

***Corporate performance:  
What do investors want to know?  
Innovate your way to clearer financial reporting***

October 2014





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# Introduction

In recent years, some companies have begun experimenting with the format and layout of their financial statements. Their innovations include changing the ordering of their note disclosures and the location and content of their accounting policies.

Although many companies retain a more traditional approach to presenting their financial statements, the increasing level of innovation raises an important question: do investment professionals find alternative formats more useful? And if so, how might companies adapt their financial statements and notes so that they become the best communication tools they can be?

We interviewed 85 investment professionals from around the world to hear their views on what they find useful, and where companies might improve. We asked for their thoughts on accounting policy notes, the format of financial statements and the linkage between financial results and management commentary. This publication, the third in our three part series focusing on the needs of investment professionals, sets out our findings. You can find the first report in the series, looking at the use of alternative performance measures, and the second, focusing on integrated reporting, [here](#).<sup>1</sup>

<sup>1</sup> [www.pwc.com/gx/en/audit-services/corporate-reporting/publications/investor-view/investor-survey-edition](http://www.pwc.com/gx/en/audit-services/corporate-reporting/publications/investor-view/investor-survey-edition)

## Executive summary

Investment professionals are relatively open-minded when it comes to the presentation of accounting policies and notes to the financial statements. However, companies need to ensure that, whatever format or approach they choose, they help the users of their accounts find information easily and provide clear links between related content.

In our recent conversations with investment professionals we heard that:

- Grouping accounting policy notes together is still popular, but many investment professionals would like to see policies presented alongside other relevant notes.
- Moderate detail on accounting policies is usually sufficient, though policies should be set in the context of the company and any changes clearly explained.
- Notes can be organised in different ways, but must be easy to find.
- Management teams should clearly show how the financial results relate to the business model, identified risks and the company's strategy.
- Many investment professionals find it hard to see how a company's income statement, balance sheet and cash flow statement fit together. It is worth making the effort to explain this.
- Moving management commentary into the financial statements or providing better links could help investment professionals in analysing company performance.

Companies should be willing to experiment with the way they present elements of their financial statements. Investment professionals will give feedback on whether new approaches tell your company's performance story more clearly.

### Action points

- Make sure your accounting policies are easy to find.
- Consider whether combining your accounting policies with related notes would make them more accessible and help provide a clearer picture of your company's performance.
- Be clear about what has changed in your accounting policies, key judgements you have made and choices you have taken.
- Set your accounting policies in the context of your business, and explain how the policy links to the specific nuances of your business model.
- Make sure you have clear linkage between your financial performance and your business model, strategy and risk disclosures.
- Consider whether the layout of the notes to your financial statements is effectively telling the story of your performance: could locating your management commentary alongside your primary financial statements help<sup>1</sup>?

<sup>1</sup> In some jurisdictions, regulatory change would be required for this innovative new format to be allowable.

# Survey findings

*“The location isn’t important to me; it’s about being able to see the important information easily.”*

*“This is a really big opportunity to make financial statements easier to understand. Combining the policy with the relevant note means I am much more likely to pay attention to it.”*

*“Sometimes more detail is useful; these [the application of accounting policies] are inherently complex things to understand.”*

*“It would be really helpful to draw out what has changed [in the accounting policies] so it is easy to see.”*

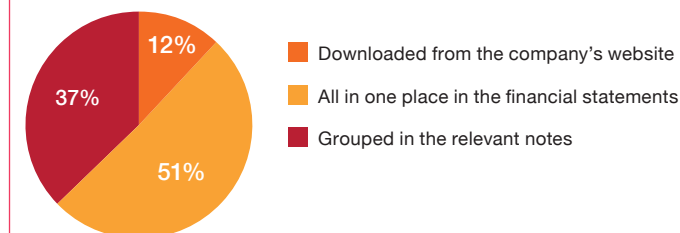
## Investment professionals are open to accounting policy innovation

When companies begin to experiment with financial statement presentation, accounting policies are often at the forefront of innovation. The traditional approach is to group all the accounting policies together in a single note (typically Note 1), but some companies now split them up and position them alongside other relevant notes. Which approach do investment professionals find more effective?

Our interviews reveal that a small majority (51%) still prefer to see accounting policies as a single note to the financial statements, but support for alternative approaches is also strong. A large minority like companies to combine the policies with the related notes.

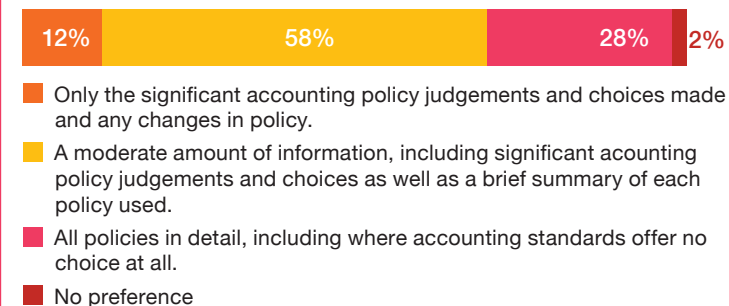
More radically, some think the accounting policies don’t need to be contained in the annual report at all: over one in ten (12%) would be happy to leave accounting policies out of the annual report altogether, as long as they are easy to find and downloadable from the company’s website. Today’s accounting standards require companies to disclose their accounting policies within their financial statements, so we would need to see significant change from standard setters and regulators before such practice could become the norm. With the investment community split as to what the best presentation method might be, we think there is a fantastic opportunity for innovation as more technology-enabled, integrated reporting gains momentum.

Where do you prefer companies to disclose their accounting policies?



Asked about the detail required in an accounting policy note, the majority (58%) of investment professionals we spoke to prefer a moderate amount of information. They want to see disclosures that include a description of significant accounting policy judgements and choices, and a brief summary of individual policies. A significant minority (28%) would like to see all policies in detail, perhaps to help them to compare policies across companies or to provide a point of reference if needed.

How much detail do you like companies to disclose in their accounting policy note?



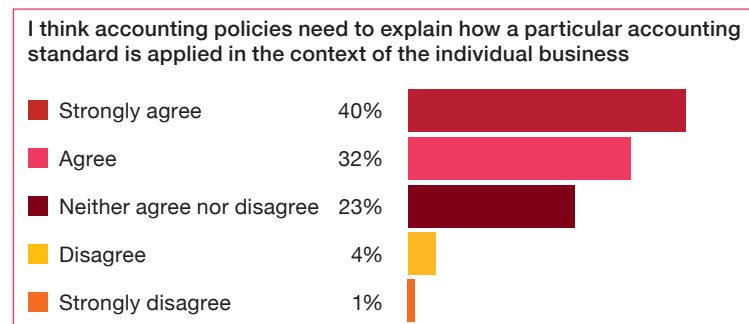
Survey findings (continued)

*“Disclosure of new and significant accounting policies is a real potential area for improvement. It shouldn’t just be boilerplate; I need a clear statement on how a new or significant standard will affect the business.”*

*“It’s not so much about the order of the notes, it’s about signposting to make it easy to find the information that I want. In fact, if I could just click on something and get to the note – that would be a great idea.”*

*“We are used to the notes being the way they are, and that is fine.”*

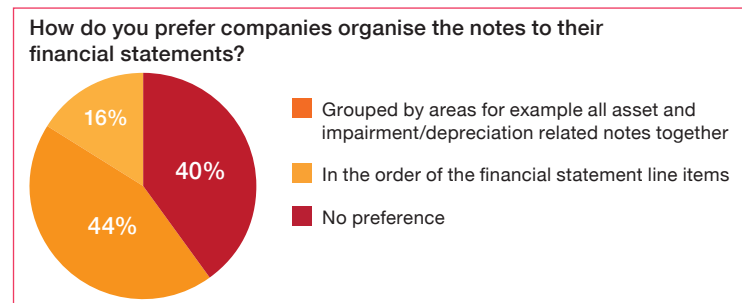
Over many years investment professionals have consistently told us that they want to see policies set in the context of the business, for example, explaining the revenue recognition policy in the context of different product lines or business units. Our latest research confirms this preference. Investment professionals also find it particularly useful when companies clearly disclose any changes to their accounting policies.



### Clarity and linkage matter, whatever the financial statement format

We talked to investment professionals about the ordering of note disclosures. Do they prefer a particular order or approach? Notes could, for example, be grouped by topic or area, or presented in the same order as the financial statement line items. We found that investors and analysts are fairly evenly split on this question. What matters most, they tell us, is their ability to

find the information they need – and to find it easily. Although the investment professionals we spoke to value consistency and comparability over time, this may be another opportunity for technology-enabled reporting to enhance communication and improve the effectiveness of reporting. Of course, any new solutions that help users more easily navigate the financial statements would need to be applied consistently over time so that users can become familiar with the methodology and gain maximum benefit.



Clear signposting to help investment professionals find information easily isn’t just needed for note disclosures. Investors and analysts also call for better linkage across the different elements of the annual report or other equivalent document. They want to understand how the financial results relate to the information provided on the company’s business model, the risks it faces and its strategy.



Survey findings (continued)

*“I would like to see clearer links, but to do that well companies need to include different types of information, particularly in longer duration businesses.”*

*“Rather than just ticking the boxes, the annual report should be used as a communication tool.”*

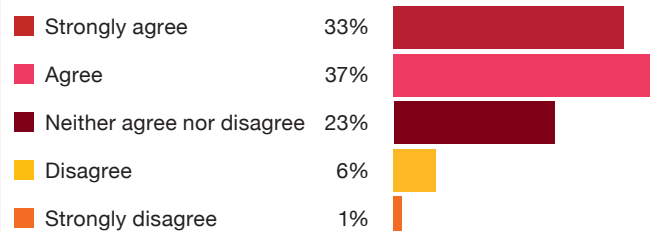
*“I think the income statement and balance sheet are more intuitive. The cash flow statement is much more difficult [to understand].”*

*“I do understand [how the financial statements fit together], although some companies make it much harder to figure out than others.”*

*“I often just cannot reconcile the three statements, even with other comprehensive income.”*

*“I don’t think anyone really finds it easy. If you have ever built a model from the beginning then you know – it’s difficult to understand the flows and links.”*

I would like to see clearer links between the financial results and the business model, risk and strategy information in the annual report/10-K/20-F



This call for linkage may provide a good opportunity for management teams to consider whether their reporting is cohesive: do the constituent parts of the annual report (and other communication channels) work together to tell the story of the business clearly?

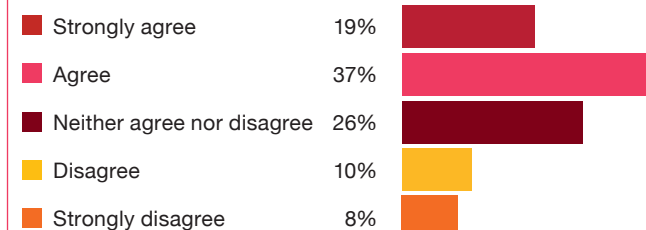
**Action points**

Put yourself in the shoes of your investors. Thinking about the questions they might ask could help you identify the main linkages that need explanation. Such questions could include:

- How do the financial results relate to your identified strategic priorities?
- What impact have key risks had on your financial performance?
- How successfully have you mitigated your risks?
- How do your operational key performance indicators relate to your financial performance?

Based on our interviews with investment professionals, it is particularly worth companies explaining how their income statement, balance sheet and cash flow statement fit together. Only 56% of the investment professionals we spoke to find this cohesiveness easy to see when they review financial statements. Better linkage and signposting could perhaps help to draw out these links. Consider how accounting policy choices, or judgements and estimates, impact each statement. For example, how does the income statement expense relate to the cash outflow?

I find it easy to see how the income statement, balance sheet and cash flow statement fit together when I review financial statements



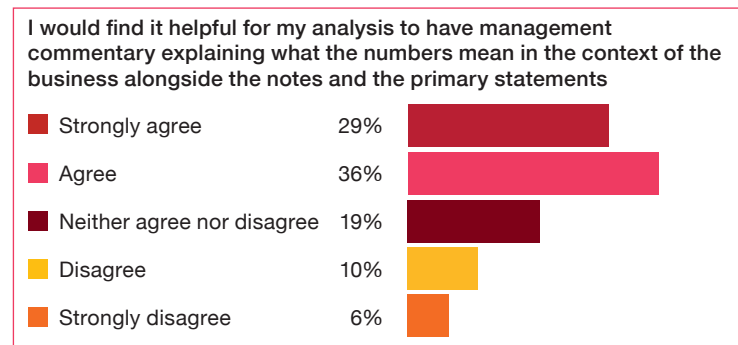


Survey findings (continued)

*“The whole point of the notes is to help me understand and reconcile the information, so I would like to see more on what the number means and what the reasons for the balance or changes are.”*

*“This really brings the numbers to life, and helps me to deconstruct the financial statements; it’s an opportunity for innovation, to get investors really engaged.”*

One of the more experimental disclosure innovations is the inclusion of management commentary within the financial statements. This usually appears as a boxed-out, unaudited piece of commentary on the same page as, or on the facing page of, the primary statements. Many (65%) of the investment professionals we spoke to felt this was a good idea and that it would be helpful for them in performing their analysis. While there may need to be regulatory change in some jurisdictions to allow this idea to become the norm, this interesting new idea again reflects a demand for more clarity and linkage across the various elements that play a part in telling a company’s performance story.



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## Conclusion

Although there is little consensus among investment professionals about any particular preference on the presentational format or delivery method for accounting policies, some important themes come through strongly – be clear, be specific, and link related information. Investment professionals may not all agree on how companies should lay out their financial statements in order to communicate most effectively, but it is worth experimenting to find the best approach.

However you present your accounting policies and notes, try to explain your approach clearly. Management teams need to make sure their disclosures are company-specific rather than boilerplate – and provide a useful level of detail, without drowning out key messages. Linking information and signposting between relevant sections of your report also helps investment professionals to be more efficient and thoughtful in their analysis.

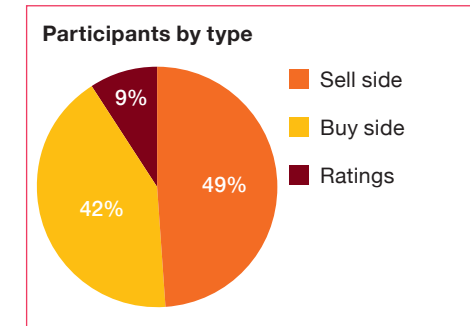
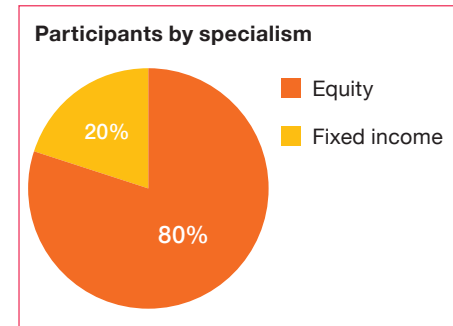
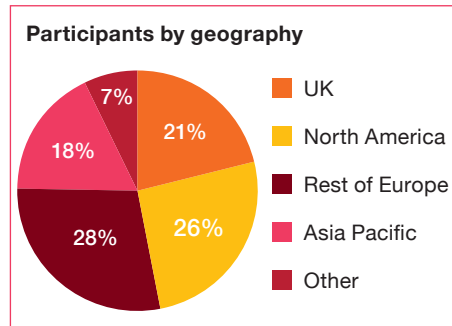
Investment professionals understand that improving reporting effectiveness is a journey. They tell us they are willing to go on that journey with management teams, giving feedback on how they might improve their reporting. For their part, management teams need to be willing to listen to and act on the feedback received.

We therefore encourage you to step back from your financial statements and related commentary. Challenge yourself. Is your reporting to the market as effective as it could be? Have you told your company's performance story in the best possible way? There is almost always room for improvement. Applying some of the ideas highlighted here could be a useful next step.

## Appendix: Survey population

We conducted interviews with 85 investment professionals from the buy side, sell side and ratings agencies. Their roles included equity analysts, fixed income analysts, ratings agencies, portfolio managers, chief investment officers and heads of research.

Survey participants were drawn from key markets across the world.



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