Deloitte.

Issue 9
June 2013

Deloitte Financial Reporting Survey Series

Perspectives on annual reporting
Surveying annual reports – 2012

Executive summary

The annual report is an important communication tool for directors and management to share their views on the company's performance, position and progress during the period. Previous surveys have focused on the financial reporting component which typically makes up 55% of the annual report, in order to understand current financial reporting practices, and how they change over time due to changes to standards, regulation and industry practice. However, a period of stability in standard setting has resulted in few changes to financial reporting practice.

As a result, this year our survey delves into the other components of an annual report – in particular management commentary and corporate governance disclosures. The Companies Act 1993, NZX Listing Rules and other legislation provide some minimum requirements for disclosure in these areas, but companies get to decide how to "tell the story" of their performance to shareholders and other stakeholders. In particular, there are few requirements specified for management commentary, and much international debate on what management commentary should look like. This has led to considerable variation in the extent of reporting by the companies in our survey with some providing the minimum information on performance for the year, and others providing detailed reports including discussion on the entity's business model, objectives and strategies, achievement against targets set to achieve those objectives, and information on how the company impacts the wider community.

From our perspective, the better reports provide more information than is currently required by legislation and the NZX Listing Rules. These reports used imagery (such as business cycle diagrams, maps, icons, graphs and tables) to provide an overview of the business model, linking results to objectives and strategies so that the reader could understand what the entity was trying to achieve and how they performed against those goals.

We acknowledge that more guidance might be helpful for companies to consider when preparing their annual reports but this comes with a caution. We certainly don't want to see the disclosure overload situation that is a common complaint about financial statements. Companies should have some flexibility to decide what information is of most use to their shareholders and other stakeholders and how best to present it. For most companies, 2013 will also be a period of stability. However, companies with December balance dates will need to consider the adoption of new standards on accounting for investments in other entities and fair value measurement, and issuers will need to consider the NZX Listing Rules changes requiring disclosure of the company's gender mix of directors and executives and information on the company's diversity policy (if there is one). 19 companies already provide disclosure on their diversity policy, with differing views expressed on what diversity involves. Current practice in this area is explored further in section 3 of this report.

In addition, guidance issued by the Financial Markets Authority around reporting non-GAAP measures (i.e. underlying profit) will need to be implemented by issuers. We consider this guidance against current practice in Issue 10 of our survey series *Underlying profit 2012*.

We will continue to follow the companies in our sample to see how reporting practices evolve as these (and other) requirements change.

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Survey details

The Deloitte Financial Reporting Survey Series has been following the financial reporting practices of New Zealand companies since 2009. This year the survey extends to include reporting practice across the entire annual report, incorporating management commentary and corporate governance disclosure practices. Our focus is on the annual reports of a sample of 100 companies complying with NZ IFRS and IFRS, with a separate sample of 30 companies taking advantage of differential reporting concessions. The sampling methodology is outlined in the Appendix. The objective of the survey is to build an understanding of how entities apply the reporting requirements in practice, and we will continue to follow these companies to see how reporting changes over time due to the changing influences of rules, recommendations, regulators and industry practice.

Survey results for 100 companies complying with NZ IFRS and IFRS

The annual report is an important communication tool for directors and management to share their view on the company's performance, position and progress during the period. These messages are typically delivered in the following components:

Commentary

The Companies Act 1993 requires details of material changes in the nature of the business of the company or the class of business in which the company has an interest. In addition, a commentary on the results for the period is a requirement under the Listing Rules for the preliminary announcement in respect of a full year. As a result, many companies include a Chairman's Report, a Managing Director's Report and other information in the annual report regarding the performance of the company and the events that have occurred during the reporting period. We consider the nature of commentary provided further in section 1.

Financial statements

The Companies Act 1993 requires financial statements to be provided in the annual report. For the companies in our sample, the format and content of financial statements are driven by New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS). We consider the financial reporting disclosures further in sections 4 - 8.

Corporate governance disclosures

Corporate governance requirements are specified in the NZX Listing Rules and in guidance is used by the Securities Commission (predecessor to the Financial Markets Authority). We consider these further in section 2. In addition, from 31 December 2012 listed companies are required to provide disclosures on diversity as a result of changes to the NZX Listing Rules. We consider this further in section 3.

Statutory information

Various legislation (such as the Companies Act 1993, Securities Markets Act 1988 and other entity, sector and industry specific Acts) and the NZX Listing Rules specify other information that should be included in the annual report. We have not considered these disclosures as part of this survey.

Sections 1 - 8 provide an overview of the 2012 annual reports of a random sample of 100 companies complying with NZ IFRS. Information on how the survey population was selected is set out in the Appendix. An overview of the profile of the companies in the sample including balance date, industry, length of reports etc. is included in section 8.

1. Telling the story

The number of pages of management commentary and analysis provided in the annual report ranges from 0 to 74 pages

22 companies provide detailed information on the company's strategies and objectives

10 companies report critical KPIs against the company's strategies and objectives

The annual report commentary is an important communication tool for directors and management to share their views on the company's performance, position and progress during the period as a complement to information provided in the financial statements. There are no specific requirements on what should be included in the commentary, except to provide detail of material changes in the nature of the business of the company or the class of business in which the company has an interest under the Companies Act 1993. As a result, directors and management have flexibility to determine what information should be shared with shareholders and other stakeholders.

In practice, the lack of guidance and differences in the complexity and size of entities in the survey leads to variability in reporting as companies navigate the difficult balance between providing sufficient relevant detail to users, but keeping it succinct so that the key messages aren't lost in "disclosure overload".

This begs the question – what should be included in management commentary?

While there is no one answer, there has been a lot of discussion internationally on this topic. One of the more recent international developments has come from the International Integrated Reporting Committee (IIRC) which is developing an international framework for integrated reporting with a consultation draft currently on issue. The IIRC defines an integrated report as *"a concise communication about how an organisation's strategy, governance, performance and prospects lead to the creation of value over the short, medium and long term"* (as summarised on the IIRC website: **http://www.theiirc.org/**). While it is early days yet for the development of this framework it demonstrates a move towards more integrated reporting between narrative commentary and financial reporting.

There are frameworks on issue that can be followed by companies unsure of what disclosures to provide as summarised overleaf.

Annual report commentary – examples of frameworks and requirements in other jurisdictions

- **IASB Practice Statement Management Commentary:** The International Accounting Standards Board (IASB) issued a non-mandatory practice statement in December 2010, which was also released in New Zealand as an optional document. It sets out the principles, qualitative characteristics and elements of management commentary that are needed to provide users of financial reports with useful information, while retaining flexibility for companies to determine how the principles will be implemented. The elements they consider should be included cover – nature of the business, management's objectives and strategies for meeting the objectives, the entity's most significant resources, risks and relationships, the results of operations and prospects, and the critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives.

- **The Global Reporting Initiative (GRI) Framework:** The GRI is an international organisation that has developed a framework for reporting on an organisation's economic, environmental and social performance. The guidelines (G3.1) include topics for disclosure across the following categories: strategy and profile, economic, environmental, social: labour practices and decent work, human rights, society, product responsibility. In 2010 the Securities Commission noted that the GRI is *"widely considered a leading standardised framework for environment, social and governance (ESG) reporting"* and recommended that entities adopt the GRI framework. We identified seven companies in our sample that made reference to the GRI framework. We note that G4.0 was issued in May 2013.

We also note that in other jurisdictions there are more extensive requirements for the annual report. For example:

- **United Kingdom:** The UK's Companies Act 2006 requires companies to include a business review in their directors' report. This would include an analysis of the development and performance of the company during the financial year and the position at the end of the year, a description of the principal risks and uncertainties of the company, analysis using financial key performance indicators (KPIs) and where appropriate other KPIs (e.g. environmental and employee matters). Quoted companies should also provide (to the extent necessary) the main trends and factors likely to affect the future development, performance and position of the company's business, information about environmental matters, the company's employees and social and community issues, and information about persons with whom the company has contractual or other arrangements which are essential to the business of the company. In addition the UK Corporate Governance Code requires the annual report to contain an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company. The Code recommends including this with the business review.

- **Australia:** The Corporations Act 2001 requires entities to provide an operating and financial review. This should include information that shareholders would reasonably require to make an informed assessment of the entity's operations, financial position, business strategies and prospects for future financial years.

The detail of these frameworks and overseas regulatory requirements differ, but there are some common themes as to what information might be included:

- The business model
  - What the entity does – industry, markets, regulatory and macro-economic environment
  - Objectives and strategies for adding value
  - Risks faced by the entity
  - Prospects
- Performance during the year including assessment against KPIs
- Impact of the entity on the wider community - environment, employees, stakeholders, community (also referred to as sustainability information).

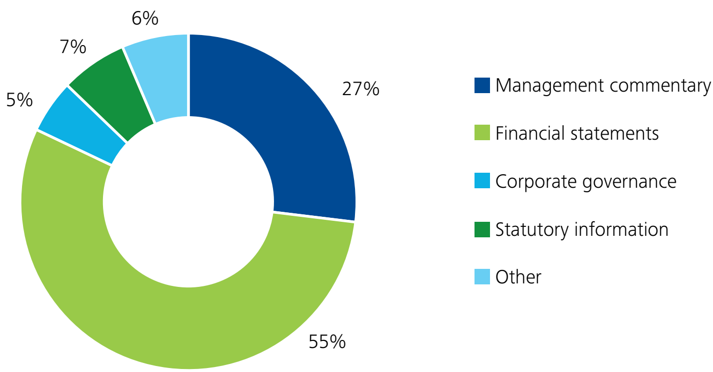
Let's be clear – this information is not mandatory in New Zealand. Even if there is agreement that information across these topics could be useful for shareholders and other stakeholders, how detailed should it be and is the annual report the right place for it? We certainly wouldn't want to see the disclosure overload situation that is a common complaint about financial statements (refer section 7). We note that there is a proposal in the UK which would take the strategic information (strategy business model, risks) out of the annual report, with links through to the financial statements and remuneration disclosures.

We expect that debate will continue internationally on this topic. In the meantime, companies are continuing to make decisions on what to include in their annual (and interim) reports – so we asked the following series of questions in respect of the 2012 annual reports for the 100 companies in our sample to get an understanding of current practice.

What is the extent of annual report commentary?

The average annual report is made up of the components as shown in Figure 1. "Other" captures information such as cover pages, glossary, contents, shareholder meeting information or proxy forms.

Figure 1: What is the profile of an average annual report?



Commentary on an entity's results including director reports, financial commentary and trend analysis, takes up on average 21 pages. However the range varies widely from no information to 74 pages, which is not surprising given the lack of formal requirements in respect of management commentary.

Do companies use the GRI or IASB frameworks?

In total, seven companies made reference to the GRI. Two of these companies used the framework as a tool for strategic planning, and the other five companies had a more complete application of the framework's reporting guidelines, with three also receiving independent assurance on their reporting.

No companies made any reference to the IASB's practice note, although this is not required by the practice note.

What information is provided on the entity's business model?

What the entity does – industry, markets, regulatory and macro-economic environment, resources

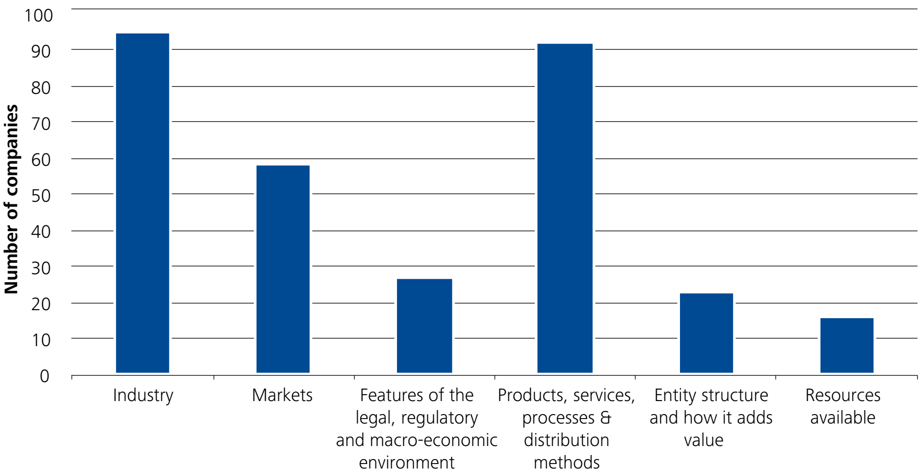
The most common disclosures provided were in respect of what the entity does, particularly around the industry they operate in, and the products and services provided, as shown in Figure 2.

We note that it was easier to understand the entity's business model when it was presented through imagery instead of text, such as through the use of business cycle diagrams and maps of resources and markets.

Objectives and strategies for adding value

22 companies gave detailed disclosure of the entity's objectives and strategies, setting out priorities for action. Another 44 companies provided a high level comment on the entity's strategy such as a "growth strategy". In setting out the company's strategy, only 13 companies explained how success would be measured.

Figure 2: What information is provided about the entity?



Risks faced by the entity

Risk disclosures were provided by 16 companies, although detailed risks were only provided by four companies. The others gave categories of risks instead such as "operational", "financial", "regulation" risks. Corporate governance principles recommend that *"the board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks."* This includes some disclosure on how this is achieved in the annual report as discussed further in section 2. Financial reporting standards also require disclosures in respect of financial risks which are explored further in section 7.

Prospects

An entity's prospects is more commonly discussed through narrative discussion, with 81 companies providing some form of forward looking comments in respect of the company's prospects. For example.

- *"We expect to deliver a more than 100% improvement in normalised earnings before tax in the 2013 financial year."*
- *"We are well positioned to take advantage of future market opportunities as they arise.*
- *Expect to see continued overall gradual improvement in the markets that our businesses are positioned in..."*
- *"Outlook for next 12 months is for a continuation of current market conditions."*

Of the companies providing comments, 27 gave one or more quantifiable measures, covering expectations for dividend payments, projections for profit, or about percentage growth in demand. Some of these were prefaced with comments about "difficult" or "challenging" conditions to alert the reader to the risk that these expectations may not eventuate. Six companies provided detailed disclaimers about forward looking commentary setting out the assumptions made and risks that the information may differ materially from those projected or implied.

What information is provided on performance during the year including assessment against KPIs?

The result of operations was commonly disclosed, particularly for financial performance with 92 companies providing detail in this area. 53 companies also provided information on significant changes in financial position, often in respect of debt arrangements or changes in working capital.

A lot of measures are provided by companies to explain their performance, with measures located on introductory pages with images or icons, in a separate financial commentary, spread throughout the director or CEO commentary or in the five year trend analysis. These were often provided in isolation with no explanation as to why they were important measures, and sometimes to explain a trend identified by management. We identified ten companies that clearly outlined the critical measures used to assess the achievement of the entity's objectives.

Overall, 67% of measures are financial measures and 33% non-financial. Examples of the financial measures used include:

- earnings per share
- distributions per share
- return on average capital employed
- free cash flow
- gearing
- operating margin
- net debt
- and others.

We discuss the non-financial measures overleaf.

Sustainability

New Zealand entities are not currently required to provide information on sustainability in their annual report, although the Securities Commission has previously noted that reporting on environmental, social and governance matters are recommended in order for issuers (and public sector entities) to meet the corporate governance principle that *"The board should respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose."* (refer section 2 for further discussion on the corporate governance principles).

As a result of the corporate governance principle, information on stakeholder relationships was provided by 32 companies with 13 companies saying how they impact the entity. Of these six companies also explained how the relationships were managed. The more informative disclosures were provided by companies following the GRI framework. For example, one company provided a table identifying the key stakeholders, what interaction the company has with them, the key interests and concerns those stakeholders have, and how the company responds to those interests and concerns.

Deloitte's Director 360° survey issued in December 2012 interviewed 288 directors in 19 countries around the world on the topic of board effectiveness and the issues, challenges and opportunities that boards face. Included were 29 New Zealand directors. This survey noted that 69% of the New Zealand directors interviewed considered that sustainability and corporate social responsibility (CSR) are becoming more important to the board (similar to the global result of 68%).[1]

[1]Deloitte's Director360° 2012: *Degrees of progress* is available at: **http://www.deloitte.com/assets/Dcom-NewZealand/Local%20Assets/Documents/Services/Audit/Directors%20Survey/FINAL%20nz_en-Director-360-survey.pdf**

Internationally, some jurisdictions already require or are considering sustainability type reporting either in an entity's annual report or elsewhere. As noted earlier, this is already a requirement in the UK. We also note that the European Commission adopted a proposal in April 2013 for a directive which would require large companies to disclose information on the major economic, environmental and social impacts of their business as part of their annual reporting cycle.

As a result of increasing interest in sustainability and CSR reporting, we have considered what information companies currently include on these topics in their annual report.

Overall, we noted that 46 companies made a statement of support for sustainability and/or corporate responsibility practices. For example:

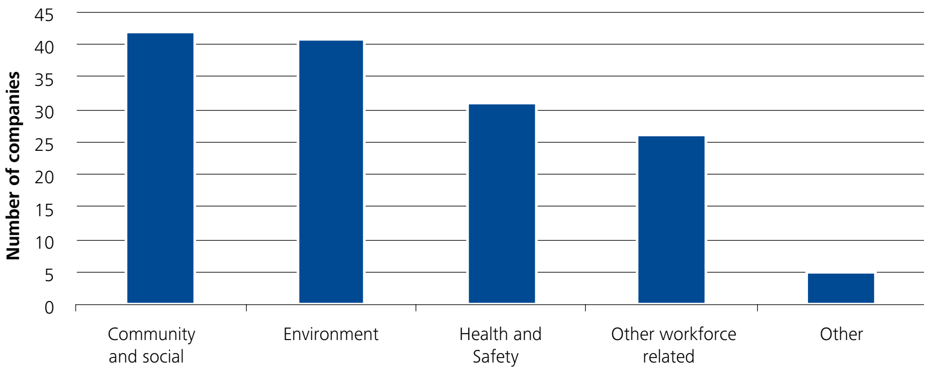
- *"We are committed to managing our impact on the environment and believe that we have an important role to play in contributing to sustainable development"*
- *"The Company is strongly committed to acting in a socially responsible manner with all stakeholders, including the wider community"*
- *"…is committed to operating sustainability and contributing to the communities in which we operate"*
- *"We remain firmly committed to leading the uptake of sustainability practices into our business operations"*
- *"…is committed to managing and developing its business in a sustainable manner and to minimising the environmental impact of its activities"*

The type of information provided by companies is shown in Figure 3 with the most common disclosures relating to community and social information followed by environmental information.

For the companies providing these disclosures, the average number of pages dedicated to sustainability/CSR information within the annual report is 3.3 pages with the maximum at 14.6 pages (excluding corporate governance disclosures). This company provided a detailed report in accordance with the GRI framework. In total seven companies made reference to the GRI which led to a higher average number of pages dedicated to sustainability information at 8.4 pages.

The type of information provided varied. Some companies profiled community projects they were involved in, or initiatives implemented to reduce waste or other environmental impacts.

Figure 3: What type of sustainability/CSR information is provided?



Other companies provided specific targets they were aiming towards and how they had met those targets. Examples of the types of targets set included:

- reducing water consumption, waste generation, greenhouse gas emissions, transport emissions etc.
- zero harm (to employees, communities and stakeholders)
- improving employee engagement
- staff turnover rates
- reduced level (or zero) lost time injuries
- stakeholder satisfaction
- number of stakeholder engagement meetings held
- investment in community projects
- and others.

Five companies referred to separate reports on sustainability, available on the company's website.

Summary

Management commentary varies significantly across the survey population with some companies only commenting on current year results, and others providing detailed information on their business model, risks, results and sustainability. From our perspective, the better reports provide more information than is currently required by legislation and the NZX Listing Rules. These reports used imagery (such as business cycle diagrams, maps, icons, graphs and tables) to provide an overview of the business model, linking results to objectives and strategies so that the reader could understand what the entity was trying to achieve and how they performed against those goals.

As noted earlier more guidance might be helpful for companies to consider when preparing their annual reports but this needs to be flexible, to deal with companies of different sizes and complexity, and balanced to avoid dlsclosure overload. Debate also continues internationally around "integrated reporting" which aims to concisely bring together information on how an organisation's strategy, governance, performance and prospects lead to the creation of value over the short, medium and long term. We look forward with interest as to how this develops.

2. Corporate governance policies and procedures

37% of companies identify how they comply with both the NZX Code and SC Principles in respect of corporate governance	**86% of companies have a majority of non-executive directors**	**77% of companies have at least 1/3 independent directors**	**56 different board committee labels were used**

Corporate governance guidance for New Zealand issuers comes from two key sources:

- The NZX Listing Rules with reference to the Corporate Governance Best Practice Code (the NZX Code), and
- The Securities Commission (predecessor to the Financial Markets Authority) publication titled: *Corporate Governance in New Zealand Principles and Guidelines, A Handbook for Directors, Executives and Advisors* (the SC Principles).

The NZX Listing Rules (10.5.5(h)) require a statement of any corporate governance policies, practices and processes, adopted or followed by the Issuer to be disclosed in the annual report. Paragraph 10.5.5(i) of the NZX Listing Rules require a statement on whether and, if so, how the corporate governance principles adopted or followed by the issuer materially differ from this best practice code. This could be by providing a clear reference to where such a statement may be found on the issuer's public website. We noted that 90 companies included detail on their corporate governance policies, practices and processes in the annual report, but only 73 companies provided detail on their compliance with the NZX Code (out of the 85 listed companies in the survey population).

In addition to this statement in the annual report, the NZX Code notes that issuers should identify in their annual report the members of their audit committee, remuneration committee and nomination committee. We comment on these requirements below, in conjunction with our consideration of the SC Principles.

The Securities Commission publication (originally issued in 2004) sets out nine principles of corporate governance with guidelines that issuers could apply for each. The guidelines were intended to help entities think about how they can achieve each principle. Some principles include areas for disclosure in annual reports and this survey focuses on those areas, and other matters where implementation of the principles can be readily identified in the annual report.

We have considered the SC Principles in respect of our full sample of 100 companies. While not all companies in our sample are issuers, the principles are equally relevant for public sector entities. References to the annual report are to the sections of the report excluding the financial statements and audit report except where specified.

Principle 1: Directors should observe and foster high ethical standards

This principle notes that every entity should publish its code of ethics and that annual reports should include information about the steps taken to implement a code of ethics and monitor compliance, including as appropriate any serious instances of unethical behaviour and the action taken. The NZX Code also requires an issuer to formulate a code of ethics.

73 companies provided information about the entity’s approach to ethics in the annual report, noting as a minimum that there is either a focus on ethics, or that the entity has a code of ethics. No companies reported any serious instances of unethical behaviour, six specifically said there were no instances and the other entities reporting on ethics remained silent in that respect. The remaining 27 companies made no reference to ethical standards.

Principle 2: There should be a balance of independence, skills, knowledge, experience and perspectives among directors so that the board works efficiently

Securities Commission suggestions	Survey results
A majority of directors should be non-executive	86 companies have a majority of non-executive directors. Five did not and information was not provided by the remaining nine companies
A minimum of one third of directors should be independent	One third or more of directors were independent for 77 companies. Six had less than one third independent directors, and information was not available for the remaining 17 companies
The chairperson should be independent	68 companies have an independent chairperson and 19 did not. It was not possible to tell for the remaining companies
Annual reports should include information about each director, identify which directors are independent and include information on the board's appointment, training and evaluation processes	17 companies provided detailed information. 47 companies provided some of the recommended information – with detail on training the most common area not covered

Principle 3: The board should use committees where this would enhance its effectiveness in key areas while retaining board responsibility

The 100 companies in our sample disclosed 253 committees with 56 different names. The most common committee titles are:

- Audit Committee
- Audit (or Assurance) and Risk Committee
- Nominations (or Appointments) Committee
- Remuneration (or Compensation) Committee

Examples of other committee titles included:

- Treasury Committee
- Investments Committee
- Corporate Governance Committee
- Health & Safety Committee
- Finance & Risk Committee
- Nomination & Corporate Governance
- Health, Safety and Environment Committee

Despite the differing names, it appears that:

- 92 companies disclosed that they had an audit committee or equivalent,
- 83 companies disclosed that they had a remuneration committee or equivalent, with three companies noting that the full board takes this responsibility, and
- 54 companies disclosed that they had a nomination committee or equivalent, with 15 companies noting that the board takes this responsibility and four companies stating that they select a committee as needed.

The SC Principles recommend that the charter and membership of each committee is published for investors, but does not require this disclosure in the annual report. However the NZX Code does require issuers to identify in their annual report the members of their audit committee, remuneration committee and nomination committee.

We noted that 60 companies provided the membership of their committees in the annual report. This information is often included with the director profiles, or in the corporate governance section.

Principle 4: The board should demand integrity both in financial reporting and in the timeliness and balance of disclosures on entity affairs

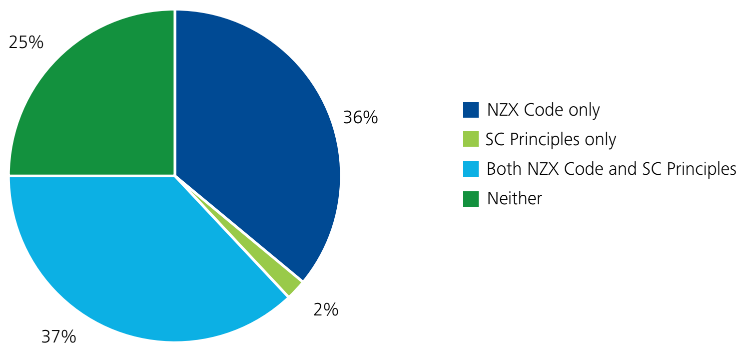
One of the guidelines is that the chief executive, CFO (or equivalent) and at least one other director should certify in the published financial reports that they comply with generally accepted accounting practice (GAAP) and present a true and fair view of the financial affairs of the entity.

Under the Financial Reporting Act 1993, two directors are required to approve the financial statements so the certification recommended is broader than that requirement.

Two companies have the CEO, CFO and two directors certifying the financial statements. 16 companies disclosed that the CEO and CFO provide this certification to the Directors. The remaining 82 companies did not provide this disclosure.

Both the NZX Listing Rules and the SC Principles ask boards of issuers to report to investors on how the entity is implementing the NZX Code/SC Principles and to explain any significant departures from the guidelines supporting each principle. Figure 4 shows whether reference is made to the NZX Code or the SC Principles with 75 companies making reference to one or both of these. Of the 75 companies, five mention the

Figure 4: Is reference made to the NZX Code and the SC Principles?



guidance but do not comment on whether they have implemented the guidelines, and 24 companies disclose that they only partly comply.

The most common departures from the NZX Code and SC Principles relate to:

- not having a nomination committee or remuneration committee, and
- not having any performance based remuneration for executives.

Principle 5: The remuneration of directors and executives should be transparent, fair and reasonable

The SC Principles note that disclosure of the entity's remuneration policy should be included in the annual report. 46 companies provided this information, with one company setting out the policy for the chief executive officer, but not for other executives. The remaining companies did not disclose the policy under which remuneration is set, although some of these companies did not have employees, instead operating under management agreements with third parties.

The guidelines also recommend that executive remuneration packages include an element that is dependent on entity and individual performance. 45 companies disclosed in the annual report that they had this sort of executive remuneration package with two main types of arrangements discussed:

- a cash bonus based on achieving individual and entity level targets – often used as a short term incentive based on targets set annually, and
- a share scheme arrangement, used more commonly for the longer term achievement of entity goals.

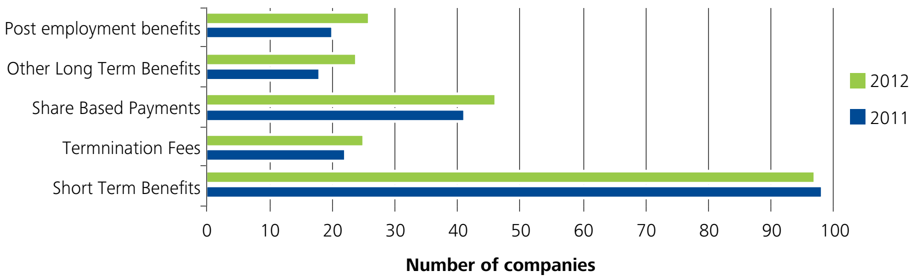
Short term incentive arrangements are typically set annually with a maximum amount achievable split between achievement of individual goals, and company goals (such as financial performance).

Long term incentives are often based on a three year period that the executive must remain with the company in addition to achieving other targets. The most common measure was reaching a specified target for Total Shareholder Return (13 companies), earnings per share (6 companies) with others referring to growth in share price, EBITDA or Economic Value Added (EVA). Details of hurdles were not always provided.

Directors fees are typically fixed within a maximum possible amount approved by the shareholders. Equity based remuneration is not common for directors. Two companies disclosed that they reimburse directors in shares for a portion of the fixed fee until a set level of shares are held by the director. Two companies noted that directors are encouraged to hold shares and one company required directors to hold a specified level of shares during their term as a director.

Accounting standards also require disclosure in the financial statements of remuneration paid to key management personnel (KMP) who are *"those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity".* This disclosure is typically included in the related party note (76 companies). There are five categories of disclosure to provide (where relevant) as shown in Figure 5. Short term benefits are the most common including salaries, leave entitlements and directors fees.

Figure 5: What types of compensation are paid to key management personnel?



Principle 6: The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks

The SC Principles recommend that issuers report annually on risk identification and management.

The Securities Commission stated in a report on their *Review of Corporate Governance Disclosure by Selected Issuers*[2] that *"few issuers disclose information on any significant risks affecting their business. This is a serious deficiency that must be addressed in the corporate governance disclosures of New Zealand entities."* They noted that improvements could be made by including information on the entity's business model, risk appetite and nature and magnitude of material risks and how those risks are managed.

We identified disclosures around risk in the annual reports of 47 companies but only four companies provided detail of specific risks. Another 12 companies disclosed the categories of risks they are exposed to such as "operational", "financial", or "regulation" risks. The financial statements of companies also discuss financial risks – more information on those disclosures is included in section 7.

Principle 7: The board should ensure the quality and independence of the external audit process

As noted earlier, most companies have an audit committee responsible for ensuring the quality and independence of the external audit process. The SC Guidelines recommend that boards of issuers report annually on the amount of fees paid to auditors, differentiating between fees for audit and other services, and should explain what non-audit work was undertaken and why this did not compromise auditor independence. We noted that:

- Fees paid to auditors are disclosed in the financial statements by all companies, although one company did not explain what services were provided for the amount disclosed as non-audit fees. 14 companies also provided information on fees paid to auditors in the annual report.
- 11 companies confirmed the independence of the auditors in the annual report. We also note that the audit report includes a section on auditor independence.
- 31 companies noted that they had a policy on what services the auditor can and cannot do with five of these companies providing a detailed summary of the policy in the annual report.

[2]Securities Commission Review of Corporate Governance Disclosure by Selected Issues is available at: **http://www.fma.govt.nz/keep-updated/reports-and-papers/review-of-corporate-governance-disclosure-by-selected-issuers/**

Principle 8: The board should foster constructive relationships with shareholders that encourage them to engage with the entity

The guidelines provided do not include any particular disclosures for the annual report but do specify that publicly owned entities should have clear published policies for shareholder relations, and a website that maintains up to date information on the entity (such as corporate governance documents, information released to the stock exchange, commentary on goals, strategies and performance etc.).

We note that 53 companies disclosed a shareholder relations policy in the annual report.

Principle 9: The board should respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose

The guidelines for stakeholder interests also do not include a requirement for disclosure in the annual report, instead specifying that there should be clear policies for an entity's relationships with significant stakeholders taking into consideration the nature of the entity's ownership. These policies should be assessed for compliance with the code of ethics and the law and to ensure it is within broadly accepted social, environmental, and ethical norms, subject to the interests of the stakeholders.

24 companies disclosed their policy for stakeholder relationships, and of these, six companies provided detailed information on the nature of existing key relationships and how they manage those relationships.

The Securities Commission stated in a report on their Review of Corporate Governance Disclosure by Selected Issuers that *"to meet Principle 9, the Commission recommends entities to report on Environmental, Social and Governance (ESG) matters relevant to each entity's purpose, nature and relations".* The Commission also noted that the GRI is *"widely considered a leading standardised framework for ESG reporting"* and recommended that entities adopt the GRI framework. Further discussion on the use of the GRI framework by companies in our survey is included in section 1. We note that some of the more informative stakeholder relationship disclosures were from entities following the GRI framework.

3. Diversity

On average, 13% of Board members and 14% of executives are female

19 companies disclosed that they had a diversity policy

There are differing views as to the definition of diversity

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 an issuers directors and officers as at the balance date (comparatives are not required in the first year of adoption, but are required subsequently). 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.

To aid companies in considering this requirement in 2013, we have considered where disclosures are already provided by the companies in our survey, highlighting examples of current practice.

Gender composition

The requirement to provide a quantitative breakdown of gender composition of directors and officers was only applicable for issuers in our sample with a 31 December 2012 balance date. Four out of the seven issuers with a December balance date provided a specific disclosure in this respect. However, in total 21 companies in our survey provide information on gender composition. As this disclosure is also an Australian Stock Exchange (ASX) requirement, dual listed companies are already providing this information.

As many annual reports provide profiles of directors and the executive team it is possible to identify the gender composition of these groups.

We were able to determine the gender composition of the Board for 93 companies. On average 13% of Board members are female, with a maximum at 50%.

In respect of the executive team, we were able to determine this information for 46 companies, with a similar result to the profile of the Board. On average 14% of the executive team is female, with a maximum at 50%.

Do companies disclose that they have a diversity policy?

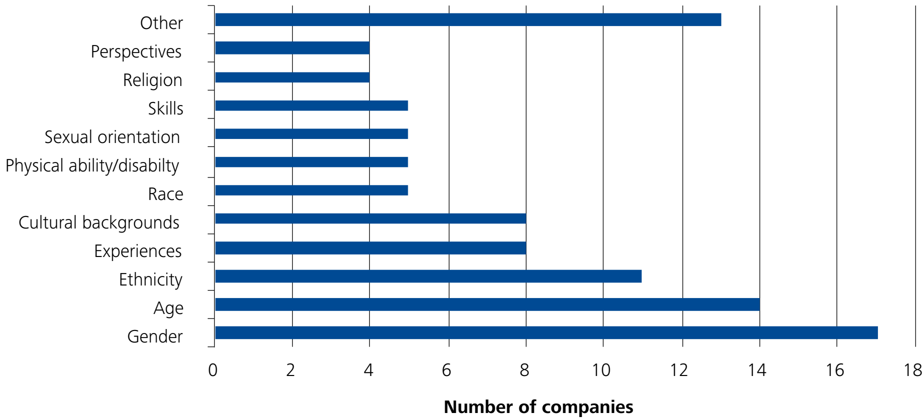
19 companies in our survey noted that they had a diversity policy. For example:

- *"The focus of the policy is to leverage differences as a competitive advantage through its attraction and development practices, develop inclusiveness as a core capability for its people leaders and as a channel to its people, and to continue to recognise individual contribution and performance"*
- *"The value of diversity is recognised as beneficial to decision making, improving and increasing corporate and shareholder value and enhancing the probability of achieving [Entity's] objectives ("the Principle"). [Entity] ensures that it has strategies, initiatives and practices to promote the Principle, Management monitors, reviews and reports to the Board on [Entity's] progress under this policy"*
- *"[Entity's] Diversity Policy enshrines the Company's commitment to diversity and sets out the respective responsibilities of the board, the Human Resources and Compensation Committee and management in relation to building diversity across the organisation"*
- *"The Company has a Group wide Diversity Policy which reflects the Company's commitment to diversity and provides a structure for, and complements, the Company's diversity related initiatives and policies"*

What is considered to be diversity?

Where disclosure is provided, there are differing views as to what is considered to be diversity with gender, ethnicity and age the most common areas discussed as shown in Figure 6.

Figure 6: What do companies consider to be diversity?



Some examples of what companies define as diversity are as follows:

- *"We value diversity in culture, age, gender, thinking styles and preferences"*
- *"Diversity is about recognising and appreciating the variety of differences between people in an organisation. It includes gender, age, disability, religion, race, sexual orientation, family circumstances and ethnicity"*
- *"[Entity] defines diversity as the characteristics that make one individual similar to or different from another. It defines inclusion as the recognition that diverse backgrounds, experiences and perspectives lead to a better experience of work for its people, makes teams stronger, leads to greater creativity and performance, contributes to a more meaningful relationship with its retail service provider customers and stakeholders and ultimately lead to increased value to shareholders"*
- *"Our diversity is represented in various ways including gender, age, origin, race, cultural heritage, language and physical ability"*

Are measureable objectives set related to diversity?

Of the 19 companies with a diversity policy, only seven provided measureable objectives against which they evaluate the issuer's performance in respect to its diversity. These companies were predominantly dual listed on the ASX. The ASX Corporate Governance

Council included a series of diversity recommendations in its corporate governance recommendations in 2010. The ASX Listing Rules require listed entities to benchmark their corporate governance practices against these recommendations and disclose where they do not confirm and the reasons why in their annual report. As a result, the level of New Zealand companies providing this disclosure is driven by their compliance with Australian requirements.

Some examples of targets established include:

- Building a database on ethnic diversity in the workforce
- Median age target based on Statistics New Zealand National Labour Force Projections
- Employee satisfaction target
- Flexible working arrangements – including a target percentage for staff working part-time hours
- Conduct an analysis of the current state of diversity in the global organisation – representation by organisational strata, representation by occupational group, retention rates and attraction and recruitment rates. Gender and age done first, other diversity dimensions (e.g. ethnicity) is a priority
- Source best practice diversity representation benchmarks and strive to achieve top quartile performance against appropriate peer comparator companies
- Establishing initiatives to increase the proportion of women in senior leadership roles
- Monitoring recruitment processes to ensure effectiveness in sourcing candidates from a wide talent pool
- Targets that 33% of the Board, Executive Team and Senior Management Team should be female and 50% of employees should be female.

We also noted one entity which specifically commented that it did not set specific targets for gender diversity because they consider that *"a merit based approach is the only appropriate approach for selection and promotion of employees and executives, and for determining the composition of the Board".*

Guidance on diversity disclosures

We note that the NZX issued a guidance note in December 2012 in order to assist issuers. The guidance includes suggestions as to the content of a diversity policy and provides examples of measurable objectives that issuers may wish to set. The guidance note focuses 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.

4. The financial year in perspective

53 companies saw an improvement in profit before tax	**22 companies made a loss after tax (consistent with the prior year)**	**The level of impairments, onerous contracts and restructuring costs dropped to $878 million (from $1.1 billion)**

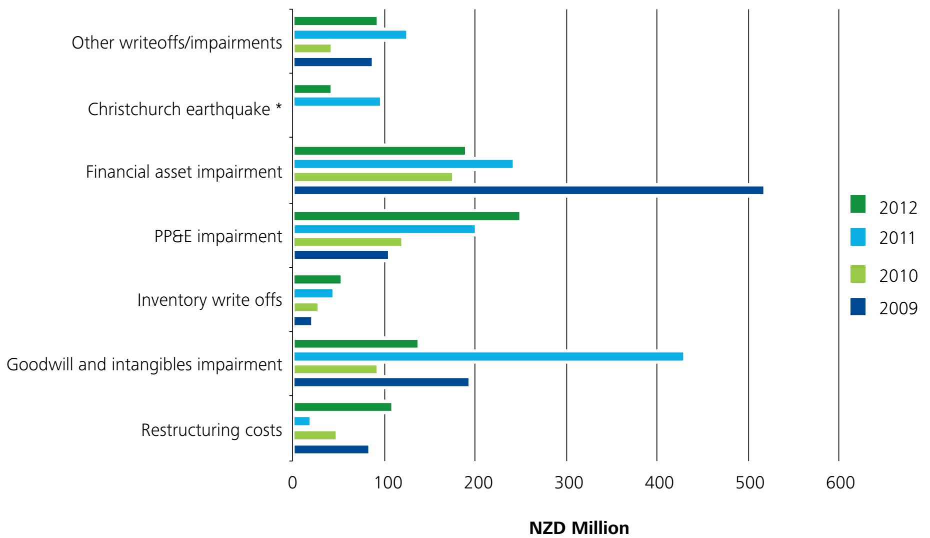
2012 Annual Reports continue to reference the challenging global economic environment, but are generally more positive in respect of the year ahead. For example:

- *"despite volatility in world markets.. the longer term outlook…is very optimistic"*
- *"expect to see continued overall gradual improvement in the markets that our businesses are positioned in..."*
- *"We are targeting continued positive earnings and CF growth for 2012-13. However, conditions in all markets are fickle and uncertain and as a consequence we have deemed it would be imprudent to provide guidance on the level of growth that we might achieve."*
- *"While we are expecting increased revenue from most international markets in local currency terms in the coming year the continued high NZD will negate much of this growth."*
- *"Despite this rather bearish background [Entity] is optimistic that a stable level of tax-paid profit can be achieved for the 2013 financial year"*

In terms of the financial result for 2012 annual reports, 53 companies in our sample saw an improvement in profit before tax, although this increased to 55 companies when considering profit after tax. While 45 companies saw a reduced profit after tax, only 22 companies made a loss after tax, consistent with the prior year result.

Figure 7 sets out the costs recorded for impairment, onerous contracts and restructuring since 2009. In total, these costs decreased from $1.1 billion in 2011 to $878 million in 2012. 2010 had the lowest level of impairments at only $510 million. The main source of impairments in 2012 was from property, plant and equipment impairments. Partially offsetting these costs were earthquake recoveries of $160 million (2011 $63 million) and other recoveries of $88 million (compared to $41 million in 2011).

Figure 7: What impairment and other related costs were incurred?



* Some companies offset their earthquake recoveries against their costs so this number will be less than the actual costs incurred.

5 . Presentation of the primary statements and accounting policies

Presentation of the primary statements remained largely consistent with the prior year	**15 companies made 28 reclassifications of items leading to changes in comparative information**	**One company provided a third balance sheet as a result of correcting an error**

Financial reporting standards require consistency in reporting year on year. As a result we do not expect there to be significant movements in the presentation of the primary statements or accounting policies unless there are new or amended standards or interpretations requiring a change in treatment or presentation. In 2012, there were no significant changes in accounting standards or interpretations, so as expected companies had consistent reporting compared to their previous financial reports.

In summary

Order of statements:

- The most common order to present the primary statements is to start with the statement of comprehensive income (as either one or two statements) followed by the statement of changes in equity, balance sheet and cash flow statement (or other naming conventions used as appropriate). This order was presented by 59 companies (PY: 60 companies). 29 companies modified this order by swapping the balance sheet and statement of changes in equity (PY: 27 companies).

Statement of comprehensive income:

- 50% provide a single statement of comprehensive income, with the other 50% providing two statements (a separate 'income statement' and a 'statement of comprehensive income').
- The average number of lines from the top of the income statement to the profit after tax total, ranged from seven to 36 lines (PY: six to 32 lines) with an average of 18 lines (PY: 18 lines), higher than the minimum six lines prescribed by NZ IAS 1: *Presentation of Financial Statements.*
- Expenses are most commonly presented by nature (60%) as opposed to function (28%) or mixed (11%).
- 65% of companies provide subtotals on the face of the income statement that are not required by NZ IAS 1 such as earnings before interest, tax, depreciation and amortisation (EBITDA), or operating profit before gains and losses, finance costs and tax. For more information and guidance on reporting underlying profit measures refer to Issue 10 in the Deloitte Financial Reporting Survey Series.
- The most common items that companies classify as other comprehensive income are cash flow hedges (60%) followed by translations of foreign operations (49%). 53% disclose their items of other comprehensive income gross with tax shown for each item either on the face of the statement or in the notes.

Statement of changes in equity:

- The most common presentation of the statement of movements in equity is to show profit or loss, other comprehensive income and transactions with owners in equity by reserve. However, 20 companies combine profit or loss with other comprehensive income (showing one line as total comprehensive income) and seven companies disclose equity in total with movements by reserve included in the notes to the financial statements.

Balance sheet:

- 93% of companies presented a balance sheet with current and non-current subtotals and 7% presented it in order of liquidity.
- The most common reserve presented, other than share capital and retained earnings, was a cash flow hedge reserve (65%). NZ IAS 1 requires a description of the nature and purpose of each reserve within equity.4% of companies did not explain the nature and purpose of their reserves (PY 3%) and 14% only explained some of their reserves in the summary of accounting policies (PY 13%).

- Consistent with last year's survey, the most common provisions held are for rectification work (20 companies) such as making good leased properties at the end of the lease term, and warranty obligations (20 companies). There were also 10 companies with restructuring provisions.

Cash flow statement:

- While operating cash flow was positive for 84% of companies surveyed, only 41% had positive total cash flow.
- All companies used the direct method to present their cash flow statement with a reconciliation of operating cash flows to net profit after tax provided with the statement by 22% of companies (PY: 19%) with the remaining companies providing the reconciliation in a separate note.

Accounting policies:

- Accounting policies often take up a significant proportion of the statements. Excluding items that are not strictly accounting policies (critical judgements and estimates, reporting standards in issue but not yet effective, basis of preparation, statement of compliance and company information) on average 14% of financial statements (PY 13%) are accounting policies with nine companies giving more than 20% of their financial statements to explaining their accounting policies.
- We continue to identify accounting policies where there is no underlying transaction or balance. For example:
  - 20 companies had an accounting policy for research and development expenditure with no underlying activities
  - Five companies had a cash flow hedging policy with no derivatives identified as hedging instruments and no cash flow hedge reserve, and
  - 26 companies had a fair value hedging policy with no underlying activity.

  If these policies are no longer relevant, they could be removed.

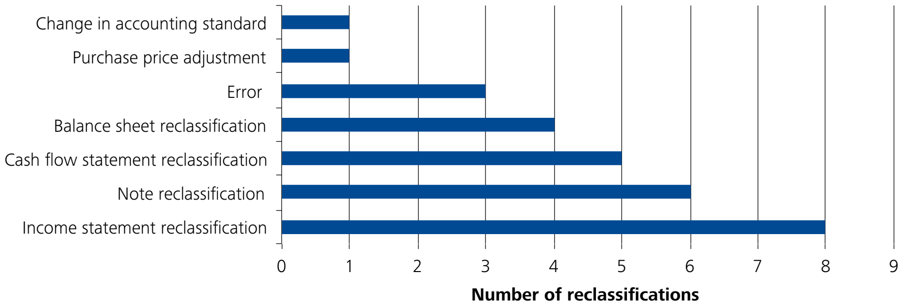
Changes in presentation

The areas that led to changes in presentation included reclassifications, discontinued operations and business combinations.

Reclassifications

15 companies made 28 reclassifications in the financial statements as shown in Figure 8. Most of the reclassifications had a net nil impact on profit being either reclassifications within the income statement (moving items between income and expenses or to change categorisation of expenses), or within the balance sheet or cash flow statement. All of the balance sheet reclassifications resulted in movements between current and non-current assets.

Figure 8: What was the nature of reclassifications made?



One of the reclassifications resulted in the provision of a third balance sheet in the financial statements, as required by NZ IAS 1 when *"an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements"*. This company restated a liability due to an error. Ten reclassifications included disclosure that the change did not impact the opening balance sheet, and the others remained silent.

In addition to the companies disclosing reclassifications, 14 companies (PY: 17 companies) included a generic sentence in the financial statements to the effect that *"certain comparatives have been restated to ensure consistency of disclosure with the current period"* with no information as to what the restatement was.

Business combinations and discontinued operations

Business combinations and discontinued operations can lead to a change in presentation, and the additional disclosures required under NZ IFRS 3: *Business Combinations* and NZ IFRS 5: *Non-current Assets Held for Sale and Discontinued Operations* also have an impact on the length of the financial statements. In the current year 25 companies had business combinations and 10 companies had discontinued operations.

6. Critical estimates and judgements

333 major sources of estimation uncertainty were disclosed	38% of estimates included information on the sensitivity of the estimate to possible changes in assumptions	In goodwill impairment testing the average growth rate applied was 2.6% and the average discount rate used was 12.1%

In preparing financial statements, entities have to make decisions about outcomes that are subjective or uncertain. NZ IAS 1 requires disclosure of:

- the critical judgements, other than those involving estimations, made by management in the process of applying the entity's accounting policies. These are described as those judgements that have the most significant effect on the amounts recognised in the financial statements, and
- the major sources of estimation uncertainty (referred to as 'estimates') at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

The purpose of these disclosure requirements is to enable stakeholders to understand the areas of the financial statements that are the most subjective, and which could have a material impact on the financial statements if different judgements or assumptions were made.

The level of disclosure in respect of these matters has not changed significantly compared to previous surveys. We identified 60 companies which disclosed 81 critical judgements (PY: 58 companies with 82 judgements), and 95 companies which disclosed 333 major sources of estimation uncertainty (PY: 94 companies with 335 estimates).

Most companies (67%) do not clearly distinguish between their judgements and estimates, and it wasn't always clear what the source of the judgement or estimation uncertainty was. For example, if the reference was "tax" it wasn't clear if this was an estimate around future profits to utilise tax losses, or a judgement on whether an item is deductible. As a result the number of critical judgements and major sources of estimation uncertainty provided required some judgement on our part.

The most common judgements disclosed included:

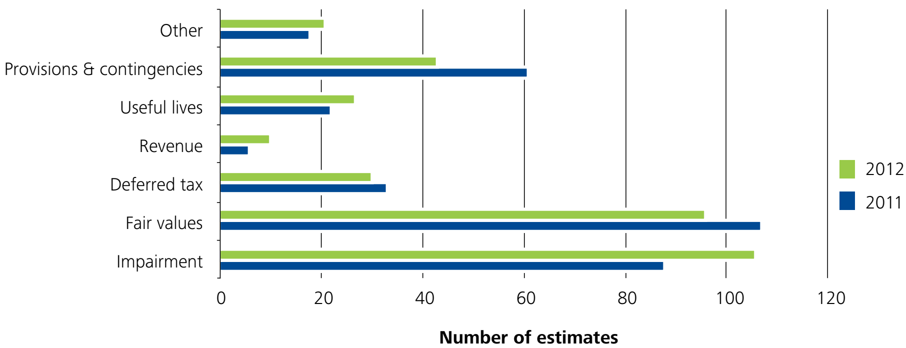
- Recognition of deferred tax – 19 companies (PY: 17 companies)
- Timing of revenue recognition – 12 companies (PY: 14 companies), and
- Whether there are indicators of impairment – 8 companies (PY: 9 companies)

Consistent with last year's survey, the most common sources of estimation uncertainty discussed were in relation to impairment and fair value measurement (mostly in relation to financial instruments, investment property and property, plant and equipment), as shown in Figure 9.

The sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including reasons for sensitivity, were provided for 38% of estimates disclosed (PY: 39%). This includes companies that provided the reasons why it was impracticable to determine the sensitivity of the estimate to possible changes in assumptions.

We did note some particularly informative sensitivity disclosures, mostly in relation to goodwill impairments. Some examples of informative disclosures are provided overleaf.

Figure 9: What topics do the major sources of estimation uncertainty disclosures cover?



Example 1: Impact of reasonably possible alternative assumptions on the key assumptions used in a value in use model

The assumptions used in the valuation were separately disclosed, followed by a table setting out the impact on the valuation within a range of reasonably possible alternative assumptions.

Assumption	Low	High	Valuation impact
Weighted average cost of capital	x%	x%	$x / ($x)
Other assumptions...			

Example 2: Impact of changes in discount rates in a value in use calculation

The following table shows the effect on the recoverable amount of [CGU] resulting from different discount rates. The most material assumptions used in the calculation of the value in use is the13% discount rate:

Discount rates				
11%	**12%**	**13%**	**14%**	**15%**
$x	$x	$x	$x	$x

Example 3: Sensitivity of useful life assumptions for useful lives of assets for depreciation purposes

Depreciation expense

A significant amount of judgement is used when determining the useful lives of the Group's [nature of] assets for depreciation purposes. This is especially so for the Group's longer lived assets.

Sensitivity analysis:

If the estimated useful lives of the [nature of] assets was x% higher/lower, operating profit for the year would have increased/(decreased) by $x/($x) (PY $X/($X)).

Example 4: Sensitivity of property, plant and equipment

The following table outlines the key assumptions used in preparing the valuation of [asset type]. The table shows the movement in fair value as a result of the change in assumption and keeping all other valuation inputs constant.

Assumption	Base case	Sensitivity	Valuation impact
Assumption 1	x%	+/- x%	$x / ($x)
Assumption 2	x million p.a.	+/- x million p.a.	$x / ($x)

Example 5: Sensitivity of provision

The assumptions used to estimate the [provision type] require a balanced judgement as there are a range of possible assumptions that could be used in estimating the carrying value of these obligations. The current assumption is that [describe the current assumption]. If [possible scenario 1], the provision would need to increase by up to $x. If [possible scenario 2], the provision would need to decrease by $x.

Goodwill impairment

59 companies held goodwill on balance sheet totalling $8.8 billion, an increase on the prior year amount of $8.2 billion due to business combinations taking place during the year and a lower level of goodwill impairments than experienced in prior years (refer section 4) at $139m (PY $429m). The most common method for determining impairment of goodwill is to do a value-in-use calculation with 50 companies using that method. Three companies used a fair value approach, one company used both methods but for different cash generating units (CGUs) and the remaining five companies did not disclose the method used. Methods used to determine fair value included discounted cash flow analysis and multiple of earnings.

In determining the value in use of CGUs when testing for impairment of goodwill and indefinite life intangible assets, companies are required to disclose a description of the key assumptions used, management's approach to determining the value assigned to each key assumption, the period over which cash flows have been projected, the growth rate used to extrapolate cash flow projections and the discount rate used. The period over which cash flows are projected was typically set at 5 years prior to applying a terminal growth rate (59 companies) which is the maximum period recommended in NZ IAS 36: *Impairment of Assets.* 16 companies used a period in excess of five years.

The graphs below show what the range of assumptions used were for long term growth rate assumptions (Figure 10) and discount rates (Figure 11). For companies where these disclosures were made, the average growth rate used was 2.6% and the average discount rate applied was 12.1%.

Figure 10: What are the long term growth rate assumptions used?

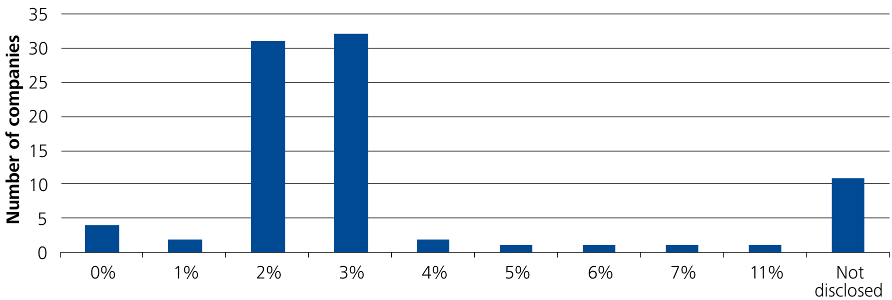
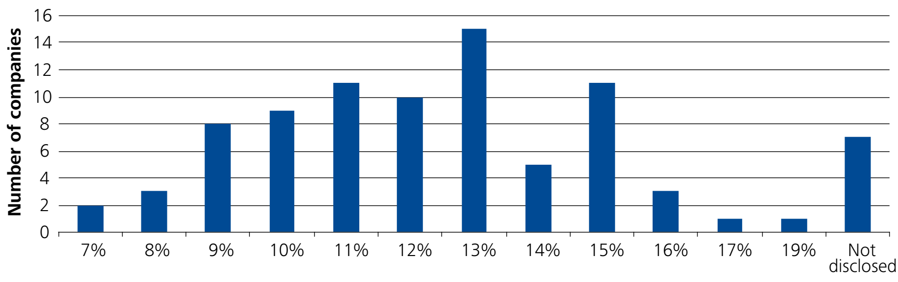


Figure 11: What are the discount rates used?



If a reasonably possible change in a key assumption would lead to the carrying amount of a CGU (or asset) to exceed its recoverable amount then sensitivity analysis is required. No sensitivity information was provided by 21 companies with goodwill (PY: 22 companies), although this may be because any reasonably possible change would not impact the carrying amount. 28 companies disclosed that any change in assumption would not lead to impairment, for example: *"Any reasonably possible change in the key assumptions on which the recoverable amount is based would not cause the aggregate carrying amount to exceed the aggregate recoverable amount of the CGU."*

7. Disclosure and other matters

The "Disclosure Problem"?

Over the last few years there have been significant concerns from many that the financial statements are becoming too difficult for investors to come to grips with because of disclosure overload. Last year the IASB consulted on its agenda for projects going forward and received feedback that it needs to review the existing disclosure requirements in IFRS and develop a disclosure framework to deal with this problem. In respect of a framework, the IASB has recommenced its project on the conceptual framework and one of the topics included is disclosure which is *"likely to set out principles relating to materiality, aggregation and the purpose of notes"*[3] . However, there have also been calls for a reduction in specific disclosures included in standards. In January 2013, the IASB conducted a Discussion Forum to discuss the work various bodies have already undertaken in this area, what issues users, preparers, standard-setters, auditors and regulators think need to be addressed and whether there are any immediate steps that could be taken in this area. As part of this work they conducted a survey, where 80% of respondents were of the view that there was a "disclosure problem".

The IASB will be considering actions to take in the short to medium term as a result of matters raised at the Disclosure Forum. In the short term, the IASB will consider whether to develop educational material or guidance on materiality, will look to draft disclosure requirements in new exposure drafts using less prescriptive language and will consider narrow scope amendments to IAS 1. In the medium term, the IASB's aim is to develop a disclosure framework, including a review of IAS 1, IAS 7 and IAS 8 which are the standards that set out the general disclosure requirements for the financial statements. The IASB's report from the Discussion Forum is available at: **http://www.ifrs.org/Alerts/PressRelease/Documents/2013/Feedback-Statement-Discussion-Forum-Financial-Reporting-Disclosure-May-2013.pdf**

[3]Discussion Forum – Financial Reporting Disclosure: Feedback Statement, May 2013 issued by the IASB. Available at: **http://www.ifrs.org/Alerts/PressRelease/Documents/2013/Feedback-Statement-Discussion-Forum-Financial-Reporting-Disclosure-May-2013.pdf**

Materiality

Participants at the Disclosure Forum identified difficulties around the application of materiality to disclosures. As a result, we wanted to understand whether the concept of materiality was being used by the companies in our sample to reduce disclosures. We identified:

- three companies which did not disclose share based payment arrangements as they were not considered material
- five companies that did not provide disclosure for business combinations that were not considered to be material, and
- one company that did not value a liability or provide the disclosures in respect of that liability due to materiality.

Other materiality references were provided for sensitivity disclosures such as litigation outcomes (in the contingent liability note) which are not expected to have a material impact and foreign currency or interest rate risk sensitivities which were not material.

We have not attempted to identify all circumstances where judgement around materiality was applied. The above comments relate to disclosure where materiality was specifically referenced. There are other examples in practice where companies appear to have exercised judgement around materiality without specifically disclosing that an item was not material. For example, property, plant and equipment (PP&E) being incorporated in "other assets" instead of in a separate line on the face of the balance sheet, and the reconciliation disclosures for PP&E not being provided as a result.

Based on these results we can see that judgement around materiality is being made by some companies in New Zealand.

Financial instrument disclosures

On average, 14% of the financial statements is dedicated to disclosures on financial instruments, covering both the quantitative disclosures such as categorisation of financial instruments, and qualitative disclosures such as risk management.

Most companies are exposed to financial risks such as market risk, liquidity risk and credit risk. As these risks can affect the recoverability of assets, valuation of investments and ability of the entity to pay its debts as they fall due, these are typically considered to be important disclosures.

Market risk sensitivity

A sensitivity analysis is required for each type of market risk that the company is exposed to. Most companies in our sample provided a sensitivity analysis primarily for interest rate and foreign exchange volatilities, where applicable to their business. Companies must determine what a reasonably possible change in exposure could be and disclose the possible impact on profit and equity. The most common reasonably possible change is 100 basis points (bps) for interest rate risk sensitivity and a 10% variation for foreign currency sensitivity.

We identified 16 companies that did not provide foreign currency sensitivity and ten companies that did not provide interest rate sensitivity analysis, it is possible that exposure was considered to not be material.

Sensitivity to other price risks, such as to equity prices, oil, electricity and other commodity prices was provided by 21 companies (PY: 22 companies).

Liquidity risk

NZ IFRS 7: *Financial Investments: Disclosures* requires disclosure of how companies manage their liquidity risk (which is how they ensure they will meet their financial obligations) and 98 companies provided some information in this respect. 73 companies included comment on the extent of unused credit facilities that they had access to in order to manage this risk although the liquidity risk note often just referred to facilities being available with the quantum disclosed in another note (such as the borrowings note). Others noted that they had sufficient cash flows to meet obligations, or made reference to facilities but did not disclose any.

Credit risk

NZ IFRS 7 requires entities to provide information about financial assets that are more likely to become impaired so that users can estimate the level of future impairment losses. As a result entities must disclose financial assets that are past due but not impaired.

We identified 19 companies (consistent with the prior year) that did not provide this information for their trade receivables and 18 companies (PY: 22 companies) which provided disclosure combined with impaired items. We also identified 19 companies that did not provide an ageing of past due but not impaired items for their other financial assets. It is not possible to determine whether lack of disclosure was because there were no past due items.

Capital management disclosures

Capital risk management disclosures continue to vary between the generic and the informative. Informative capital risk management disclosures should provide users with information on the entity's risk profile and its ability to withstand unexpected adverse events and may also indicate whether an entity is able to pay dividends.

NZ IFRS requires the disclosure of information for users on an entity's objectives, policies and processes for managing capital. Detailed disclosure requirements supporting these principles are not prescribed except to require disclosure of what the entity manages as capital, whether there are any external capital requirements and how those requirements are managed. This information should be consistent with disclosure provided in the annual report. In considering the below questions, we noted several instances where the commentary in the annual report provided better analysis of changes in capital management during the year or achievement of gearing and other ratios which were not included in the financial statements.

In summary:

- 77 companies (PY: 73 companies) outlined what items on balance sheet were considered to be capital either through a table or commentary which could be reconciled back to the balance sheet. 20 companies did not provide an explanation and three companies did not provide a capital management note.
- 73 companies (PY: 69 companies) provided some information about the capital management objectives and policies, although some disclosures are more informative than others. The most informative disclosures included key ratios used to evaluate capital such as gearing or leverage target ratios and performance against them.
- Generic commentary continues to dominate with 30% providing comments such as *"the Group manages its capital to ensure that the entities in the Group will be able to continue as a going concern while maximising the return to shareholders through the optimisation of the debt and equity balance"*.
- Loan agreements continue to impose capital requirements with common covenant requirements including gearing ratios and interest cover.

Extracted examples of informative capital risk management policies

"The Group has established policies in capital management, including the specific requirements that interest cover is to be maintained at a minimum of X times and that the [debt/[debt + equity]] ratio is to be maintained at a X% maximum. It is also Group policy that the dividend payout is maintained between a level of between X% and Y% of surplus after tax."

"The Group's policies in respect of capital management and allocation are reviewed regularly by the Board of Directors… As outlined in Note X, [e.g. debt facilities renewed, extended, new facilities]"

"As a result of a review of the Group's capital structure in [date], the Directors are intending to continue to progressively increase shareholders' funds to ensure that the Group has capacity to continue to implement [ ]"

"the Group's dividend policy is to pay a dividend equal to X% of adjusted net profit (refer note X). The Group also has a stated policy of returning surplus cash to shareholders where it is not required to fund growth in the immediate future"

"…seeks to retain a modest gearing ratio of net debt to total capital funding and maintain earnings sufficient to cover its interest borrowing costs satisfactorily [detail of calculation and table setting out gearing calculation provided compared to the prior year]"

Related party transactions

The purpose of related party disclosures is to enable users to understand the possible impact of such relationships on the profit or loss and financial position of the entity, primarily because related parties may enter into transactions that unrelated parties may not. Of particular interest are transactions that do not take place on normal commercial terms. As a result, these disclosures are typically always considered to be material to the users of the financial statements.

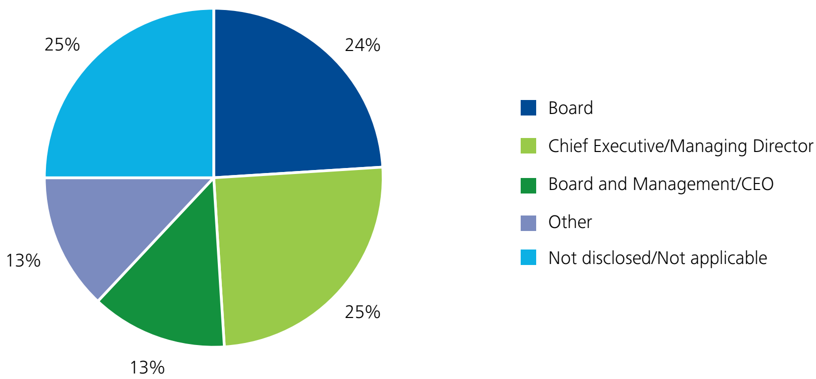
The most common related party transaction types disclosed are loans to related entities, sales/purchases, fees and transactions with directors (other than directors fees but including fees to an entity that the director manages). 74% of companies made reference to such transactions taking place on an "arms length basis" or on "normal commercial terms" (PY: 76 companies). NZ IAS 24: *Related Party Disclosures* notes that this statement should only be made if the terms can be substantiated.

Segment reporting

Segment reporting is mandatory for entities whose debt or equity instruments are traded in a public market, as well as for entities that file, or are in the process of filing, financial statements for the purpose of issuing any class of instruments in a public market. Segment information needs to be disclosed on the same basis as internal management reporting used for strategic decision making by the entity's "chief operating decision maker" so that users of financial statements can obtain a better perspective of how the business is managed.

NZ IFRS 8: *Operating Segments* does not require disclosure of who the "chief operating decision maker" is, but 75% of companies provided this information as shown in Figure 12.

Figure 12: Who is identified as the chief operating decision maker?



90 companies provided segment disclosure with 27 showing only one segment, consistent with the prior year survey. On average three segments were shown, with a maximum number of eight segments. Segments disclosed were predominantly by business type with only 14 companies giving a geographical presentation.

As the segment note is a presentation of how the business is managed, it is expected that annual report commentary would be presented on a similar basis. We identified seven companies (PY: 12 companies) who did not discuss the business in the same way as the segment reporting note. It is possible that some inconsistencies are due to the application of the aggregation criteria.

Impact of future standards

For periods beginning on or after 1 January 2013, companies will need to adopt the suite of standards and amendments relating to interests in other entities, in particular NZ IFRS 10: *Consolidated Financial Statements*, NZ IFRS 11: *Joint Arrangements* and NZ IFRS 12: *Disclosure of Interests in Other Entities.*

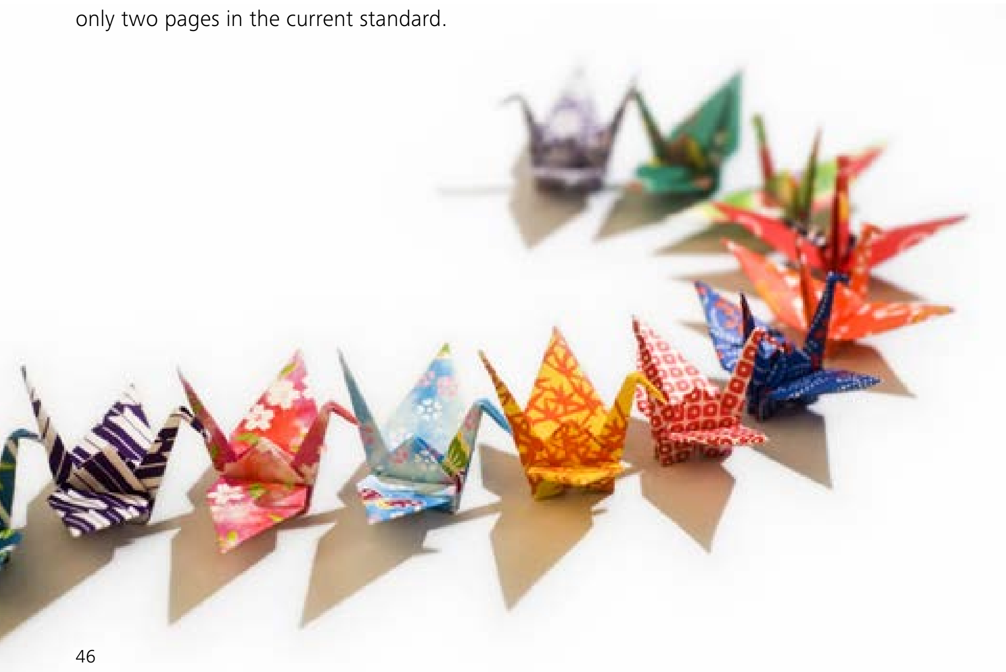
We note that 28 companies have joint arrangements which will need to reconsidered under NZ IFRS 11. In addition, the disclosure requirements of NZ IFRS 12 are much more extensive than current standards particularly in relation to companies involved with special purpose vehicles or who have subsidiaries that are not wholly owned. We expect there to be a corresponding increase in the length of financial statements as a result.

NZ IFRS 13: *Fair Value Measurement* also becomes applicable for periods beginning on or after 1 January 2013. Most companies in our sample commenting on this standard in their "standards on issue but not yet effective" note, state that this standard is expected to impact on disclosure.

A number of projects are also on the horizon. In particular, the IASB is expected to issue a final standard on revenue in the third quarter of this year, which will require all companies to reconsider their current practices around revenue recognition. In addition, the exposure draft has much more extensive disclosure requirements compared to the current standard NZ IAS 18: *Revenue.*

The IASB also recently reissued the leases exposure draft for comment. This project is expected to have a significant impact on the companies in our sample. For example, the exposure draft proposes bringing operating leases on balance sheet. The 100 companies in our sample have $8.8 billion of operating lease commitment payables disclosed in the notes to the financial statements (PY: $8.1 billion). Recording a right of use asset and lease payments liability will clearly impact on some of the key ratios used by companies such as debt to equity and net asset value measures. The exposure draft also has approximately 4.5 pages of disclosure requirements compared to only two pages in the current standard.

For most companies 2013 will be a stable year for financial reporting as the first significant changes are only applicable for companies with December balance dates. While there will be measurement and recognition impacts, the most significant differences in the new standards come from the increasing level of disclosure required. While the IASB has agreed to consider possible short and medium projects to address the "disclosure overload" problem as identified on page 39, it is as yet not clear whether these projects will be completed in time to reduce the burden of change from these new standards.



8. Profile of the survey population

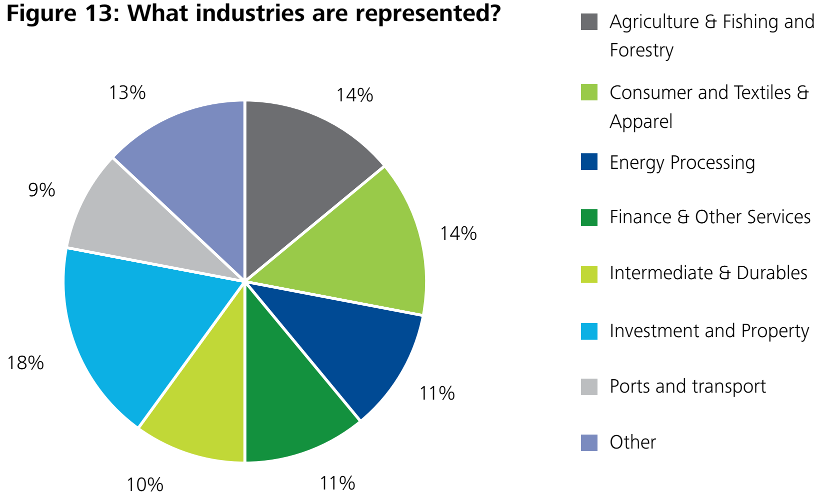
Annual report length remained consistent with the prior year survey at 78 pages	**43% increased the length of their financial statements**	**Modified audit reports dropped to seven companies (from ten in prior year)**

Of our 100 companies in the survey, 81 are listed on the NZSX, four are listed on the NZDX and the remaining 15 are other entity types (such as state owned enterprises, co-operatives and non-listed issuers) that were in the top 200 companies (by revenue) in New Zealand from the Deloitte / Management magazine article reported in December 2009.

We note that these companies continue to be in the Top 200 as reported in December 2012.

The companies represent the industries shown in Figure 13 as is consistent with the prior year, and have predominantly June balance dates (50%) followed by March (27%), December (7%) and July (6%).

Figure 13: What industries are represented?



Note: The industries shown in Figure 13 are as determined by the NZX sector groupings. Companies without an NZX industry allocation are allocated based on similarity to existing sector constituents. Some sectors have been combined as shown. The "Other" category includes entities in the following industries: Building Materials & Construction, Food & Beverages, Leisure & Tourism, Media & Telecommunications, and Mining.

Length of reports

The average length of the annual report remains unchanged compared to the prior year survey at 78 pages as shown in Figure 14. The length of the financial statements also remained unchanged – going up only marginally from 42.4 pages to 42.6 pages as shown in Figure 15. Financial statements (including the audit report but excluding trend statements or five year summaries) make up approximately 55% of the average length of an annual report, compared to 54% in the prior year. While the average number of pages remained stable, 43% increased the length of their financial statements. Some of these increases can be explained by events such as business acquisitions or disposals, but most of the increase was due to changes in formatting and other incremental changes.

Conversely, 34% of companies decreased the number of pages in their financial statements (2011: 27%). The most significant declines were due to note disclosures that were no longer required because the entity no longer had to report against prospectus forecasts or had removed discontinued operations disclosures for disposals made in a previous year.

Figure 14: What is the average number of pages in the annual report?

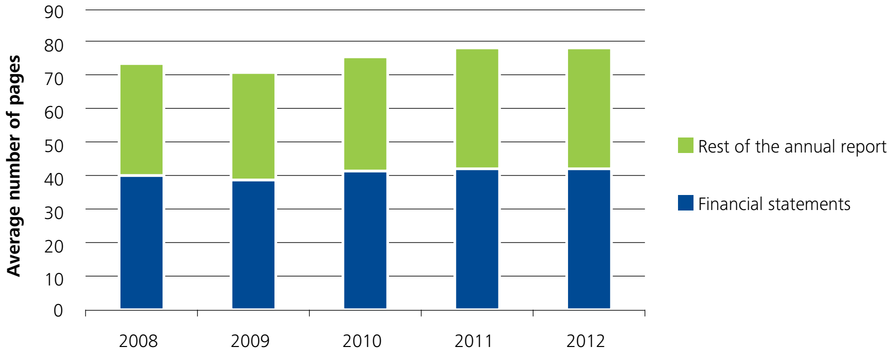
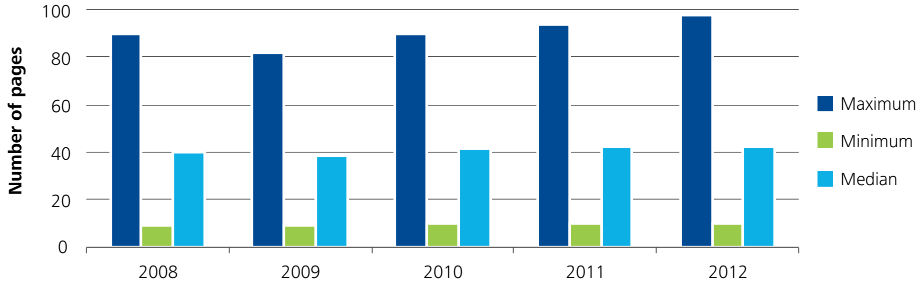


Figure 15: What is the average, maximum and minimum number of pages in the financial statements?



Speed of reporting

Listed companies
Listed companies are required to make their annual report available within three months of the end of the financial year. On average listed companies reported within 59 days of the financial year end (PY: 59 days). Other than one company with a simple balance sheet (where the financial statements were approved within 14 days of balance date), the quickest listed companies managed to approve financial statements 35 days after balance date (PY: 36 days).

Unlisted companies
Only 15 companies in the sample were not listed entities. The Companies Act 1993 requires companies to prepare an annual report within five months of balance date. Only four companies took advantage of this later deadline (PY: three companies).

Nature of Audit Reports

In 2012, seven companies had a modified audit report. One was qualified, five made reference to fundamental uncertainties due to going concern and the remaining one included an emphasis of matter to note that the financial statements were not prepared on a going concern basis. This is a decline on the prior year result when ten entities had modified audit reports but is not yet a return to the lowest point since our survey started in 2009 (four modified reports in 2010).

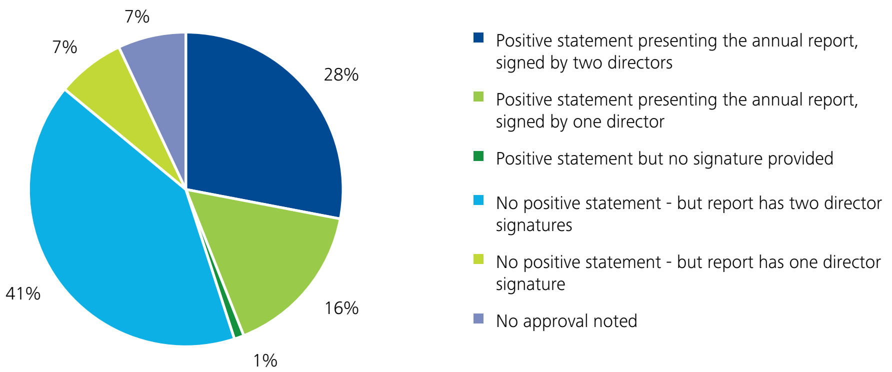
Approval of the Annual Report and Financial Statements

The Companies Act 1993 requires an annual report to be dated and signed by two directors of the company or, if the company only has one director, by that director. As shown in Figure 16, two signatures of directors were provided by 69 companies, with 28 making a positive statement presenting the annual report.

Two directors are also required (under the Financial Reporting Act 1993) to date and sign the financial statements on behalf of the directors, or, if the entity only has one director, that director. All companies had at least two signatures.

This approval was provided on the balance sheet by 45 companies, in a separate responsibility statement by 36 companies and both locations by 14 companies. The five remaining companies provided approval in other locations (such as on the income statement).

Figure 16: Is the annual report signed by two directors?



Survey results for 30 companies taking advantage of differential reporting concessions in NZ IFRS

This section of the publication provides an overview of the 2012 annual reports of a random sample of 30 companies complying with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) as applicable to entities taking advantage of differential reporting concessions. Information on the full survey population, from which the sample of 30 was selected, is set out in the Appendix.

9. Differential reporting practices

Financial statements are on average 25 pages long, consistent with prior year results

Companies report, on average, within 128 days after balance date

All 30 companies will ultimately have to report using NZ IFRS RDR

Balance dates

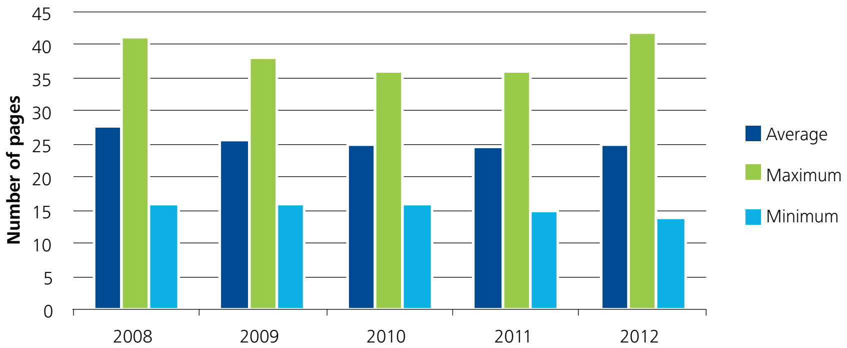
The most common balance date for companies in the sample is June (50%) followed by March (23%), and September (13%).

Length of reports

Financial statements (including the audit report) are on average 25 pages long and vary between 4 and 42 pages in length as shown in Figure 17. The average number of pages has remained stable since 2009 (2008 was the first year of adopting NZ IFRS so had additional pages discussing the transition implications). As there haven't been many changes to the accounting standards since 2009, this result was expected. This year we had to replace four companies in the sample due to financial information no longer being publically available. This impacted on the maximum number of pages reported – which comes from one of the new companies.

Differential reporting concessions have significantly reduced the disclosure requirements for qualifying entities, reflected in the average length of 25 pages compared to an average of 42.6 pages for companies that cannot take advantage of these concessions as shown on page 49.

Figure 17: What is the average, maximum and minimum number of pages in the financial statements?



Speed of reporting

The Companies Act 1993 requires companies to prepare an annual report within five months of balance date. On average, companies in our sample reported within 128 days (compared to 119 days in our prior year survey), with the quickest company in our sample managing to approve their financial statements 39 days after balance date.

Nature of audit reports

All companies had an unmodified audit report. In the prior year there was one company with an emphasis of matter in relation to going concern. This company no longer has publicly available information.

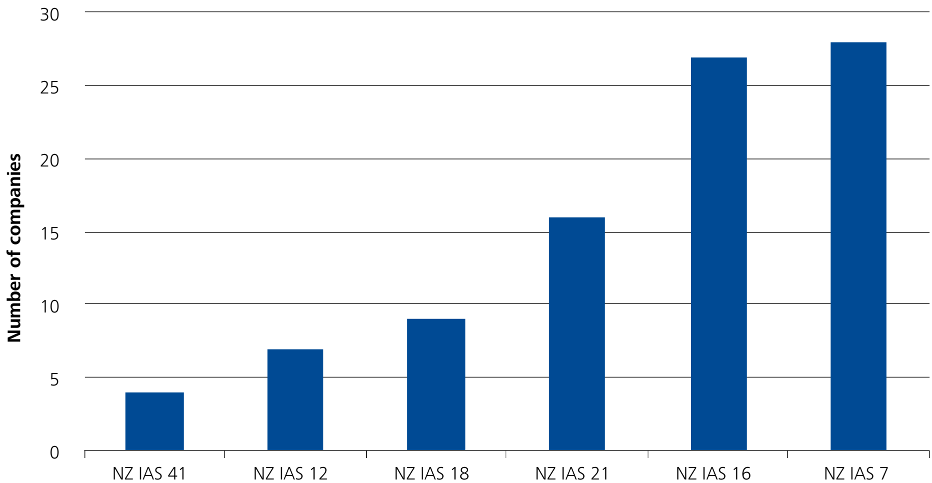
Differential reporting concessions applied

The companies in our sample meet the differential reporting criteria because they are not publicly accountable and do not have separation between owners and managers. As the survey relies on publicly available financial statements, they are typically wholly owned subsidiaries of overseas companies (so are required to file financial statements under current legislation).

We note that these companies meet the criteria for "large" under the proposed legislation (revenue over $30m or assets over $60m) so will continue to have a financial reporting requirement if the proposed Financial Reporting Bill 2012 is passed in its current form. However, when legislation is passed, the External Reporting Board (XRB) intends to remove the NZ IFRS Diff Rep framework, such that companies will have to choose between NZ IFRS or NZ IFRS RDR. For the companies in our survey, we expect that NZ IFRS RDR will be adopted.

NZ IFRS RDR only includes disclosure concessions, with the same measurement and recognition requirements as are included in NZ IFRS. As a result changes will be needed to accounting policies where concessions have been applied by entities under the NZ IFRS Diff Rep framework. Figure 21 sets out the some of the concessions being applied by the companies in our sample which will no longer be available on moving to NZ IFRS RDR.

Figure 18: Differential reporting concessions applied



In summary, the key measurement and recognition differences between NZ IFRS Diff Rep and NZ IFRS RDR are as follows:

Standard	NZ IFRS Diff Rep exemption no longer applicable	NZ IFRS RDR requirement
NZ IAS 11: Construction Contracts	Completed contract method can be used to determine the timing of profit recognition on construction contracts	Profit on a contract has to be recognised using the stage of completion of the contract, if the outcome of the contract can be measured reliably
NZ IAS 12: Income Taxes	Income taxes payable method	Income tax has to be calculated following NZ IAS 12, including deferred tax
NZ IAS 16: Property, Plant and Equipment	Tax depreciation rates can be used to depreciate items of PP&E	Assets should be depreciated over their estimated useful life
NZ IAS 21: The Effects of Changes in Foreign Exchange Rates	Settlement rate (i.e. the exchange rate ultimately paid in cash) is available for the translation of transactions in foreign currencies	The spot rate at the date of transaction has to be used to translate transactions in foreign currencies
NZ IAS 23: Borrowing Costs	Can expense or capitalise borrowing costs	Borrowing costs that meet the applicable criteria in NZ IAS 23 must be capitalised
NZ IAS 36: Impairment of Assets	Goodwill, indefinite life intangibles and intangibles not yet available for use only need to be tested for impairment when there is an indication that the asset is impaired	Goodwill, indefinite life intangibles and intangibles not yet available for use must tested for impairment on an annual basis
NZ IAS 38: Intangible Assets	• Can expense all research and development expenditure. • Tax depreciation rates are able to be used to amortise intangible assets	• Development expenditure that meets the applicable criteria has to be capitalised. • Assets should be amortised over their estimated useful life
NZ IAS 41: Agriculture	Biological assets can be measured at either cost or fair value. IRD proxies for cost or fair value of livestock are allowed	Biological assets are measured at fair value less costs to sell

While some disclosure requirements will be reduced under NZ IFRS RDR, there are new disclosure requirements including:

- cash flow statement,
- critical judgements and major sources of estimation uncertainty,
- disclosures relating to discontinued operations as included in NZ IFRS 5.

We expect that there will be an impact on the average length of financial reports once NZ IFRS RDR is adopted.

NZ IFRS RDR can be adopted for financial periods beginning on or after 1 December 2012, but companies that continue to meet the differential reporting criteria do not have to adopt it until such time as NZ IFRS Diff Rep is removed (expected to occur when the legislation is passed). We look forward with interest to see if any of the companies in our sample choose to adopt NZ IFRS RDR early.

For more information on the impact of changes to the framework for financial reporting refer to our publication: *Financial reporting framework for "for-profit" companies in New Zealand: Frequently asked questions* available at: **www.deloitte.co.nz**

Appendix: How the survey population was selected

The Deloitte Financial Reporting Survey Series has been following the reporting practices of New Zealand companies since 2009.

The survey population was initially made up of the annual reports of the top 200 companies (by revenue) in New Zealand from the Deloitte/Management magazine article reported in the Management Magazine issued in December 2010, and other NZSX and NZDX listed entities. Only those companies with publicly available financial statements are part of the population. In order to focus the survey some of the companies in the original population were removed:

- Public benefit entities were removed as they formed a small percentage of the population and often have unique disclosures. The survey instead focuses on for-profit entities.
- A small number of dual listed entities complying with the GAAP of another country were removed as their disclosures would not be consistent with entities reporting in accordance with NZ GAAP.
- Subsidiaries were removed, where the New Zealand group entity was represented in the population. For example there were some cases where the subsidiary was listed on the NZDX, and the group was included in the Top 200. They were excluded as they are already included in the group results.

Once the population was determined, it was segmented into two groups – those that report in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) and those that take advantage of differential reporting exemptions.

A random sample of 100 companies complying with NZ IFRS formed the basis of the main survey in sections 1 to 8 which focused on the 2012 annual reports of these entities compared to data collected in our surveys of 2009 - 2011 annual reports.

Section 9 considers a sample of 30 companies taking advantage of differential reporting exemptions, also focusing on their 2012 annual report.

While our aim is to follow the same companies to identify trends we had to replace two companies in our sample of 100, and four companies in our sample of 30, due to annual reports no longer being publicly available.

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

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