

ANNUAL REPORTING AND NARRATIVE DISCLOSURE:

A Guide For The Modern Finance Leader

In the digital age, it ought to be easy to gather data and present it well. But in recent years, producing annual reports has become increasingly pressurized.

This digibook contains a step-by-step guide to overcoming the new challenges of raised expectations, big data, and globalization, with case studies and examples of how smart CFOs are redefining reporting.

In this guide, you'll find out:

- I. The New Financial Reporting Landscape**
Why the CFO's job is getting harder, and no-one seems to care
- II. Four Steps to Winning at Qualitative Disclosure**
"Imagine your business intelligence is aimed at a three-year-old"
- III. Mitigating Five Big Risks in Your Analysis and Disclosure**
Streamline your financial reports without making a career-ending error

- IV. What Can Finance Do to Reduce Human Error in Other Departments?**
When peer pressure is a CFO's best friend
- V. How to Increase Efficiency in the Finance Department**
Is it enough to be the leanest team in your company?
- VI. Building your action plan**
Build your comprehensive list of next steps

Further reading

If we seem to be missing three big ticket items, it's because they're covered elsewhere in this series. Check out our three digibooks on [Thriving in the Digital Age](#), [Organizational Change](#) and [Forecasting](#).

Who will find this digibook useful?

This has been written with CFOs and finance VPs at international companies of all sizes in mind, but our research and case studies also include smaller businesses and public sector bodies, as well as larger multinationals, so any senior finance person will find it useful. It also has insights into the life of the CFO that other C-suite team members may find useful in understanding the challenges and pressures that go into annual reporting.



THE NEW FINANCIAL REPORTING LANDSCAPE



Quarterly and annual reports are the most basic function of the finance department. And they're getting harder every year.

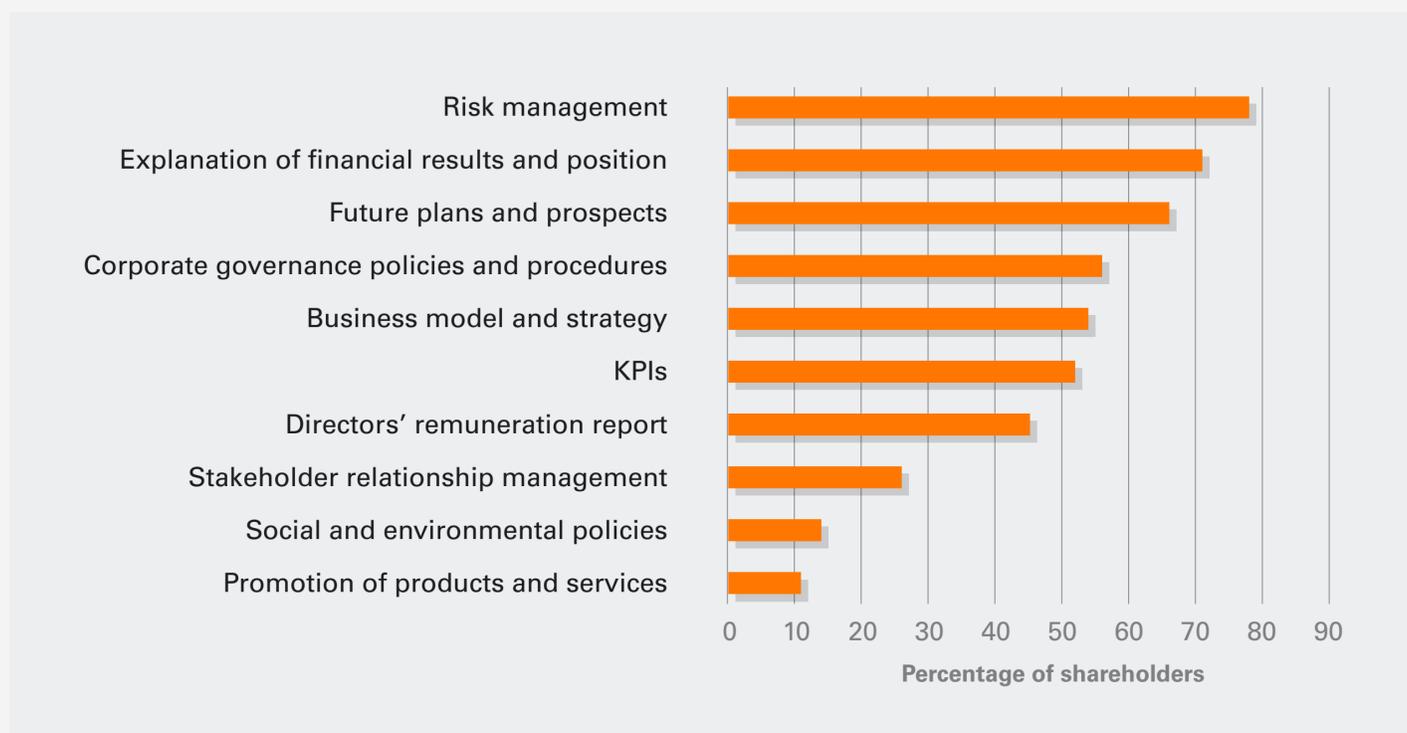
Business is increasingly global; legislation varies wildly between jurisdictions; post-2008 rules are complex, ambiguous, and inconsistently applied (and, of course, can put CFOs in jail if they get things wrong).

The proportion of companies closing their books in five to six days has **fallen** since 2007 from 47% to 38%.¹

Despite this, expectations have gone through the roof. **Your C-suite, board and shareholders don't care that their demands are impossible.** The smartphones in their pockets, the business dashboards on their SaaS solutions, and the Fitbits on their wrists have taught them that all data can be **instant, accurate and actionable.**

Not only that, but your shareholders want more and better disclosure. Building your reports around historical performance is no longer enough. They want better integration of everything from risk to governance and relationship management.

FIGURE 1: POST-CRISIS REPORTING—WHAT DO SHAREHOLDERS CONSIDER 'OF GREATER INTEREST'?²



There are huge opportunities out there—but the expectations that have been created are even bigger.

In this digibook, we ignore the myths to look at how the landscape really has changed, and give you the solutions to meet those changes. At the end, there's an opportunity to build a personal checklist for meeting these new challenges head on.

¹ Oracle: 5 Minutes on Modern Finance
<http://www.oracle.com/us/cio-docs/5-minutes-modern-finance-br-2210880.pdf>

² Accaglobal.com: Accountancy Futures - Hitting the notes, but what's the tune?
http://www.accaglobal.com/content/dam/acca/global/PDF-technical/narrative-reporting/hitting_the_notes.pdf





FOUR STEPS TO WINNING AT QUALITATIVE DISCLOSURE

Expanding qualitative disclosure in reports is crucial to a comprehensive picture of how well a company has delivered.

90% of organizations see switching to greater qualitative commentary as crucial: with intangibles now worth 80% of corporate value³, having context and explanation is [more important than ever](#).⁴

These are the four key steps to take:

Step 1. Understand your audience: ask some questions.

An **annual stakeholder survey** is the simplest way to find out what your report should include. Without this, you might find that the CEO, the CFO and the compliance department work together to write a report that is only truly interesting if you are a CEO, CFO or a regulator.

Aegon, winners of PWC's 2014 'Towards Integrated Reporting' award, survey every individual or group affected by the business about what topics they are interested in.⁵ This means that reports can be built with the real audience in mind.

Step 2. Narrative reporting: find your shareholder sex appeal.

As of August 2015, there were 138 'unicorn' startups with a value over \$1bn listed by Fortune magazine.

Investors believe in unicorns not because of any quantitative data (Uber is a loss-making business valued at over \$62bn), but because of the **narrative** of disruption that Silicon Valley has perfected. Sky-high valuations are based on a mastery of qualitative disclosure: releasing the right data, and telling the right story around it.

"It's almost like you're a real estate company wrapped in this tech sheen," was how Bloomberg's Betty Liu described co-working startup WeWork in February.⁶ The company's valuation has since risen to over \$10bn, in spite of it being a twentieth the size of its main competitor and having never shown a profit.

You need to define a story that is consistent with what customers and internal stakeholders know about your business, and you need support from outside the finance team to do this—brand marketing, PR, investor relations and internal communications teams can all help you define your narrative.

Your enterprise may never have the shareholder sex appeal of a WeWork or an Uber, but, even so, only by offering a wider narrative than your P&L can you demonstrate its true value to investors.

Step 3. Clear reporting: don't make your audience think

Never assume that investors (or even your own board) are doing due diligence. As individuals they may be clever, careful and well-informed. But groups behave differently to individuals. Collectively, it's safer to **imagine you're working with three-year-olds**: they will sway from elation to sulking in moments, and only the clearest information will have an impact on their decisions. They need to be spoon-fed the data.

In March 2011, flexible working specialist Regus changed its annual reports. It removed business centers under two years old from its operating profit figures, instead showing data from the newer centers as 'net investment in growth'.

³ Deloitte Research, "The Wall Street Journal: Deloitte Insights," 28 June, 2014.
<http://deloitte.wsj.com/cfo/2014/07/28/cfos-embrace-digital-or-put-your-companys-future-at-risk/>

⁴ Oracle: Enterprise Performance Clearly Explained
<http://www.oracle.com/us/infographics/eprcs-infographic-2521061.pdf>

⁵ PCW Interview: Aegon's award-winning approach to integrated reporting
<http://www.pwc.com/gx/en/services/audit-assurance/corporate-reporting/world-watch/aegon-integrated-reporting-interview.html>

⁶ The AWL: Where Will We Work?
<http://www.theawl.com/2015/05/where-will-wework>

This simple qualitative change showed the business model as fundamentally robust, proving that new, loss-making centers were a predictable source of future profits.⁷

That a new business center took a year or two to turn a profit should have been obvious to any investor who thought for a moment about the nature of the commercial real estate business. However, with this data explained more clearly, Regus saw a **19% increase in its share price** in the week the annual report was released.⁸

- Is there something that everyone in your industry knows, which you regard as too obvious to point out?
- Would these basic facts about the way that your business works help the market better understand your fundamentals?

A recent survey shows **97%**⁹ of **shareholders** consider the most important disclosures to be:

- an explanation of the financial results and position
- the most important risks
- future prospects and plans and KPIs

If you can build absolute clarity around these, you might just be able to increase the value of your business by a fifth in a single week like Regus.

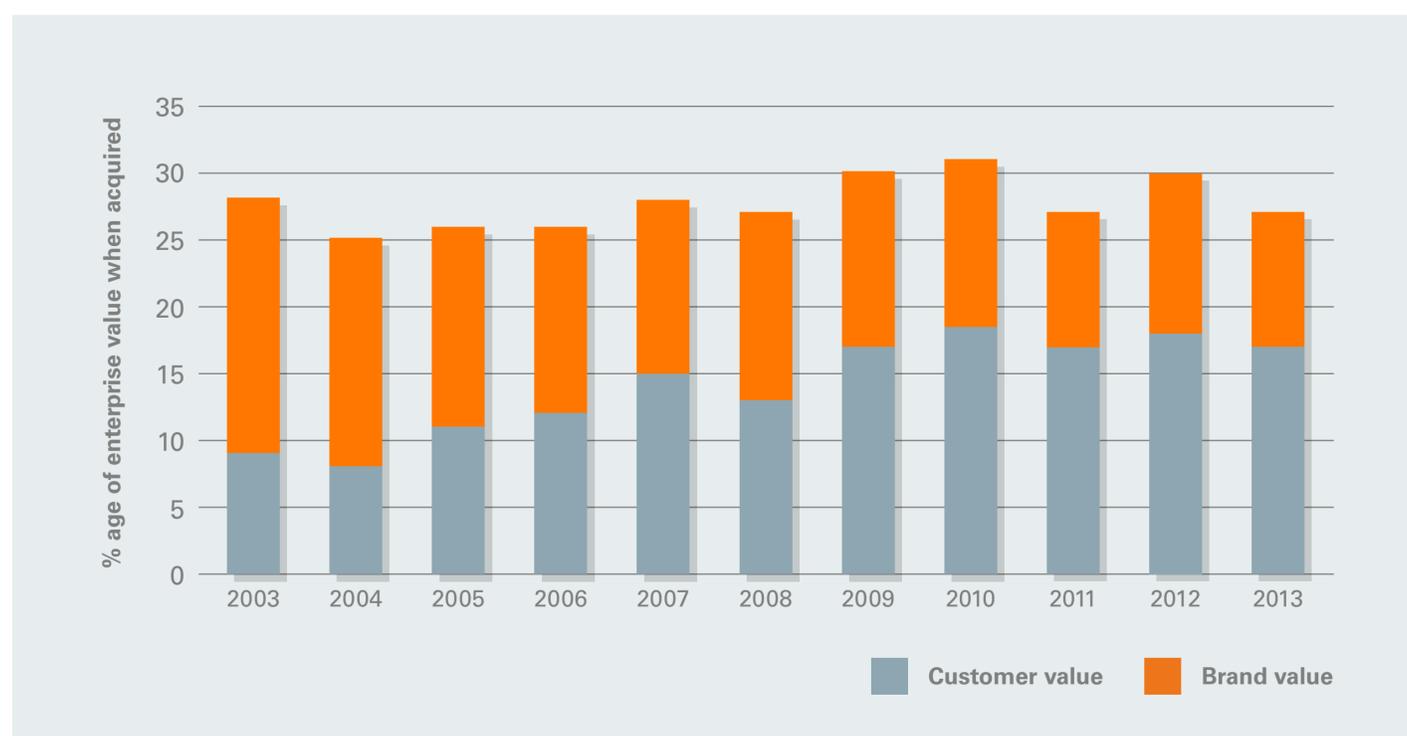
Step 4. Integrated reporting: include your intangibles

If your reporting's going to be up-to-date, it needs to include **integrated metrics**. These, measured consistently year after year, communicate the combined impacts of profit, investment, human capital, market trends, customer loyalty and other tangible and intangible factors.

Intangibles are tricky, but vital: the 'Coca-Cola' brand, for example, could be understood as The Coca-Cola Company's single most valuable asset. But the lack of globally recognized standards mean that measures of 'brand value' (or intellectual property, or human capital) are only translated into shareholder value if they can be rigorously measured.

One of the times they get measured is when a company gets acquired, and the acquirer has to put a specific price on those intangibles as part of the acquisition. This allows us to see just how important intangibles have become:

FIGURE 2: VALUE OF 2 KEY INTANGIBLES IN ENTERPRISE WHEN ACQUIRED^{10,11}



⁷ Regus: Annual Reports
<http://www.regus.co.uk/investors/annual-reports.aspx>

⁸ Google: Finance - Regus PLC
<https://www.google.co.uk/finance?q=LON:RGU>

⁹ Oracle: Reinvent Narrative Reporting
<http://www.oracle.com/us/products/applications/oracle-eprcs-wp-2522870.pdf>

¹⁰ HBR: Why Strong Customer Relationships Trump Powerful Brands

¹¹ Data from Markables

If you can find a consistent, trustworthy way to report these intangibles—and with all the additional data coming into your business, this should not be impossible—you could start seeing this value reflected in your day-to-day valuation. Ask your marketing department if they can prove the lifetime value of a loyal customer, or the year-on-year change in your brand value, and they may come back with a surprisingly rigorous answer.



MITIGATING FIVE BIG RISKS IN YOUR ANALYSIS AND DISCLOSURE

As reporting automates, expectations rise

A modern finance department has to offer a blink-and-you'll-miss-it close cycle, accompanied by perfectly accurate results, all bound up in a clear narrative.

No wonder that errors creep in: US companies typically make more than 1000 restatements each year to their published financials, a quarter of which are substantial.¹²

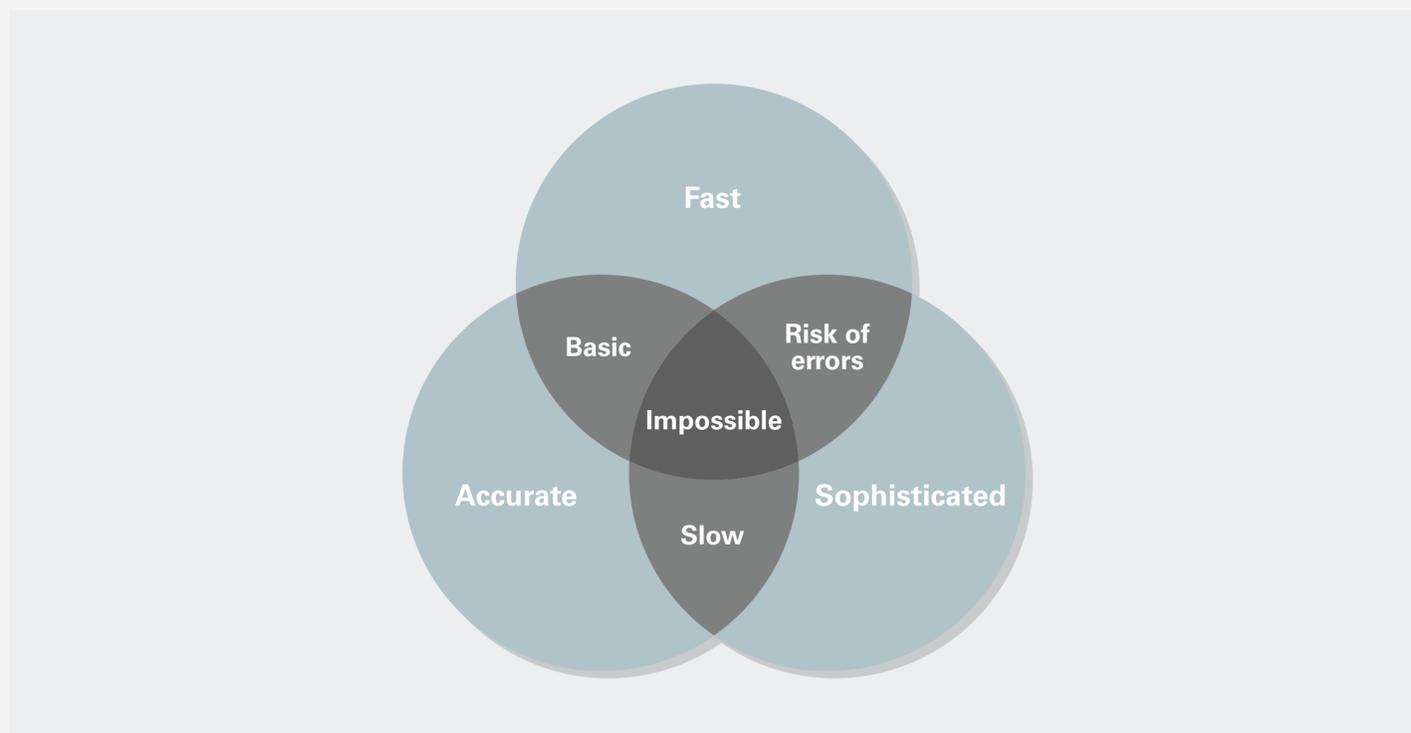
These reflect badly on the business and the CFO. They have rapid and painful impacts on the share price... and on the career prospects of the CFO involved.

Whenever you change your reporting process, you run a risk—these are five to avoid:

Risk 1. Trying to do everything at once: The iron law of changing your reports is “faster, more accurate, more sophisticated: pick any two.” Attempting to improve all three at once is a recipe for disaster.

Prioritize the areas that matter to you most, and don't set yourself up for a fall by trying to do too much too fast.

FIGURE 3: THE IRON LAW OF CHANGING YOUR REPORTING



¹² The Chief Financial Officer, Jason Karaian, 2014

Risk 2. Depending solely on extra resources to shorten your close cycle: Everyone is impressed by a short close cycle: it's the best evidence you can present that a finance department is efficiently run.

But trying to shorten the cycle by adding people to the information-gathering stage is a recipe for disaster: too many stakeholder relationships is fatal to accountability.

At Enron, it was found that thousands of employees were sending hundreds of spreadsheets a day—and that 24% of those spreadsheets contained data or formula errors. Increasing the number of people involved simply increased the margin for mistakes.¹³

The biggest opportunities to shorten the cycle are enabled by [process management](#), [cultural changes](#), and [technology](#), all of which can be leveraged to run account reconciliations in parallel with the critical path rather than in the middle of it.¹⁴

Keep teams small and lines of accountability clear. If you need to speed up your close cycle, look to a technical or cultural solution before you consider recruiting.

Risk 3. Too many spreadsheets: Spreadsheets are manual and ad hoc—meaning it's easy for a junior employee outside the finance team to accidentally replace a multiplication sign with a division sign and create a self-replicating error that gets manually rekeyed into the finance system.

16% of large companies in the UK found more than ten pieces of inaccurate information in accounts spreadsheets in 2014.¹⁵

Understand the spreadsheets that your lines of business are using to report financial data, and wherever possible replace them with automated processes that pull in real-time data. Where spreadsheets are unavoidable, create and own them in Finance for maximum control.

Risk 4. No public accountability: Speed and accuracy come when everyone is publically accountable for their work. Erich Hunziker, former CFO of Roche, refers to the 'brutal openness of peer pressure' in the system he set up whereby any employee could go in and see the reporting status of every entity in the group. Managers hated it—but it built a new culture of responsibility and hitting deadlines.

Ensure that if teams are slow or inaccurate, their peers can see the problem—it can be as simple as a shared calendar with a clear color scheme for those who have fallen behind or made mistakes.

Risk 5. Globalizing without simplifying: Ambiguous accounting rules proliferated after 2008. For international businesses, the smartest response is to simplify your reporting. Globalization adds complexity to the finance function without offering any economies of scale: doing business in five markets is (more or less) five times harder than doing business in just one.

If the business is expanding, reporting needs simplicity. In periods of multinational growth, focus on metrics that are meaningful, clear and absolutely consistent in every market.

¹³ [People.engr.ncsu.edu: papers](http://people.engr.ncsu.edu/papers)
<http://people.engr.ncsu.edu/ermurph3/papers/icse-seip-15.pdf>

¹⁴ [Oracle: 5 Minutes on Modern Finance](http://www.oracle.com/us/cio-docs/5-minutes-modern-finance-br-2210880.pdf)
<http://www.oracle.com/us/cio-docs/5-minutes-modern-finance-br-2210880.pdf>

¹⁵ [Telegraph: Stupid errors in spreadsheets could lead to Britain's next corporate disaster](http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11518242/Stupid-errors-in-spreadsheets-could-lead-to-Britains-next-corporate-disaster.html)
<http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/11518242/Stupid-errors-in-spreadsheets-could-lead-to-Britains-next-corporate-disaster.html>

IV.

WHAT CAN FINANCE DO TO REDUCE HUMAN ERROR IN OTHER DEPARTMENTS?

There are tricky little clauses in Sarbanes-Oxley and post-2008 legislation in many countries that make CFOs liable to criminal charges if they don't have accurate data about what is going on in their businesses.

To some extent this is an acknowledgement of the great job that finance departments are doing. Gathering complete, accurate and timely data about a company's core business functions is regarded as a solved problem, and failing to do so can therefore be punished.

In a traditional model, qualitative information can take a long, winding path to the CFO's door. The people on the ground reassure their managers that everything is fine. The managers tell the regional heads that the business is in great shape. The regional heads tell the CFO that things are just awesome—and then everyone wants a pay rise.

Meanwhile, the quantitative data continues to show rising costs and falling revenue

An integrated digital business is different: the path is shorter and more direct. The CFO's team should be able to gather qualitative information straight from the source for a clear understanding of the business that can be fed through to shareholders. How to shorten the journey is covered in more detail in our digibook on [Thriving in the Digital Age](#).

When it comes to quarterly and annual reporting, the most important thing is to ensure that sensitive content is handled appropriately. Empowering employees with tools alone is not enough. A CFO needs to draw on their mandate to implement a cultural change throughout their organization to make data handling accurate, consistent, and confidential.

1. Choose change agents—excellent communicators who share your vision—to educate your employees on handling data.
2. Standardize your workflows so that you can quickly identify where problems are arising and why.
3. Don't let the process become a complex web reliant on local idiosyncrasies.
4. Peer pressure is your friend again here: publically identify stakeholders who make claims they cannot support or allow errors to creep in.

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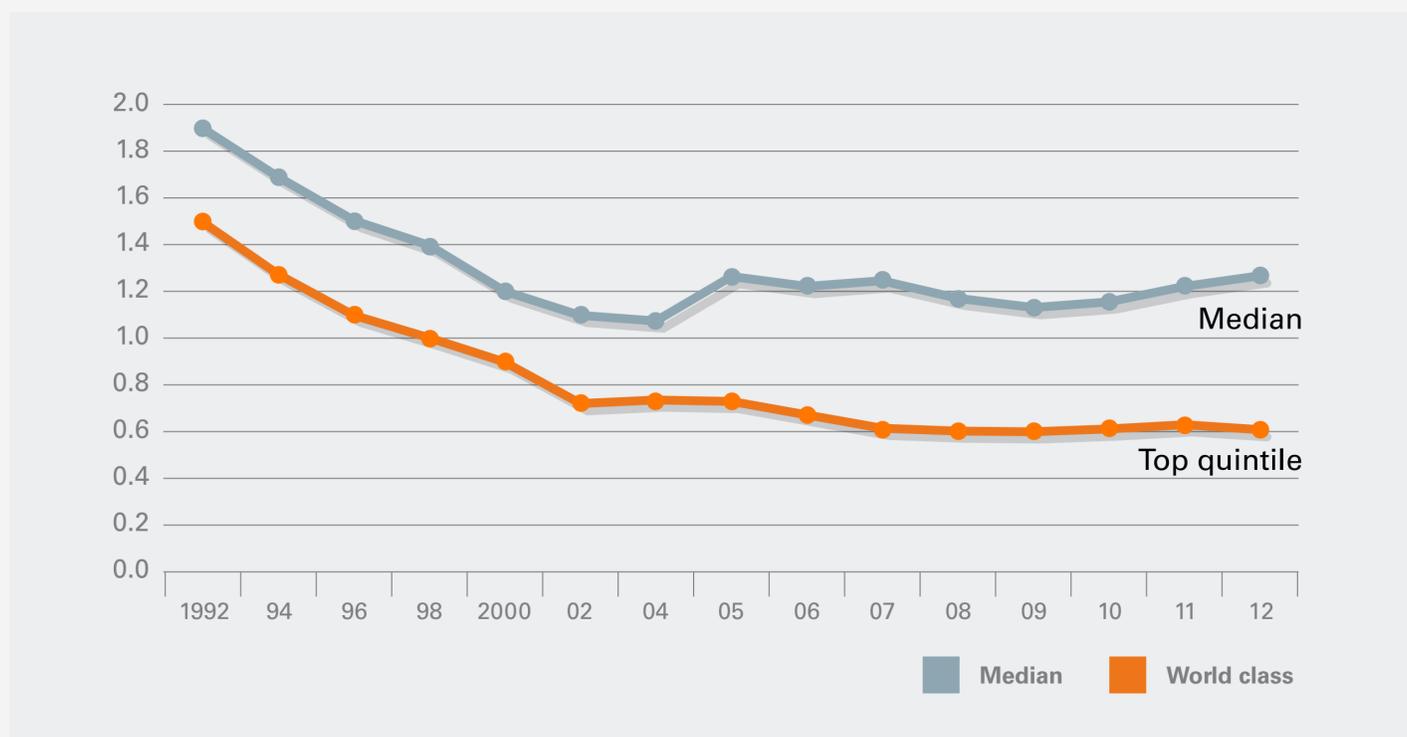
HOW TO INCREASE EFFICIENCY IN THE FINANCE DEPARTMENT

Are you practicing what you preach? If you're demanding that every other department is lean, hungry and smart, then you have to be the leanest, hungriest and smartest of them all.

Fortunately, finance departments excel at efficiency. Since 1992, the cost of the finance department has halved as a percentage of enterprise turnover.

More recently, the role of the finance department has increased in scope and difficulty. But, as the chart shows, the very best finance departments have kept these costs low.

FIGURE 4: FINANCE COST AS PERCENTAGE OF REVENUE: GLOBAL 1000 COMPANIES¹⁶



There are three steps that these top CFOs are taking to keep this upward trend under control:

Step 1. Set relative targets: In order to maximize efficiency—and therefore set the best example—it's too easy to just focus on being better than other departments, or on setting simple percentage targets.

Your real competitors for efficiency are the finance departments of other companies your size—set these up as moving targets to keep your team ahead of the game.

Step 2. Invest in analysts and tools together: A good modern system will generate terabytes of data and gigabytes of reports. You need to get the highest value from this information. And that means spending time or money on implementation and analysis.

A rough rule of thumb is 10,000/1: for every \$10,000 you spend on analytics tools and vendor implementation, expect employees to spend one day's work in the first year of use on getting the most out of it.

So if you've spent \$1,000,000 on bringing in additional data, you should expect your current team, and the other departments that need to gather and implement the data, to be *seriously* stretched if they're going to make sense of all those new live metrics.

Ensure you're getting true value from your dashboards by freeing up the human capital to use them properly.

¹⁶ Data from the Hackett Group, quoted in *The Chief Financial Officer*, Jason Karaian, 2014

Step 3. Test your metrics' values: Along with the big external disclosures, your team will also be producing a set of internal reports, containing actionable versions of the same data.

Next month, take out a few graphs and spreadsheets from them.

If someone in your company complains, that means those numbers are important. If nobody notices: congratulations! You've discovered a 'filler' piece of data. Stop reporting it, and you'll save time and (more importantly) remove some complexity from your system.



BUILDING YOUR ACTION PLAN

Use this checklist to build your action plan

WHICH OF THE FOLLOWING DO YOU NEED TO DO?

1. Qualitative reporting

- Set up an annual stakeholder survey
- Identify a narrative around your business
- Find the things in your industry that you think are too obvious to point out: Make sure these are built into the top-line profit and loss figures
- Increase your focus on intangibles

2. Analysis and disclosure

- Choose two from fast, accurate and sophisticated, and accept that while you are changing these, the third metric should stand still
- Reduce the number of employees involved in the disclosure process
- Cut down on use of spreadsheets
- Make each department publically accountable for its failures
- Simplify your reporting as your business expands internationally

3. Reduce human error in other departments

- Shorten the journey that information has to take
- Choose change agents to spread a culture of better reporting
- Standardize your workflows
- Eliminate local idiosyncrasies
- Publically identify stakeholders who have failed on speed or accuracy

4. Increase efficiency in the finance department

- Set relative targets for your team
- Invest in analysts and tools together
- Test the value of your metrics using your internal reporting