Room for improvement

The KPMG Survey of Business Reporting, second edition – an Australian perspective

kpmg.com.au
270 listed company annual reports from across 15 non-financial services sectors, with a focus on the larger companies in each market were examined in the global survey.

15 companies were included from Australia in the survey. The analysis is based on our local review and assessment of each company’s annual report against 100 information points.
Welcome to the Australian supplement of the second edition of KPMG’s global Survey of Business Reporting, *Room for Improvement*. It builds on our report of September 2015, *A New Era in Corporate Reporting – review of recent corporate reporting and de-cluttering trends in the ASX 200*, which showed that more than half of the ASX200 were able to reduce the page count of their financial report in 2015 through removing, re-ordering and rewriting.

KPMG’s global survey focuses on company annual reports. In this Australian supplement, we compare the survey results for annual reports of Australian companies reviewed with those from the global group.

What we found was:

- Australian reports are shorter and therefore the ‘cutting the clutter’ focus of the past 18 months has had a positive effect.
- Australian remuneration reports are a significantly larger proportion of annual reports than for overseas companies.
- Australian disclosures around operating performance and the link to strategy lag global company disclosures except in the area of people-based measures.

Companies embracing better business reporting disclosures are connecting their business models, strategies and KPIs quite directly and are contributing to the momentum towards integrated reporting-styled reports. Interestingly, we are also starting to see major investors calling for integrated reports and empirical evidence of their benefits in relation to capital allocation is beginning to emerge.

The next edition of this survey will take a deeper look at this area. The final section of this supplement gives some examples.

The time to take a fresh look at your corporate reporting is now. I hope you find this Australian supplement useful.

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**Duncan McLennan**

National Managing Partner – Audit & Assurance
KPMG Australia
Main Findings for Australia
The must do’s for improvement

1
Give investors the information they need

Australian annual reports are required to provide more than just financial information. In particular ASIC’s RG247 requires information on the company’s business model, strategy, risks, performance and prospects as they relate to ongoing financial performance and position.

Report content
The diagram below shows that Australia is still significantly behind our global comparators when it comes to reporting on business model and strategy.

45 percent (global 42 percent) of the average Australian report is devoted to the financials, with only 5 percent (global 14 percent) addressing business strategy.

In addition, Australian companies devote 28 percent (global 19 percent) of the annual report to governance and remuneration. This is largely driven by remuneration reports, partly driven by company law but also significantly influenced by the consequences of the ‘two-strike’ rule (if the remuneration report is not accepted by members at the AGM) and the information requirements of proxy voters.

Australian remuneration reports tend to be long and complex, and so provide an opportunity to cut further clutter from their annual reports. Governance reporting is starting to improve in Australia as discussed in section 6 below.

Looking forward
19 percent (global 15 percent) of the average Australian company’s report is devoted to explaining ‘performance & prospects’. RG247 has driven increased discussion on past financial performance. The quality of ‘outlook’ information has improved but companies tend to make short term and generic disclosures. In the short term, there is opportunity to cut clutter and better align reporting on all aspects of performance and prospects to strategy in operating and financial reviews.

2
Keep the report content clear and relevant

Australian companies have performed relatively well in ‘cutting the clutter’ in their financial reports. There is opportunity to cut clutter in other parts of the Annual Report, as well as improve clarity and relevance across the corporate reporting portfolio, including sustainability reports, investor presentations, websites, and many industry regulator-required corporate reports.

Plenty of space
The average Australian annual report is 155 pages (global 204 pages) long.

Different views of ‘concise’
Financial statement length varies significantly between countries – from 60 pages to 140. In Australia the average length is at the lower end of this range at 70 pages as many listed companies have ‘cut the clutter’ in their financial statements.

Annual report content

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Provide a longer term view using operational performance measures

Improved reporting of strategy-aligned non-financial value drivers (KPIs) can help companies balance short-term discussions of financial performance with a more holistic view of broader business success in creating value to date, and setting themselves up to achieve future value for investors.

A Healthy Business
No Australian reports (global 11 percent) came close to covering performance information on all six key areas of business health identified in the diagram below.

Opportunity to explain longer term drivers of value
Australian companies don’t rank well relative to global peers in discussing how they create, utilise and grow their key non-financial resources and relationships to create value over time. In particular, disclosures with respect to their use and development of intellectual capital (including R&D), workforce (including efficiency), products and brand are poorly reported in Australia. For many Services and Technology businesses, these are the key drivers of business value.

Companies reporting an operational performance measure

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Provide practical measures to compare performance with strategy

RG247 guides Australian companies to provide an explanation of their business model. Linking the description of the business model to the company’s strategy, risk, performance and prospects information in corporate reports can help explain both how the company creates value for investors, and what resources and relationships are fundamental to ongoing achievement.

**Winning Customers**
Only 14 percent (global 17 percent) of reports tell you whether the business is winning or retaining customers.

**Building Presence**
No Australian reports (global 15 percent) show how brand or market share is developing.

**Building Capability**
Only 7 percent (global 8 percent) of reports show whether the business is building or retaining its know-how and expertise.

**Delivering efficiency gains**
As shown in the diagram below, no Australian company (global 10 percent) presented key lead indicators to demonstrate performance in business optimisation strategies e.g. asset and staff utilisation. Likewise lead indicators around staff productivity gains are not disclosed by many organisations (e.g. key staff retention rates, and labour relations outcomes).

**Performance insight — efficiency**

<table>
<thead>
<tr>
<th>Australian result</th>
<th>Global result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utilisation</td>
<td></td>
</tr>
<tr>
<td>Variance analysis</td>
<td></td>
</tr>
<tr>
<td>Production cost base</td>
<td></td>
</tr>
<tr>
<td>Efficiency initiatives</td>
<td></td>
</tr>
<tr>
<td>Other measures</td>
<td></td>
</tr>
<tr>
<td>Context and capability</td>
<td></td>
</tr>
</tbody>
</table>

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Many companies comment that staff are their most important asset and provide contextual information to support this claim. Australian companies do comparatively well in this respect, but report less insightful and forward-looking information. As companies integrate their reporting further, focus is required on how staff create value, how this is measured and how performance is communicated to key external stakeholders.

**Performance insight — staff based**

- Retention rates for identified groups of key staff
- Training time or spend
- Training completion rates
- Participation in flexible working schemes
- Lost time and injury rates
- Absenteeism
- Average productivity rates
- Details of union or labour agreements
- Industrial action rates
- Qualification levels
- Experience
- Single period quantitative data for the above and other contextual information

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Australian result</th>
<th>Global result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key staff retention</td>
<td>55%</td>
<td>57%</td>
</tr>
<tr>
<td>Benefits, training and flexibility</td>
<td>43%</td>
<td>27%</td>
</tr>
<tr>
<td>Health and safety</td>
<td>36%</td>
<td>7%</td>
</tr>
<tr>
<td>Productivity and labor relations</td>
<td>26%</td>
<td>6%</td>
</tr>
<tr>
<td>Expertise</td>
<td>27%</td>
<td>1%</td>
</tr>
<tr>
<td>Context and capability</td>
<td>7%</td>
<td></td>
</tr>
</tbody>
</table>

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Provide deeper analysis of strategy

Australian companies have not performed well compared to their international counterparts in making disclosures about all aspects of strategy assessed in the survey; and reporting on strategy tended to be very much focused on short term management initiatives. If companies want investors to focus on their longer term strategy and performance prospects, and make effective decisions about them, this needs to be explained in sufficient detail for it to be considered as part of investment decisions. In many instances only a few of the key aspects of each company’s business model in Australian, and indeed global reports are disclosed.

**Short Term**

86 percent (global 44 percent) of Australian reports do not look beyond short-term initiatives when discussing strategy. In other words only 14 percent (56 percent) of companies provide information on their longer term strategy.

**Missing the Point?**

50 percent (global 75 percent) of Australian reports do not discuss customer-focus as a key business objective.

**Part of the Story**

Only 50 percent (global 58 percent) of Australian reports identify knowledge and expertise as a key part of their business model.

**Aspects of the business model described in reports**

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Australian Results</th>
<th>Global Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product base</td>
<td>36%</td>
<td>18%</td>
</tr>
<tr>
<td>Customer base</td>
<td>50%</td>
<td>25%</td>
</tr>
<tr>
<td>Employee base</td>
<td>25%</td>
<td>43%</td>
</tr>
<tr>
<td>Key processes</td>
<td>26%</td>
<td>50%</td>
</tr>
<tr>
<td>Brand and market position</td>
<td>50%</td>
<td>75%</td>
</tr>
<tr>
<td>Operating sites</td>
<td>36%</td>
<td>64%</td>
</tr>
<tr>
<td>Knowledge and expertise</td>
<td>26%</td>
<td>61%</td>
</tr>
<tr>
<td>Suppliers and inputs</td>
<td>21%</td>
<td>79%</td>
</tr>
</tbody>
</table>

**Covered in the report**

**Not covered in the report**
Focus risk discussion on what’s important to the future of the business

The Third Edition of the ASX CGC’s Corporate Governance Principles (2014) require Boards to ensure the integrity of all corporate reporting (Principle 4), as well as provide details on material economic, environmental and social and governance risks to achievement of the corporate strategy over the short, medium and long term (Recommendation 7.4).

They also allow Corporate Governance Statements to be located on the company’s website rather than in its annual report. It is important, even if the Corporate Governance Statement is positioned on the company website, that there is adequate explanation of key areas of focus for the Board during the year in the annual report. We call this ‘active governance reporting’. Investors want to know that the Board is providing effective oversight and is focused on the key short, medium and longer term business issues across strategy, risk, performance, people, including remuneration and incentives, and prospects.

Risk overview
Australian companies report on average 10 key risks (global average 14 risks). However, none of these major risks tended to focus on intangible assets (eg brand).

Strategic Risks
Less than 7 percent (global 10 percent) of companies identify risks in relation to strategy selection, product relevance, or change management.
Momentum is now building towards improved corporate reporting more generally, including the adoption of the International Integrated Reporting (<IR>) Framework.¹

Global investors such as BlackRock and CalPERS, and leading Australian superannuation funds such as VicSuper, are calling for integrated reports. Integrated reports are being prepared by leading companies such as GE, Blackrock and NAB. It is estimated that over 1,000 organisations around the world are now preparing integrated reports.

Empirical evidence is emerging from leading academics. For example, a group of academics led by Professor Mary Barth² of Stanford University has recently reported: “We find that integrated reporting is positively associated with both stock liquidity and firm value. When we decompose the firm value into an expected future cash flow effect and cost of capital effect, we find that the positive association between integrated reporting quality and firm value is driven mainly by the cash flow effect, consistent with investors revising their estimates of future cash flows upward as a result of a better understanding of the firm’s capitals and strategy or future cash flows increasing because of improved internal decision making by managers.”

Business performance improvements from pursuing an integrated reporting journey are also being reported by leading integrated reporters. For example, NAB has said on its website “We see many benefits of integrated reporting including: We can more clearly illustrate who we are as a company and how culture and corporate responsibility are a fundamental part of how we do business; we can better articulate how we create and sustain value for our stakeholders by bringing together material information about our operating environment, business strategy, governance and financial and non-financial performance in one report; there is one single source, which in turn helps shareholders and our broader stakeholders find the information they require to meaningfully assess our performance in one report; one integrated report enables more effective reporting and efficient use of resources.”

There is a trend toward adoption of integrated reporting through national corporate governance mechanisms, as well as global endorsement of integrated reporting by the B20. The next edition of this survey will take a deeper look at integrated reporting.

¹ <IR> framework on IIRC website http://integratedreporting.org/resources/
² Paper 2: “The Economic Consequences Associated with Integrated Report Quality: Early Evidence from a Mandatory Setting” – Mary Barth (Joan Horngren Professor of Accounting, Graduate School of Business, Stanford University, USA), Steven Cahan (University of Auckland, Auckland, New Zealand), Li Chen (University of Auckland, Auckland, New Zealand), Elmar Venter (University of Pretoria, Pretoria, South Africa)
Conclusion

The Australian survey identifies a number of opportunities for companies to further improve the quality of their reporting to the investment community. In order to attract longer term investors, companies will need to provide better information in terms of format, timing and content on how they are creating value over the short, medium and longer term. This will require further disclosure and discussion on the underlying resources and relationships that are fundamental to continued business success.

This supplement identifies a number of potential gaps for consideration now by Australian Boards and management.
Room for improvement

The KPMG Survey of Business Reporting, second edition

KPMG International

kpmg.com/betterbusinessreporting
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
Global Head of IFRS
KPMG International

Matt Chapman
Senior Manager, Better Business Reporting
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.

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.

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.

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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.

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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.

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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.
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.

**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.

![Annual report content](image)
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**

![Bar chart showing the length of annual reports by number of pages.](image)

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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.
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

Reports encourage a backward-looking view of performance

More backward-looking

More forward-looking
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.
## Companies reporting a customer/sales performance measure

<table>
<thead>
<tr>
<th>Industry</th>
<th>Performance measures provided</th>
<th>Contextual information only</th>
<th>Not addressed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic resources</td>
<td>15%</td>
<td>20%</td>
<td>65%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>17%</td>
<td>28%</td>
<td>56%</td>
</tr>
<tr>
<td>Technology</td>
<td>21%</td>
<td>29%</td>
<td>50%</td>
</tr>
<tr>
<td>Oil and gas</td>
<td>25%</td>
<td>25%</td>
<td>50%</td>
</tr>
<tr>
<td>Food and beverage</td>
<td>29%</td>
<td>19%</td>
<td>52%</td>
</tr>
<tr>
<td>Construction and materials</td>
<td>35%</td>
<td>25%</td>
<td>40%</td>
</tr>
<tr>
<td>Health care</td>
<td>35%</td>
<td>25%</td>
<td>40%</td>
</tr>
<tr>
<td>Media</td>
<td>35%</td>
<td>24%</td>
<td>41%</td>
</tr>
<tr>
<td>Personal and household goods</td>
<td>43%</td>
<td>14%</td>
<td>43%</td>
</tr>
<tr>
<td>Automobiles and parts</td>
<td>54%</td>
<td>31%</td>
<td>15%</td>
</tr>
<tr>
<td>Utilities</td>
<td>56%</td>
<td>28%</td>
<td>17%</td>
</tr>
<tr>
<td>Retail</td>
<td>58%</td>
<td>26%</td>
<td>16%</td>
</tr>
<tr>
<td>Industrial goods and services</td>
<td>61%</td>
<td>22%</td>
<td>17%</td>
</tr>
<tr>
<td>Travel and leisure</td>
<td>67%</td>
<td>17%</td>
<td>17%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>68%</td>
<td>21%</td>
<td>11%</td>
</tr>
</tbody>
</table>

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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.

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.

Room for improvement

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Companies reporting on brand and market position

<table>
<thead>
<tr>
<th>Industry</th>
<th>Performance measures provided</th>
<th>Contextual information only</th>
<th>Not addressed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic resources</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction and materials</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health care</td>
<td>5%</td>
<td>40%</td>
<td>55%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>6%</td>
<td>28%</td>
<td>67%</td>
</tr>
<tr>
<td>Travel and leisure</td>
<td>6%</td>
<td>33%</td>
<td>61%</td>
</tr>
<tr>
<td>Food and beverage</td>
<td>10%</td>
<td>48%</td>
<td>43%</td>
</tr>
<tr>
<td>Retail</td>
<td>11%</td>
<td>26%</td>
<td>63%</td>
</tr>
<tr>
<td>Personal and household goods</td>
<td>14%</td>
<td>43%</td>
<td>43%</td>
</tr>
<tr>
<td>Technology</td>
<td>14%</td>
<td>36%</td>
<td>50%</td>
</tr>
<tr>
<td>Utilities</td>
<td>17%</td>
<td>50%</td>
<td>33%</td>
</tr>
<tr>
<td>Industrial goods and services</td>
<td>17%</td>
<td>26%</td>
<td>57%</td>
</tr>
<tr>
<td>Oil and gas</td>
<td>19%</td>
<td>31%</td>
<td>50%</td>
</tr>
<tr>
<td>Automobiles and parts</td>
<td>31%</td>
<td>31%</td>
<td>38%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>32%</td>
<td>37%</td>
<td>32%</td>
</tr>
<tr>
<td>Media</td>
<td>47%</td>
<td>24%</td>
<td>29%</td>
</tr>
</tbody>
</table>

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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.

### Illustrative measures

- **New product history** — Revenue from products developed in the last $x$ years
- **Key staff profile** — e.g. by qualification
- **Expert staff retention rates**
- **Measures of knowledge base stability**
- **Factual analysis of new products by development phase**
- **Patent grants**
- **Number of new product launches**
- **Expenditure-based disclosures (other than GAAP measures)**
- **Other factual analysis**
- **Revenue from products coming off patent in the next $x$ years**
- **Single period quantitative data for the above and other contextual information**

### Performance insight — intellectual capital

<table>
<thead>
<tr>
<th>Lagging indicators</th>
<th>Leading indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Context</strong></td>
<td><strong>New product history</strong></td>
</tr>
<tr>
<td><strong>IP expiry exposure</strong></td>
<td><strong>Expertise</strong></td>
</tr>
<tr>
<td><strong>Other quantitative measure</strong></td>
<td><strong>Development pipeline</strong></td>
</tr>
</tbody>
</table>

- **41%**
- **4%**
- **8%**
- **7%**
- **1%**
- **10%**

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### Companies reporting on intellectual capital performance

<table>
<thead>
<tr>
<th>sector</th>
<th>0%</th>
<th>20%</th>
<th>40%</th>
<th>60%</th>
<th>80%</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic resources</td>
<td>5%</td>
<td>5%</td>
<td></td>
<td></td>
<td></td>
<td>90%</td>
</tr>
<tr>
<td>Retail</td>
<td>5%</td>
<td>16%</td>
<td></td>
<td></td>
<td></td>
<td>79%</td>
</tr>
<tr>
<td>Media</td>
<td>6%</td>
<td>24%</td>
<td></td>
<td></td>
<td></td>
<td>71%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>11%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>42%</td>
</tr>
<tr>
<td>Travel and leisure</td>
<td>11%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>61%</td>
</tr>
<tr>
<td>Utilities</td>
<td>17%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>61%</td>
</tr>
<tr>
<td>Industrial goods and services</td>
<td>22%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>43%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>28%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>56%</td>
</tr>
<tr>
<td>Food and beverage</td>
<td>29%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>57%</td>
</tr>
<tr>
<td>Personal and household goods</td>
<td>29%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>57%</td>
</tr>
<tr>
<td>Technology</td>
<td>29%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>50%</td>
</tr>
<tr>
<td>Oil and gas</td>
<td>31%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>44%</td>
</tr>
<tr>
<td>Construction and materials</td>
<td>35%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>55%</td>
</tr>
<tr>
<td>Automobiles and parts</td>
<td>38%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>38%</td>
</tr>
<tr>
<td>Health care</td>
<td>50%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>25%</td>
</tr>
</tbody>
</table>

- **Performance measures provided**
- **Contextual information only**
- **Not addressed**
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**

---

10%  
Utilization

6%  
Variance analysis

23%  
Production cost base

6%  
Efficiency initiatives

10%  
Other measures

65%  
Context and capability

Illustrative measures

- Staff utilization
- Asset utilization
- Capacity limits
- Production yield
- Mix and cost variances
- Unit costs
- Fixed: variable cost base
- Cost composition
- Anticipated impact of cost initiatives
- Single period data for the above contextual information

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Reporting on efficiency

- Technology: 14% Performance measures provided, 29% Contextual information only, 57% Not addressed
- Construction and materials: 15% Performance measures provided, 35% Contextual information only, 50% Not addressed
- Media: 24% Performance measures provided, 24% Contextual information only, 53% Not addressed
- Health care: 30% Performance measures provided, 25% Contextual information only, 45% Not addressed
- Chemicals: 33% Performance measures provided, 50% Contextual information only, 17% Not addressed
- Food and beverage: 33% Performance measures provided, 38% Contextual information only, 29% Not addressed
- Automobiles and parts: 38% Performance measures provided, 38% Contextual information only, 23% Not addressed
- Retail: 42% Performance measures provided, 47% Contextual information only, 11% Not addressed
- Personal and household goods: 43% Performance measures provided, 29% Contextual information only, 29% Not addressed
- Industrial goods and services: 43% Performance measures provided, 30% Contextual information only, 26% Not addressed
- Utilities: 50% Performance measures provided, 44% Contextual information only, 6% Not addressed
- Telecommunications: 58% Performance measures provided, 26% Contextual information only, 16% Not addressed
- Basic resources: 60% Performance measures provided, 20% Contextual information only, 20% Not addressed
- Travel and leisure: 61% Performance measures provided, 22% Contextual information only, 17% Not addressed
- Oil and gas: 69% Performance measures provided, 13% Contextual information only, 19% Not addressed
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**

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

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Staff-based performance reporting by industry

- Retail: 11% Business-focused, 47% General staff, 42% Not addressed
- Technology: 14% Business-focused, 29% General staff, 57% Not addressed
- Travel and leisure: 17% Business-focused, 50% General staff, 33% Not addressed
- Media: 18% Business-focused, 41% General staff, 41% Not addressed
- Food and beverage: 19% Business-focused, 52% General staff, 29% Not addressed
- Telecommunications: 21% Business-focused, 42% General staff, 37% Not addressed
- Health care: 30% Business-focused, 55% General staff, 15% Not addressed
- Personal and household goods: 36% Business-focused, 29% General staff, 36% Not addressed
- Automobiles and parts: 38% Business-focused, 38% General staff, 23% Not addressed
- Chemicals: 50% Business-focused, 39% General staff, 11% Not addressed
- Industrial goods and services: 52% Business-focused, 39% General staff, 9% Not addressed
- Basic resources: 55% Business-focused, 15% General staff, 30% Not addressed
- Construction and materials: 55% Business-focused, 25% General staff, 20% Not addressed
- Utilities: 56% Business-focused, 22% General staff, 22% Not addressed
- Oil and gas: 63% Business-focused, 38% General staff, 38% Not addressed

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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**

Illustrative measures

- Products launched in the last year
- Track record of product launches
- Sales by product category
- Product failure/recall rates
- Quality control measures
- Price/volume for main product groups
- Single period quantitative data for the above and other contextual information

**Lagging indicators**

- New products: 24%
- Other measures: 38%
- Product sales: 67%

**Leading indicators**

- Product quality/safety: 3%
- Product price/volumes: 5%
- Context and capability: 21%
<table>
<thead>
<tr>
<th>Industry</th>
<th>Performance measures provided</th>
<th>Contextual information only</th>
<th>Not addressed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial goods and services</td>
<td>35%</td>
<td>17%</td>
<td>48%</td>
</tr>
<tr>
<td>Technology</td>
<td>36%</td>
<td>21%</td>
<td>43%</td>
</tr>
<tr>
<td>Media</td>
<td>41%</td>
<td>12%</td>
<td>47%</td>
</tr>
<tr>
<td>Retail</td>
<td>42%</td>
<td>16%</td>
<td>42%</td>
</tr>
<tr>
<td>Construction and materials</td>
<td>50%</td>
<td>15%</td>
<td>35%</td>
</tr>
<tr>
<td>Personal and household goods</td>
<td>50%</td>
<td>21%</td>
<td>29%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>61%</td>
<td>22%</td>
<td>17%</td>
</tr>
<tr>
<td>Food and beverage</td>
<td>62%</td>
<td>24%</td>
<td>14%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>63%</td>
<td>16%</td>
<td>21%</td>
</tr>
<tr>
<td>Oil and gas</td>
<td>69%</td>
<td>19%</td>
<td>13%</td>
</tr>
<tr>
<td>Health care</td>
<td>70%</td>
<td>5%</td>
<td>25%</td>
</tr>
<tr>
<td>Travel and leisure</td>
<td>72%</td>
<td>11%</td>
<td>17%</td>
</tr>
<tr>
<td>Utilities</td>
<td>72%</td>
<td>17%</td>
<td>11%</td>
</tr>
<tr>
<td>Automobiles and parts</td>
<td>95%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Basic resources</td>
<td>90%</td>
<td>10%</td>
<td>0%</td>
</tr>
</tbody>
</table>
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

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Covered in the report</th>
<th>Not covered in the report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product base</td>
<td>18%</td>
<td>82%</td>
</tr>
<tr>
<td>Customer base</td>
<td>25%</td>
<td>75%</td>
</tr>
<tr>
<td>Employee base</td>
<td>26%</td>
<td>74%</td>
</tr>
<tr>
<td>Key processes</td>
<td>28%</td>
<td>72%</td>
</tr>
<tr>
<td>Brand and market position</td>
<td>36%</td>
<td>64%</td>
</tr>
<tr>
<td>Operating sites</td>
<td>39%</td>
<td>61%</td>
</tr>
<tr>
<td>Knowledge and expertise</td>
<td>42%</td>
<td>58%</td>
</tr>
<tr>
<td>Suppliers and inputs</td>
<td>25%</td>
<td>75%</td>
</tr>
</tbody>
</table>

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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

<table>
<thead>
<tr>
<th>Area</th>
<th>Core value identified</th>
<th>Not identified</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer</td>
<td>27%</td>
<td>73%</td>
</tr>
<tr>
<td>Environment</td>
<td>27%</td>
<td>73%</td>
</tr>
<tr>
<td>Society</td>
<td>36%</td>
<td>64%</td>
</tr>
<tr>
<td>Business</td>
<td>44%</td>
<td>56%</td>
</tr>
<tr>
<td>Employee</td>
<td>47%</td>
<td>53%</td>
</tr>
</tbody>
</table>

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

### Aspects of strategy addressed in reports

<table>
<thead>
<tr>
<th>Aspects of Strategy</th>
<th>Companies describing</th>
<th>Not describing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk appetite</td>
<td>10%</td>
<td>90%</td>
</tr>
<tr>
<td>Reputation</td>
<td>11%</td>
<td>89%</td>
</tr>
<tr>
<td>Expansion (M&amp;A)</td>
<td>13%</td>
<td>87%</td>
</tr>
<tr>
<td>Rationalization</td>
<td>14%</td>
<td>86%</td>
</tr>
<tr>
<td>Customer experience</td>
<td>15%</td>
<td>85%</td>
</tr>
<tr>
<td>Customer base</td>
<td>21%</td>
<td>79%</td>
</tr>
<tr>
<td>Geographic focus</td>
<td>26%</td>
<td>74%</td>
</tr>
<tr>
<td>Sector focus</td>
<td>27%</td>
<td>73%</td>
</tr>
<tr>
<td>Social responsibility</td>
<td>32%</td>
<td>68%</td>
</tr>
<tr>
<td>Product base</td>
<td>42%</td>
<td>58%</td>
</tr>
<tr>
<td>Efficiency</td>
<td>44%</td>
<td>56%</td>
</tr>
<tr>
<td>Expansion (organic)</td>
<td>52%</td>
<td>48%</td>
</tr>
</tbody>
</table>

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

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Room for improvement
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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