

Corporate reporting

Is it what investment professionals expect?

International survey of investors' and analysts' views on the information that companies provide

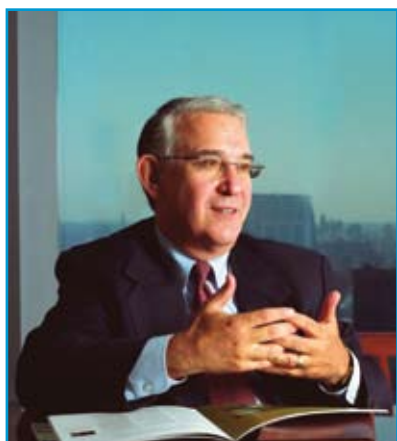
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Foreword



Transparency demands that we understand the needs of the investment community

In recent years we have become keenly aware of the need to simplify reporting, to create a framework that will promote healthy and vibrant capital markets. To accomplish this, all critical stakeholders have to be at the standard-setting table; their needs understood, their priorities recognised.

While the views of the major corporates and the accounting profession are regularly shared with the standard-setting community, there is one vital stakeholder group whose opinions on the overall adequacy of reporting are rarely heard – the investment community.

Through this engagement with some of the world's leading investors and analysts, we have taken a 'pulse check' on the adequacy of reporting for this key player in our capital markets. More than that, we have discovered that, given the right forum, investment professionals are willing to accept their part in forging a reporting model more suited to the 21st century.

The report will provide companies that are serious about improving stakeholders' understanding of their business with a detailed understanding of the needs of the investment community and opportunities to improve transparency. It is clear that significant steps can be taken immediately – without waiting for direction from standard setters or regulators.

I am personally committed to building on this initiative and working with the key stakeholders in the reporting debate to find a common language and environment for effective collaboration. Together, we can evolve our reporting model appropriately.

This study represents an important step on the path towards a more cost-effective and relevant corporate reporting model.

Samuel A. DiPiazza Jr.
CEO, PricewaterhouseCoopers International Limited

Executive summary

A cost-effective and relevant corporate reporting model remains fundamental to the health of the capital markets and the societies in which they operate.

There are many stakeholders who share an active interest in corporate reporting. Companies, governments, customers, employees, credit rating agencies, academics, the media, and so on, all depend in part upon a cost-effective reporting model for their decision-making.

However, among all stakeholders, the investment community stands out. These are the individuals who most closely read and analyse corporate reports. They are the hungriest for information and, in many respects, the most demanding.

Key questions

What is the investment community's view of the current corporate reporting framework? What do they see as its strengths and weaknesses? What information really matters to them, and what do they all but disregard? What further information could or should be offered to help their assessments of corporate performance? All of these questions are asked and answered in this report, which spans the views of investment professionals in Australia, Canada, France, Germany, the UK and the US.

The insights offered by the professional investors and analysts interviewed for this survey provide

important input to the global debate about the direction of corporate reporting now under way. Other stakeholders may not share all of the views expressed by participants in this study. However, our research with the corporate preparer community over the last ten years suggests there is more alignment between companies and investors than many believe.

Opportunities to improve

The findings of this survey help to point the way toward a 21st-century reporting framework that better meets the needs of global capital markets.

Significant opportunities exist for chief financial officers to enhance investors' understanding of their companies' performance, and achieve, over the longer term, a more accurate pricing in the capital markets. Standard setters and regulators, concerned with efficient capital markets, can gain insight into how to prioritise the reporting agenda. Professional investors will find here an echo of their own concerns, and may be moved to play a more influential role in the public forums where reporting issues are analysed and decided.

Time for collaboration

Achieving the desired improvements in corporate reporting will require collaboration between all stakeholders but the rewards will be worth the effort. The more the reporting model enables investment professionals to

assess the quality and sustainability of a company's earnings, the greater will be investors' confidence in their forecasts of future returns. If the perceived risk lessens, so do the returns that investors demand on the capital entrusted to management and, hence, the cost of capital falls.

Despite differences in reporting regimes across the territories surveyed, there is striking uniformity in the views revealed. The highlights set out in this section summarise the key insights of the survey.

The big picture

Corporate reporting remains vitally important to the investment community. There is a high level of agreement among the investment professionals interviewed world-wide about the improvements they would like to see in corporate reports.

- GAAP remains the bedrock for financial analysis.
- A number of areas in which investors and analysts commonly want better information, such as revenue recognition and segment reporting, can be remedied by individual companies with little or no change to the existing accounting framework.
- Investment professionals do not feel fully engaged in the standard-setting process, but many express a willingness to join the debate.

(See page 8)

Income statement

Investment professionals place high importance on the income statement for assessing operating performance, but they would like to have more detail.

- Participants want to be able to assess whether an increase in revenues or earnings is sustainable, whether it has come from organic or acquired growth, from unit volume gains or price rises, or other causes.

- More breakdown of costs would help analysts and investors better understand the operational leverage of the business.
- Revaluations of assets and liabilities should be presented separately to avoid obscuring underlying operating performance.
- Investors value the net income figure and other summary earnings numbers such as EBITDA.
- Those interviewed believe that management has a high degree of discretion in the way that a company's performance is reported.

(See page 10)

Balance sheet

The most common use for the balance sheet, or the line items within it, is as an input into a cash flow model. Other uses include assessing debt levels and working capital, and determining return on invested capital.

- The balance sheet as a whole is not typically forecast by survey participants, although it is still considered an important element of the financial reporting model.
- There is a desire to retain historical costs for certain assets, such as those used in ongoing operations, but there is also support for current values for liquid financial assets and investments.

'Improved transparency will be rewarded.'

Australia

'I should be able to read an annual report and know what the business is doing and know the key drivers.'

US

- Concerns about more widespread use of current values relate to: a reduced ability to calculate return on invested capital; the potential for subjectivity in valuations; and the potential impact on the income statement.
- Where current values are given, analysts and investors want to be told about key assumptions to enable comparisons across companies and assessments of reasonableness.

(See page 12)

Cash flow

Most investment professionals build their own cash flow models from the company's income statement.

- Investment professionals want more detail in the cash flow statement and in the supporting notes.
- There is little support for the 'direct method' of cash flow reporting.

(See page 14)

Segment reporting

As most valuation models are built from the segment up, improving segment reporting offers companies great potential to enhance the information provided to investors.

- Segment information identified by product line or business unit is

important; geographic breakdown is of less interest.

- Respondents expressed a desire to see more performance measures reported per segment, so that there is adequate coverage of the major items of the income statement, cash flow statement and balance sheet.
- Consistency from period to period is critical among product groupings, as well as between segment definitions in annual reports and those in investor briefings.

(See page 16)

Non-GAAP information

Non-GAAP information is valued by investors.

- The use of non-GAAP information is perceived by respondents to be pervasive in the communication of corporate performance.
- Views are mixed on management's motivations when presenting this information, but its presence provides a valuable signal to market participants.

(See page 18)

Management commentary

Investment professionals want to be able to piece together sufficient information to put the financial numbers in context.

- Market information and management's strategy are the non-financial or 'contextual' data considered most useful for assessing a company.
- Many sources of information apart from the annual report are used to enhance contextual understanding, including competitors' data, market research reports, trade magazines and face-to-face management briefings.
- The objectivity and timeliness of the contextual information presented by management in annual reports is widely questioned by respondents.
- Participants express less interest in social or environmental issues, although the latter may be becoming of greater interest, particularly in certain territories such as Australia.
- Respondents questioned the value of management reporting on governance. They believe that management behaviour in practice is a better guide.

(See page 20)

Research methodology and survey population

Fixed-income perspective

Fixed-income specialists perceive a greater gap than their equity peers between the information they want and the information they receive.

- Fixed-income participants primarily want to understand the extent of corporate indebtedness, as well as cash inflows and outflows and the related risks.
- More detailed operational cash flow data is necessary.
- Debt disclosures are inadequate.

(See page 22)

For a number of years, PwC has been engaged in a campaign to connect the investment community more thoroughly and consistently with the standard-setting process. To that end, we created a survey report – a pulse check on the adequacy of reporting – that has served to open a dialogue with investment professionals in a number of the world’s leading capital markets.

Because most of the interviews were conducted face to face, these studies have allowed us both to codify respondent preferences on a series of reporting issues and to explore the rationale for any given reply.

The findings from these conversations form the core of this report.

While we do not claim that these studies represent a statistically significant analysis of investment professional opinion in each of the markets reviewed, the consistency of views expressed both within markets and across territories suggests that the findings offer reliable insights.

This pulse check on reporting has stimulated a number of other research and engagement activities. We refer to some of these additional studies in this document.

The respondent population

Buy side (investor)	59%
Sell side (analyst)	41%
Fixed income	23%
Equity	77%

UK	42
USA	105
Canada	53
Germany	21
Australia	27
France	14
Total	262

1 Corporate reporting: the big picture

The importance of corporate reporting in sustaining strong and effective capital markets is confirmed. Interviews with investment professionals in six countries, from three continents, emphasise the fact that financial statements are the bedrock of financial analysis. They underpin critical decisions on whether to invest in a company or not.

Use of reports

Participants in this study gave consistent explanations, regardless of territory, about how they use financial reports. Equity specialists focus on building intrinsic valuation models, such as discounted cash flow and

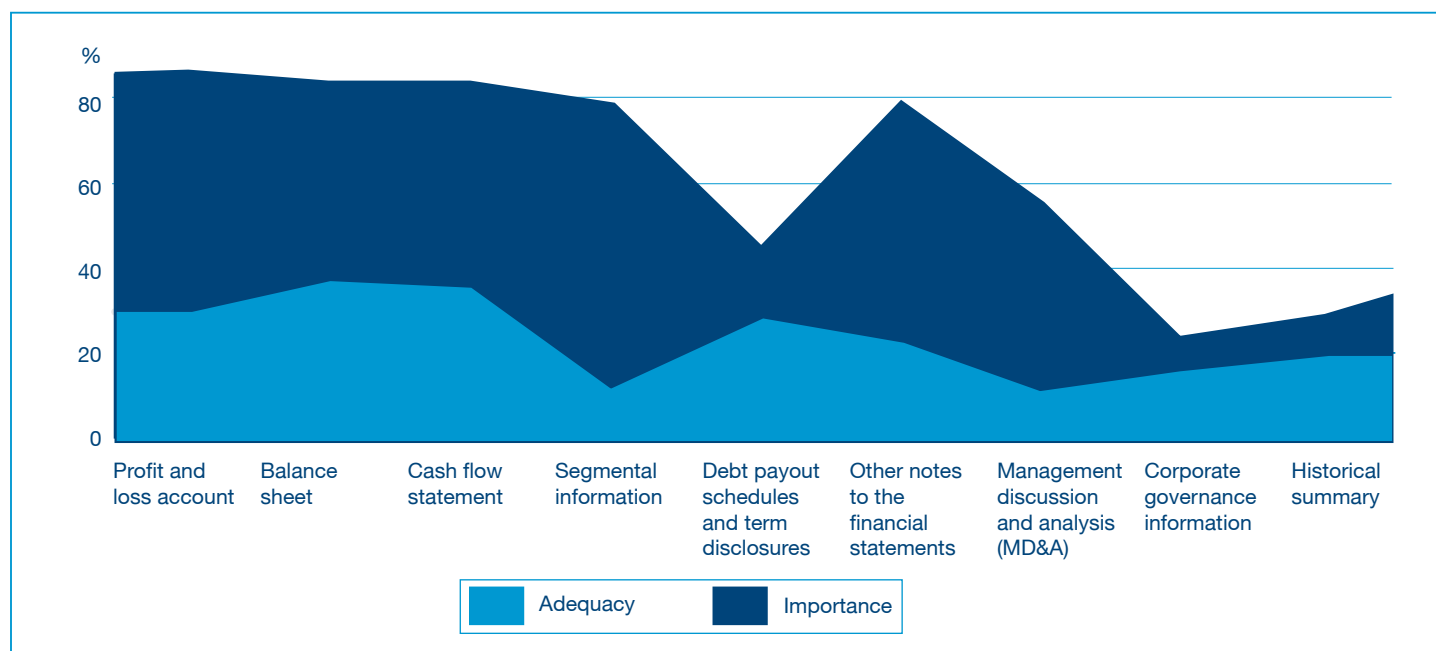
return on investment capital. They also want to perform market-based analysis, using ratios such as price/earnings. Fixed-income specialists focus more on cash flows: how much cash will go out when, and what is the risk that incoming cash won't cover the outflows?

There are some understandable differences in the views of equity and fixed-income specialists. Equity respondents see little importance in debt payment disclosures, for example. However, in general, all respondents agree that the income statement, balance sheet, cash flow statement, segment analysis and notes to the accounts are of high importance.

Meeting investors' needs

How well do financial reports meet the needs of the participants in this study? In figure 1, a measure of the gap between need and adequacy starts to emerge. Read vertically, the chart indicates the perceived importance of a given information set and the adequacy of information provided in that area. Read horizontally, the chart shows where the survey participants particularly focus and where they are less concerned. As a group, for example, they highly value 'other notes to the financial statements' and believe that they are not well served by current financial reporting in this area.

Figure 1: Importance vs adequacy of key aspects of financial reports



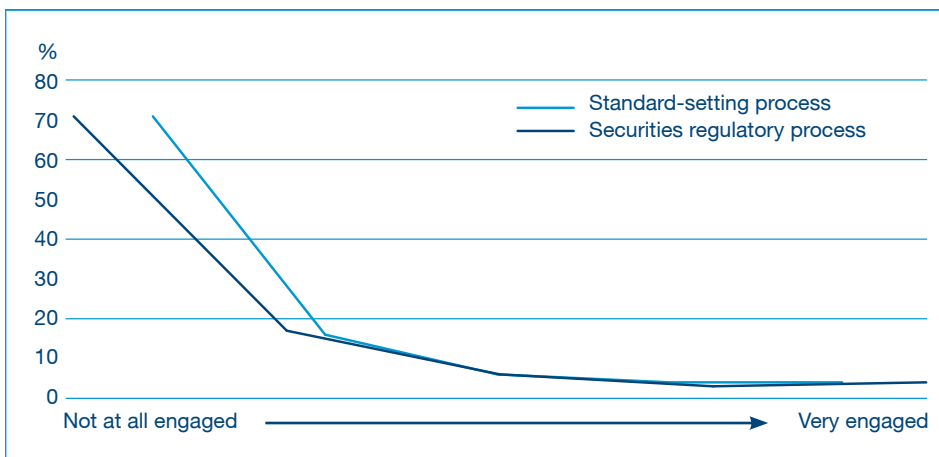
They have little interest, however, in reported corporate governance information and are not particularly critical of the current depth of reporting in this area.

Engaging in the process

Despite the undisputed value of efficient reporting standards for assessing investment opportunities, few respondents feel engaged in the standard-setting process.

Figure 2 illustrates the degree to which participants feel isolated from the development of an effective reporting framework. In conversation, many acknowledge that unless they do voice their opinion in debates on reporting, they will ‘end up with the reporting model they deserve’. The challenge now is to find a mechanism that allows these critical stakeholders to participate in the evolution of reporting in a time- and cost-effective manner.

Figure 2: How engaged are you in the securities regulatory and standard-setting processes?



Substantial opportunities

In the rest of this report, we examine a number of areas where there are substantial opportunities to meet the reporting needs of investment professionals. We also touch on a few of the other sources of information that investment professionals draw on to build a more rounded picture of corporate performance.

Throughout this review, we take note of information areas where companies can enhance their reporting within the local GAAP, quite apart from any long-term ambitions of regulators and standard setters to improve reporting standards. In these areas, companies do not need to wait for further guidance from standard setters; it is possible to make reporting changes today that could benefit market valuations tomorrow.

‘You apply a bigger discount to companies where there is stuff you don’t understand.’

US

‘We are speaking and no-one is listening: that is how it feels.’

Canada

2 Income statement: all about performance

The income statement is extremely important to the investment community. Analysts and investors go to the income statement to try to assess how successful management has been in adding value to the factors of production.

However, the way in which information is presented in the income statement could be improved. Common refrains, detailed in this section, emerge from the survey. It is worth noting that the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) recognise the importance of an effective income statement. This is currently a topic on their shared agenda.

Companies' operating performance is key

Investors want to understand a company's operating performance. They want to be able to assess whether an increase in revenues or earnings is sustainable, whether it has come from organic or acquired growth, core or non-core operations, from unit volume gains or price rises. At present, many say that making such assessments is a greater challenge than it could, and should, be.

Talking point

Revenue recognition is also a talking point among analysts and investors, particularly in the US and UK. The current methodology is considered overly complex, with many companies insufficiently clear about how accounting standards have been implemented. This makes it hard for investment professionals to be confident that they are comparing companies on an equitable basis.

Another common frustration relates to the breadth of the cost categories reported by companies. The survey respondents point out that there is often insufficient detail: cost of goods sold may represent 90% of total costs. The move by the International Accounting Standards Board (IASB) to mandate reporting 'by nature' (ie, the nature of specific costs such as labour, depreciation, etc.) is widely supported. Investors and analysts see this as providing valuable information

about the operational leverage – and thus the riskiness – of the business, enabling them to prepare their own assessments of fixed, quasi-fixed and variable costs. Ideally, respondents would prefer to see costs analysed by nature and by function, with greater detail in both categories.

Many respondents say that their ability to assess performance is increasingly muddled by revaluations of assets and liabilities. Although views are split on the merit of further use of current values, there is a strong feeling that revaluations should not be allowed to obscure an understanding of underlying business performance.

Assumptions

In general, there is a widespread belief that management is able to exercise a high degree of discretion in the way that company performance is reported. While such discretion is not necessarily viewed as inappropriate, greater clarity on management assumptions and accounting policies is needed. Figure 3 shows the consistent assessment of both equity and fixed-income investors: management exercises considerable but not unlimited discretion.

If there were greater clarity, analysts and investors believe that they would have a better understanding of sources of growth and therefore less doubt about the sustainability of corporate performance – with a resulting impact on the company's market valuation.

‘Revaluations booked in a P&L [profit and loss] make the task of forecasting impossible.’
Australia

‘When you look at a set of financial statements, pretty much every line item is subject to management’s discretion.’
US

‘There’s probably a growing need for something understandable and standardised by way of earnings concepts — to rescue earnings from oblivion.’
Australia

Desire for subtotals

Again with notable world-wide consistency, study participants prefer to see subtotals on the face of the income statement.

A ‘net income’ or ‘earnings’ number is generally seen as helpful. Similarly, many cite EBITDA as a measure for which a standard

Figure 3: How much discretion do management teams have in the financial numbers they report?

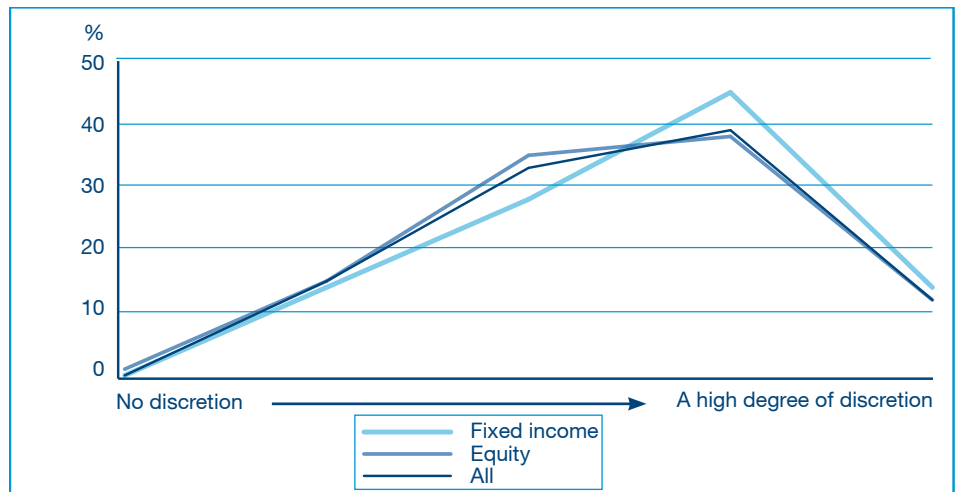
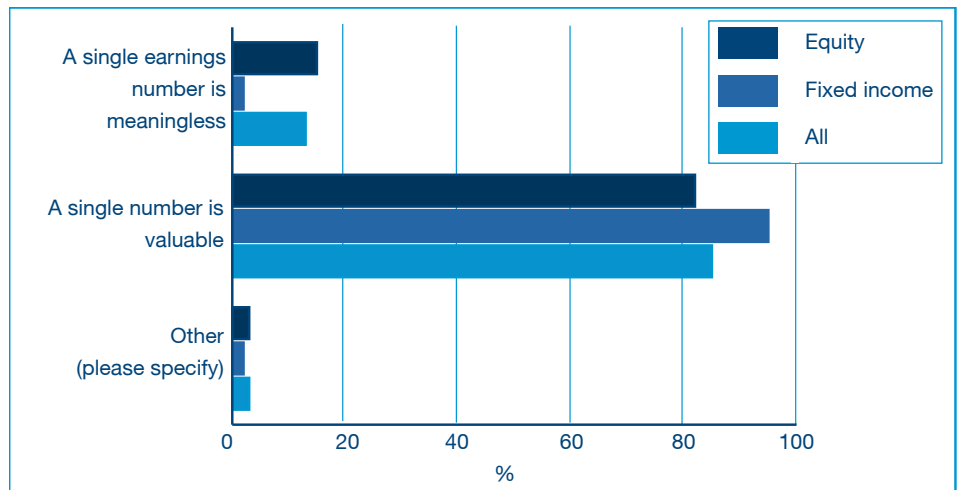


Figure 4: Is the ‘earnings’ number meaningful?



definition and standardised reporting would be helpful.

This is particularly true for fixed-income specialists because covenants are often related to EBITDA.

There are understandable concerns that trying to encapsulate performance in a single number could be misleading. Virtually all investment

professionals adjust a given earnings number in order to meet their own assessment criteria.

Nevertheless, the survey participants believe that a key attribute of a successful reporting model is its ability to communicate succinctly to a broad audience. Earnings numbers are an important building block of that communication.

3 Balance sheet and use of fair value

Analysts and investors value the balance sheet as a highly important element of the financial reporting model.

However, despite its importance as an input to the investment professionals' assessment of performance, the balance sheet is not typically forecast

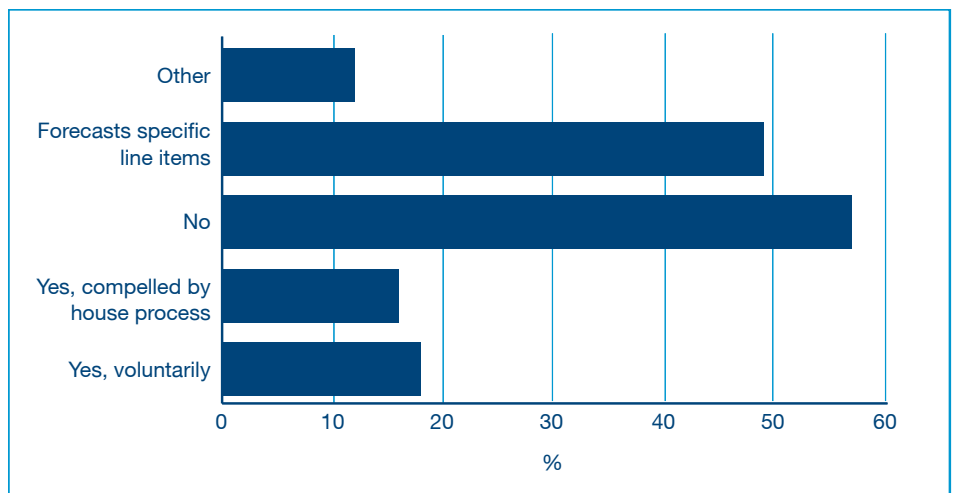
in any detail. Research has shown that few analysts and investors forecast the whole GAAP balance sheet (see the PwC report, *Measuring Assets and Liabilities – Investment Professionals' Views*, available online at www.pwc.com). Figure 5 indicates that just 18% of respondents choose to forecast the

whole balance sheet, while a further 16% do so only because they are required to by their investment houses or because this is a necessary input to their modelling systems. 57% do not forecast the entire balance sheet though may forecast specific line items.

'Both fair value and historical cost have their place. You need the historical cost information to track and have accountability.'

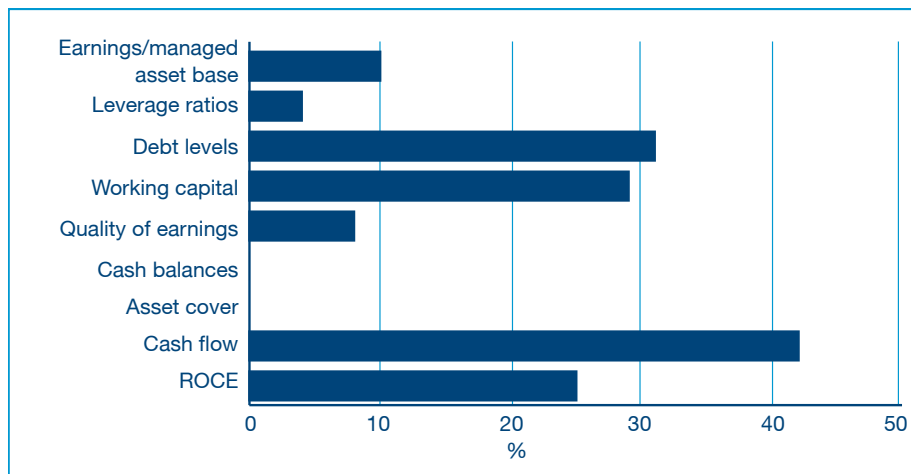
US

Figure 5: Do you forecast the balance sheet?



Source: *Measuring Assets and Liabilities*, PwC 2007

Figure 6: What do you use balance sheet data for?



Source: *Measuring Assets and Liabilities*, PwC 2007

Inputs to cash flow models

As discussed in *Measuring Assets and Liabilities*, the most common use for the balance sheet, or particular line items within it, is as an input to a cash flow model. Balance sheet items are also frequently used to assess debt levels and working capital, and to determine return on capital employed. Trend data offers insights into the quality and sustainability of business performance.

There is some agreement about the importance, or otherwise, of certain aspects of the balance sheet. For example, few respondents explicitly factor goodwill balances into their analyses. Working capital, by contrast, is viewed as much more useful. Not surprisingly, interest in some elements of the balance sheet varies by industry. Retail analysts, for example, find working capital information very useful, while financial services analysts do not. Investors in asset-intensive businesses (such as automotive and retail) are more likely to be interested in information about property, plant and equipment than investors in financial services.

Current value vs historical cost

One controversial balance sheet topic concerns the measurement of assets and liabilities, specifically the impact and usefulness of measuring at current value or historical cost. Early surveys within the investment community uncovered support for both methods and prompted further investigation. As highlighted in *Measuring Assets and Liabilities*, in some cases more than one measurement basis is required to establish the company's economic position and to populate the multiple models used by investment professionals. Respondents generally welcome a current value for liquid financial assets and assets deemed to be 'investments' or 'available for sale'. However, the majority question the

relevance of current value measures for assets used in the on-going operations of the business, for which historical cost is taken to be more appropriate.

Some survey participants made the point that current value would be a useful additional disclosure for certain operational assets — for example, a store purchased 50 years ago, for which the historical value probably bears no relation to current market value. However, for a number of reasons there is concern in the investment community about moving to a pure fair value model.

First, respondents express the concern that their ability to assess managements' stewardship of the assets with which they are entrusted would be impeded if all assets and liabilities are restated.

Second, they worry about the potential for subjectivity in valuations and ask whether management always provides reliable estimates of current value? While it is understood and accepted that management wants to present the business in a positive light, respondents question whether greater use of revaluations could increase the scope for management discretion to a point at which investors would no longer trust reported numbers. Revaluations can also have an impact on the income statement. Hence, participants expressed concern that more frequent marking to market could obscure assessments of true operating performance.

'It makes no sense to measure operating assets and liabilities at fair value; there is no need.'

US

'Fair value is just so subjective. Give me the historical cost and I'll figure it out.'

US

And, finally, the respondents question whether introducing a pure fair value model would, in practice, deliver a favourable cost/benefit outcome for management. Their time might be better spent elsewhere.

If current value measures are to be provided, the vast majority of analysts and investors want key assumptions disclosed so that they can compare across companies and evaluate reasonableness. They want gains and losses on re-measurement of current value to be clearly distinguished from the underlying operating performance of the business. They want to see ranges of outcomes, rather than point estimates, and benchmarking against industry norms.

4 Cash flow: cash is king?

‘The direct method is tough to forecast.’
Germany

‘Linking the income statement to the cash flow statement is almost impossible.’
UK

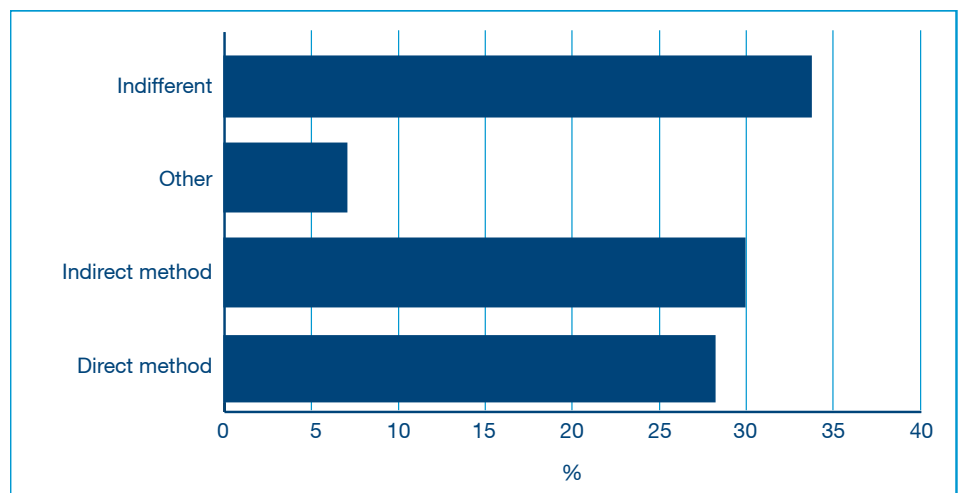
‘Let’s clear up the cash flow statement because at the end of the day it’s our best indicator of what’s real.’
US

The cash flow statement is important to investment professionals, but in their view the existing statement falls short of its full potential. Both the level of detail within the statement and the quality of the supporting notes are frequently cited as areas for improvement. Moreover, investors and analysts often find it difficult both to ‘tie across’ to the other primary statements and to reconcile with changes in net debt.

Direct method rules?

Standard setters have traditionally held that investors prefer the direct method – a format that resembles a ‘cheque book’ with inflows and outflows detailed by line. However, conversations with investment professionals across multiple geographies indicate that this assumption is questionable. It transpires that there is no overwhelming support for the direct method, and the issue as a whole is not given a high priority. This is so even in Australia, where the country’s equivalent of IFRS, Australian International Financial Reporting Standards (AIFRS), has until now mandated use of the direct method.

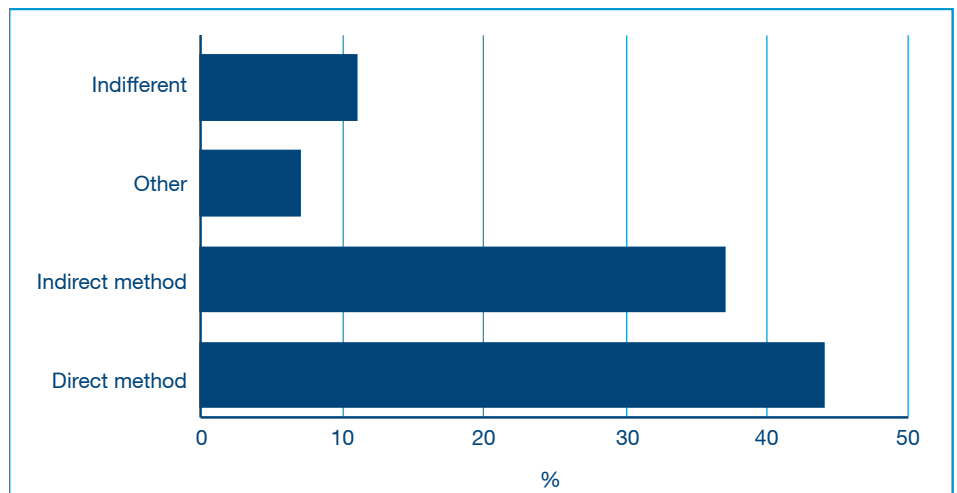
Figure 7: Cash flow reporting preferences in markets outside Australia



A major reason why the indirect method remains in favour is that, when building their cash flow models, most investment professionals use the company's income statement rather than its cash flow statement. This remains the dominant approach even in Australia, despite the use of the direct method. Analysts and investors see the income statement as offering greater insight into both completed and accrued transactions and so, potentially, better insight into the company's actual performance over the period.

In general and regardless of location, respondents are looking for more lines of information in the cash flow statement and better notes to help them tie data between the income and cash flow statements. They are also keen to ensure consistency in the way that cash is reported over time.

Figure 8: Cash flow reporting preferences in Australia



5 Segment reporting: critical for analysis

‘The area where there’s the greatest potential for increased disclosure that would add value is in the segmental information.’
US

‘In reporting segments, sometimes management seems to lump together soup and nuts, liquids and solids.’
Canada

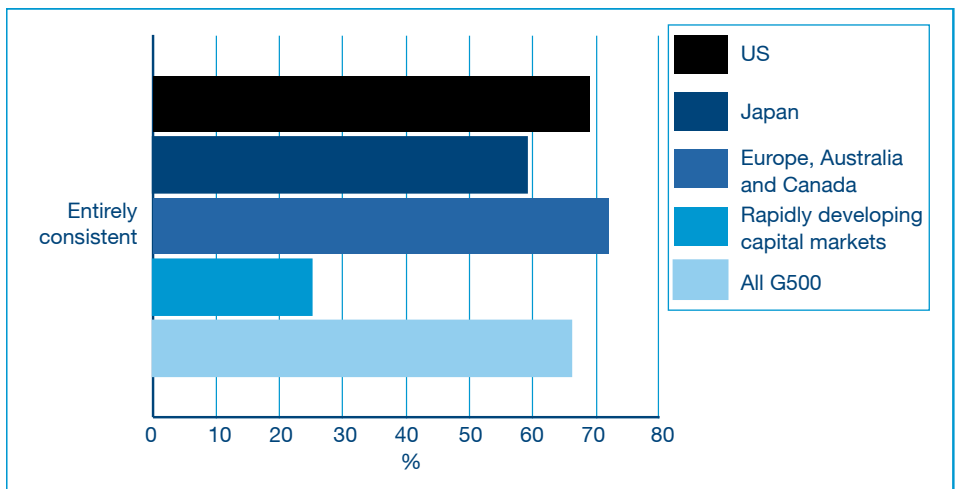
It is clear that segment reporting is highly important to investors and analysts (see figure 1, page 8). Most intrinsic valuation models are built from the segment up. A good understanding of performance by segment is fundamental, investors tell us, in assessing which areas of a business are more productive and where value is or is not being added.

However, figure 1 also illustrates that the segment information companies now provide does not meet the needs of investment communities world-wide. There are several reasons for this shared perception.

Definition challenge

Investors and analysts complain that the way some companies identify segments changes regularly, making comparability impossible. Moreover, many companies group disparate business activities into a single segmental category. Without adequate segment data, investors and analysts are left guessing at the exposure of a company to potentially very different industries. Investment professionals tell us that they would like segments to be identified by product line or business unit. Breaking down results across geographies is typically not considered as important. Analyses ‘through management’s eyes’ and ‘according to industry practice’ are last on the list but often considered a welcome addition.

Figure 9: Segment reporting — consistency between financial statements and narrative reporting



Source: *Corporate reporting — a time for reflection*, PwC 2007

There is also a concern about inconsistencies in the segment definitions used in annual reports and investor briefings. This was a key finding in the PwC study, *Corporate reporting – a time for reflection*, which surveyed the Fortune Global 500 companies' narrative reporting. On a positive note, that survey found that 65% of companies are consistent in their definitions, presentation, and related discussions of financial data in their financial statements and narrative reporting. However, the level of consistency falls when comparing the segment reporting in investor briefings with the financial statement notes in primary filings.

Performance measures required per segment

The survey indicates that there are also opportunities – and investor appetite – for companies to improve the performance measures (both GAAP and non-GAAP) reported per segment. Investors and analysts seek data that spans the major items of the income and cash flow statements and the balance sheet. Measures such as revenues, segment results and total segment assets are consistently in demand, and most G500 companies provide them. However, other segment information is often scarce. Cash flow, working capital, capital employed are all frequently cited as data points that would be valued by investment professionals.

Analysts and investors also want non-GAAP data per segment to be reconciled back to the GAAP numbers. They also call for a clear definition of terms when non-GAAP segment data is given.

'I don't believe there's a real competitive risk in segment disclosures. I think it's just being honest.'

US

'Companies should keep their segments consistent, and their reports should be qualified if they change their segments when nothing fundamental changes.'

Germany

6 Non-GAAP data: spin or substance?

Asked whether there has been an increase in non-GAAP information, the investment professionals interviewed were unsure because in their view the use of non-GAAP information is widespread.

This opinion is confirmed by an extensive PwC study of non-GAAP elements in European financial reporting, *Presentation of income under IFRS: flexibility and consistency explored*, from which figures 10 and 11 are drawn. This analysis of European financial statements found that 44% of companies reported additional income measures excluding depreciation and/or amortisation (EBITDA and similar measures) somewhere in their financial statements. In addition, 34% of companies reported one or more results that excluded certain non-recurring items in their financial statements.

EU non-GAAP reporting

There are clear national and industry differences. For example, 59% of companies in Germany reported EBITDA and similar measures, while only 32% in the UK did so. However, only 12% of German companies were found to report one or more results that excluded certain non-recurring items, while almost four times as

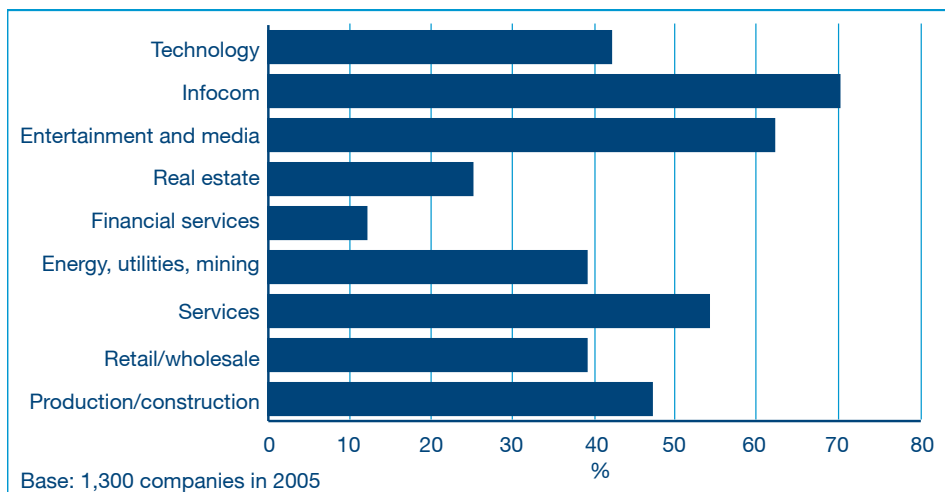
many companies in the UK (47%) and France (45%) did so. In terms of EBITDA reporting, 70% of infocom companies reported such numbers, compared to only 12% of financial services companies and 23% of real estate companies. Figure 11 shows the range of industry sector findings in this area.

Figure 10: Survey of non-GAAP reporting under IFRS

Non-GAAP measures reported	Percentage of companies reporting in 2005 financial statements (sample size: 1,300)	Percentage of companies reporting in 2005 income statements (sample size: 250)
1 EBITDA and similar measures	44%	10%
2 Profit excluding non-recurring items	34%	26%
3 Operating profit/EBIT	Not investigated	96%

Source: *Presentation of income under IFRS: flexibility and consistency explored*. PwC 2007

Figure 11: EBITDA and similar measures in financial statements – by industry



Source: *Presentation of income under IFRS: flexibility and consistency explored*, PwC 2007

Non-GAAP is valued

The investment professionals interviewed do not agree on management's motivation for using non-GAAP numbers so widely. Some interpret their use as management's effort to 'spin' the company's performance; others consider it a valid attempt to overcome the limitations of GAAP in explaining performance.

Regardless of their differing views of management's motivation, virtually all analysts and investors find non-GAAP information useful to fill the gaps left by reporting standards. Even if it is perceived as 'spin', non-GAAP information is viewed as a signal about the company's management and how it views the world. Hardly any of those interviewed would have non-GAAP data banned, and many say that it is increasingly important because revaluations make it harder to gain a clear view of operating performance.

'Not that many companies would use non-GAAP measures to portray a negative impression of a company.'

Canada

'We need standard definitions for EBITDA.'

Germany

'It is incredibly important to get a bigger sense of what's going on in the marketplace. What type of secular changes are taking place? What are management doing to address these changes?'

UK

7 Management commentary: untapped

Without exception, active portfolio managers and analysts view financial statements as just one piece, albeit a critical piece, of the mosaic of information they use in their evaluations of companies' economic potential.

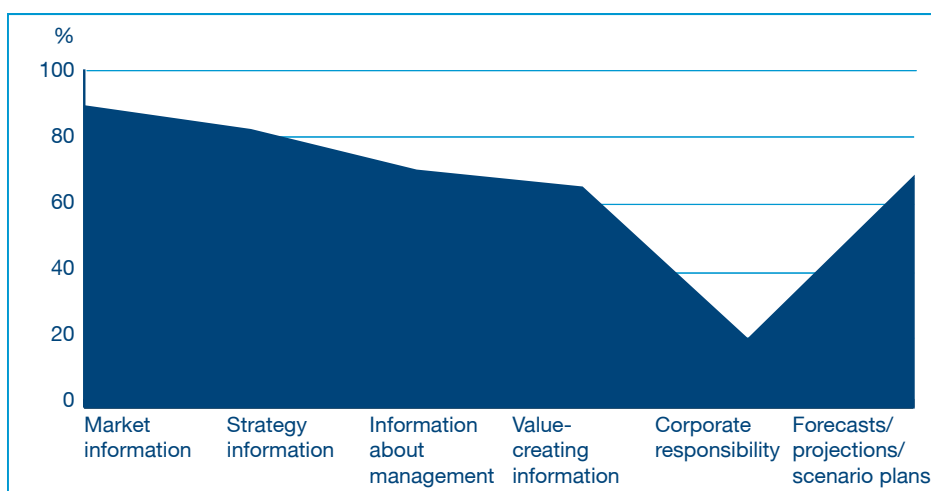
The survey offers insights into the scope of the information factored, often subjectively, into the valuation process. It also raises interesting questions about the preferred dissemination channels for 'contextual' data.

Pieces of the mosaic

When asked about the importance of various categories of non-financial or contextual information, participants across the territories painted a similar picture. Market data is considered critically important: analysts and investors want to know about a company's position in its markets, including sales trends. Explanations of strategy are only marginally less important. Information about the drivers of operational performance (customers, brands, innovation, etc) also ranks highly.

However, as figure 12 graphically illustrates, information about the social, environmental and ethical position of the business is of less importance to investment professionals. In conversation, analysts and investors make clear that good corporate governance is important to their assessment of a company. However, the company's

Figure 12: Importance of contextual data to evaluate performance



own corporate governance statement is not perceived as the best indicator of performance. The quality of financial reporting as a whole is considered a better guide.

Evaluating the economic impact of a company's social and ethical position is held by most respondents to be beyond the scope of their investment mandate. However, a notable minority (particularly in Australia) indicate that they expect environmental issues to increase in significance over the coming years.

Sourcing contextual information

Investors and analysts may place high importance on certain non-financial data, but, as figure 13 illustrates, they do not rate highly the contextual information presented by management in the annual report or 10K.

However, this apparent weakness in the annual filing by management is not a source of concern for most participants in the survey. Why?

First, analysts and investors do not expect to be able to rely on this type of management information. Respondents commonly observed that human nature leads those reviewing their own performance to emphasise the positive. There is a perception that management will almost invariably use the management discussion and analysis (MD&A) as a public relations tool rather than an opportunity for candid performance analysis.

Second, many contend that much of the contextual data that management might present has a limited shelf life. Given the production time required, the annual report does not necessarily contain the latest market data, and is not viewed as an adequate

dissemination channel for time-sensitive information.

Finally, an honest appraisal of market conditions by management is helpful for investors and analysts, but a company offers only one perspective. As figure 14 illustrates, seasoned investment professionals draw on many other sources of market data (including industry research and data provided by competitors) rather than rely solely on a single management team’s view of an industry.

Demand for standards?

The survey made clear that there is little investor demand for prescriptive standards on narrative reporting.

The one exception arose when talking to specialists in industries that rely on non-GAAP metrics to assess performance. For example, retail analysts are interested in same store sales or sales per square foot, while telecoms investors want to know data such as average revenue per user. Because management is the only credible source of critical industry-specific performance data, there is a strong call among industry-focused investors and analysts for standards to be developed that address the calculation and presentation of that data.

Figure 13: Importance vs adequacy of contextual data in the annual report/10k

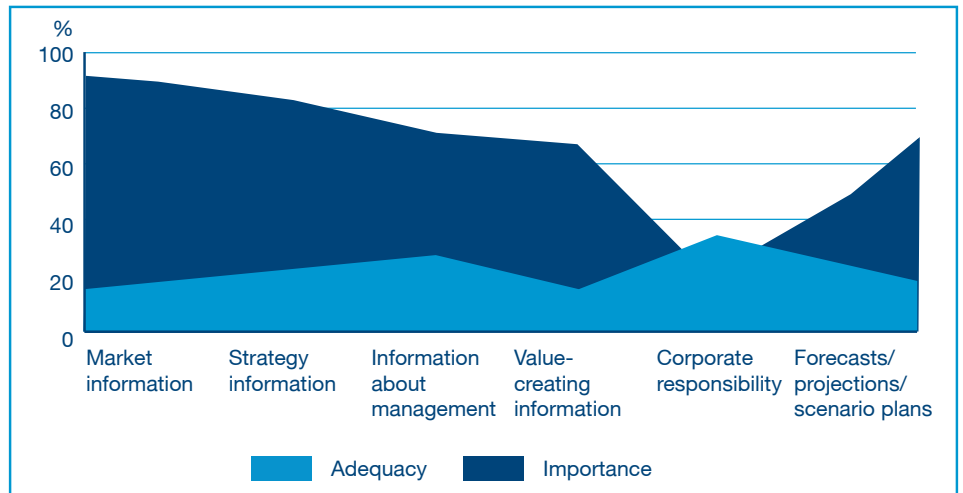
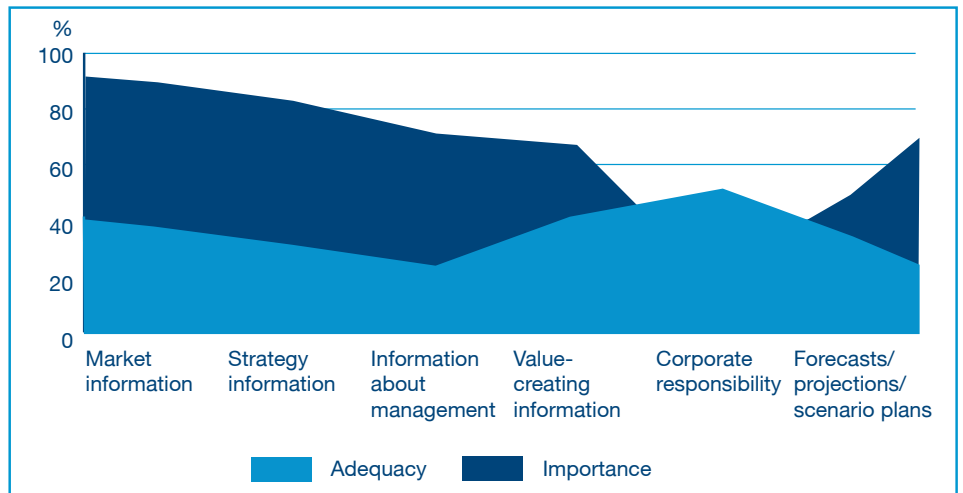


Figure 14: Importance vs. adequacy of contextual data from all sources



8 Fixed-income community: their needs

Spanning both equity and fixed-income specialists, the survey found that while both groups have information needs that could be better met, fixed-income analysts and investors perceive a greater gap between the information they want and the information they receive.

In assessing a company, fixed-income specialists are trying to answer two key questions:

- How much cash will have to go out when?
- How great is the risk that cash coming in will not cover outflows?

They want to gain a comprehensive picture of indebtedness, including the company's overall debt position and debt repayment schedule. They want to understand the underlying operational cash flow and the

financial and operational risks associated with cash flow.

The challenge for these specialists is that GAAP doesn't offer a clear view of actual cash inflows and outflows. Further, it doesn't address the sensitivity of such flows to changes in key metrics, such as interest rates.

Better disclosure required

The fixed-income participants in our study believe that disclosure of company debt could be enhanced. For example, classifying debt by repayment periods of 1-2 and 2-5 years, etc, fails to give the detail required. Similarly, effective interest rates are not always apparent (ie, the rates applying after swapping between fixed and variable interest rates, or after swapping currencies).

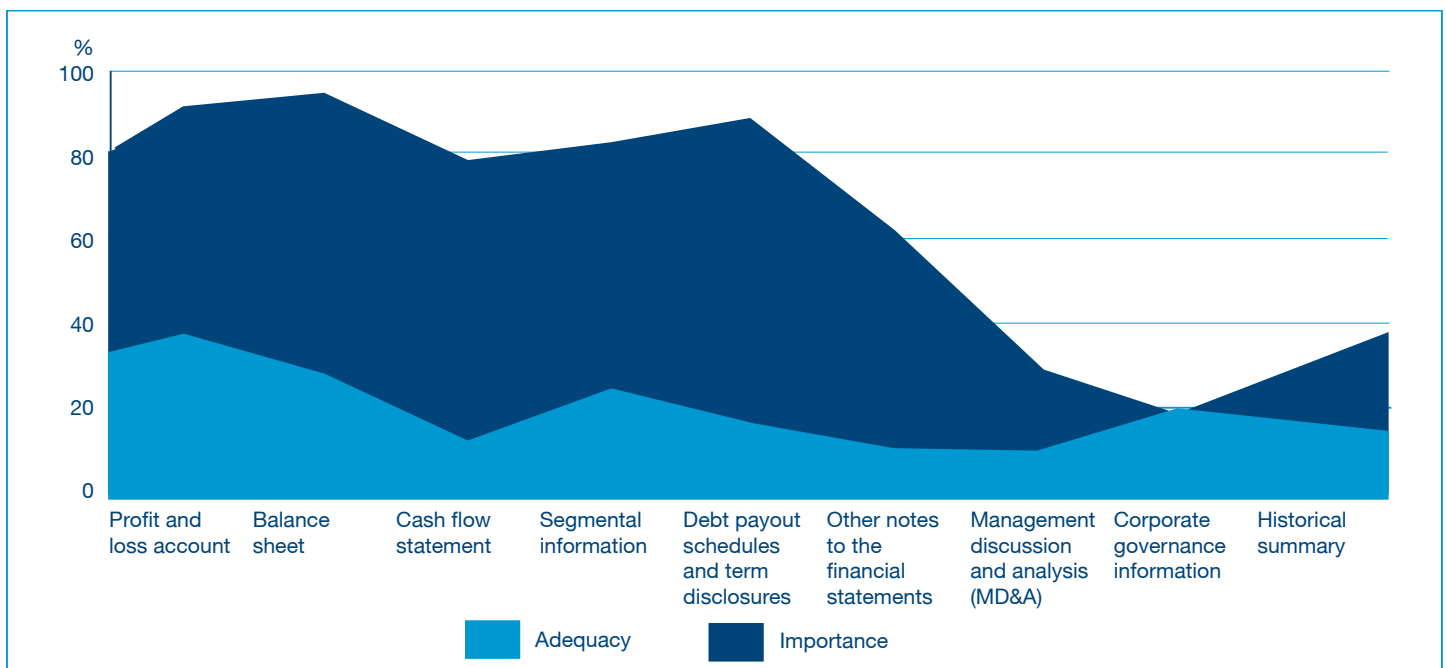
More information about covenants is desired, as is information relating to the repatriation of cash from a subsidiary to repay debt.

Organisational charts – or 'organograms' – would be welcome to help clarify the potential for intra-group debt repayments.

As highlighted in the PwC report, *Measuring Assets and Liabilities*, fixed income specialists want to see disclosure in the notes of a 'best possible use' sale price for key assets, which might be used to repay outstanding debts.

Adequately addressing these issues is likely to improve companies' price of debt and could therefore reduce the cost of cash.

Figure 15: Importance vs adequacy of annual report/10k data (fixed income specialists)





9 Moving forward: a model for the 21st century

While there are many stakeholders who rely upon financial reports to underpin economic decisions, few are as dependent upon a cost-effective and relevant reporting model as the investment professional.

In the interviews conducted for this study, investors and analysts told us that there are significant gaps in the data that they can access from financial statements – gaps that materially impact their ability to analyse the long-term prospects of a company.

Given this, one has to question why the voices of investors and analysts have been so rarely heard at the standard-setting table. Why have they not been working with standard setters and corporates to create a more cost-effective, timely and relevant reporting model?

From our engagement with investors and analysts – and indeed with other stakeholder groups, such as company management – we have identified two frictions that must be overcome if meaningful reform of the reporting model is to occur: inertia and process.

The inertia challenge

The inertia inherent in a complex system such as the development of corporate reporting is potentially the most challenging issue that needs to be addressed before reform can get started. In the past, investors, analysts and, to a lesser extent, management have not had to prioritise time and resources to the development of reporting standards. They were content to live with the information provided under the status quo. The problem was not perceived as sufficiently costly to warrant attention, particularly as there were alternative sources of information and as many corporates went out of their way to present information in a more digestible form.

Today, however, there is a growing recognition by many of the lead players in the debate that the reporting model has reached a tipping point and is failing to communicate what is important despite the volume of information being produced. Something needs to be done. Reporting standards have reached levels of complexity that leave all but the accounting élite struggling to understand key elements of financial reports. Moreover, concerns about the relevance of the reporting model are

now routinely voiced. Corporate associations, investor trade bodies, audit firms and, more recently, the SEC have called for reporting reform.

However, perhaps the strongest signal that the tipping point has indeed been reached comes not from the protestation of trade bodies and public entities, but from the actions of individuals whose livelihoods depend so heavily upon the relevance of reported information. For example, in recent years we have witnessed the formation of informal, self-organising groups of practitioners – leading investors and analysts from multiple territories – who acknowledge that they have a critical role in ensuring the relevance of the reporting model. Probably most notable amongst such groups is the Corporate Reporting Users' Forum (www.cruf.com), which is engaging with corporates and standard setters alike on many of the issues raised in this study.

Although such forums are relatively new entrants to the reporting debate, their presence offers some hope that the challenge of inertia can be overcome.

Inclusive multi-stakeholder change process

Most recognise that the best way to generate a reporting model that meets user needs in a cost-effective way is to create an environment in which the different stakeholders actively work together to find solutions. Such collaboration requires an investment in time and resource by all of the key players in the reporting debate. It requires a willingness to listen to the needs of others, to compromise and adapt. Working within a single-stakeholder community to try to achieve consensus about reporting topics is challenging enough. Finding a mechanism for debate and reconciliation that also allows representation across multi-stakeholder groups presents an even greater hurdle.

Standard setters have already taken action to modernise their due process through the creation of several multi-stakeholder committees, but they need further support to implement a mechanism that effectively engages and empowers multi-stakeholder groups to take collaborative ownership of the direction of reporting. This challenge will only become more critical as the convergence process proceeds.

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Further information



Report Leadership

Report Leadership, a multi-stakeholder group, focused on the annual report to develop simple, practical ways to improve narrative and financial reporting to the capital markets. Reflecting input from a range of investors, the publication outlines some far-reaching, yet practical, ideas for improving the content of annual reports and other communications. These ideas have been received very positively, not least by the UK Hundred Group of Finance Directors.

The contributors to this initiative are the Chartered Institute of Management Accounts (CIMA), PricewaterhouseCoopers LLP, Radley Yeldar and Tomkins plc



Corporate reporting: a time for reflection

During 2006, PricewaterhouseCoopers surveyed the narrative reporting practices of the world's largest companies, the Fortune Global 500. Its objective was to provide answers to questions such as: What does the narrative discussion actually communicate? Are companies meeting the information needs of investors, their priority audience for these strategic communications?



Measuring assets and liabilities: investment professionals' views

How do investment professionals use the balance sheet? How do they want assets and liabilities to be measured? This publication offers the thoughts of participants in the major global capital markets.



World Watch

The latest developments and trends in governance, financial reporting, broader reporting and assurance are covered in this global magazine. It includes news and opinion articles on issues of international interest and gives the 'big picture' to help inform executive and non-executive directors, regulators, standard setters, academics and investors. The magazine is published twice a year and circulated in 94 countries. To subscribe, email sarah.grey@uk.pwc.com or order direct from www.cch.co.uk/ifrsbooks



Dutch Survey

This survey examines the use of non-GAAP income measures in 2,800 European financial statements. Debate around this topic has intensified with the move to IFRS and some regulators are raising questions. The research shows diversity among European companies in the non-GAAP income measures reported in their annual financial statements. Copies can be ordered from www.cch.co.uk/ifrsbooks or you can ask your usual PwC contact.



Points of View

Our global position papers give the PwC network of firms' point of view on issues that affect our clients and our Assurance profession. These short, one-page papers present a distilled perspective on a range of current regulatory, auditing and assurance topics and are of interest to executive and non-executive directors, regulators, standard setters, and investors. If you are interested in receiving our Points of View, please contact bridget.atherton@uk.pwc.com.

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