



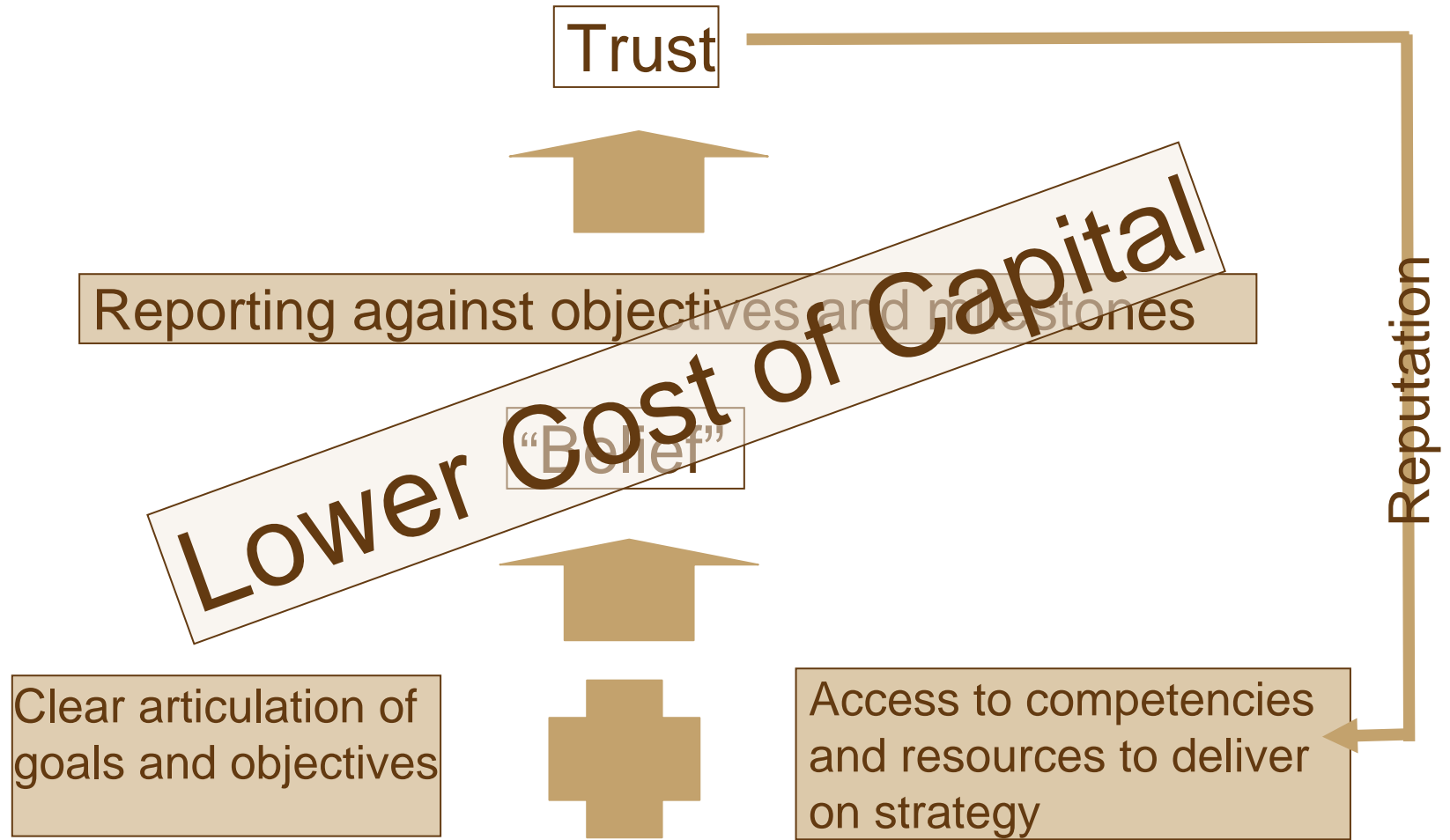
Building Public Trust  
*by “telling it how it is”*

Alison Thomas

Henley

*September 2005*

# Building Reputation in the Capital Markets.....



# Agenda

## The Limitations of the Current Financial Reporting Model

- The Objective of Financial Reporting Standards
- Fit for Purpose?: *A Survey of the Investment Community*

## ValueReporting™: A Research Programme

- Codifying User Needs: *The ValueReporting™ Framework*
- The Economics of Transparency

## The New Operating and Financial Review

## In Conclusion

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# The Objective of the Current Financial Reporting Model

“The objective of financial statements is to provide information about the financial position, performance and changes in the financial position of an entity that is useful to a wide range of users in making economic decisions”

*The Objective of the Financial Statement,*  
IASCF, paragraph 12

“Financial statements also show the results of the stewardship of management or the accountability of management for the resources entrusted to it”

*The Objective of the Financial Statement,*  
IASCF, paragraph 14

Investors  
Employees  
Lenders  
Suppliers & other trade creditors  
Customers  
Governments & their agencies  
Public

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## Fit for Purpose?: *A Survey of the Investment Community*

*“...what’s the earnings number?  
Anything I want it to be.”*

*...you have to dig around a lot more  
with respect to the P&L as to what’s  
actually happening what’s operating  
what’s financing what’s non recurring”*

*“...most of the numbers on the balance  
sheet are complete nonsense, with no  
underlying rationale.”*

*“I find cash flow statements amazingly  
inconsistent”*

*“..if something is going on in corporate  
governance the last place you will look is  
in the corporate governance statement...”*

*“I’m not sure if risk is covered  
enough...I don’t think it’s fair that  
there’s a nobby paragraph  
somewhere saying “here’s the  
key risks”...”*

*“One of my biggest gripes with  
companies is there lack of  
segmental data. If you’re a company  
making cheese and shoes why put  
the cheese and shoes together and  
assess capital density, growth,  
returns and risks, because the risk,  
growth and returns etc are so  
different between cheese and  
shoes”*

*“...visibility of risk is much  
more of a  
problem...disclosure at  
present is boiler plate”*

*“Operating and Financial  
Review; I don’t believe it...”*

The verdict from all 43 respondents was clear. The financial reporting model is failing to meet some of its most basic objectives.

## Fit for Purpose?: *A Survey of the Investment Community*

### Fixed Income

- Comprehensive picture of indebtedness
  - Overall debt position
  - Repayment schedule
- Underlying operating cash flow
- Financial and operational risks associated with cash flow

### Equity

- Return on capital employed
- Understanding of sustainability of growth
  - Acquisition vs organic
  - Price vs volume
- View of cost structure
  - Fixed vs variable
  - Maintenance vs investment capex
- Financial and operational risks

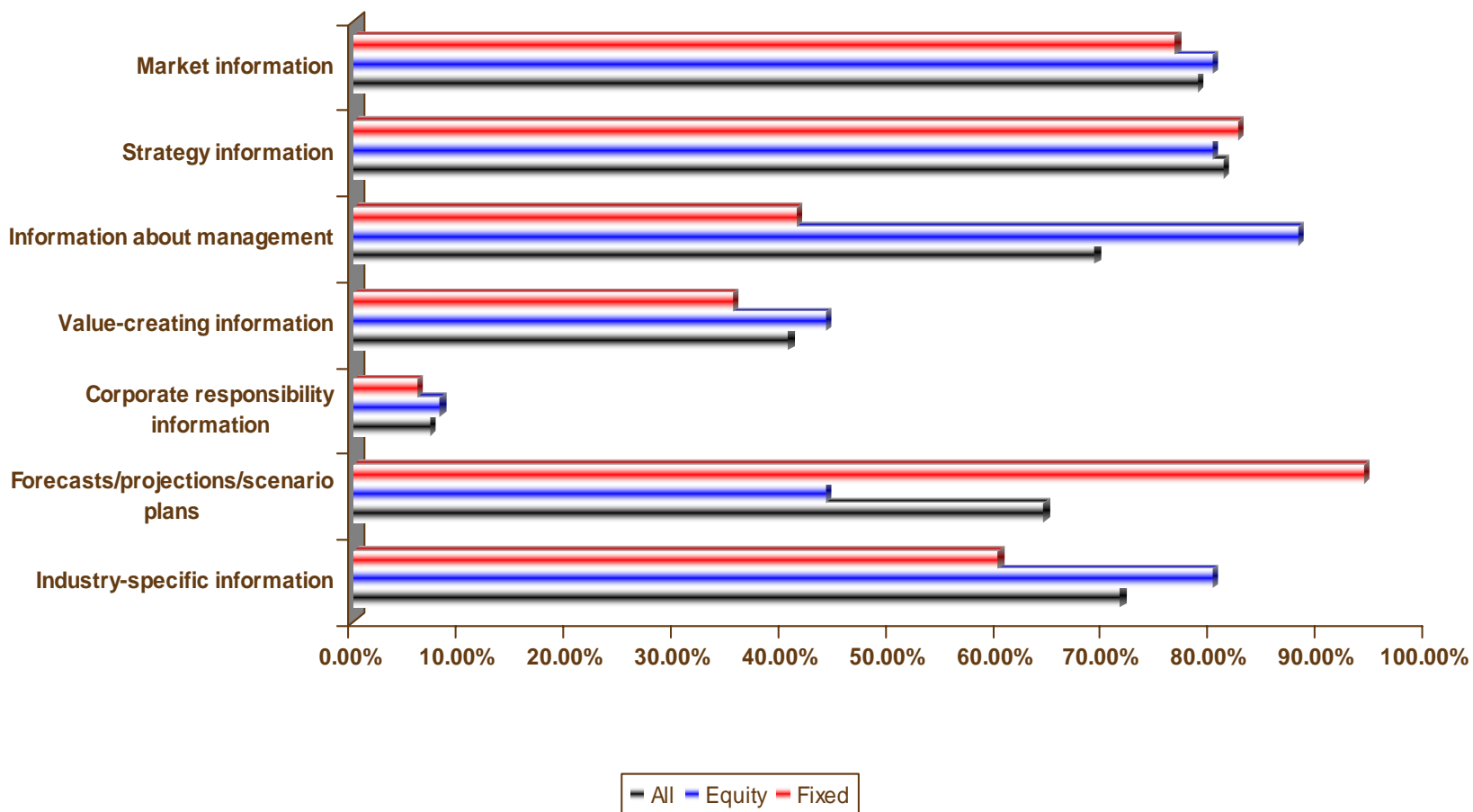
There was strong consensus about the building blocks of a good financial reporting model.

Current financial reporting standards do not allow the user to extract any of these elements in a consistent and comparable basis.

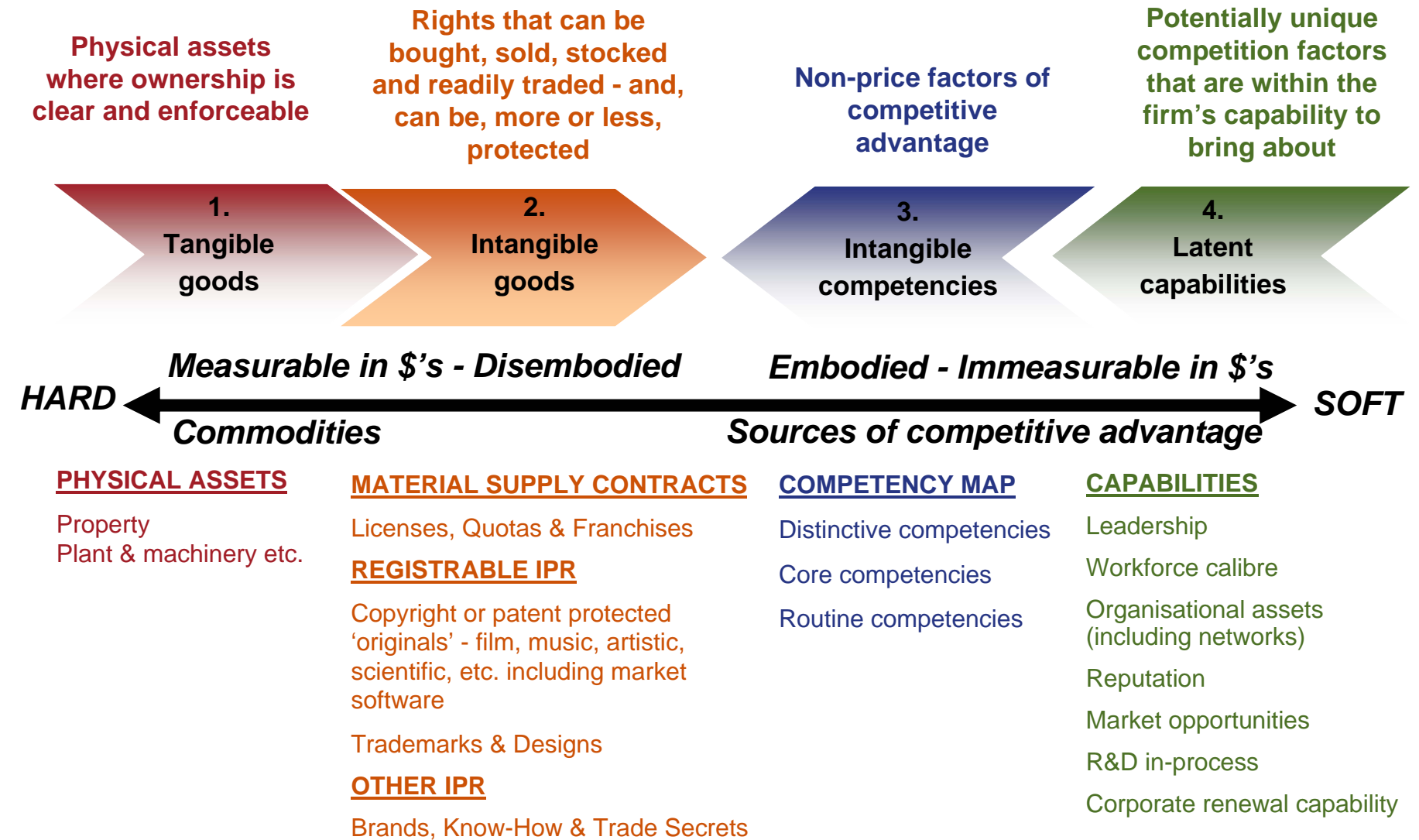
Further segmental detail was requested by all.



# Fit for Purpose?: A Survey of the Investment Community



# The Limitations of the Current Financial Reporting Model



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# A Global Research Programme

## ***VR Research completed***

***Banking***

***Chemicals***

***Diversified***

***Manufacturing***

***High Tech***

***Cons. Products***

***Entertainment & Media***

***Infocoms***

***Insurance***

***Investment Management***

***Metals***

***Mining***

***Oil & Gas***

***Pharma***

***Real Estate***

***Retail***

***Utilities***

# Codifying User Needs: *The ValueReporting™ Framework*

Market Overview	Strategy & Structure	Managing for Value	Performance
		Resources, Risks and Relationships	Non-financial and Financial
Competitive Environment	Goals & Objectives	Financial Assets	Economic
Regulatory Environment	Governance	Physical Assets	Operating
Macro Environment	Risk Framework	Customers	Environmental, Social & Ethical
	Organisational Design	People	Segmental
		Innovation	
		Brands & Intellectual Assets	
		Supply Chain	

# Codifying User Needs: *The Attributes of Good Reporting*

- Good qualitative supported by relevant quantified data, benchmarks, targets
- Linked to strategy
- Balanced

...with consistency over time and with sufficient detail at a segmental level

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# The Economics of Transparency

The costs of transparency are apparent to management.

- Collection and dissemination costs can be substantial.
- In a few cases, there may also be “proprietary” costs as operationally sensitive information becomes visible to competitors, suppliers and customers.

Cognisant of these costs, ValueReporting promotes empirical research into the benefits of greater disclosure. The ambition is to provide management with an economic framework for a company’s reporting framework.



## The Economics of Transparency



There is a growing body of empirical evidence that links good transparency with improved stakeholder relationships.

## The Economies of Transparency: *Empirical Analyses*

Research indicates there is a relationship between transparency and investor confidence

*“Our findings on the stock price performance indicated that on average the sample firms showed a 7% improvement in stock performance in the year of the disclosure increase and 8% the following year. We also find that in the year of the disclosure increase and three following years on average the sample firms experienced annual increases in institutional ownership of 12%-24%, were followed by more financial analysts, had increased stock liquidity, and lower investor uncertainty.”*

P. Healy, A. Hutton, & K. Palepu

Harvard University

## S&P's Transparency and Disclosure Report Shows Link to Value

- Study of the top 1,500 global public companies
- Ranks companies based on the level of information disclosed

## Conclusions

- The amount of information companies provide in their annual reports is correlated to valuation
- Non-financial disclosure in annual reports needs improvement

# The Great Experiment!

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# The New Operating and Financial Review

## Detailed objective

- The OFR should provide a **balanced and comprehensive** analysis for a company and its subsidiary undertakings (“the Group”) of:

Development and performance of the business during the financial year	Main <b>trends and factors</b> underlying its development, performance and position
Position	Main trends and factors that are likely to affect its <b>future</b> development, performance and position

- Prepared so as to assist **members** to assess the **strategies adopted** by the entity and the **potential** for those **strategies to succeed**.

# The New Operating and Financial Review

## Principles

Standard sets out seven key principles which should be applied by companies when they are preparing an OFR. The OFR shall:

1. “set out an analysis of the business **through the eyes of the board of directors**
2. **focus** on matters that are relevant to the interests of **members**
3. have a **forward-looking orientation**,
4. **complement** as well as **supplement** the **financial statements**, in order to enhance the overall corporate disclosure
5. be **comprehensive** and **understandable**
6. be **balanced** and **neutral**, dealing even-handedly with both good and bad aspects
7. be **comparable** over time”

# The New Operating and Financial Review

## The disclosure framework

The nature, objectives and strategies of the business	Resources, principle risks and uncertainties, and relationships	Current and future development and performance	Financial position
<p>Description of business and external environment, including the market, competitive and regulatory environment</p> <p>Objectives to generate or preserve value over the longer term</p> <p>Strategies for achieving the objectives</p>	<p>Description of resources, tangible and intangible, available and how they are managed</p> <p>Description of principal risks and uncertainties and the directors' approach to them</p> <p>Information about significant relationships with stakeholders, other than members, which are likely, directly or indirectly, to influence performance and value.</p>	<p>Significant features of the development and performance of the business</p> <p>Main trends and factors likely to impact future performance</p>	<p>An analysis of the financial position and critical accounting policies</p> <p>Discussion of the capital structure</p> <p>Discussion of the treasury policies and objectives</p> <p>Discussion of the cash inflows and outflows, ability to generate cash to meet requirements and fund growth</p> <p>Discussion of current and prospective liquidity</p>
<p>Underpinned by the financial and non-financial KPIs used to assess progress against stated objectives, as well as other performance indicators and evidence.</p>			



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To build public trust, organisational reporting should meet three tests:

- Better, Not More
- Linkage
- Balanced

...with consistency over time and with sufficient detail at a segmental level

# ValueReporting™