Deloitte.

Issue 11
June 2014

Deloitte Financial Reporting Survey Series

Stability in annual reporting
Surveying annual reports – 2013

June 2014

Survey of 2014 annual reports
Key findings

Length of annual reports remains stable

78

Average = 78 pages (PY:78)
Maximum = 175 pages (PY:188)
Minimum = 16 pages (PY:16)

Length of financial statements drops slightly

41

Average = 41 pages (PY:43)
Maximum = 73 pages (PY:76*)
Minimum = 10 pages (PY:10)

Faster reporting

57

Listed companies reported 57 days after balance date on average (PY:59 days)

67

Non-listed companies reported 67 days after balance date on average (PY:84 days)

8 Audit reports referenced going concern issues

Underlying profit

90 companies provided

251 alternative profit measures

44 companies had

3 or more alternative profit measures

New diversity disclosures provided

78% Provided gender information

14.6% OF DIRECTORS ARE FEMALE (maximum 50%)

21% OF OFFICERS ARE FEMALE (maximum 63%)

32% OF COMPANIES HAVE A DIVERSITY POLICY

*The comparative has been adjusted to remove an entity that is no longer in the survey population.

Background

Issue 11
June 2014
Deloitte Financial Reporting Survey Series

2013 was a year of stability with few changes in annual reporting requirements for preparers to consider. As a result, the average profile of the annual report remains largely unchanged, with the average length of the annual report remaining at 78 pages, with 47% as management commentary and statutory disclosures, and 53% the financial statements (2012: 45% and 55% respectively).

As there were so few changes, we have not performed a full survey of 2013 annual reports. Instead we have focused our attention on those areas where changes were expected:

- **Non-GAAP financial information**: Financial Markets Authority (FMA) guidance on non-GAAP financial information in market communications and other documents (excluding the financial statements) became applicable for FMA regulated entities from 1 January 2013, and
- **Diversity disclosures** - 2013 was the first full year that diversity disclosures had to be included in the annual reports of listed entities.

There continued to be stability in standard setting with new requirements around interests in other entities and fair value disclosures not coming into effect until 31 December 2013 balance dates. Our next survey will look at how companies have implemented these new standards. In addition, as each new standard brings increased disclosure with it, the IASB is working on a disclosure initiative to address complaints of "disclosure overload". We will continue to watch how the IASB's activities in this area impact on financial reporting. We comment on this further, along with an update on developments in wider corporate reporting, from page 8.

We note that many of the findings from Issue 9 of our survey series *Perspectives on Annual Reporting – Surveying Annual Reports 2012* will continue to be relevant as significant shifts in reporting practice are unlikely to have emerged since then given the consistent page numbers noted above. Issue 9 of our survey series is available at:

www.deloitte.com/nz/financialreportingsurvey

Underlying profit – non-GAAP financial information

90 companies provided **251** alternative profit measures

44 companies had **3** or more alternative profit measures

Number of alternative profit measures:

2010	2011	2012	2013
214	250	253	251

This year our survey considered how companies had implemented the Guidance Note issued by the Financial Markets Authority (FMA) in September 2012 titled *Disclosing Non-GAAP Financial Information*. The guidance note became applicable for issuers from 1 January 2013 so this is the first full year that annual reports have been prepared taking the new guidance into account.

The Guidance Note defines non-GAAP measures as "*financial information that is presented other than in accordance with all relevant GAAP*" which is New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for the companies in our sample. Common examples of measures used range from those that are readily understood and consistently applied, such as earnings before interest, tax, depreciation and amortisation (EBITDA), to those where more subjectivity is introduced, such as "underlying profit", "adjusted EBITDA", "operating profit" or "normalised earnings".

The inclusion of non-GAAP measures in annual reports is common practice for the companies in our survey with **90%** providing one or more non-GAAP measures. Such measures may be presented in the financial statements, making use of the lack of guidance on subtotals in NZ IFRS, or as part of the annual report commentary.

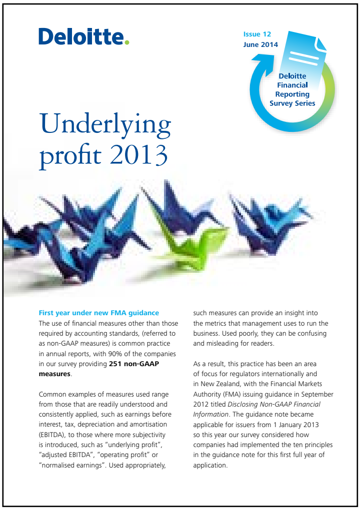
The reasons provided for presenting such measures ultimately stem from preparers believing that they provide useful information to a reader. Some of the reasons given included:

- *"Management believes that these measures provide useful information as they are used internally to evaluate performance of business units, to analyse trends in cash-based expenses, to establish operational goals and allocate resources."*
- *"EBITDA (i.e. Earnings before Interest, Taxation, Depreciation and Amortisation),… is a non-GAAP earnings figure that equity analysts tend to focus on for comparable company performance analysis, because that number removes distortions caused by the differences in asset ages, depreciation policies, and debt : equity structures"*
- *"Net operating income is an alternative performance measure which adjusts net profit after tax for a number of non-cash items as detailed in the reconciliation above. [Entity's] dividend policy is based upon net operating income. This alternative performance measure is provided to assist investors in assessing [Entity's] performance for the year."*

A summary of the results of our survey against each of the FMA's ten principles is provided below. Issue 12 in our financial reporting survey series titled Underlying Profit 2013 provides further information on the results of our survey including:

- examples of how entities have applied the FMA's ten principles,
- questions Directors should consider when reporting underlying profit, and
- an illustrative example of disclosure that could be provided in an annual report or market announcement.

It is available on our website at:
www.deloitte.com/nz/financialreportingsurvey


Deloitte.

Issue 12
June 2014
Deloitte Financial Reporting Survey Series

Underlying profit 2013

First year under new FMA guidance
The use of financial measures other than those required by accounting standards, (referred to as non-GAAP measures) is common practice in annual reports, with 90% of the companies in our survey providing **251 non-GAAP measures**.

Common examples of measures used range from those that are readily understood and consistently applied, such as earnings before interest, tax, depreciation and amortisation (EBITDA), to those where more subjectivity is introduced, such as "underlying profit", "adjusted EBITDA", "operating profit" or "normalised earnings". Used appropriately, such measures can provide an insight into the metrics that management uses to run the business. Used poorly, they can be confusing and misleading for readers.

As a result, this practice has been an area of focus for regulators internationally and in New Zealand, with the Financial Markets Authority (FMA) issuing guidance in September 2012 titled *Disclosing Non-GAAP Financial Information*. The guidance note became applicable for issuers from 1 January 2013 so this year our survey considered how companies had implemented the ten principles in the guidance note for this first full year of application.

At a glance:

1 WHY MEASURE IS USEFUL	34% of measures provide some explanation as to their use (PY:33%)
2 PROMINENCE	5 companies (PY:11) emphasised underlying profit with no discussion on statutory profit
3 APPROPRIATE LABEL	25% of measures (PY:31%) used confusing labels, e.g. EBITDA which excluded more than interest, tax, dep'n / amortisation
4 EXPLAIN THE CALCULATION	A narrative explanation of the measure was provided for 67% of measures (PY:63%)
5 RECONCILE TO PROFIT AFTER TAX	81% of measures (PY:79%) were reconciled to a subtotal on the income statement (not always profit after tax)
6 CONSISTENT APPROACH	82% of the measures are the same as those used in the prior year, although adjusting items may have differed
7 COMPARATIVES	Comparatives are provided where reconciliations were given
8 ENSURE UNBIASED	81% of measures provided better results than the GAAP profit after tax (2011:85%)
9 ONE OFF OR NON-RECURRING ITEMS	17% of measures (PY:15%) made a reference to "one-off" or "non-recurring" items
10 EXPLAIN IF AUDITED OR REVIEWED	8 companies (PY:3) noted whether the measures provided were taken from audited or reviewed financial statements

Diversity disclosures

14.6%
OF DIRECTORS ARE FEMALE
(maximum 50%)

21%
OF OFFICERS ARE FEMALE
(maximum 63%)

32%
OF COMPANIES HAVE A DIVERSITY POLICY

For balance dates ending on or after 31 December 2012, the NZSX and NZDX Listing Rules (the 'Listing Rules') require a quantitative breakdown of the gender composition of Directors and Officers, and disclosures where a diversity policy is adopted by a listed entity. Differing practices have emerged, as discussed further below.

Profile by gender

The NZX listing rules require a quantitative breakdown of the gender composition of an entity's directors and officers as at the balance date (Rule 10.5.5(j)).

78% of companies provided this quantitative information, 10% did not and the remaining 12% were not required to comply with this requirement. Where disclosure was provided by the companies in the survey population, 14.6% of Directors are female and 21% of officers were female. The maximum Board representation by females was 50% and 63% for officers.

The NZX provides gender diversity statistics on a quarterly basis. For annual reports released during 2013 (which will reflect the December 2012 position for companies with a December balance date) the NZX noted that 12% of Directors were female and 19% of officers were female, which is similar to our survey results.

We note that this requirement has been interpreted differently by companies with some providing absolute figures and others providing percentages. A small proportion (4%) only provided disclosure for directors and officers as a combined figure, with the majority providing this information separately for directors and for officers.

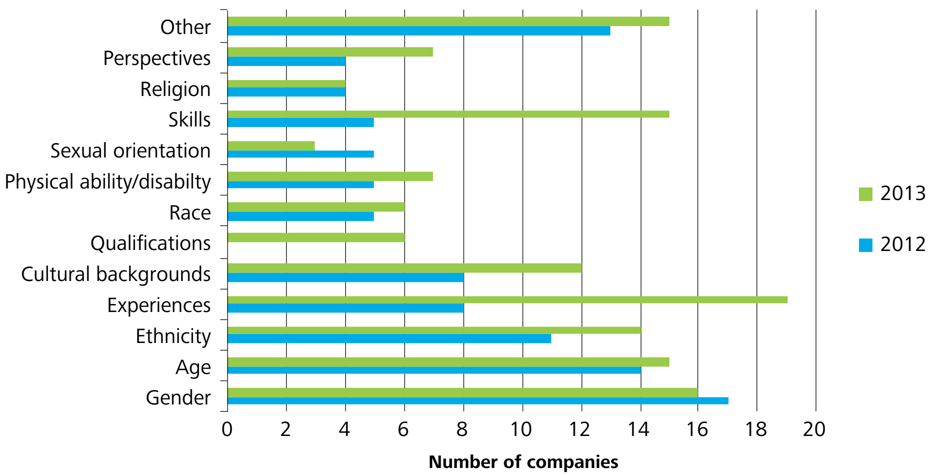
Diversity policies

The Listing Rules do not require issuers to adopt a diversity policy. However, if a diversity policy is adopted Rule 10.5.5(k) requires listed issuers who have quoted equity securities to provide "*a statement from the Board of the Issuer providing its evaluation of the Issuer's performance with respect to its diversity policy*" in the annual report. NZX also encourages issuers to disclose any diversity policy or any matter related to diversity practices or position that relate to diversity matters other than gender.

32 companies in our survey noted that they had a diversity policy, an increase from 19 companies in the prior year. Where disclosure is provided, there are differing views as to what is considered to be diversity from a simple "*balance/mix of skills and perspectives*" through to diversity *"as including but not being limited to skills, qualifications, experience, gender, race, age, disability, ethnicity and cultural background*".

Of the 32 companies with a diversity policy, only 11 provided measureable objectives against which they evaluate the issuer's performance with respect to its diversity. In total, 20 provided commentary on the achievement of their diversity policy. We note that the NZX issued a guidance note in December 2012 in order to assist listed entities with their development of a diversity policy. This guidance includes examples of measurable objectives that issuers may wish to set with a focus on gender diversity. It is available at: **https://www.nzx.com/market-supervision/rules/nzsx-and-nzdx-listing-rules**. The NZX also provides links to other available diversity resources.

What do companies consider to be diversity?



Looking forward

Looking forward, preparers of 2014 annual reports will have some changes to implement. New requirements around interests in other entities (subsidiaries, associates, joint arrangements and unconsolidated structured entities) and fair value measurement will be applicable, which bring with them increased disclosure requirements. The IASB has also recently issued a new revenue standard applying to periods beginning 1 January 2017 which will require all companies to reconsider their current practices around revenue recognition, as well as coming to grips with the more extensive disclosure requirements.

These developments continue to contribute to the rising level of concern in relation to "disclosure overload". Common complaints include that: financial statements have become less readable and understandable because the requirements are complex; the volume of disclosure required is overwhelming – masking what is important; boilerplate disclosures don't explain key risks or areas of subjectivity; the structure of the financial statements is often unhelpful; and more. The complaints are many, but so are the solutions being discussed by standard setters, regulators and other groups which cover corporate reporting more broadly.

Disclosure initiative

The International Accounting Standards Board (IASB) has started a project to address some of these issues as part of its "disclosure initiative". Hans Hoogervorst, Chairman of the IASB commented:

"*The Disclosure Initiative is focused on ensuring that financial reports are instruments of communication and not simply compliance documents. These proposals form a small part of our efforts to encourage preparers, auditors and regulators away from a ticking-the-box mentality towards disclosures.*

These proposals are designed to help change behaviour, by emphasising the importance of understandability, comparability and clarity in presenting financial reports."[1]

A first exposure draft has been issued as part of an initial short term fix, to clarify some of the requirements of IAS 1: *Presentation of Financial Statements* around the materiality requirements, specific line items required, and to remove the requirement for a specific order of notes to the financial statements.

What can you do now?

We note that entities don't need to wait until the IASB has completed its project to improve the readability and understandability of their financial statements. Key things to think about include:

- **Cut the clutter** – the IASB has clarified that the standards only require material disclosures to be provided. So don't just roll forward last year's report - be ruthless and cull information that is no longer relevant or not material.
- **Tell a story** – read the annual report and make sure it tells a consistent story across the management commentary and financial statements.
- **Explain the numbers and risks** – assess what is material and provide meaningful disclosures to explain the significant risks that exist.
- **Make it clear** – write in plain English and explain acronyms so as to make sense to the average reader.

[1]Refer IASB press release dated 25 March 2014 available at:
http://www.ifrs.org/Current-Projects/IASB-Projects/Amendments-to-IAS-1/Project-news/Pages/Project-update-March-2014.aspx

Wider corporate reporting

The need for change is not just focused on financial reporting with a number of developments in non-financial reporting driven by calls from companies, regulators and the investor community to have improved, concise and meaningful reporting of the drivers of value within a business, the risks it faces and information on sustainability.

Various developments are taking place in other jurisdictions requiring transformation of corporate reporting as set out opposite.

Currently in New Zealand there are few requirements specified for inclusion in annual reports and as a result there is significant variability in practice. In our prior year survey of 2012 annual reports[2], commentary provided ranged from very little information on the entity's performance for the year, to detailed reports including discussion on the entity's business model, objectives and strategies, achievements against targets set to achieve those objectives, and information on how the company impacts the wider community. This variability indicates that some companies consider that additional information on the broader view of a company's business activities is important for investors, consistent with the emerging developments in other jurisdictions noted opposite.

Against this international backdrop, New Zealand will need to consider whether to follow. We are supportive of moves to make reports more meaningful and relevant to users by showing a more holistic picture of a company's performance. However, further guidance needs to ensure this does not merely add to the compliance and volume burden, that the reported information is scalable as well as being comparable and can be relied upon by the users. The emerging frameworks such as the IIRC and the GRI G4 are good initiatives that could be used as a base for developing such guidance.

[2]Refer to Issue 9 of our survey series Perspectives on Annual Reporting – Surveying Annual Reports 2012 available at **www.deloitte.com/nz/financialreportingsurvey**.

Issue 11
June 2014
Deloitte Financial Reporting Survey Series

Emerging developments in other jurisdictions

International Integrated Reporting Council ("the IIRC")

The IIRC (a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs) released the Integrated Reporting Framework in December 2013. An integrated report is defined as "*A concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term.*" The Framework is currently being piloted, and is on the agenda for discussion at the upcoming G20 Group of Nations in November 2014.

Australia

The ASX will require an entity to disclose *"whether it has any material exposure to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks"* on an *"adopt or explain"* basis.

Global Reporting Initiative ("the GRI")

The GRI (an international not-for-profit organisation), released the fourth version of their guidance in 2013 on reporting sustainability performance information. A sustainability report is defined as: *"A report published by a company or organisation about the economic, environmental and social impacts caused by its everyday activities, that also presents the organisation's values and governance model, and demonstrates the link between its strategy and its commitment to a sustainable global economy."* This guidance is the most widely used globally for non-financial reporting.

United Kingdom

From 30 September 2013 a strategic report (separate to the annual Director's report) is required. Quoted companies' strategic reports will need to include new information on the company's strategy, business model, human rights and gender diversity of its employees (not just directors). Directors reports will also require greenhouse gas emissions to be disclosed by quoted companies.

European Union

The European Parliament has adopted a Directive which will require disclosure of non-financial and diversity information by specified entities in Member countries by the end of 2016. Information required includes environmental, social, employee-related aspects, respect for human rights, anti-corruption and bribery issues, diversity on boards of directors and other legal aspects related to sustainability.

The Financial Reporting Survey Series

The survey series has been following the annual reporting practices of a sample of New Zealand companies since 2009. All issues in the series are available at:
www.deloitte.com/nz/financialreportingsurvey

Contacts

Auckland

Denise Hodgkins
+64 (0) 9 303 0918
dhodgkins@deloitte.co.nz

Peter Gulliver
+64 (0) 9 303 0891
pegulliver@deloitte.co.nz

Victoria Turner
+64 (0) 9 303 0794
viturner@deloitte.co.nz

Hamilton

Bruno Dente
+64 (0) 7 834 7842
bdente@deloitte.co.nz

Wellington

Jacqueline Robertson
+ 64 (0) 4 470 3561
jacrobertson@deloitte.co.nz

Christchurch

Michael Wilkes
+64 (0) 3 363 3845
mwilkes@deloitte.co.nz

Paul Bryden
+64 (0) 3 363 3862
pbryden@deloitte.co.nz

Dunedin

Mike Hawken
+64 (0) 3 474 8684
mhawken@deloitte.co.nz