

Better Business Reporting: Enhancing Financial Reporting

AUSTRALIA



Foreword

The journey to better business reporting requires a shift from our current compliance focus to an integrated and holistic business reporting approach that improves communication to the markets and contributes to better capital allocation decisions.



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There are increasing calls from capital market participants for clearer, more concise information about financial and non-financial business drivers, which ideally can be delivered in real time utilising technological innovations such as XBRL (extensible business reporting language).

These developments do not, however, mean traditional financial reporting is irrelevant – rather, they provide an impetus to increase the relevance of financial statement disclosures and better integrating these into the broader business reporting context.

In this second paper of our Better Business Reporting series, we focus on immediate steps organisations can take to enhance the more strategic and forward looking aspects of financial statements and so better inform investors. We have included examples of leading practice in key areas of financial reporting from some of Australia's large listed entities, including BHP Billiton, Origin Energy, Rio Tinto, Telstra, Wesfarmers, Woodside and Woolworths.

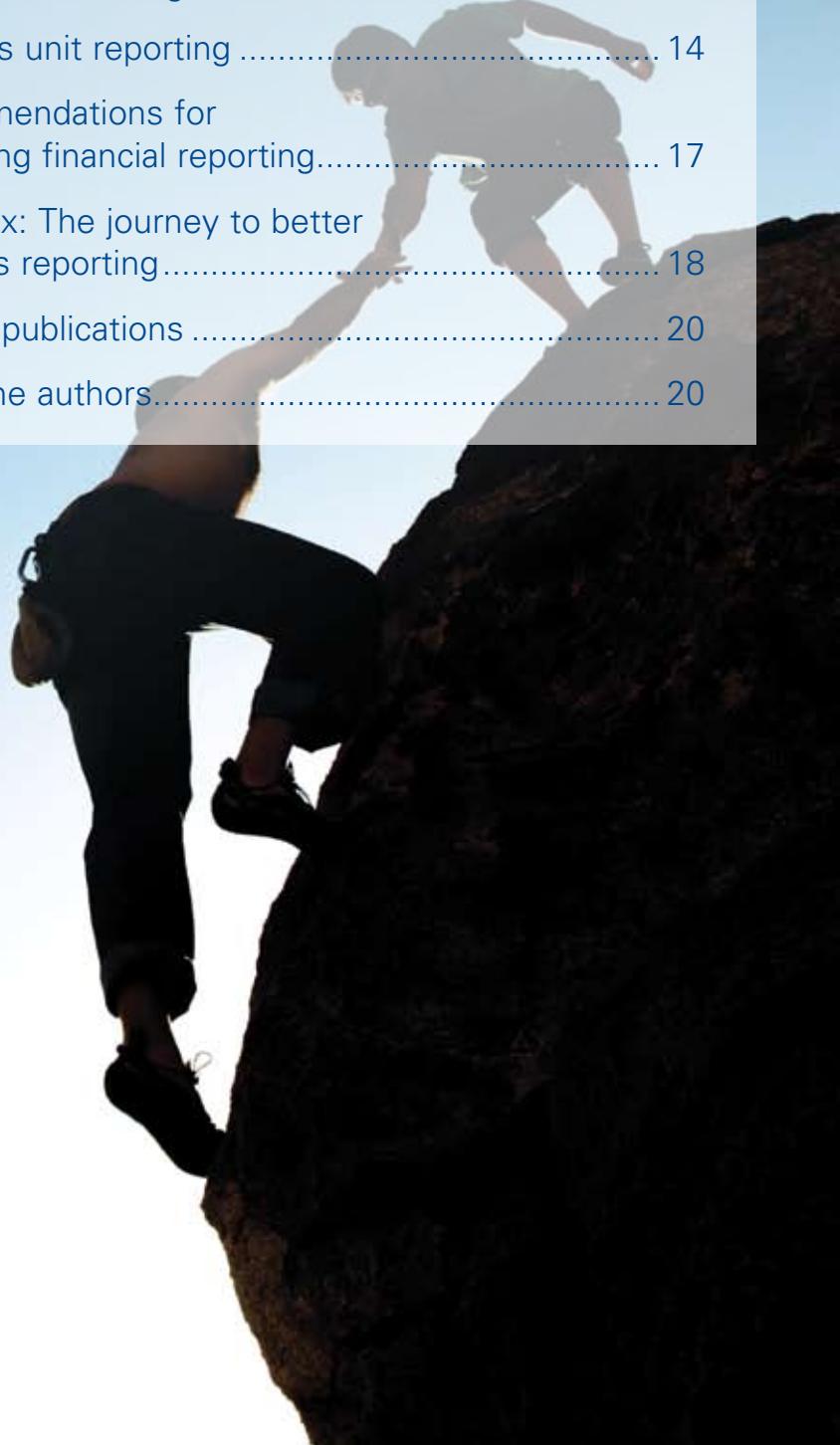
We believe enhancing financial reporting provides an opportunity for organisations to communicate more clearly about important investment drivers. It also delivers this information with a higher level of credibility, reliability and consistency within the current financial reporting and assurance framework.

I trust you find this paper a useful contribution to the development of better business reporting in support of improved investor decision making.

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

Contents

Executive summary	2
Disclosing information of value in financial statements	4
Capital and liquidity management disclosures	6
Financial risk management disclosures.....	12
Business unit reporting	14
Recommendations for enhancing financial reporting.....	17
Appendix: The journey to better business reporting.....	18
Related publications	20
About the authors.....	20



Executive summary

Financial statements today show an increasing trend of organisations defaulting to template narrative disclosures in the financial statements and workarounds such as ‘underlying profit’ and other non-GAAP measures in Management Commentary. However, Australian organisations can take immediate steps to enhance financial statement disclosures and thus begin a journey to better business reporting.

Currently financial statements have a ‘look back’ orientation which tends to be more effective in enabling the evaluation of historical financial performance than they are at providing insights into business strategies and performance prospects.

As a result of these shortcomings, the accounting profession – supported by leading corporations, investors, industry groups, legislators and regulators – has been pushing for the development of better business reporting.

The end game is the development of a flagship business report that fully integrates critical business performance information, traditional financial reporting, Management Commentary and sustainability reporting to allow investors to make informed judgements about the organisation’s prospects. Moving beyond financial reporting to improve investment decision making is explored further in Appendix A to this paper and a related publication *The Journey to Better Business Reporting*.

The first step, and the focus of this paper, is to improve what you already report. Enhancing financial statement disclosures allows organisations to communicate to investors on important investment drivers, within the current reporting and assurance framework which has the benefit of adding a greater level of credibility, reliability and consistency to the information disclosed. This is not to argue in defence of retaining lengthy financial statement disclosures; rather enhancing the quality of disclosure practices on key investment drivers within the mandatory financial reporting framework.

In this paper we provide observations and recommendations from examining the financial statement disclosures and Management Commentary of the Top 20 ASX listed companies in the following three areas which we see as critical to both an organisation’s strategy and investor decision making:

- Capital and liquidity management
- Financial risk management
- Reporting of business unit performance.

We have provided leading practice examples from Top 20 ASX listed companies to illustrate our observations and recommendations. Our suggestions for simple enhancements to financial statement disclosures are easy to execute and potentially high impact. They include simplifying communications, aligning financial statement disclosures with Management Commentary and providing insight into the business and its prospects through the eyes of management.



Disclosing information of value in financial statements

‘The evidence suggests accounting’s comparative advantage in supplying information to capital markets is... to produce ‘hard’ verifiable numbers that discipline other sources of information’.

‘Financial reporting information provides a way of checking how far expectations generated on the basis of soft information have actually been realised in practice. It therefore encourages both those who provide soft information not to misstate it and those who use it to have a greater degree of confidence in it’.

Presently communications of an organisation’s strategy, performance and prospects to the capital markets are largely through voluntary disclosures such as analyst presentations that accompany the release of the interim and annual reports, and investor day presentations (collectively referred to in this paper as ‘Management Commentary’).

In many cases, the information communicated through Management Commentary is consistent with the objective and/or requirements of financial statements.

Increasingly accounting standards are requiring disclosure in the financial statements of information in a manner that is consistent with that internally reported to management. This is facilitating an organisation’s ability to align certain financial statement disclosures with internal reporting and Management Commentary provided to investors.

The requirement under International Financial Reporting Standards (IFRS) for entities to provide disclosure about capital and liquidity management, financial risk management and business unit reporting are examples of the opportunity to tell more of the business story through the eyes of management in areas of critical importance to the business strategy in the financial statements.

These areas are important to an organisation’s strategy, and are particularly relevant in the current environment. We would therefore expect them to also be a focus of Management Commentary. For example, how is the company:

- using its capital and liquidity e.g. financing of growth/expansion plans, refinancing of existing facilities?
- managing overall exposure to market risk e.g. foreign exchange rates, interest rates, commodity prices and other forces impacting the organisation’s competitive position?
- implementing its strategies at a business unit level, and performing/tracking against these strategies?

The key is to strike the right balance of information, analysis and interpretation between base reports such as financial statements and sustainability reports, and Management Commentary. Financial statements should focus on providing information and analysis capable of being audited, and Management Commentary should focus on closing gaps in information and analysis, and providing interpretative guidance. Such a focus should enable a reduction in clutter and repetition, and an increase in clarity, in the reports portfolio as a whole.

Following are our suggestions for simple enhancements to financial statement disclosures that are easy to execute and have potentially high impact:

- simplifying the message communicated to investors
- aligning financial statement disclosures with Management Commentary, and
- providing context to the information communicated to enhance investors' understanding of the organisation's strategy and performance, and provide insight into the business through the eyes of management.

Capital and liquidity management disclosures

Information about capital and liquidity management is a key element of an organisation's business plan, and is critical to understanding an organisation's financial position and ability to execute its strategy in the future. It is therefore essential to link the reporting of capital and liquidity management with the reporting on the business strategy being funded by that capital.

Our review of financial statements and Management Commentary identified a number of differences in the way management communicates how an organisation's capital and liquidity risks are managed.

Information about an entity's management of capital and liquidity risks in the financial statements tended to be based on template-driven narrative disclosures aimed at compliance with accounting standards rather than providing insights into the performance of the organisation and the achievement of the business strategy for which this capital was raised. As a consequence, the financial statement disclosures were not always aligned with the messages communicated in Management Commentary (for example, how the capital being managed is being used to fund the execution of the business strategy).

Ensuring that messages communicated in both the financial statements and Management Commentary are **consistent** provides more relevant information and analysis in the financial statements and allows Management Commentary to be more succinct and focused upon interpretative guidance through the eyes of management. This should assist the capital markets in better understanding the likely availability of capital to fund the execution of the business strategy.

We observed that information relevant to how a company manages its capital is often not located in one place in the financial statements, but spread throughout numerous note disclosures for example, cash on hand, debt, contributed equity, capital and other commitments and the cash flow statement. This could flow from a 'checklist' approach to preparing financial statement disclosures in accordance with the various disclosure requirements of International Financial Reporting Standards (IFRS).

As a result, the disclosures are typically not given **context** by being linked or cross-referenced to a discussion of the overall business strategy in Management Commentary. It is therefore possible that readers could miss critical pieces of information, or not understand how the pieces of information fit together.

The below table illustrates the various capital and liquidity disclosures that may be spread throughout the financial statements which provide information about an organisation’s funding profile.

Table 1: Typical capital and liquidity management financial statement disclosures

Funding profile	Available cash on hand	Free cashflow	Available debt facilities	Equity
<p>Example financial statement disclosures that provide information about the different funding profile components</p>	<ul style="list-style-type: none"> • Cash on hand 	<ul style="list-style-type: none"> • Cash flow statement and reconciliation to profit 	<ul style="list-style-type: none"> • Debt maturity profile • Weighted average interest rate • Credit rating • Interest rate hedging • Debt to equity ratio and definition of capital • Facility key terms and conditions • Undraw facilities 	<ul style="list-style-type: none"> • Dividend policy • Dividend re-investment plan • Externally imposed capital requirements (e.g. banks and insurance) • Debt equity ratio and definition of capital

Source: KPMG analysis of ASX top 20 company’s financial statements

Centralising (or cross referencing) relevant information can enhance the accessibility and understandability of the information and provide a more complete picture of how the organisation is managing capital and liquidity risks (refer example 1).

Example 1: Centralising Management Commentary on capital and liquidity management

A good example of an organisation effectively **centralising** key information is provided below in the summary of key capital and liquidity information provided in the Management Commentary accompanying BHP Billiton's 2009 Annual Report.

<p>3.7.3 Net debt and sources of liquidity</p> <p>Our policies on debt and treasury management are as follows:</p> <ul style="list-style-type: none"> • a commitment to a solid 'A' credit rating • to be cash flow positive before dividends, debt service and capital management • to target a minimum interest cover ratio of eight times over the commodity cycle • to maintain gearing (net debt/net debt + net assets) of 35 per cent to 40 per cent • diversification of funding sources • generally to maintain borrowings and excess cash in US dollars. <p>Solid 'A' credit ratings</p> <p>The Group's credit ratings are currently A1/P-1 (Moody's) and A+/A-1 (Standard & Poor's). The ratings outlook from both agencies has changed back to stable from negative following the decision not to proceed with the proposed offers for Rio Tinto plc and Rio Tinto Limited.</p> <p>Interest rate risk</p> <p>Interest rate risk on our outstanding borrowings and investments is managed as part of the Portfolio Risk Management Strategy. Refer to note 30 'Financial risk management' in the financial statements for a detailed discussion on the strategy. When required under this strategy, we use interest rate swaps, including cross currency interest rate swaps, to convert a fixed rate exposure to a floating rate exposure. All interest swaps have been designated and are effective as hedging instruments under IFRS.</p> <p>Gearing and net debt</p> <p>30 June 2009 compared with 30 June 2008</p> <p>Net debt, comprising cash and interest bearing liabilities, was US\$5,586 million, a decrease of US\$2,872 million, or 34.0 per cent, compared to 30 June 2008. Gearing, which is the ratio of net debt to net debt plus net assets, was 12.1 per cent at 30 June 2009, compared with 17.8 per cent at 30 June 2008.</p> <p>Cash at bank and in hand less overdrafts at 30 June 2009 was US\$10,831 million compared with US\$4,173 million at 30 June 2008. Included within this are short-term deposits at 30 June 2009 of US\$9,677 million compared with US\$2,503 million at 30 June 2008.</p>	<p>30 June 2008 compared with 30 June 2007</p> <p>Net debt, comprising cash and interest bearing liabilities, was US\$8,458 million, a decrease of US\$1,513 million, or 15.2 per cent, compared with 30 June 2007. Gearing, which is the ratio of net debt to net debt plus net assets, was 17.8 per cent at 30 June 2008, compared with 25.0 per cent at 30 June 2007.</p> <p>Cash at bank and in hand less overdrafts at 30 June 2008 was US\$4,173 million compared with US\$2,398 million at 30 June 2007. Included within this are short-term deposits at 30 June 2008 of US\$2,503 million compared with US\$1,603 million at 30 June 2007.</p> <p>Funding sources</p> <p>The maturity profile of our debt obligations and details of our undrawn committed facilities are set forth in note 30 'Financial risk management' in the financial statements.</p> <p>During FY2009, we made the following debt issues:</p> <ul style="list-style-type: none"> • In March 2009, we issued a two tranche Global Bond under a debt shelf registration statement, which had been previously filed with the US Securities and Exchange Commission. The Global Bond comprised US\$1,500 million 5.5 per cent Senior Notes due 2014 and US\$1,750 million 6.5 per cent Senior Notes due 2019. • In the same month, we issued a two tranche Euro Bond. This comprised €1,250 million (US\$1,761 million) 4.75 per cent Euro Bonds due 2012 and €1,000 million (US\$1,408 million) 6.375 per cent Euro Bonds due 2016. <p>None of our general borrowing facilities are subject to financial covenants. Certain specific financing facilities in relation to specific businesses are the subject of financial covenants that vary from facility to facility, but which would be considered normal for such facilities.</p>
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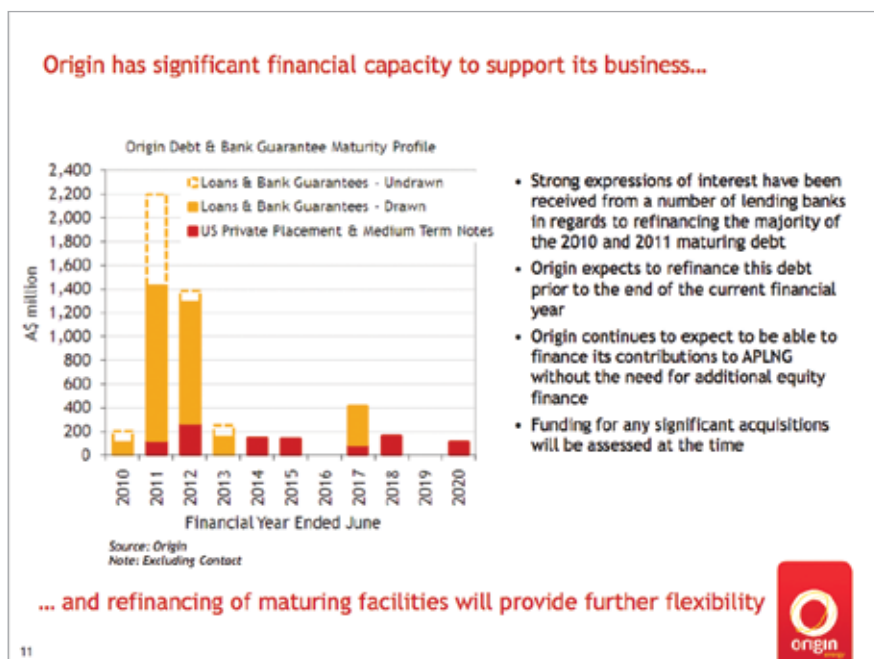
Source: BHP Billiton Limited, Annual Report 2009, p.119

Reconciling information and analysis in the financial statements to interpretive material in the Management Commentary can also enhance investor understanding of the information. While capital management disclosures in the financial statements focus more on the information and analysis of capital and liquidity management they can also be explicitly linked to that part of the Management Commentary that provides the full business strategy context. This not only assists in providing context for the information disclosed in the financial statements but also adds credibility to the information in Management Commentary by being anchored to audited financial statements.

Management Commentary generally provided greater context for capital and liquidity management as part of the overall business strategy, but did not always provide a comprehensive picture. The focus was generally on the business growth pipeline/expansion plans, not on how the growth would be funded. Reporting the business strategy in a holistic way lies at the heart of business reporting. The usefulness of Management Commentary could be enhanced if it were to include a discussion about how the business strategy will be funded, that is, the link to capital management (refer example 2). Alternatively, it can be linked back to the capital management discussions elsewhere in the Management Commentary or in the financial statements.

Example 2: Management Commentary on how capital is funding the business strategy

A leading example of an organisation linking its capital and liquidity management with reporting on the business strategy being funded by that capital, is provided below in an extract from Management Commentary by Origin Energy.



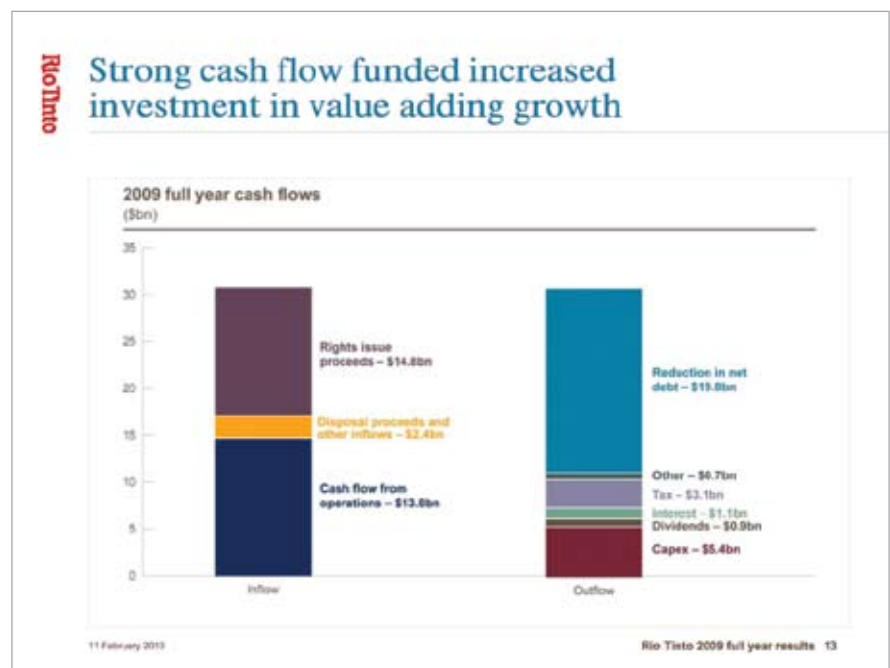
Source: Origin Energy Limited, March 2010 US Roadshow presentation, p 11

Quantitative data in Management Commentary was often prepared on a different basis to the amounts disclosed in the financial statements with little or no explanation for or reconciliation between the two. For example, discussions of net debt in the Management Commentary were not generally reconciled to cash on hand and the carrying amount of debt in the financial statements. Such gaps or inconsistencies have potential for making analysis in the capital markets more difficult. In contrast, demonstrating the link between the two can provide clarity about how the organisation defines and calculates key components of capital management, and how that capital will be used in funding the execution of the business strategy.

Generally, more tailored and concise information on managing capital and liquidity risks was provided in Management Commentary. This information is more likely to be presented visually e.g. a graph or waterfall chart (refer examples 3 and 4), and often enables trend analysis by the inclusion of comparative results for more than one year. This can simplify the message being communicated. Often visual information is auditable and can be included in the financial statements to more succinctly express the organisation’s capital management activities.

Example 3: Visually communicating capital and liquidity management information

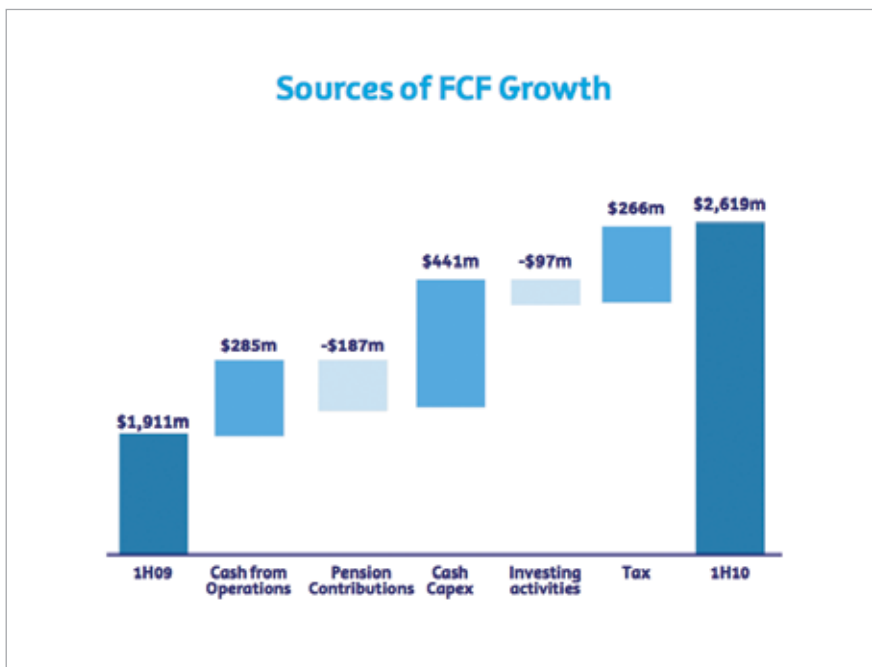
A leading example of visually communicating key capital and liquidity management information is provided below via a graphical analysis of cash flows by Rio Tinto in its full year results Management Commentary.



Source: BHP Billiton Limited, Annual Report 2009, p.119

Example 4: Management Commentary on capital and liquidity management

A leading example of visually communicating key capital and liquidity management information is provided below via a waterfall diagram used by Telstra in Management Commentary accompanying its 2010 half year results.



Source: Telstra Limited, 2010 Half Year Financial Results Presentation, February 2010, p.13

Financial risk management disclosures

Information about financial risk management is another key element of understanding an organisation's ability to implement its business strategy. However, required disclosures about financial risk management in financial statements are often not provided in the context of the business strategy and broader business risk management.

Financial risk management disclosures required by accounting standards focus solely on the impact of risks arising from financial instruments. They require qualitative information on the nature and extent of risks arising from financial instruments and quantitative data to enable evaluation of the significance of financial instruments, held at a point in time, on an entity's financial position and performance.

The capital markets typically have a different question in mind in modelling investment decisions – how exposed is the entity's earnings/equity to market risk factors? Investors are interested in the broader strategic risks such as the markets in which the organisation operates, longer term drivers of supply and demand, the unique features and competitive advantage of different business models, and cost pressures. It is this broader economic exposure, not just exposure to financial instrument risks held at a point in time, which contributes to future cash flow variability and changes in the investors' outlook on forecast earnings.

With two different objectives in mind, the information provided to the capital markets in financial statements cannot be expected to fully meet the needs of the capital markets. However, could that information be enhanced?

To investigate this further we reviewed a number of organisations' sensitivity analysis disclosures. Sensitivity analysis is a common inclusion in Management Commentary as it enables an organisation to demonstrate the impact of risks on its performance and is required by accounting standards to be disclosed in the financial statements.

As noted above, the accounting standard only mandate disclosure in relation to risks arising from financial instruments, including for sensitivity analysis. Entities are required to disclose how profit and/or equity would be impacted if the risk variable changes due to the financial instruments existing at balance date. As expected, our observations showed that sensitivity analysis in the financial statements was usually limited to that required to be disclosed under accounting standards – risks from financial instruments.

Management Commentary can provide a 'work around' to allow organisations to communicate a more holistic view of business sensitivities. However, confusion can often be created as the objectives, and therefore basis of reporting between the financial statement disclosures and the Management Commentary are not aligned.

Areas that may cause confusion include:

- not clearly explaining that the sensitivities provided in the financial statements relate only to exposures arising from financial instruments, and not providing a link between sensitivities in financial statements and those in Management Commentary

- using a different base for the calculations, for example using spot rates in the financial statements and average rates in Management Commentary
- using different magnitudes, for example using an increase of 5% in the financial statements compared to 10% in Management Commentary, and
- not providing a context for the disclosures, for example not explaining the link between the use of financial instruments and the business strategy.

Linking the information in financial statements to the strategic and interpretative material in Management Commentary can achieve greater clarity and provide consistency. Likewise, explaining the basis of calculations also helps ensure the reader can understand what you are telling them. For example, 'earnings' sensitivities can be differentiated from 'financial instrument' sensitivities and the assumptions used and method of calculation can be clearly set out so as not to confuse or mislead readers. The sensitivity analyses can be linked or integrated by showing their linkage to the business strategy.

Reporting on the risks that are critical to your business is also important. Most companies use financial instruments, (for example a derivative contract) to decrease or minimise a risk exposure. Hence, reporting only the financial instrument risk generally does not provide a complete picture of the risk exposure for the business, or how well management are managing risks.

If exposure to financial instruments is not representative of the overall business risk organisations can consider including information relating to non financial instrument risks in the financial statements. It may also be useful to include some of the analysis found in Management Commentary within the financial risk management disclosures in the financial statements. Examples of information and analysis that is usually auditable and could be included in the financial statements may include an analysis of the organisation's sensitivity to unhedged or residual exposures (after hedges), hedge cover and duration, and realised prices/rates achieved (refer example 5). This provides context for the financial instrument risk disclosures relative to the overall business risk and provides the additional credibility associated with the financial reporting and assurance framework. Disclosure around core business risks can also assist in overcoming some of the difficulties encountered when 'economic hedges' do not meet the requirements for hedge accounting.

Example 5: Management Commentary on commodity prices

A leading example of management analysis of the core risk exposures affecting an organisation is provided below by Woodside in their analysis of realised commodity prices in its 2009 Annual Report.

Realised price per boe			
	2009	2008	Change
	US\$/boe	US\$/boe	
Pipeline gas	16.7	20.6	▼
LNG	38.1	61.8	▼
Condensate	57.6	73.1	▼
LPG	64.7	65.1	▼
Oil	61.0	91.6	▼
Average realised price (US\$/boe)	43.0	64.0	▼
Average realised price (A\$/boe)	55.1	76.3	▼

Source: Telstra Limited, 2010 Half Year Financial Results Presentation, February 2010, p.13

Business unit reporting

Reporting on performance at the business unit level is critical to understanding a company's past financial performance and its future performance prospects. Critical business unit information is today often not included in financial statements.

In the financial statements, information on the performance of individual business units is reported through the requirement to disclose disaggregated financial information by segment.

Similar to our findings for capital, liquidity and financial risk management above, we noted that business unit reporting is more tailored in the Management Commentary compared to financial statements disclosures. This may in part be because accounting standards only mandate specific measures to be disclosed in the financial statements. These specific measures are primarily focused on the income statement, for example revenue and segment result. While financial statements are seen as a compliance requirement, organisations are unlikely to disclose information over and above the mandatory requirements.

However, if key performance indicators (KPIs) provided in Management Commentary are critical to an understanding of how a business unit has performed, organisations should consider providing this information in the segment disclosures within the financial statements. This gives context to the business unit performance relative to the overall organisational strategy. It presents investors with a more complete picture of the performance of a business and how management is tracking against its strategy at the business unit level (refer example 6). Including these measures within a document governed by a reporting and assurance framework also adds credibility to the amounts shown.

It is not however, all about increasing the disclosures in the financial statements. Simply, reconciling information provided in Management Commentary to the financial statements can also enhance the clarity and usefulness of the information provided. In many instances, financial based KPIs which are included in Management Commentary are anchored in or derived from information disclosed in the financial statements (refer example 7). For example, many companies disclose a return on capital measure which compares earnings with capital invested in the company. Inputs to these KPIs (e.g. return on capital employed, which is calculated based on profit/earnings before interest and tax (EBIT) and net assets) can be either directly sourced from or reconciled to audited amounts in the financial statements.

Example 6: Reporting on key performance indicators

A leading example of an organisation reporting on KPIs and providing a clear link between the long term KPI and business unit performance in the current period is provided below by Woolworths in their 2009 Annual Report and Management Commentary.

Gross store openings in FY09		Target
Australian Supermarkets	28	15–25 new Supermarkets per annum 3%+ space growth
New Zealand Supermarkets	3	3–5 new Supermarkets per annum 23 sites have been secured for future development
Dan Murphy's	16	Target of 150 stores
BWS	57	Plans to open 10 stores (net) per annum
Petrol	21	Will grow supporting the Supermarket rollout strategy
BIG W	5	4–5 stores per annum targeting 200+ stores
Consumer Electronics	51	Plans to convert all Consumer Electronics stores to the new concept format within approximately two years
Hotels (ALH Group)	12	Acquired selectively as opportunities arise

Source: Woolworths Limited, Annual Report 2009, p.27

Report Card											
In comparison with our regularly expressed goals											
Percentage	2001	2002 ¹	2003 ¹	2004	2005	2006	2007	2008 stat	2008 ¹	2009 stat	2009 ¹
Sales will grow in the upper single digits assisted by bolt on acquisitions	10.1	14.9	9.6	6.1	12.2	20.4	12.6	10.7	8.7	5.4	7.5
(excluding Petrol)	8.9	13.7	7.4	4.6	9.0	18.9	12.9	10.0	8.0	6.6	8.5
EBIT will outperform sales growth assisted by cost savings	13.7	15.7	15.6	12.6	20.5	32.3	22.6	19.8	17.6	11.3	13.4
EPS will outperform EBIT growth assisted by capital management	24.1	22.5	18.0	15.6	13.7	14.8	19.7	24.0	21.7	11.7	13.8
CODS will reduce by 20 bps ²	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓ ³	✓ ³

¹ Normalised to remove the impact of 53rd week
² Excludes Hotels and Petrol
³ Excludes the impact of prior year profit on sale of certain properties (\$49.7m) and 2009 release of provision (\$17.0m)

Source: Woolworths Limited, Annual Results Presentation 2009, p.16

It is not however, all about increasing the disclosures in the financial statements. Simply, reconciling information provided in Management Commentary to the financial statements can also enhance the clarity and usefulness of the information provided. In many instances, financial based KPIs which are included in Management Commentary are anchored in or derived from information disclosed in the financial statements (refer example 7). For example, many companies disclose a return on capital measure which compares earnings with capital invested in the company. Inputs to these KPIs (e.g. return on capital employed, which is calculated based on profit/earnings before interest and tax (EBIT) and net assets) can be either directly sourced from or reconciled to audited amounts in the financial statements.

Example 7: Key Performance Indicators by business unit

A leading example of reporting on KPI's at the business unit level is provided by Wesfarmers in their 2009 Annual Report.

Kmart		
KEY FINANCIAL INDICATORS		
For the year ended 30 June		
	08*	09
Revenue (\$m)	2,454	3,998
Earnings before interest and tax (\$m)	111*	109
Capital employed (\$m)	996*	1,038
Return on capital employed (%)	nm	10.5
Capital expenditure (\$m)	41	63

* For the ownership period 23 November 2007 to 30 June 2008.
 * Restated for finalisation of Coles acquisition accounting.
 nm = not meaningful given ownership period from 23 November 2007 to 30 June 2008.

Source: Wesfarmers Limited, Annual Report 2009, p.32

The International Accounting Standards Board (IASB) has acknowledged the benefits of viewing business unit performance 'through the eyes of management' with the recent introduction of a revised segment reporting standard IAS 8 Segment Reporting.

The revised standard, implemented for the first time by many listed Australian entities for their interim reporting at 31 December 2009, adopts a management approach for segment reporting to allow readers to view an entity's operations from the same perspective as management. This provides greater flexibility for management to report measures such as 'underlying earnings', industry specific measures and other 'non-GAAP' measures at the segment level. We expect segment disclosures in the financial statements will continue to evolve as the requirements of the standard are embedded in financial reporting disclosures.

Given the change in emphasis of the standard, we would expect that the segment information and analysis provided in financial statements will become more aligned with Management Commentary. This provides an opportunity to reduce the compliance burden for organisations given one set of information can be used for both communications. It can also provide the opportunity to enhance financial reporting communications. Information and analysis on the way management measures business unit performance can now be included in the financial statements and Management Commentary can be more focused on strategic and interpretative commentary.

Recommendations for enhancing financial reporting

Following are recommendations for simple enhancements that can be made now to financial statements to help facilitate clear, concise communications to the capital markets and so help organisations begin their journey to better business reporting.

Explicitly link the business and reporting strategies

Business reporting focuses on reporting the strategy, performance and prospects of the organisation. We advocate the articulation of a reporting strategy that makes it clear that communicating effectively with the capital markets and other stakeholders is a critical aspect of the business strategy.

Aligning communications to the capital markets offers the opportunity to include analysis as well as information in the financial statements under the financial reporting and assurance framework, which adds credibility and reliability to the information. It also enables Management Commentary to be more focused on interpreting the results and communicating insights into the business performance and prospects.

Open the boardroom

Provide investors with an insight into how your business is implementing its strategy. Equip investors with the knowledge of the business strategy, business drivers and risks, and what measures of performance are important in making capital allocation decisions. Let investors see the business through your eyes.

Reduce the clutter and increase clarity

Consider using graphs or diagrams to **illustrate** your message. Visuals are often far more effective in conveying a clear and succinct message and can be included in financial statements. It can also help direct a reader's attention to the key focus areas.

Likewise, centralising the critical information in one place in the financial statements can improve the accessibility of information and present a more complete picture – assisting investors to see how all the pieces fit together.

Reduce duplication

We suggest one time inclusion of information and analysis in either the financial statements or Management Commentary (rarely both), maximising the usage of linkages and cross-referencing within the reports portfolio. These linkages will increasingly be achieved electronically (for example through financial statements and Management Commentary in XBRL). Real time business reporting opportunities are covered in another paper in the Better Business Reporting series.

In the meantime, **reconciling** information in the financial statement to the interpretive material in Management Commentary can also be an effective way of achieving this link.

Appendix A: The journey to better business reporting

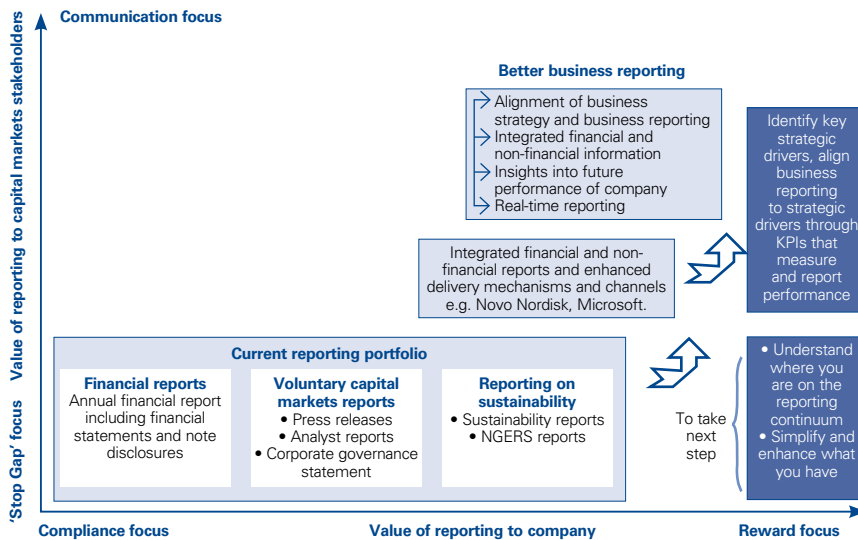
The journey to better business reporting involves a move from the compliance focus of current reporting to an integrated and holistic business report focused on providing information for capital allocation.

Business reporting focuses on reporting the business strategy, performance in implementing it and insights into performance prospects. At its best, it should fully integrate financial and non-financial information in a flagship business report, which is delivered in real time and offers the capital markets true insights into the performance prospects of the organisation.

Delivering information in this manner will enable the capital markets to understand the organisation's strategy, align their models with business performance, and make forward-looking investment decisions based on business reports. The journey to better business reporting involves an alignment of the organisation's reporting strategy with its business strategy.

The following diagram depicts the evolutionary steps in the business reporting journey. This paper focuses on steps which can be taken in the short term to improve current financial reports and voluntary capital markets reports to assist companies to move to the second tier of the diagram. Tier two achieves greater integration of financial and non-financial information in financial statements and Management Commentary.

Steps in the business reporting journey



The Journey to Better Business Reporting, KPMG in Australia, 2010.

These steps are part of the journey to better business reporting, where reporting has greater value to the company as it has greater value in the capital markets.

The benefits of improved business reporting can include more efficient capital allocation, streamlined reporting processes, reduced reporting costs and enhanced organisational clarity in terms of business strategy and the business model.

Further details are available in KPMG’s *The Journey to Better Business Reporting* whitepaper. Please contact your KPMG adviser or one of the professionals listed at the back of this publication if you would like to obtain a copy.

Related publications

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

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

The journey to better business reporting, KPMG in Australia, 2010.

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

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

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