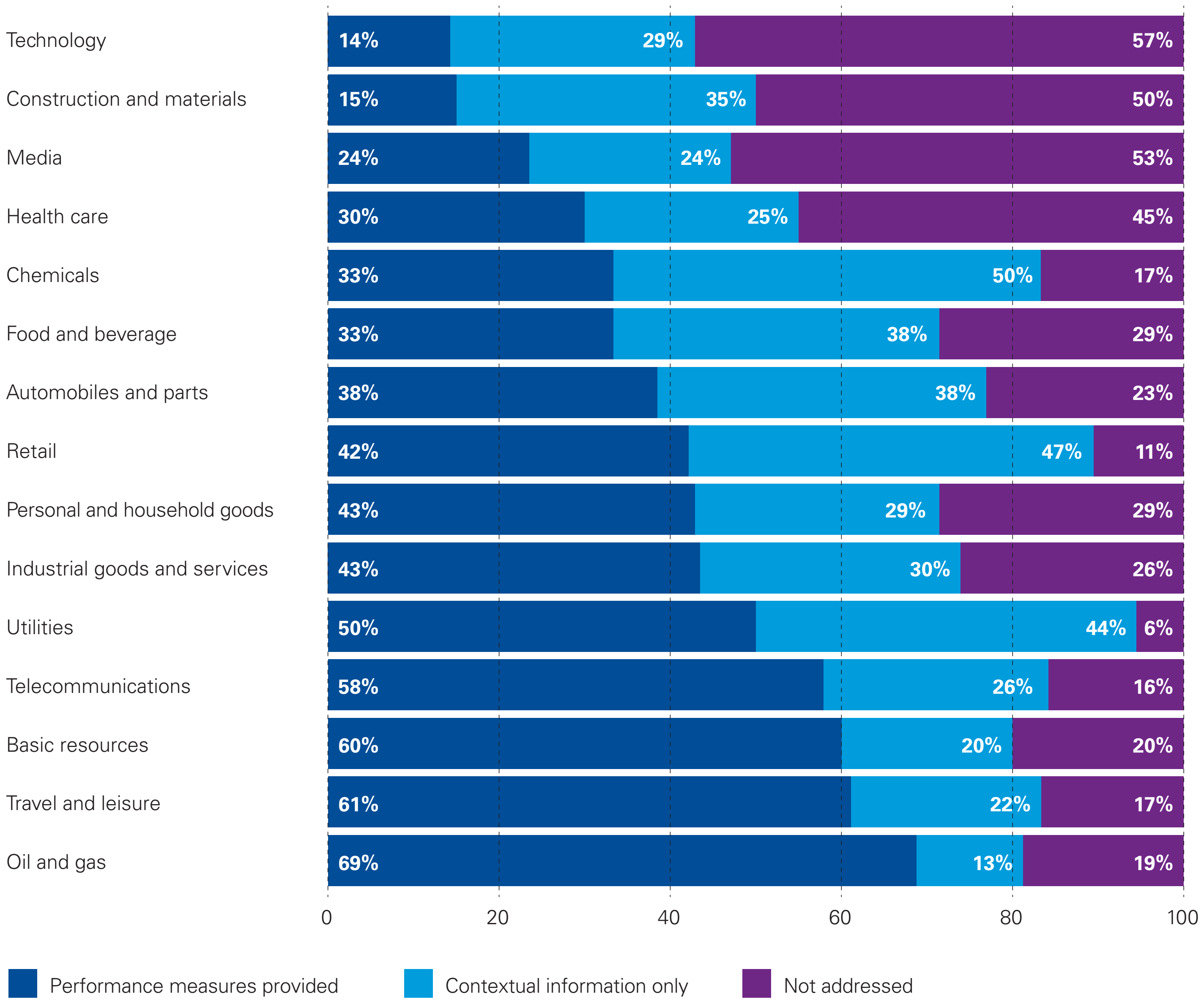
Nearly a quarter of companies reported on the impact of specific efficiency initiatives. This may help the reader understand the extent to which last year's cost base is representative of next year's, but it is often difficult to interpret the information provided. A figure for expected annual savings from an improvement initiative has limited value if the reader has not been told how much has been recognized in the current year's results.

Some companies are providing information about long-run production costs. Notably, measures such as 'all-in sustaining cost' are common in the basic resources sector. These measures can complement the view provided in the financials by conveying information that is specifically focused on the underlying costs of production.

Performance insight — efficiency



Reporting on efficiency

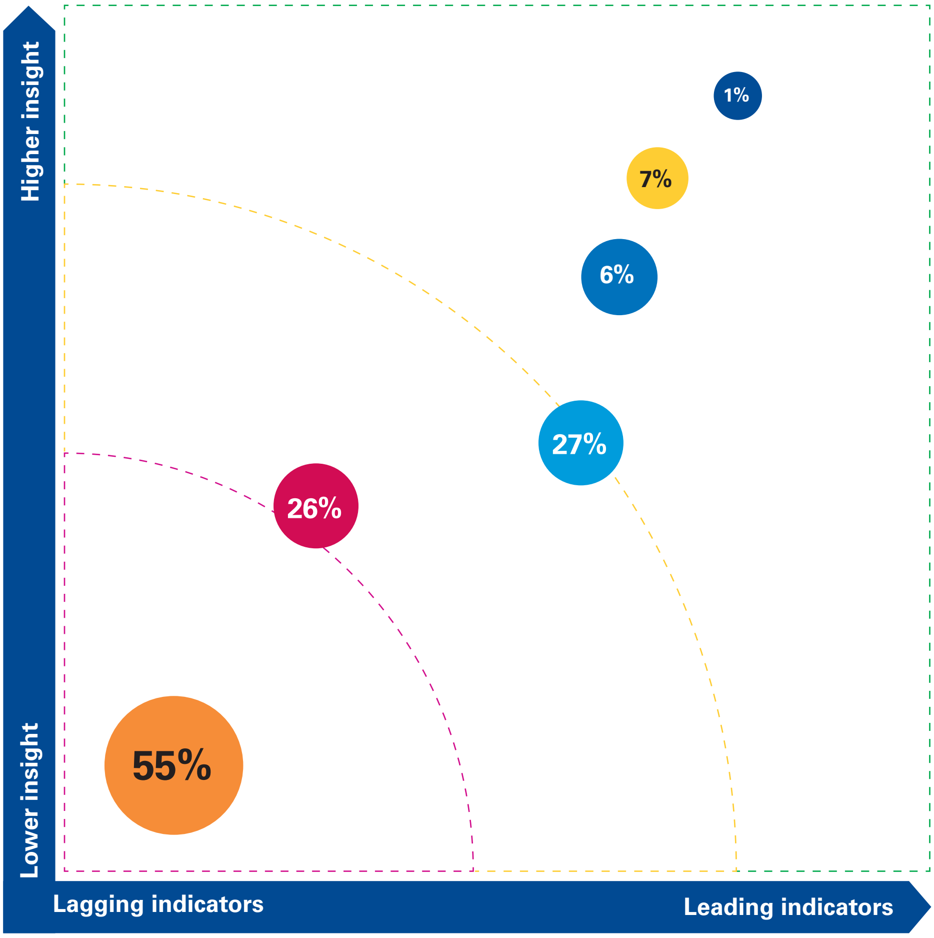


Staff-based performance

Staff-based performance measures have an important role to play in explaining business performance, but although 73 percent of businesses report at least one staff-based measure, the measures reported are often not focused on investor needs. For example, measures such as staff retention or satisfaction are usually reported for the business as a whole, yet an investor would need to understand whether the business is retaining key types of staff. Other staff-based measures were reported for a single period only and therefore do not show whether performance is improving or deteriorating. After these measures are excluded, only 35 percent of reports provide a business-focused staff measure.

Some of the potentially most insightful aspects of performance were also the least reported. Just 7 percent of reports provided measurements of staff productivity or labor relations, such as days lost to industrial action. And only six percent provided information on expertise within key areas of the business.

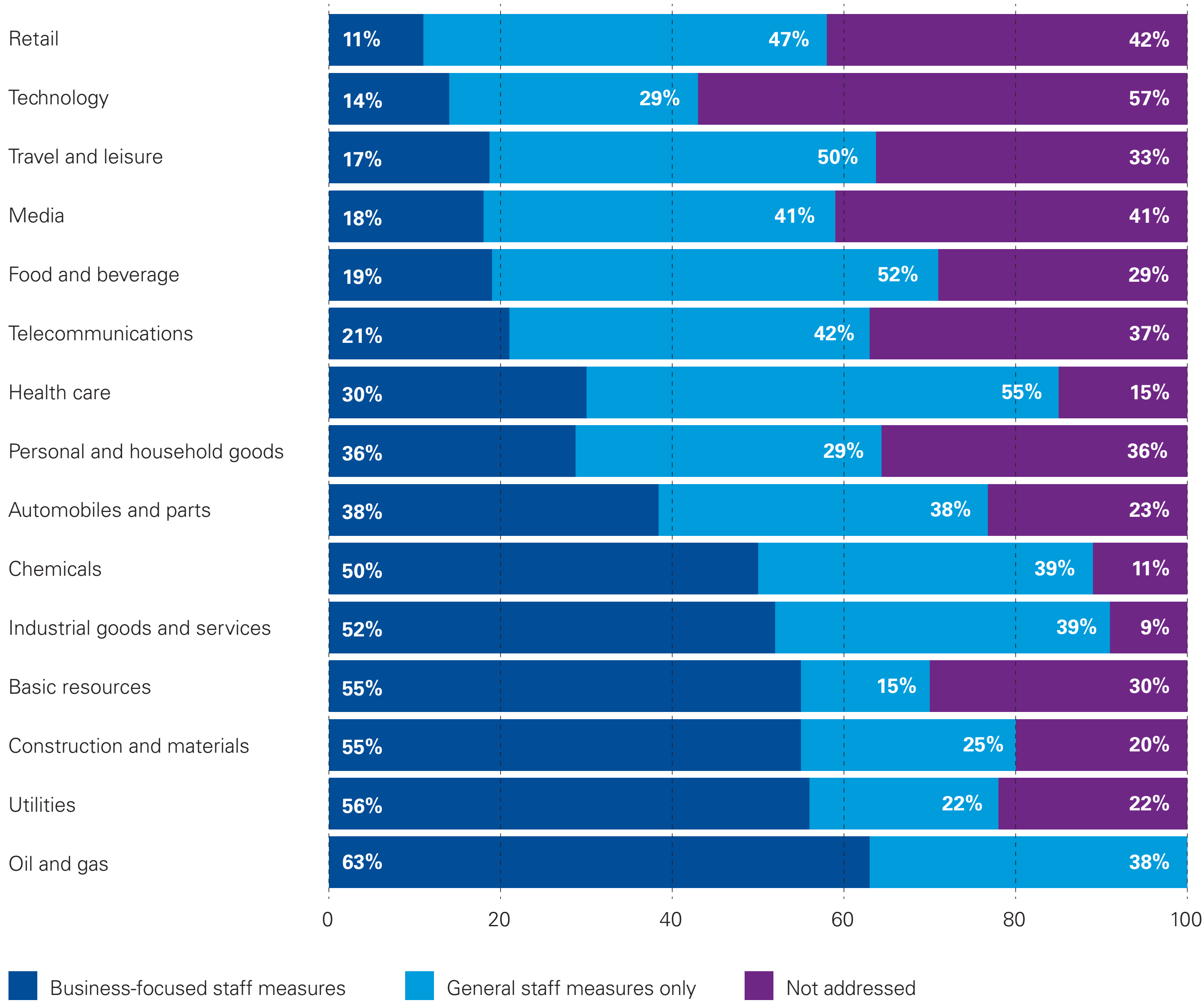
Performance insight — staff based



Illustrative measures

- Key staff retention
  - Retention rates for identified groups of key staff
- Benefits, training and flexibility
  - Training time or spend
  - Training completion rates
  - Participation in flexible working schemes
- Health and safety
  - Lost time and injury rates
- Productivity and labor relations
  - Absenteeism
  - Average productivity rates
  - Details of union or labour agreements
  - Industrial action rates
- Expertise
  - Qualification levels
  - Experience
- Context and capability
  - Single period quantitative data for the above and other contextual information

Staff-based performance reporting by industry

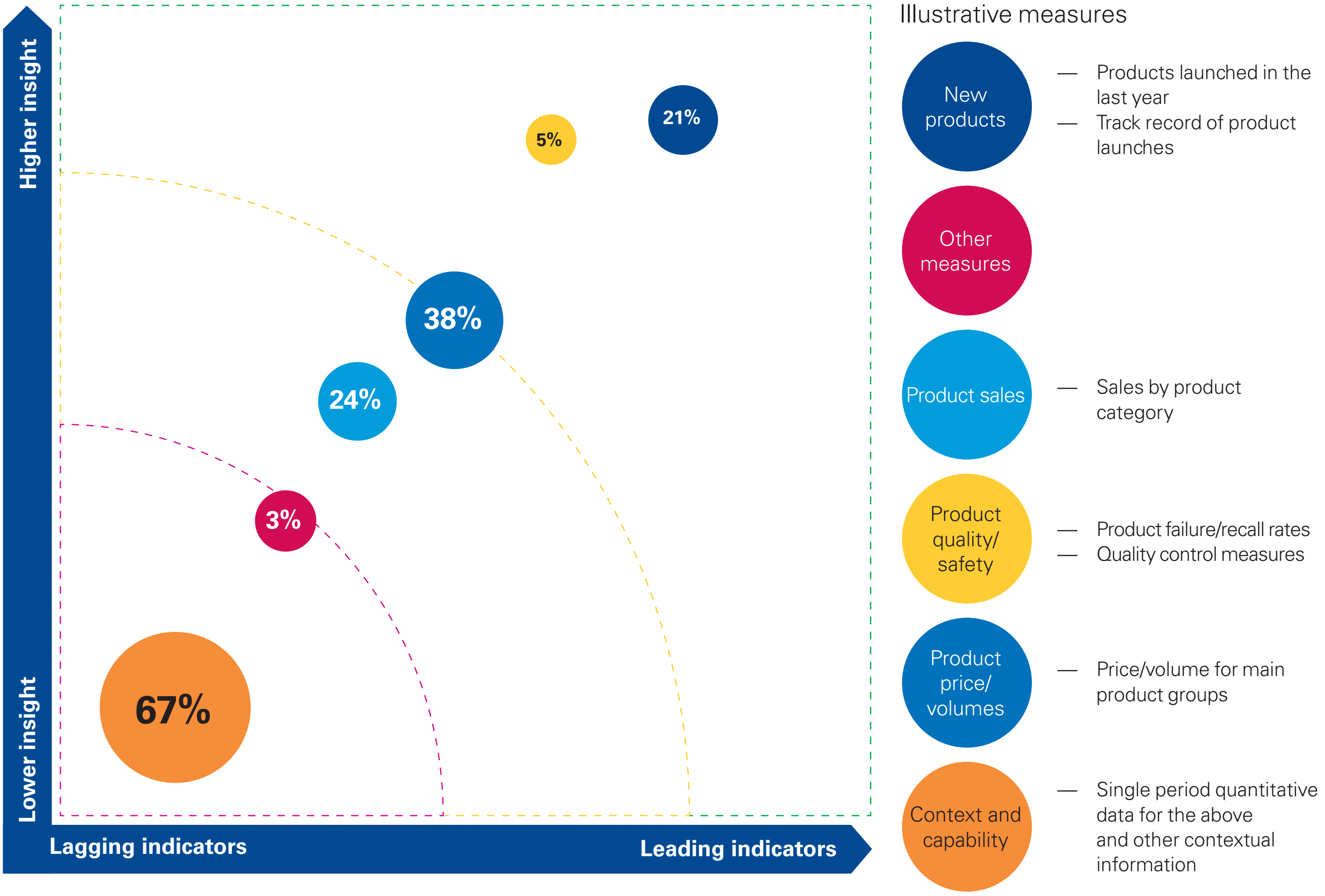


Product performance

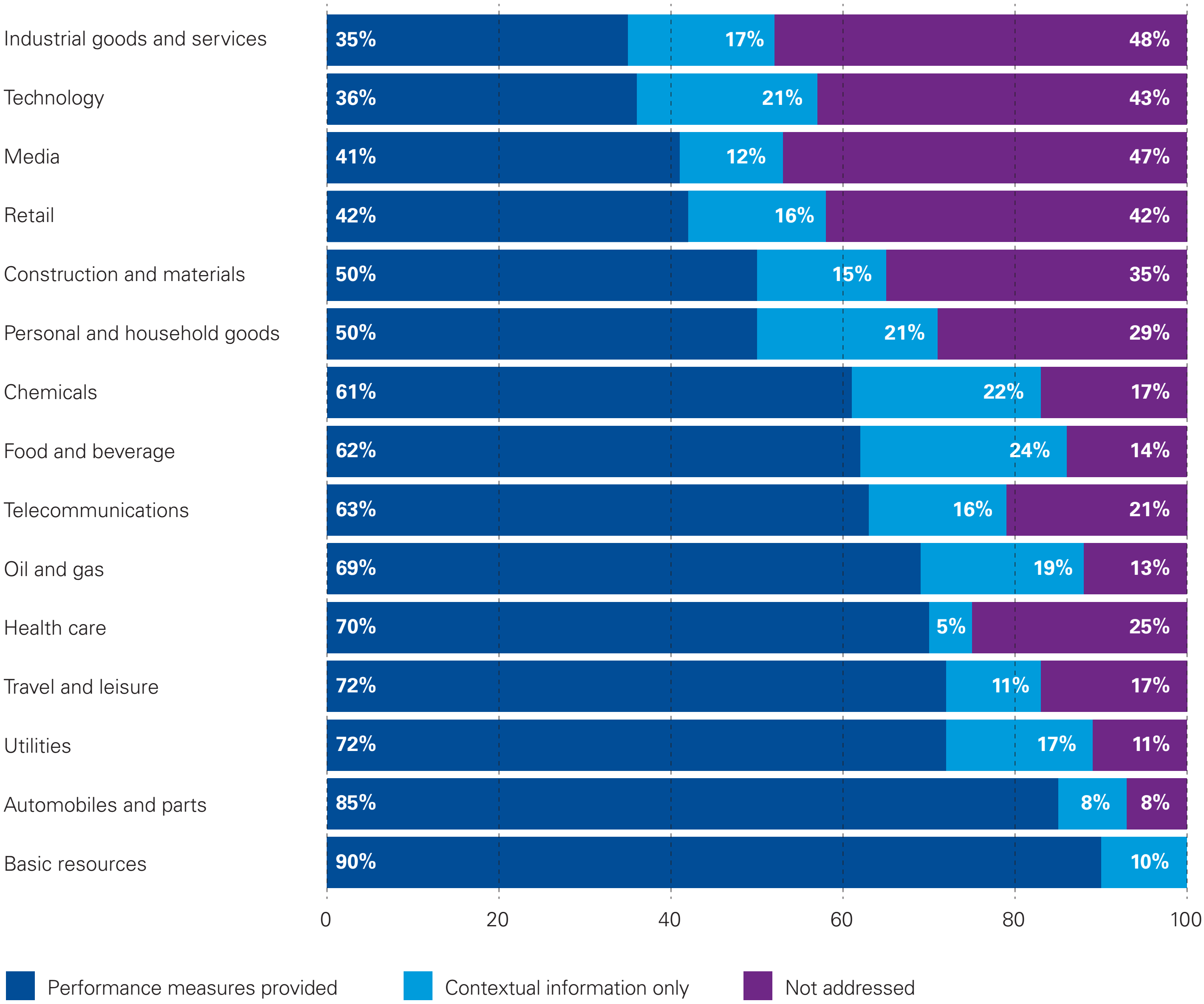
Product performance measures were provided by 58 percent of companies on average, but reports generally addressed only one aspect of product performance, typically focusing on product sales or production. These measures can provide valuable insight into the drivers of profits and growth, but they do not address longer-term factors relating to the health of the product base.

Only 21 percent of reports provided information on new product launches. And, despite the fact that 18 percent of companies identified product failure as a principal risk, only 5 percent of reports provided performance indicators for product quality or safety.

Performance insight — product base



Companies reporting on the product base



Reporting on strategy

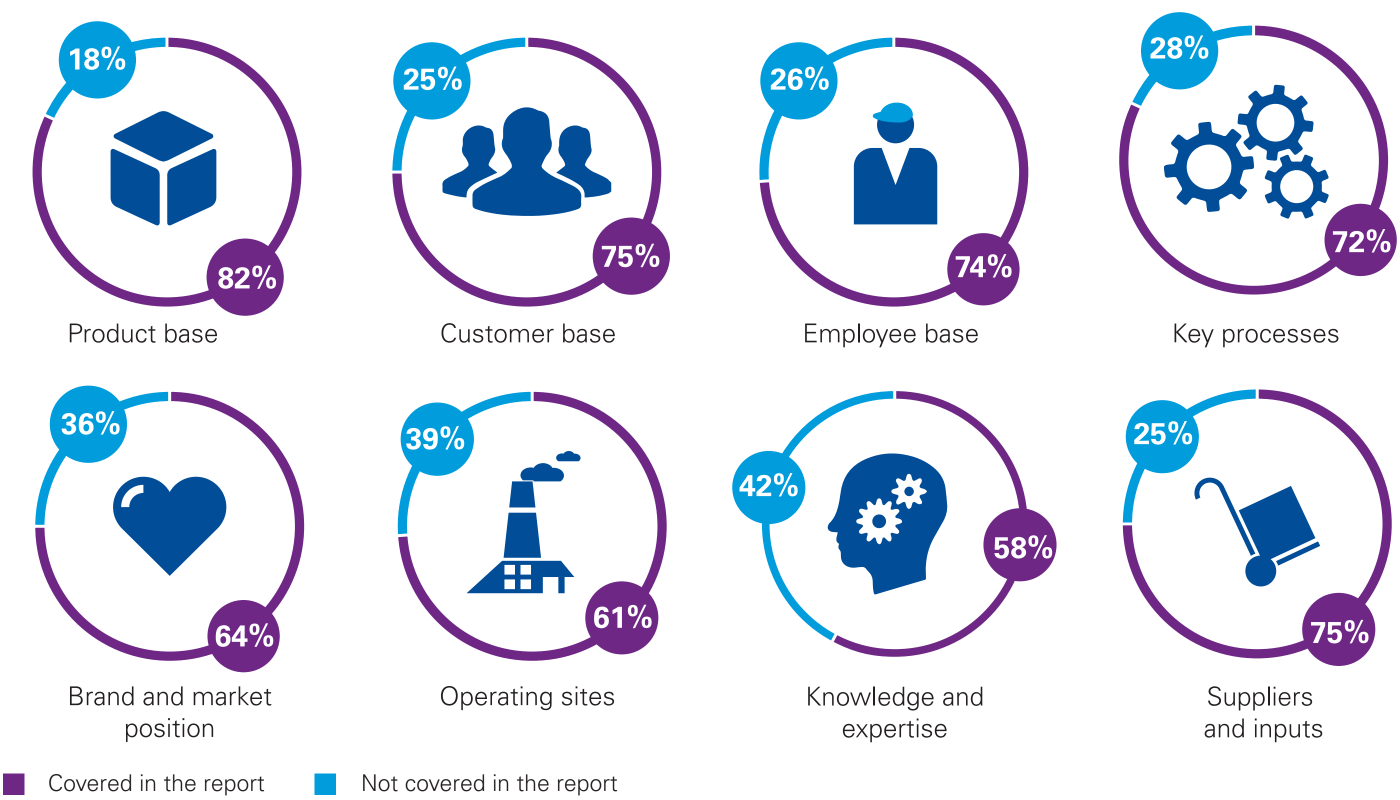
The section of the annual report devoted to the company's strategy and business model is, on average, only slightly more than a third the length devoted to the financial statements. Here, the issue is not information overload, but too little relevant information.

The business model can provide the base for a good report, but many descriptions of the model are too generic to do this effectively. An effective description can provide a basis for readers to assess the implications of matters raised elsewhere in the report, and it can provide a foundation for the report as a whole. A complete business model description linking to strategy and performance information can also help readers assess whether all aspects of business performance have been addressed in the report.

Business-centric reporting frameworks for example, Integrated Reporting, and the UK's Strategic Report, rely on an effective business model description as the foundation for the rest of the report. Rather than prescribe every potentially relevant disclosure, they make use of the description of the business itself as a basis for defining what to include in the report.

We looked at the proportion of companies providing at least basic information on eight broad aspects of the business, covering its products, customers, staff, brand, expertise, operating base, supply relationships and key processes. On average, only five of the eight areas were addressed. The result is that readers can be left with the impression that key aspects of the business are being taken for granted.

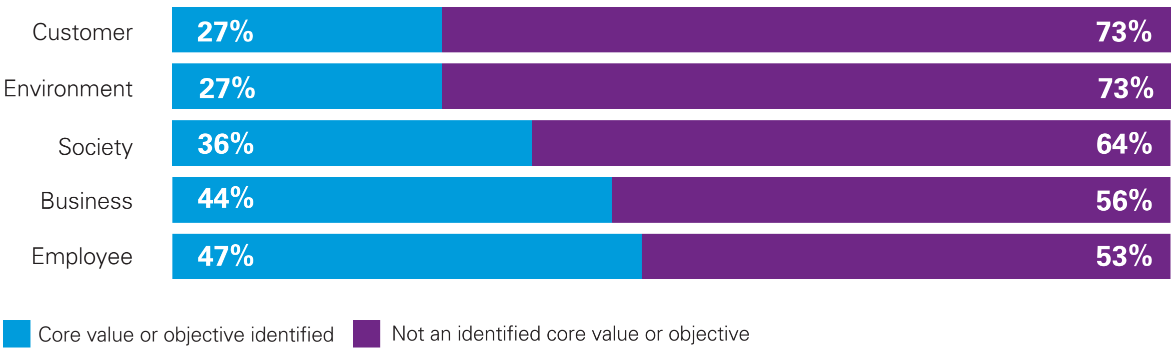
Aspects of the business model described in reports



A description of business objectives and values can enhance readers' understanding of the company's long-term strategy, providing it focuses on the specific factors affecting business success. But our survey shows that 43 percent of reports do not specify the commercial objectives for the company, and only 27 percent of reports address the aims of the company in customer-focused terms.

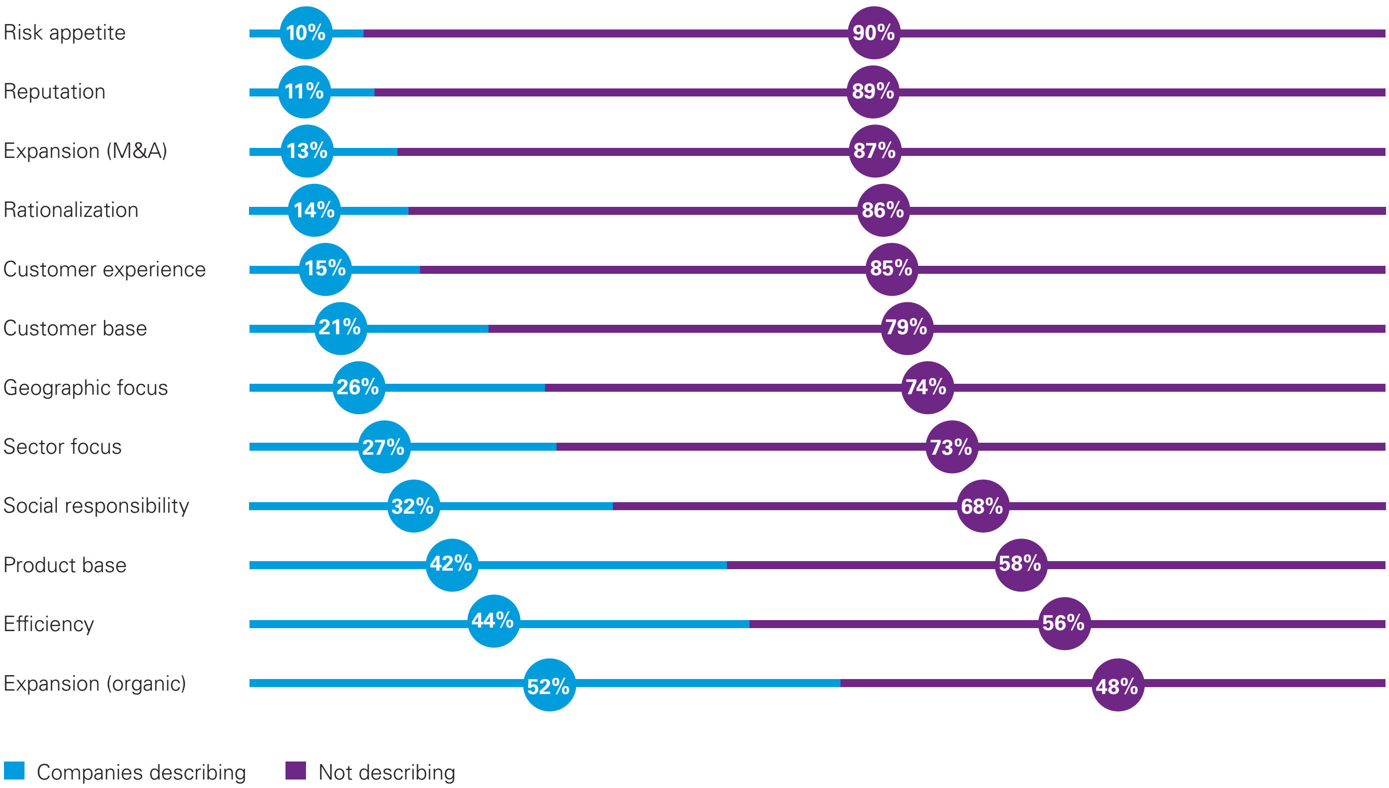
When reports discussed business strategy, they often focused on areas that offer the most immediate returns, such as organic expansion and efficiency. In contrast, aspects of strategy that address the longer-term health of the business, such as customer experience and business reputation, were addressed much less frequently.

Areas where the business identified a core value or objective



Note: 'Business' represents business-focused goals such as leadership in a specific segment.

Aspects of strategy addressed in reports



Business risk

Risk reporting provides an opportunity to explain how the company is managing the potential impact of major risks on shareholder value, but many risk discussions appear to have been published in order to comply with regulations rather than to help investors understand how companies manage their most important risks.

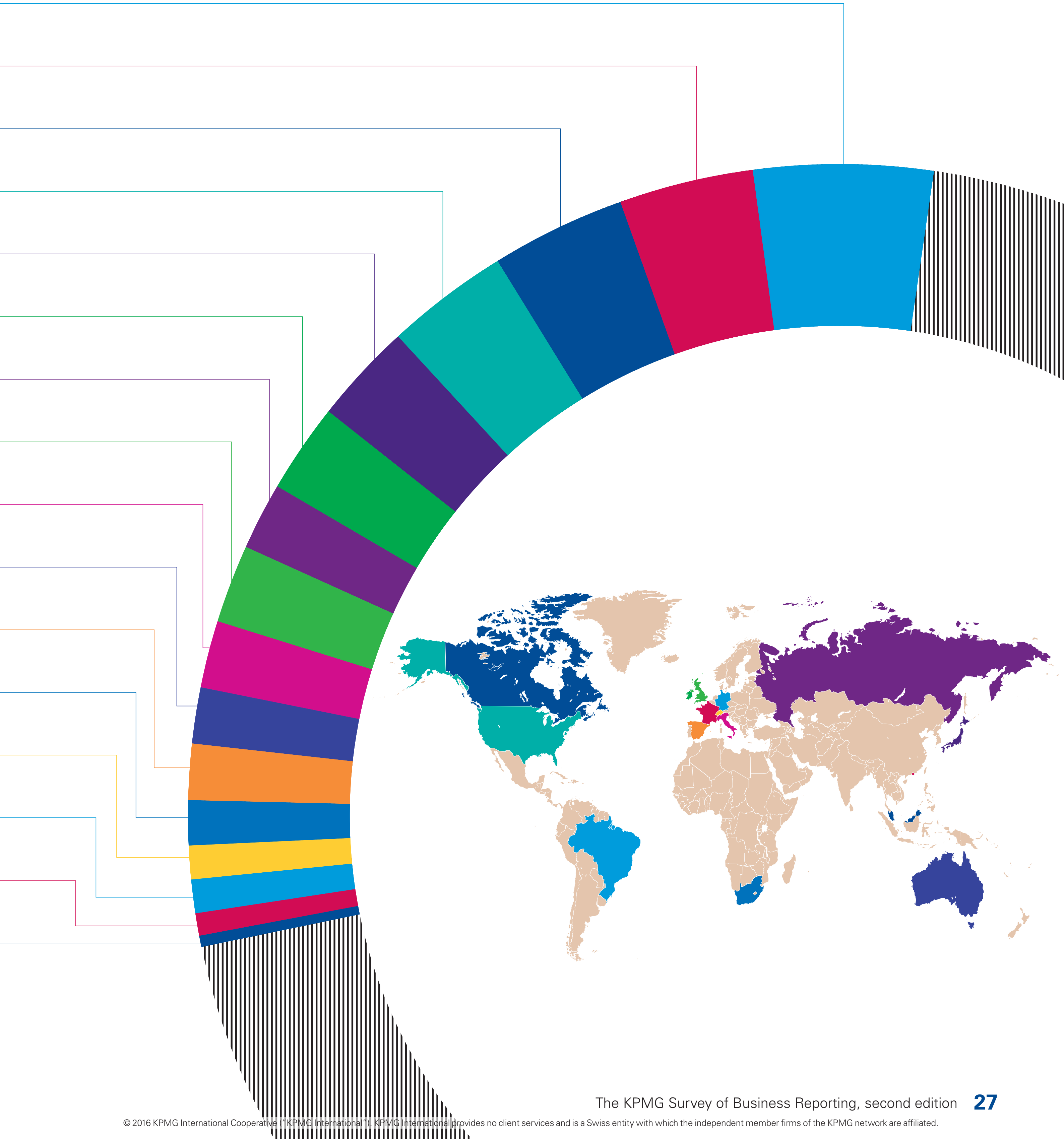
Common issues were: a failure to focus on those risks that are most relevant to business value (rather than potential short-term financial losses); and failure to address risks relating to growth strategies and underlying business resources. Less than 10 percent of companies reported on risks in relation to strategy selection, product relevance or change management. A failure to protect key business assets, such as reputation, know-how and customer relationships, can result in shareholder value destruction, but less than 25 percent report on risks to each of these aspects of the business.

We found significant variations in the approach to risk reporting among different countries. Companies in four countries — Germany, France, Canada and the US — were reporting an average of 22–31 risks, compared to a survey average of 14. The problem with publishing a long list of risks is that it can become a recitation of things that might go wrong, obscuring the most significant items. It may even give the impression that the board is not focusing on the most important ones. Companies that feel obliged by regulation to identify long lists of risks might consider highlighting those that are significant in the context of shareholder value, to prevent material disclosures getting lost in the detail.

In addition, few reports addressed how the overall risk profile of the business was being managed over time, with only 11 percent of reports going beyond simply listing out risks in order to communicate movements in the scale and likelihood of those risks.

Germany	31
France	25
Canada	24
US	22
Japan	18
Ireland	15
Russia	13
UK	13
Italy	13
Australia	10
Spain	9
South Africa	8
Switzerland	7
Brazil	5
Hong Kong	5
Malaysia	3

Average number of risks reported by companies



'Standard practice' risk disclosures

- Exposure to market rates
- Availability of finance
- Market conditions
- Access to staff
- Political/regulatory risk
- Credit risk
- Macro-economic risks
- Data security
- IT failure
- Litigation

We classify 'standard practice risk disclosures' as risks identified by more than two-thirds of companies in the country.

Conclusion

This survey highlights the significant gap between the information investors need to assess the health and prospects of companies, and the information that they are receiving through corporate reporting channels.

Companies in some sectors are addressing this gap, but only in certain areas. They are using objective operational performance information to provide their investors with the leading indicators they need to assess future performance prospects. But best practice is patchy. If the reporting of customer retention rates is well established in the telecoms sector, for example, why is this information not also available for other businesses that depend on a loyal customer base?

Gaps in performance information can, in part, be attributed to corresponding gaps in descriptions of business model and strategy. The survey highlights a common focus on shorter-term aspects of strategy. Business model descriptions address only some of the key resources and activities that the business depends on for its competitive advantage over the longer term. So, performance is not being addressed in some areas because the report does not highlight their strategic importance. More complete descriptions of business model and strategy could provide a better foundation for reports, and, importantly, give investors the confidence that they are seeing the whole story rather than just the areas of success.

Some reporting frameworks already use the business model as a basis for determining report content. It is understandable that this represents a challenge for report preparers who are used to working from a checklist of disclosures; a different approach to report drafting is required. Companies must also develop their internal reporting systems to provide non-financial information of a sufficient quality to be used in an external report.

These changes will take time, and we should therefore regard the closure of the 'reporting gap' as an evolutionary process. Companies that meet this challenge are likely to find they have the basis for a commercially focused discussion of business performance with their investors.

Read more at www.kpmg.com/betterbusinessreporting

Covered by this survey

The term 'annual report' means different things in different countries. Our survey covers each company's primary reporting document, including:

The full financial statements. Where abridged financial statements were presented, we have taken account of the separately published **full financial statements.**

Narrative reporting, which includes quantitative and qualitative commentary on the business model, strategy, risk opportunities and business performance/outlook.

Governance reporting, which includes **directors' remuneration reports.**

Any other information included in the **primary reporting document.**

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Designed by Evalueserve.
Publication name: Room for improvement: The KPMG Survey of Business Reporting, second edition
Publication number: 133309-G
Publication date: April 2016