

Insight or fatigue?

FTSE 350 reporting

*Building Public Trust:
Research into narrative
reporting and what it
says about companies*

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Foreword

Regulation alone cannot create trust – whether in capital markets or individual management teams

Our comprehensive review of how well FTSE 350 companies are responding to the challenge of effective reporting is particularly relevant this year when reporting is so much in the spotlight. The economic crisis has been a stark reminder of the importance of clear reporting and has triggered calls for improvements from government, regulators, standard setters and investors as well as companies themselves. Financial reporting is clearly just one part of essential corporate communications - investors and others are also calling for meaningful narrative on areas such as management's approach to governance and risk analysis, and how business models work. In the long run, a lack of this information undermines trust in companies and management as well as efficient capital allocation.

There is a growing recognition of the need for urgent improvement. The Financial Reporting Council's 2009 paper, *Louder than words*, highlighted that reports are becoming more complex and voluminous – but provide less insight and understanding to users. More recently, the consultation announced by the Department for Business, Innovation and Skills – *The Future of Narrative Reporting* – indicates the coalition government's appreciation of reporting's importance, and particularly the need for the reporting model to deliver information needed by the market and other key stakeholders. Separately, the formation of the International Integrated Reporting Committee gives an interesting signal about the future of reporting. It highlights the need to bring together mainstream and sustainability reporting (in a way that few companies do today) to deliver a report focused on issues of strategic and material importance to the business.

Our findings in this report provide timely insights into the quality of current UK narrative reporting, while suggesting areas ripe for improvement. These insights draw on over 10 years of investment in narrative reporting, reflecting our belief that quality reporting is critical to the effective working of capital markets and our society. This sustained focus also recognises the key role the accountancy profession must play in challenging the quality of reporting and promoting good practice. We will continue to encourage preparers to progress on the journey towards higher quality, integrated reporting.

Boards must show the way... so that reporting has substance and authenticity

But improved reporting needs all those involved to step up to the plate. Legislators can help create the necessary legal environment and incentive structure to encourage the right behaviours and better alignment between the front and back halves of the report. But we must beware triggering a compliance mindset. Regulation alone cannot create trust – whether in capital markets or individual management teams.

There is a more proactive role for companies in shaping the form and content of reports and in particular discarding immaterial information. Boards must show the way, providing greater input into the reporting process so that reporting has substance and authenticity.

Finally, if we can rethink the reporting model, reduce its complexity, and ensure it becomes truly integrated, a sensible debate can then occur regarding what information would benefit from external assurance.

Richard Sexton
Executive Board Member, PwC

Executive Summary

FTSE 350 reporting – insight or fatigue

Narrative reporting is a vital element of corporate communications and is under increasing scrutiny. This year, our review of FTSE 350 companies' narrative reporting reveals the scale of the challenge that many companies still face. We have found improved reporting in some areas, but many companies still fall short of providing the quality and degree of integration we believe constitutes good reporting practice and which investors tell us they value.

Ongoing economic uncertainty during the reporting period in question may be a factor in the limited progress, alongside compliance fatigue, conflicting reporting priorities or demands on time. But clear corporate reporting can be a competitive tool during uncertain times. Investors value the information in annual reports and look for consistency between financial and narrative sections. Companies that present joined-up reports – painting an integrated picture of strategy, actions and performance, with content based on the data used to manage the business internally – can differentiate themselves to enhance reputation and support share valuations.

Leading reporters' good practices are some way ahead of the majority

Some improvement in the basics

We looked first at whether companies provide the base level content investors tell us is important in their narrative reports. We found some slight improvements – 74% providing some forward-looking information on market trends, for example, compared to 49% last year. There has also been an increase (to 90% from 79%) in the proportion outlining how they aim to achieve their strategic priorities.

Leading reporters show what is possible

The quality of information has also moved forward in some areas, though the leading reporters' good practices are some way ahead of the majority. For example, when reporting on risks, 44% concentrate only on those risks appropriate and relevant to the company, whereas 56% include generic risks in their discussion. Although 75% of companies discuss how risks are mitigated, only 35% of this group do so with sufficient detail. There are variations too in the quality of reporting on performance – so the best performers stand out. Only 34% provide comprehensive quantified analysis of factors driving changes in revenue or profits (eg, organic vs acquired), while 12% provide a detailed set of quantified measures management use to monitor progress in delivering strategic priorities.

Few shed light on business models

In the current economic climate there has been much debate around companies' business models and how they should be presented externally. While 65% of the FTSE 350 make reference to their business model, definitions of what constitutes a business model differs widely and the quality of supporting information varies significantly. For example, focusing on how companies bring their key strategies and business models to life, only the leading reporters (29%) give information that sheds real light on their key resources and relationships (such as people and suppliers).

Just 15% explain their dependencies on significant contractual arrangements, although this is a legal requirement. While 51% give some insights into how they measure value-adding activities (such as efforts to develop talent or manage R&D), only 12% provide appropriate detail and just 3% include quantified information.

Only 25% clearly align KPIs and strategic priorities

Integrated reporting only starting to emerge

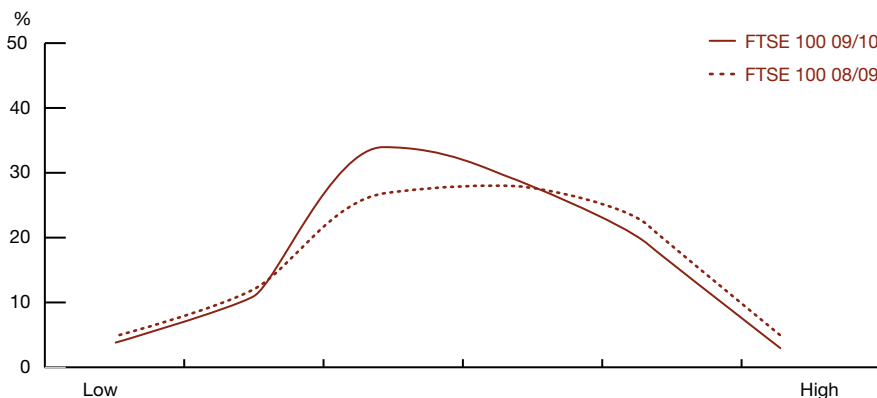
We also considered the degree to which companies produce integrated reports with clear alignment within, and between, different sections. There are signs of a gradual improvement of good practice, with 25% (13%) clearly aligning Key Performance Indicators (KPIs) and strategic priorities, for example. However, just 12% make it clear that they use their strategy to underpin their reporting – an essential requirement for integrated reporting. Only 14% have clear alignment between KPIs and remuneration metrics – an area now attracting interest from the government due to its perceived importance.

Size is no predictor of effective reporting

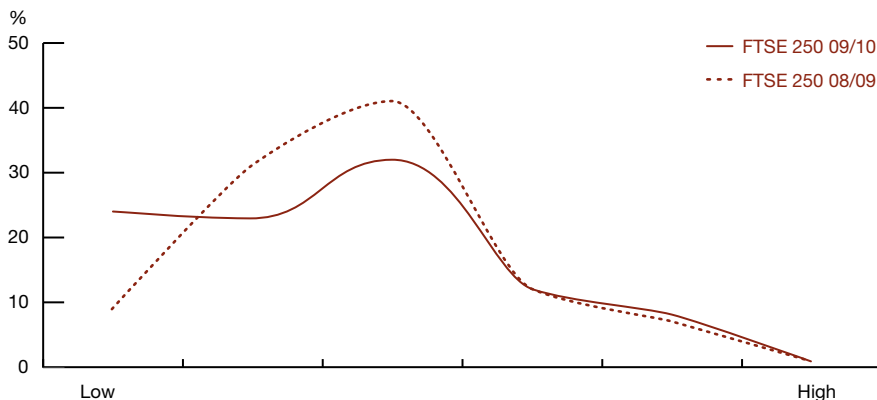
Our analysis of companies' reporting generates an overall effectiveness measure. Some commentators might expect companies in the FTSE 100 to achieve higher reporting standards than the FTSE 250, given the greater resources often at their disposal. Our findings show that, in both groups, some companies achieve very high standards of reporting. The best reporters in the FTSE 250 are as good as those in the FTSE 100. But we also saw that in both groups, no single company achieved the highest quality across all areas of their narrative report.

Effectiveness of corporate reporting

FTSE 100



FTSE 250



In both the FTSE 100 and the FTSE 250, there is still a significant gap between the best and worst communicators. But this year we found a slight deterioration in the effectiveness of the FTSE 100's middle performers, and a marked movement towards the lower end of the effectiveness scale in the FTSE 250. More FTSE 250 reporters are just doing the bare minimum – despite the need for them to make more 'noise' than FTSE 100 competitors to attract investor attention.

What does your reporting say about you?

It should present a connected picture of the business, how it is managed and governed and where it is heading.

But does it?

Does your reporting convey an organisation that is connected to:

- The external world?
- Key stakeholders?
- The right components of the business?
- The internal information system?

See page 22 for questions to think about.

Results show more FTSE 250 companies have less effective reporting this year

Narrative reporting reveals challenges

Trends identified in this year's research suggest several challenges facing corporate reporters: compliance fatigue, difficulties in assessing the value delivered by the annual report, compartmentalised reporting processes and weaknesses in the links between strategic priorities and operational and financial data.

From talking to preparers, we sense that some are suffering from compliance fatigue due to successive waves of ad hoc legislation, regulation and governance requirements. So they may be tempted to cherry pick the content they provide – reporting KPIs as the business review requires, for example, but not necessarily clearly aligning them with the company's stated strategic priorities or executive remuneration.

From talking to preparers, we sense that some are suffering from compliance fatigue

Some reporters may place a limited value on their annual report, on the grounds that investors find information they need from other – more current – sources. They may be tempted to approach the whole report with a compliance mindset. Investors do use multiple sources, but they still see annual reports¹ as important. In particular, the annual report is seen as a window on management: is management building trust through consistent messages in the report and across other communications? Investors look for a coherent story – an integrated picture of strategy, actions, performance and pay.

Such 'integrated' reporting involves analysing all material factors affecting the long-term sustainability of the business, such as governance, risk, business models, climate change and resource scarcity, in a way that is directly linked to explanations of strategic aims and actual performance. For the integrated picture to be credible, content included in the annual report should be consistent with that reported elsewhere and directly based on the data used to manage the business internally. But some organisations may feel impeded by legislative demands that have encouraged different functions to take responsibility for specific sections. This can result in content appearing disjointed and unconnected to the reporting of overall company performance.

The annual report is seen by investors as a window on management

To achieve integrated reporting needs more than inter-departmental coordination. It also depends on companies actually having the right information and understanding the relationships between different data sets. At present, companies reporting non-financial information tend to do so in isolation from financial data. This is inevitable unless management can clarify the interplay between operational data and the financials – the extent to which staff turnover or the strength of the R&D pipeline, for example, affects revenue.

Our report, *Integrated reporting: What does your reporting say about you?* explains further our view of how reporting should be structured to deliver the desired joined-up result.

¹ See our Investor view, *The role of the annual report*

Looking ahead

The process of improving corporate reporting is a journey that requires commitment from all interested parties. We believe there are a number of actions that regulators, preparers and others must take if the quality of corporate reporting is to substantially improve in future from the levels our research highlights today.

- Legislators and regulators must coordinate their activities better, to reduce the burden created for companies by the sheer volume of, and overlap in, requirements.
- Companies should think about the value of their narrative reporting to investors, working harder to deliver a coherent message and report information that helps users understand how performance relates to stated strategic aims.
- Management and boards should challenge whether their internal management information is of sufficient depth, breadth and quality to enable them to exercise effective oversight and communicate externally.
- CFOs should consider: a) is the right balance being achieved between compliance and meaningful business insight? and b) do accepted financial disciplines need to be brought to broader aspects of reporting?
- The profession, preparers, investors and other key stakeholders need to come together and debate whether the current assurance model, focused on only part of the information set, is fit for purpose.

'Integrated reporting' involves analysing all material factors affecting the long-term sustainability of the business

Acting collectively to address these issues will bring us closer to achieving important goals: reporting that meets stakeholders' needs; enhanced trust in companies and management; appropriate share valuations and efficient capital allocation in the markets.

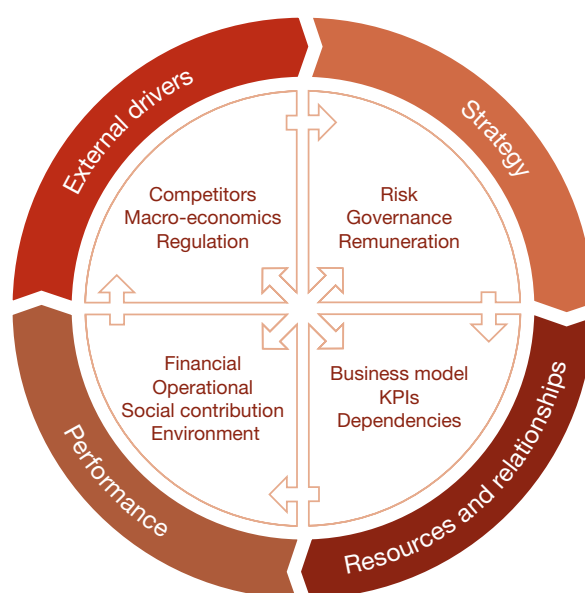
Review of reporting against our integrated model

To understand how effective companies' reporting is today, we assessed their 2009/10 reporting against aspects of our integrated reporting model, outlined in the diagram. This model is grounded in over a decade of PwC research and work with investors and companies. It identifies four broad, yet critical, categories of information common to all industries that we believe companies need to have at their disposal, both internally and externally, to be on top of the dynamics of modern business and in a position to continue building trust.

None of the information that flows within or from each category is new. The real insight and value comes from understanding the points of intersection – for example, when governance interfaces with remuneration and risk, when a strategy exploits a changing market environment and when strategic priorities, business performance and KPIs align. It is this joined-up thinking that is so critical.

For further insight into the information set outlined above, contact us for a copy of *Integrated reporting: What does your reporting say about you?* (Email: info@corporatereporting.com)

Integrated reporting model



Corporate reporting – research findings



Research approach – FTSE 100 and FTSE 250 reporting

This section of the report covers the findings of our assessment of FTSE 350 companies' narrative reporting in their annual reports. We reviewed reports for periods ended between 1 April 2009 and 31 March 2010. Each report was examined against more than 80 data points related to our integrated reporting model. This section is structured around the model's main elements.

Three companies were not reviewed because they had not published their annual report during the period of the research. Investment trust companies (48) were also excluded from the analysis, as the standardised nature of their reporting tends to skew the results of our research. Prior year numbers have been restated to exclude investment trusts as well. The final sample size for this corporate reporting research was therefore 299 companies, 98 in the FTSE 100 and 201 in the FTSE 250.

Corporate reporting – research findings

External drivers

Investors and other stakeholders want to know about external drivers shaping the marketplace in which a business operates – the trends in society and technology, the geopolitical and environmental factors, and the economic and competitive forces. This creates the context for understanding a business – particularly its strategy and potential for sustainable future performance.

Given this, we are encouraged that reporting of external drivers has generally improved this year. The increase in companies providing at least some forward-looking information on their market drivers is striking – 74% compared to 49% in 2009. This may partly be a further response to the enhanced business review. It may also reflect that, although uncertainty about future economic prospects continues, most management teams now recognise the need to provide at least some forward-looking commentary to give context to strategic choices.

But there is considerable room for improvement. Good reporters see their market discussion as an essential platform to build their reporting on and explain their strategy going forward, rather than simply to justify recent performance. The best – whether reporting on market growth, future trends or the competitive landscape – understand investors' need for meaningful detail and quantified data, rather than limiting narrative content to high-level information.

Many companies could provide more detail on external drivers without revealing competitively sensitive information. Reticence could suggest that management has doubts about the quality of their data, which may arouse concerns among investors. Some companies may feel the information is already available elsewhere. But investors want to see management's view of market trends – without this, assessing the quality of management and the appropriateness of the business' strategy is difficult.

74%

provide some forward looking information, but just

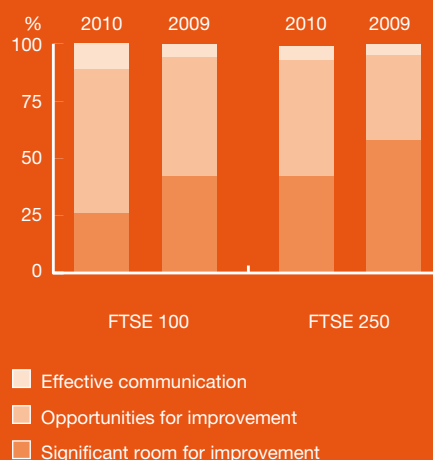
13%

give substantive explanations

What we looked for

- Explanations of markets and opportunities
- Insights into market growth drivers
- A forward-looking orientation
- Insights into competitive landscape eg, competitors, market share/ position, degree of fragmentation

Effectiveness of reporting on external drivers



Both the FTSE 100 and FTSE 250 improved the quality of their reporting on external drivers.

What we found

- 87% provide high level explanations of why markets/products/territories represent opportunities, while 30% of these give deeper insights
- 88% discuss factors affecting market growth, but only 23% of these support the discussion with quantified data
- 74% (49%)* provide some forward-looking information on market trends – but just 13% (7%)* give substantive commentary
- 35% provide only high-level insights into their competitive landscape, while just 17% give substantive analysis

* Prior year in brackets

Corporate reporting – research findings

Strategy

40%

explain strategic priorities, but just

12%

use strategy to underpin their reporting

A newcomer to corporate reporting might be surprised that only 88% of FTSE 350 companies state **what** their overall goal or objective is – to grow shareholder value, for example. Yet a significant minority still remain silent on this key point. Many more give no indication of the measures management use to monitor progress towards achieving their ultimate goal.

Management’s explanations of strategy – and how that strategy is being implemented – are valued by investors. Most companies make some reference to **how** they plan to achieve the corporate goal – providing a high quality customer experience or developing innovative products perhaps, but only 40% (37%) clearly explain these strategic priorities. Even fewer (12%) set out quantified measures management uses to monitor progress for each strategic priority – for example, customer satisfaction levels or the strength of the R&D pipeline. Some give cherry-picked measures, not necessarily quantified.

This complicates life for investors and other external observers, giving them inadequate information to make a reasoned decision about business performance against strategic aims. Such a lack of clarity can pose questions, perhaps unfairly, about whether the stated strategy reflects the internal reality, including how strategic progress is driven and assessed. Adding to this opacity, strategy is often reported in isolation from other elements of reporting such as risks and performance, with just 12% using their strategic priorities to underpin their reports.

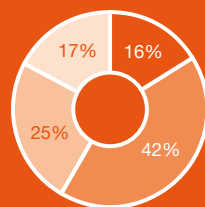
In general, we sense some appetite among management to try to articulate more clearly their aims and priorities for action. The best reporters understand that greater transparency in uncertain times is valued by investors. Yet there is some way to go before readers of annual reports have the comprehensive picture that they might like.

What we looked for

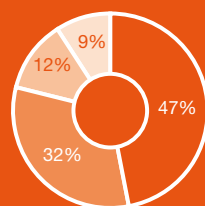
- Clear statements about overall corporate goals – what the company wants to achieve
- Clear articulation of strategic priorities – how the company aims to achieve its ambition
- Inclusion of measures used to monitor progress in achieving corporate goals and implementing strategic priorities
- Timeframes or targets
- Integration of strategic themes across the annual report

Reporting measures used to monitor strategic progress

FTSE 100



FTSE 250



- No
- To some extent
- Yes for each strategic priority
- Yes and quantified for each strategic priority

Almost half FTSE 250 companies do not report measures used to monitor progress.

What we found

- Although 88% state the company’s overall goals, only 48% set out any measures used by management to monitor progress in achieving those aims
- 90% (79%)* outline strategic priorities but just 40% (37%)* do so clearly, while only 12% (6%)* clearly use these priorities to underpin their reporting
- 12% provide comprehensive quantified measures used by management to monitor progress for each strategic priority
- 40% (31%)* provide some insight into targets or timeframes for implementing strategic priorities

* Prior year in brackets

Corporate reporting – research findings

Risks

The best reporters bring their risk management to life, linking it to other areas of their narrative reporting and providing valuable insights to investors. However, most companies fail to achieve this. Too often risks are discussed in isolation and are frequently generic, remaining unchanged year on year, regardless of the changing economic climate or market.

Expectations of risk reporting among investors, standard setters and regulators are growing in the aftermath of the credit crisis. The Financial Reporting Review Panel's (FRRP) 2009 report, *Review findings and recommendations*, found failings in principal risk reporting, including lists of risks without any proper description, generic descriptions, and insufficient detail. The Accounting Standards Board (ASB) has also identified this as an area ripe for improvement. Companies that fail to meet the spirit of risk reporting requirements may expose themselves to unwelcome regulatory attention.

Management teams need to report on how they identify principal risks, how they assess them, monitor them and take action to mitigate them. The better reporters – some 44% – include just risks appropriate and relevant to the company. In contrast, some have so many risks that not all can credibly be considered principal. We found 19% of companies identifying more than 15 risks, with the highest number reported being 44.

Only 35% of companies reporting on risk mitigation give comprehensive explanations for each principal risk. Even fewer give insights into the impact of external trends and internal actions on the company's risk profile, in terms of the impact a risk would have and the probability of it crystallising.

75%

provide some insights into how risks are mitigated but only

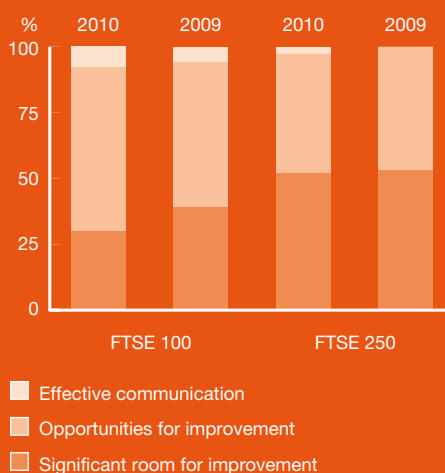
35%

of these give comprehensive explanations for each risk

What we looked for

- Identification of risks specific to the company and consistent with other areas of their narrative reporting
- Explanations of how principal risks are mitigated
- Quantifiable evidence to support the discussion
- Insights into overall risk profile, the probability of a risk crystallising, its impact and explanations of changes to the profile during the year

Effectiveness of risk reporting



There is a clear improvement in FTSE 100 companies' risk reporting, though little change for FTSE 250 companies.

What we found

- 44% report on just risks appropriate and relevant to the company, another 47% also report on some generic risks and 9% merely provide boilerplate reporting of risks potentially applicable to any business
- 75% (78%)* provide at least some insights into risk mitigation – but companies are less likely this year to give comprehensive explanations for each risk – only 35% (53%)*
- 21% (18%)* provide quantifiable evidence to support risk discussion
- 18% explain to some extent the impact of external trends and internal actions on the risk profile during the year

* Prior year in brackets

Corporate reporting – research findings

Delivering strategy

65%

refer to business models, but only

15%

provide comprehensive information on significant contractual arrangements

High profile company failures in the downturn have brought home the need to understand business models. Reflecting this concern, the new UK Corporate Governance Code requires directors to include in the annual report an explanation of the business model – “the basis on which the company generates or preserves value over the longer term” – and “the strategy for delivering the objectives of the company”. This is likely to be an area of focus for regulators going forward, so companies that currently make no reference to their business model in their reporting (35% of the FTSE 350, according to our research findings) will need to look at this.

A growing number of companies are trying to communicate how they deliver their strategy, but the approaches used vary considerably. Often the reader is left uncertain about exactly how the business creates and preserves value. Only 29% (compared to 27% last year) clearly identify the key resources and relationships needed to implement the business strategy. Just 15% (10%) provide the comprehensive information on significant contractual arrangements that is required by the enhanced business review.

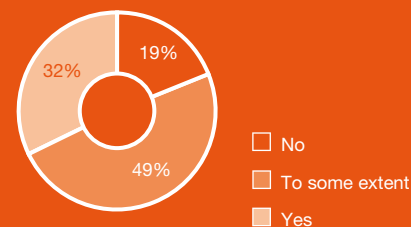
The difficult economic climate has focused boards’ attention on the fundamentals of financial performance and availability of financing. At the same time, it has challenged them on the quality of financial/operational data to make effective and timely short and longer-term strategic decisions. Their annual reports appear to reflect this – dominated by financial and regulatory material, but revealing gaps in the operational information that investors need to understand the business fully, and the sustainability of future value creation.

What we looked for

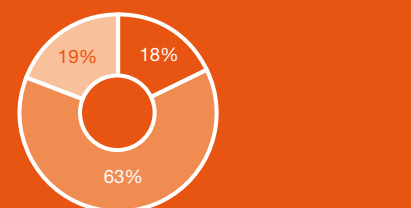
- Reference to the company’s business model
- Explanations of actions necessary to deliver business strategy
- Information on key resources and relationships, their management and measurement
- Explanations of the value-adding activities performed and the management of those activities
- Information on outputs and their management and measurement
- Quantified evidence to support discussion
- Insights into significant contractual arrangements

Description of activities, skills and competencies used to deliver on strategic priorities

FTSE 100



FTSE 250



A large majority describe, at least to some extent, how they will deliver on priorities.

Business model – what information do investors want?

A major challenge in this area of reporting is the range of opinions as to what constitutes a business model, and this is reflected in the variety of definitions used in reports. A business model may reflect a company's life cycle, for example, or its value chain, strengths and resources, or how they make money.

Our long-held view is that whatever terminology is used, investors need information on that company's key resources and relationships in order to understand how successful a company will be in delivering its strategy. They need insight, for example into the recruits needed, the critical supplies required or the customers they serve, as well as their relative dependency.

They also need to understand the business' value-adding activities – how it develops talent or manages research and development – in order to create its desired outcomes.

Finally, they need to know how the business preserves value by monitoring, managing, protecting and developing its resources and relationships, value-adding activities and outcomes.

What we found

- 65% refer to business models
- 78% report at least some key actions necessary to deliver on strategic priorities – 23% doing so substantively
- 29% (27%)* clearly identify key resources and relationships needed to implement the business strategy, but less than a third of these explain well how they measure the relative strength and/or management of these
- 51% give some insights into value-adding activities, though only 12% do so substantively and just 3% give quantified information
- 15% (10%)* provide comprehensive information on significant contractual arrangements

* Prior year in brackets

Corporate reporting – research findings

Measures of success

88%

explicitly identify their KPIs but only

25%

clearly align KPIs and strategic priorities

A quick test of the quality of management’s strategic thinking is the extent of alignment between the stated strategy, reported KPIs and remuneration policy. Most stakeholders are reassured by the knowledge that management are being rewarded in line with their success in delivering strategy – and that appropriate, clear measures have been set for assessing this success. If that alignment appears lacking, questions quickly follow: Does management have the measurement data necessary? How can management know the business is on track to deliver its strategic aims? Is the strategy presented reflective of internal reality or merely cosmetic? How are management incentivised to achieve strategic success?

The latter is an area of particular focus for investors, as seen from the number of challenges to remuneration packages. It is also on the government’s radar. The August 2010 consultation document, *The future of narrative reporting*, issued by the Department for Business, Innovation and Skills calls for comment on a number of issues, including whether current disclosure requirements provide “clear and usable information” about the linkage between the performance criteria for directors’ pay and strategic objectives.

In this year’s research we found a high level of identification of KPIs, comparable with 2009’s results. However, much of this KPI reporting is relatively superficial. For example, only 25% (compared to 13% last year) clearly align KPIs and strategic priorities and just 14% (13%) demonstrate clear alignment between KPIs and the metrics that drive remuneration. Of the companies reporting KPIs, 22% report no operational or non-financial KPIs – even though most strategic priorities are operational in nature.

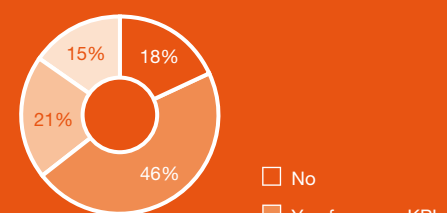
Companies applying best practice do include operational or non-financial KPIs. They also demonstrate the joined-up thinking investors like to see, making sure there is clear alignment between the KPIs they report, the strategic priorities they set out and the metrics they use to determine remuneration.

What we looked for

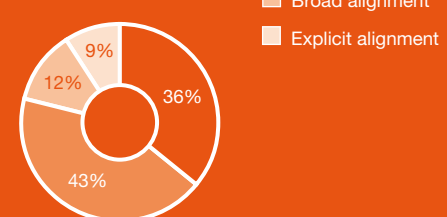
- Explicit identification of KPIs
- Provide a rationale for the use of each KPI
- Alignment of KPIs to strategic priorities
- Alignment between corporate and remuneration KPIs
- Future targets

KPIs clearly aligned to strategic priorities

FTSE 100



FTSE 250



Very few companies explicitly align KPIs with their strategic priorities.

What we found

- 88% (85%)* explicitly identify their KPIs
- The average number of KPIs is 8; 5 financial and 3 operational
- 63% define KPIs and provide a rationale for use
- Only 25% (13%)* clearly align KPIs and strategic priorities, while 31% do not do so at all
- 50% (37%)* report some KPIs that align with those driving remuneration policy, but just 14% (13%)* demonstrate clear alignment between KPIs and metrics that drive remuneration
- Only 26% give future targets for KPIs – just 6% giving quantified targets for all KPIs

* Prior year in brackets

Corporate reporting – research findings

Performance fundamentals

The economic downturn and continued strain on availability of financing have led to increased management and investor focus on cash, funding and working capital requirements. This is information of fundamental importance in narrative reporting.

So too are explanations of the key drivers of revenue or profits. A quick test of narrative reporting is whether the reader gains sufficient information to understand the movement in turnover and profit year on year – the impact of price or volume changes, organic or acquired growth or currency fluctuations. Investors want to know whether profits are sustainable or whether short-term performance is being achieved at the expense of long-term success. The best companies (34%) provide comprehensive quantified analysis of these drivers.

Investors value information on all aspects of funding (including details of working capital), maturity information, covenant restrictions and details of average debt balances. Some reporters understand these needs, with an increase this year (from 22% to 33%) in those providing a more detailed maturity profile than required by statute. The best (16%) give a comprehensive analysis of material covenants, including performance against them and future headroom. Interestingly we saw FTSE 250 companies outperforming those in the FTSE 100 in this area.

Best practice reporting also includes a net debt reconciliation, allowing investors to see how financing has changed over the year. It highlights whether increased cash is due to increased debt, the extent of debt acquired or disposed of in business combinations, foreign exchange movements on debt and information not always obvious elsewhere in the financial statements. There has been little change in the number of FTSE 350 companies providing such information – 51% this year give a reconciliation to cash flows of movements in their net debt/cash position.

34%

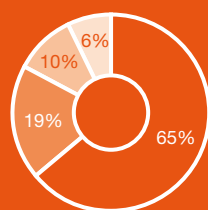
provide comprehensive quantified analysis of underlying drivers of revenue or profit

What we looked for

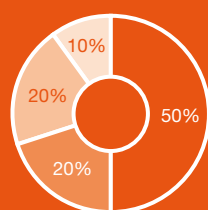
- Comprehensive discussion of underlying drivers of revenue/profit performance
- Explanations of funding strategies
- Information on cash flow strategy
- Detailed explanations of debt position, including net debt reconciliations, information on covenants and maturity profile

Provide detail of material covenants associated with debt

FTSE 100



FTSE 250



- No
- To some extent
- Yes
- No debt

This is one area where the FTSE 250 perform better than the FTSE 100.

What we found

- 34% provide comprehensive quantified analysis of underlying drivers of revenue/profit
- 84% (70%)* give some information on cash flow/funding strategy, but only 23% (18%)* give detailed commentary
- 91% quantify their net debt position, yet only 46% provide comprehensive analysis of the underlying components
- 33% (22%)* provide a more detailed debt maturity profile than statutory reporting requires
- 51% (48%)* include a reconciliation of movements in the net debt/cash position to cash flows

* Prior year in brackets

Corporate reporting – research findings

Sustainability

15%

provide a clear link between the impact of sustainability issues and the delivery of core business strategy

Historically, sustainability was equated with philanthropy. Many companies saw it as outside day-to-day business, an exercise in good corporate citizenship and responding to specific information requests from stakeholders and lobbyists.

In our view, sustainability means taking both a short and longer-term perspective of strategic decision-making – and leading companies demonstrate this. Management has to consider the implications of uncertainties like climate change, resource usage and demographic shifts on their business model’s resilience, their impact on strategic success and ultimately, their effect on the bottom line. So it’s about managing sustainability in the same way as any other business issue.

As a result, sustainability reporting should not be in a silo but firmly integrated into the mainstream reporting strategy. The reality, however, is that it has mirrored management’s perception of sustainability – most organisations produce stand-alone reports or include sections in annual reports, with sustainability issues discussed in isolation from information on corporate strategy and performance. In its 2009 report on narrative reporting, *Rising to the challenge*, the ASB noted that CSR sections of annual reports “contain significant immaterial clutter that is not necessarily essential for making resource allocation decisions”.

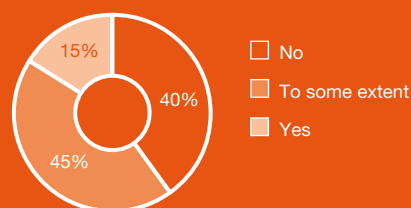
But some companies are making positive progress. The leading companies are beginning to apply best practice – 15% (compared to 12% last year) provide a clear link between sustainability factors and delivery of their strategy. The best reporters don’t talk about sustainability because they have to, but because they understand it forms the basis for ensuring long-term business success.

The challenge for companies is to identify which sustainability issues are truly relevant and material for them and so deserve management time and reporting space (including in the annual report).

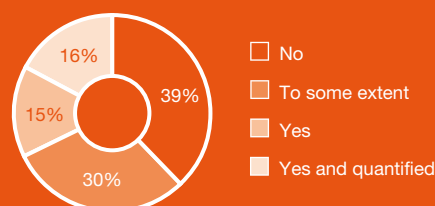
What we looked for

- Linkage of sustainability issues to the delivery of core business strategies
- Explanations of material sustainability risks and opportunities
- Explanations of actions to mitigate material risks to the sustainability of the business
- KPIs used to monitor progress against sustainability priorities
- Alignment between sustainability performance and executive remuneration

Report impact of sustainability linked with delivery of business strategy



Report KPIs used to monitor progress against sustainability priorities



What we found

- 15% (12%)* provide a clear link between the impact of sustainability issues and the delivery of core business strategy
- 61% (77%)* provide at least some KPIs used to monitor progress against sustainability priorities, a quarter of these giving measures for each sustainability priority and another quarter also quantifying them
- 15% (13%)* align executive remuneration with sustainability performance

* Prior year in brackets

Corporate reporting – research findings

Segment reporting

Segment reporting is hugely valuable to investors, providing much needed detail for building valuation models. The best reporters recognise this and provide information on external drivers and strategic priorities at a segment level.

There is plenty of room for improvement, however, and segment reporting is now on the radar of the FRRP, which has expressed concerns over the way companies are applying IFRS 8, Operating Segments. The FRRP has acknowledged that the implementation of IFRS 8 is a challenge, but stated that it is “also an opportunity to communicate better by linking the business review with the content of the IFRS accounts”.

Too many companies fail to provide this linkage or the granularity investors need. While 46% set out strategic priorities for at least some segments, just 58% of these include measures management use to monitor progress. Only 24% of all the companies report KPIs aligned to strategic priorities by segment.

Investors’ analysis is also made more difficult by the fact that 12% of companies provide inconsistent segment information in narrative content and financial statement notes. Such inconsistency can frustrate investors, and may be interpreted as an attempt by management to disguise poor performance – something that IFRS 8 was intended to reduce.

As a final thought, only 20% of companies explain the role of the corporate centre in strategy delivery. Management need to explain how the corporate centre adds value – by sharing best practice, achieving synergies or providing other benefits.

46%

set out strategic priorities for at least some segments, but only

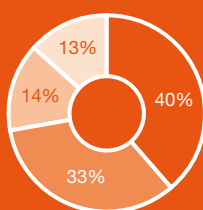
24%

report KPIs aligned to these priorities

What we looked for

- Discussions of external drivers for each significant segment
- Information on strategic priorities and the delivery of strategy by reported segment
- Segment KPIs and their alignment to segment strategic priorities
- Consistency of segments in narrative content and financial statement notes
- Explanation of the role of the corporate centre

Reporting across the integrated reporting model by segment

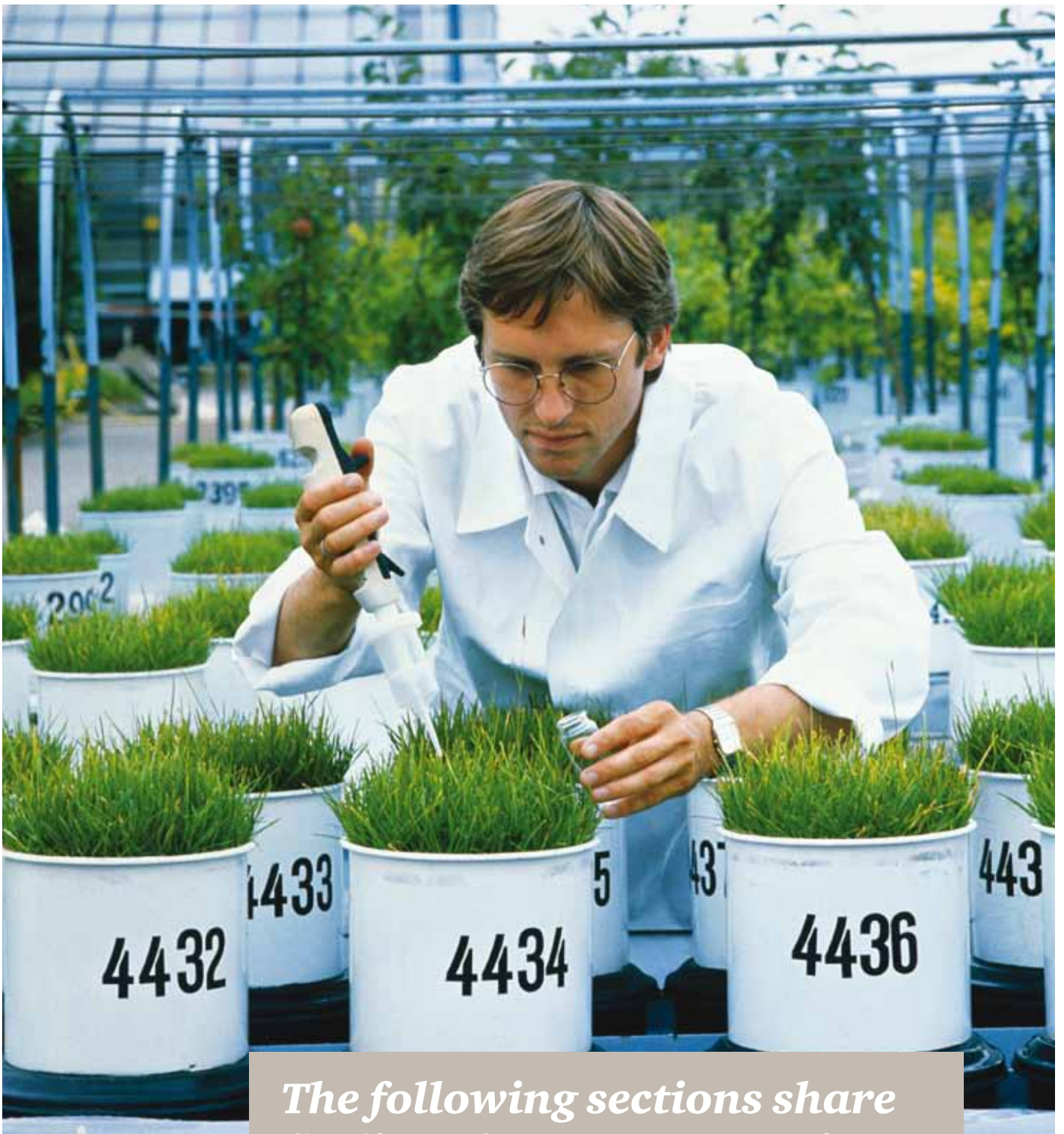


- Minimal segment reporting across framework
- Some aspects of framework covered at segment level
- Comprehensive segment reporting across framework
- Single segment

Few companies provide comprehensive segment reporting.

What we found

- 11% provide comprehensive, quantified discussions of external drivers for all significant segments, while another 24% provide comprehensive narrative discussions and another 33% provide at least high level information
- 46% set out strategic priorities for at least some segments, but just 58% of these include measures management use to monitor progress
- 40% disclose some segment KPIs, but just 24% report segment KPIs aligned to segment strategic priorities
- 12% of companies have inconsistent segment information between the narrative content and the notes



The following sections share findings from separate pieces of research focused on the following areas of reporting: People, Remuneration, Sustainability and Tax

People reporting – research findings

UK companies are increasing their focus on the measurement and reporting of people management and the impact of employees on organisational performance. This is driven by the need for companies to develop a sustainable employment model to effectively manage their investment in people in the current market climate. Developments in the effectiveness of global HR systems and processes have led to improvements in the employee data available to inform management and add value to their current people processes.

To look at the quality of companies' reporting on their people, we assessed the FTSE 350 annual reports, the same as those outlined on page 5. We also reviewed corporate social responsibility (CSR) reports where available.

In spite of the improvements in internal people practice, there has been disappointing progress in the quality of external reports. At a macro level we saw greater coverage of people information (60% of organisations we surveyed publish some form of people performance indicator in their annual reports), but the quality of the information and its link to business strategy remains inconsistent. There is a significant gap between the best reporters and the rest.

People are unquestionably a company's most important asset as well as often their most significant cost. It is a challenge to advance reporting practice from disparate people-related information to a point where people information is not only integrated into but integral to external reporting. Only a few FTSE companies could be truly said to have met this challenge.

Companies that will lead the way in people reporting will provide external stakeholders with the insights into their workforce profile that are increasingly becoming available internally through improvements in people management practice. They will also have an influential and forward-thinking HR function, which together with the business functions that manage people strategy and data, will be the key sponsors for change in the quality of people reporting.

42% of companies outline a clear human capital strategy in their external reporting

15% of companies set out a clear link between their human capital and business strategy

What we looked for

- Clear presentation of people management strategy and linkage to overall business strategy and objectives
- Relevant and concise data measuring the company's performance against its stated people strategy and objectives
- Recognition of the influence of the external market environment and how this influences people management practice
- Consistency between annual reports and CSR reports and equivalent, where both were published
- Quality of people data provided – targets, external benchmarks and trend information alongside core data

What we found

- 15% of companies set out a clear link between their human capital and business strategy
- 60% of companies include people KPIs in their annual reports
- Only 2% of companies refer to the return on investment from their workforce
- 42% of companies outline a clear human capital strategy in their external reporting

Remuneration reporting – research findings

Only 39% of companies clearly link bonus KPIs to strategic objectives

The remuneration reports of the top FTSE 150 companies reviewed were written against the backdrop of an uncertain political climate, difficult economic circumstances and increased shareholder scrutiny. We felt that the reports reflected a level of ‘regulation fatigue’ and that few companies had made a step-change in reporting this year.

The most effective remuneration reports establish the backdrop to the detailed content with an introductory letter or statement from the remuneration committee chair. This opening statement is often the channel for communicating the alignment of performance measures (used for executives’ incentives) with business strategy.

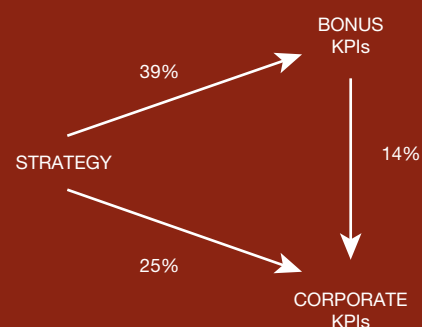
Increasingly, investors want to understand the processes undertaken by the remuneration committee in arriving at remuneration decisions for executive directors and other members of senior management within their remit. Nearly 70% of companies surveyed took the opportunity to explain candidly the measures taken to keep senior executives in place and how they ensure their remuneration policy is consistent with that adopted for other employees in the company.

Demonstrating the links between strategy, reward and performance makes logical sense and is critical to an effective remuneration report and a positive outcome in the shareholder vote. Yet our survey suggests that such an integrated picture remains a significant challenge. We are seeing an increasing number of companies justifying incentive payments by corporate performance, as evidenced by the fact that 75% of companies report that their KPIs are aligned with remuneration policy. However, when we looked in more detail for evidence, we found that only 39% of the companies reviewed actually demonstrated a clear link between remuneration KPIs and corporate objectives. Only 14% of KPIs reported by FTSE 350 companies at a corporate level were clearly aligned with those disclosed for bonus purposes (see below).

What we looked for

- Context to the remuneration report
- Explanations of the Remuneration Committee’s remit and activities
- Description of and delivery of remuneration policy
- Setting of performance conditions
- Alignment of performance measures with corporate objectives
- Amounts vesting and total package
- Information on service contracts
- Clarity of presentation

The challenge of alignment



This diagram shows the proportion of companies that align their strategy, remuneration KPIs and corporate KPIs

Overall, only around 30% of companies clearly disclose how remuneration is dependent on performance (32% describe the outcome from annual bonus metrics and 28% disclose how long-term performance conditions have been met). The performance linkage of elements of reward generated by reference to personal objectives is less transparent than that for corporate objectives.

All listed companies now have to explain the balance of fixed and variable elements in the executive directors' remuneration packages to a greater or lesser degree (because this is a legal requirement) but fewer than one third of companies use this disclosure requirement as an opportunity to present a picture of the total package.

Overall, we believe that the standard of reporting in the top 150 companies is improving. We found only a 30% correlation between the quality of reporting (as determined by our survey criteria) and the size of the company, indicating, perhaps, that the overall complexity of the arrangements in larger companies outweighs the benefit of greater resource.

Around 30% of companies disclose how performance conditions have been met

What we found

- 45% of companies set out the economic or commercial context to the report
- 61% of companies set out the processes undertaken by the Remuneration Committee
- 39% of companies demonstrate a clear link between bonus KPIs and corporate objectives
- 32% report the outcomes for each bonus KPI
- 28% describe how long-term incentive performance measures have been met
- 28% disclose all remuneration in one table

Sustainability reporting – research findings

30% link sustainability objectives to core business strategy

Sustainability reports are often challenged for selectively presenting a rose-tinted view of performance, and of acting as more of a marketing brochure than a report about the impacts and performance of the organisation. To ascertain the quality of reports today, we reviewed 125 FTSE 350 sustainability reports, selecting those companies that scored well on sustainability disclosure in their annual report and accounts (see page 14).

To demonstrate that sustainability is an important business issue, leading companies are starting to manage sustainability in the same way as they do other business issues. This starts with a clear understanding of the relevance of the issues for the business, and a strategic response to material issues connected to action plans with appropriate targets, and KPIs for monitoring progress against the stated objectives. Some forward-looking companies are also looking to demonstrate the financial implications of sustainability issues by presenting financial information alongside their sustainability metrics.

As part of our review of selected FTSE 350 sustainability reports, we assessed the degree to which these fundamental building blocks of a performance report were evident and how clear the connections were between risks, strategy, targets and performance measures.

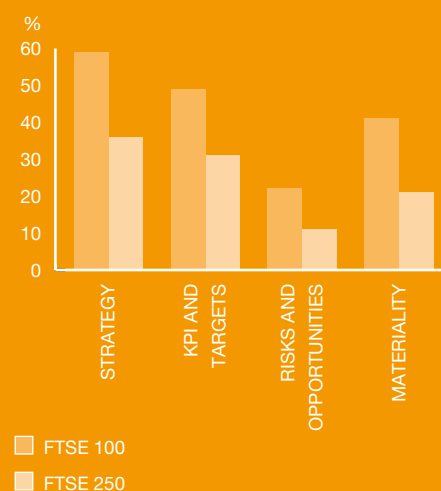
We were pleased to see an improvement from last year in the sustainability content of annual reports, which reflects the increasing interest in corporate performance on sustainability. However, there has been no significant overall improvement in the quality of sustainability reports.

The results, in our view, show that significant improvement is needed for reports to be meaningful and meet stakeholder needs. Of the 125 companies reviewed, sustainability risks were linked to company strategy by only 20% of companies (with 9% linking opportunities to strategy). Just under a third of companies

What we looked for

- Consideration of sustainable development issues factored into core business strategy/priorities
- Understanding of the impacts of sustainable development issues for both the company and the wider market environment
- Appropriate governance policies, targets and objectives relating to sustainable development performance
- Identification and explanation of relevant sustainable development key performance indicators
- Appropriate performance monitoring and reporting on the company's priority sustainable development issues

Effectiveness of disclosures in selected FTSE 350 sustainability reports



The bars show the average score for disclosures on strategy, KPIs and targets, risk and opportunities and the materiality of disclosures.

(30%) linked their sustainability objectives to the core business strategy. A slightly higher proportion (38%) linked their strategies to targets and KPIs, but only 12% provided details of plans to achieve these targets.

It is still rare for companies to provide insights into the financial implications of their sustainability activities – just 4% of the companies reviewed did so. And to date, there are no companies that show the links across all of these areas – although we believe that is what would turn a ‘marketing brochure’ into a ‘performance report’ showing a more holistic view of performance.

Our findings pose several questions:

- Does this level of disclosure provide users of sustainability reports with an understanding of management’s reasons for investing resources in the management of sustainability?
- Does the information disclosed enable stakeholders to judge performance year on year?
- Does current reporting enable stakeholders to compare the ambitions of one company with the next?
- Does the level of disclosure reflect internal reality?

Many companies invest significant resources in their sustainability activities. The results of our survey suggest that they are not effectively communicating return on this investment and therefore missing an opportunity to demonstrate how sustainability activities enhance the value of the company, rather than being seen by some investors as a drain on the company’s resources.

Only 20% link sustainability risks to company strategy

What we found

- 70% of the FTSE 100 (39%* of the FTSE 250) sustainability reports clearly disclose strategy, with 49% (22%)* showing links to core business strategy
- 84% (47%)* disclose some KPIs related to material issues, only 49% (36%)* set specific, measurable targets
- 21% (3%)* provided narrative linking their KPI performance to strategy
- 32% (27%)* disclosed the relevance and implications of identified sustainability risks
- Only 39% (17%)* disclose the process undertaken to determine their material sustainability issues

*FTSE 100 finding with FTSE 250 in brackets.

Tax reporting – research findings

More companies are talking about tax and covering different aspects of their tax affairs

The biggest area of change is the discussion about governance and oversight for tax

Our Tax Transparency Framework is used to review the tax reporting of the FTSE 350 and draw up a shortlist for the Building Public Trust tax reporting awards. We assess the 50 or so companies talking most about tax against the aspects covered in our framework. This goes beyond the disclosure requirements for accounting standards and looks at how companies communicate their tax affairs in a way that is easy to understand and informative.

There has been a significant change in how some large companies report on tax since our analysis of the FTSE 350 began in 2005, with a trend towards greater tax transparency. A number of FTSE companies have chosen to be leaders in this area. These companies are not only clearly explaining the corporate income tax charge in their financial statements, but they are being more open about other important aspects of their tax affairs, such as their tax strategy and policies, governance procedures and how tax adds value for stakeholders.

As tax systems everywhere have become more complex, with a corresponding increase in risk, companies have needed to focus more resource on governance and tax risk management. At the same time, a diverse group of external stakeholders have become more interested in tax in the corporate sector, wanting companies to be more open and provide different information about their tax affairs. A campaign for more transparent tax reporting by the civil society organisations has recently gained momentum and, in the wake of the financial crisis and a loss of public trust in business, tax has attracted a new wave of political attention.

We expect the trends that we see in tax reporting to continue and to intensify. Today's leaders have decided that the business case for tax transparency outweighs the possible risks. They are setting the leading practice in their industry sectors and potentially creating pressure for their peers to follow suit.

What we looked for

Tax strategy and risk management

- Discussion of tax objectives and strategy
- Disclosure of policies in key areas for the business, for example, tax planning and transfer pricing
- How the tax strategy and function are managed and who has responsibility for governance and oversight
- Discussion of material tax risks

Tax numbers and performance

- Clear reconciliation of the tax charge to the statutory rate
- Reconciliation of cash tax payments to the tax charge

- Forward-looking measures for tax, such as forecast accounting or cash tax rate

Total tax contribution and the wider impact of tax

- Demonstrates how tax impacts the wider business strategy and company results
- Discussion of advocacy and lobbying activities on tax
- The impact of tax on shareholder value
- Communication of the economic contribution of all taxes paid

What we found

- Almost half discussed governance and oversight for tax – a significant increase compared to five years ago
- A minority discuss their tax strategy or policies, but the number is growing and those that do, continue to do it well
- One in three provides an indication of future accounting effective tax rates, but less than one in twenty discuss their cash tax payments
- A quarter discuss how taxes are part of their economic value add² and many of these use a total tax contribution approach showing the different taxes borne and collected

² Economic value companies create and distribute to stakeholders

What does your reporting say about you?

For your consideration

External reporting

True or false

- My external reporting is a fair reflection of what is going on inside the company.
- Key components of what makes my business successful are missing from our reporting.
- My reporting poses more questions than it answers.
- I would not invest in my company based on what is presented externally.
- My market value is not a fair reflection of the business.
- The presentation of the business and its performance is disjointed.
- Sustainability is not important enough to be included in our strategy.
- My reporting fails to show clear alignment between strategy, remuneration and KPIs.
- The quality of our reporting makes us more vulnerable than peers to a hostile takeover bid.

Internal reporting

True or false

- Our reporting is too dependent on historical financial information.
- Our reporting is not integrated or flexible enough to respond to changes in the business environment.
- I am concerned that we lack the market insight and non-financial information needed to stay ahead.
- Too much time is spent producing the numbers, rather than gaining real insight.
- I don't have a complete, timely picture of what's going on in the business financially and operationally.
- Our performance measures are not transparent and there is no clear accountability for them.
- I don't always trust the numbers when I first see them.

How does your reporting measure up against the competition and best practice?

Do you know where you want to be and how to get there?

Further insights

For over a decade, we have been looking at the information needs of preparers and users, the economic benefits of transparency, as well as current and best reporting practices worldwide. We've worked with many companies to align their interests with those who make investment decisions using the information they provide.

We understand what effective reporting looks like and have practical insights into the critical building blocks of one integrated information set. Take a look at www.corporatereporting.com to find out more or contact us for a copy of any of the publications below (see contacts on inside front cover).



What does your reporting say about you? (2010)

Takes a strategic look at reporting and areas you should invest effort for value, competitive advantage and to meet your internal and external reporting needs.



World Watch – governance and corporate reporting magazine

Our flagship magazine published twice a year to share insights about developments in financial and non-financial reporting, sustainability, assurance and governance.



Report leadership – executive remuneration

Practical ideas for improving the content of remuneration reports.



Corporate reporting: is it what investment professionals expect?

Insights into the strengths and weaknesses of companies' external reporting based on interviews with over 250 analysts and investors around the world.



Corporate governance – Best practice – January 2010

Our fifth annual compendium of corporate governance good reporting examples, featuring extracts from FTSE 350 annual reports.



Management information and performance

A survey to establish how finance executives view the quality of the management information they produce and how well their organisations use management information to aid decision-making.



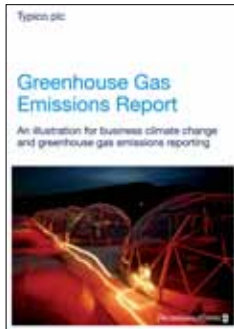
Trust: the overlooked asset

First in a series of papers on the importance of trust and the pivotal role it plays in business.



Carbon disclosure project

FTSE 350 and Global 500 – the data from this initiative is increasingly important for investors to fully assess the risks, liabilities and opportunities within their portfolios.



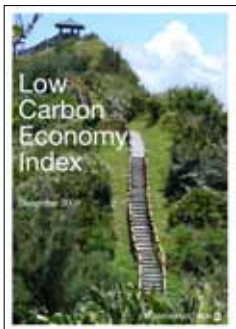
Typico: GHG emissions report

'Typico' report illustrates what effective business reporting on climate change and GHG looks like.



Corporate Reporting website

Includes good practice reporting examples, news, insight and research on corporate reporting, as well as tools for how companies can make their reporting more effective.



Low Carbon Economy Index

Assesses the progress countries have made this century in reducing the carbon intensity of their economies and how far they need to go to meet targets.



On the brink of a bright future?

Research into and analysis of the solar markets across Europe with a focus on the UK.



Corporate Reporting blog

Updated twice a month with hot topics in corporate reporting, the blog is aimed at all those with responsibility for communicating and analysing corporate performance.



Tax transparency

Building Public Trust: A review of how the UK's largest companies report on tax (November 2010).



Total tax contribution

An annual survey for The Hundred Group of all the taxes companies pay.



Investor view

Highlights reporting areas of most interest to analysts and investors.

PricewaterhouseCoopers provides industry-focused assurance, tax and advisory services to build public trust and enhance value for our clients and their stakeholders. More than 163,000 people in 151 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

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