Guidance note

Good practice for annual reports

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1 Introduction

An annual report can generate more value if viewed as a communications opportunity rather than a compliance obligation. Excellence in reporting encourages better governance. It increases levels of trust and confidence in the governance arrangements between UK companies and their shareholders and other stakeholders. It also encourages good quality investor engagement and enables stakeholders to benefit from increased levels of transparency and accountability. In return companies can benefit from greater commitment, loyalty and support from their stakeholders.

1.1 The business case for good governance and high-quality reporting

Achieving good practice in governance delivers business benefit. Companies need to provide the evidence that they have good governance systems in place, at board level and throughout the business. Disclosure becomes an essential process for building confidence that the company will deliver value over the longer term and, at the same time, manage its risks and its reputation. Many investors believe that governance is important, so demonstrating good governance can also help to reduce the cost of capital. Corporate performance is what really matters – actions speak louder than words. But there is no conflict between what a company does, and how it reports it. Disclosure changes behaviour and improvements in disclosure can become a driver of improved governance performance. This, in turn, increases the pressure on a company to maintain and improve its operational performance.

1.2 What does good reporting look like?

The best annual reports are easy to read and give an honest appraisal – ‘warts and all’ – of the year under review. They provide real insight into the company, its strategy, how the board behaves and works, and how it manages risk. It demonstrates transparency and an absence of boilerplate, telling the company’s own story in its own way. Discussion of governance too often focusses on the mechanistic ‘what’ rather than the strategic ‘why’. The UK Corporate
Governance Code (the Code) emphasises principles and provisions and it can be challenging to produce interesting disclosure against this framework. The narrative can become boiler-plate, low-value information, and convey the impression of governance being a self-contained activity. By contrast, high-quality disclosure is marked by compelling communication, which moves away from and beyond any self-imposed straitjacket. By providing insight into a company culture it acknowledges that governance permeates every aspect of the business and is the foundation for business success.

1.3 ICSA Excellence in Governance Awards

The ICSA Excellence in Governance Awards reward ‘best in class’ disclosure. By identifying and rewarding high standards of disclosure, the Awards seek to encourage this outcome.

2 How the best reports set themselves apart

The best annual reports demonstrate the following:

- an understanding of the links between governance, shareholder value creation, and the avoidance of value destruction
- responding to the opportunities created by reporting requirements rather than seeing them as obligations
- innovative and creative forms of disclosure, which move away from ‘boilerplate’ reporting that repeat the language of the Code and explain how the board and company is run
- explanations of the way the board runs itself and its committees, and how decisions are taken
- a governance report that demonstrates clear ownership by the chairman and a real desire to use governance to enhance the business rather than as a ‘box-ticking’ exercise
- comprehensive explanations of departures from the provisions of the Code
- a full description, and explanation, of the business model and the strategy, with key performance indicators (KPIs), performance against targets, and important information cross referenced to elsewhere in the report
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- discussion of the principal risks to the strategy, the company's risk appetite and culture, how the risk profile is changing, and how the risks are being managed
- joined-up thinking that links strategy, pay, performance and risk
- evidence of directors having satisfied their statutory duties, including the duty to promote the success of the company over the longer term
- recognition and balancing of the needs and expectations of different shareholder and stakeholder priorities.

Other features of award winning reports include an understanding of the drive towards integrated reporting, which requires a different way of thinking and behaving. They also use online platforms to communicate the company's story and offer improved access, whilst also recognising that this has limitations; and have a deeper understanding and appreciation of wider stakeholder interests.

Best Annual Report FTSE 100 – GlaxoSmithKline PLC Annual Report
GlaxoSmithKline PLC Annual Report

Best Annual Report FTSE 250 – Lonmin plc Annual Report
Lonmin plc Annual Report

Best Annual Report SmallCap and AIM company – VITEC Group plc Annual Report
VITEC Group plc Annual Report

Best Annual Report Unlisted company – John Lewis Partnership Annual Report
John Lewis Partnership Annual Report

2.1 Strategic report

The very best strategic reports will meet the objective identified by the Financial Reporting Council in their guidance – ‘to provide information for shareholders that will enable them to assess how the directors have performed their duty to promote the success of the company’. It should provide a clear analysis of the strategic issues facing the company, including a clear description of its business model, its key drivers, objectives and risks, with effective discussion of appropriate financial and non-financial KPIs, performance against them and explicit linkage between KPIs and strategy. This requires a clear explanation
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of the company’s strategic and operational risks, its risk management policies, procedures, controls and mitigation, with evidence of dynamic risk management, integral to strategy and operations. It should focus on ‘the bigger picture’ and include all that needs to be included for an understanding of the company, but not more.

Award winning reports provide the following:

• a clear and engaging report that is easy to read and understand and a logical flow
• an overview or ‘at a glance’ section providing all the key information
• a clear strategic framework, including objectives, vision, mission and values, and a clear description of business model with links to objectives and strategy
• real insight into the company including an industry overview, a description of the market and an explanation of why the strategic objectives are important, enhanced by detailed explanation of the business by, for example, case studies
• a strong picture of how the company does business and creates value, including opportunities for the company, and what the company does that makes it different
• a chairman’s statement that sets a clear tone of leadership and provides an honest, balanced report of progress with strategic objectives – including the bad news as well as the good
• an informative CEO’s report, explicitly linked to strategy
• well analysed KPIs that are easy to understand and clearly linked to strategy and to remuneration, with clear disclosure of performance against KPIs
• strong risk section with detailed description of specific risks and how they are managed.

Best Strategic Report FTSE100 – Babcock International plc Annual Report
Babcock International plc Annual Report

Best Strategic Report FTSE250 – Cairn Energy plc Annual Report
Cairn Energy plc Annual Report
2.2 Board reporting

The best annual reports include descriptive, reasoned and explanatory disclosure about how the board leads the company. This includes clear insightful explanations of the work of the board’s committees, reflecting stakeholders’ interests in audit, risk, remuneration and nominations and other issues as appropriate. In addition, reports should provide information about director development, skills, board evaluation and succession planning. There should be clear links to the company’s strategic purpose and an understanding of the benefits of diversity.

The best board disclosure includes:

- insights into the work of the board and board committees during the year, including the board’s challenges and action plans, and discussion of any committee investigations into specific issues
- good analysis of what each director brings to the board and a clear differentiation between roles
- a description of the process for appointing people to the board and committees
- good explanation of the board evaluation process with details of outcomes and actions, providing some real insights
- discussion of succession planning both internally and externally and the development of executive directors
- information on board changes during the year shown in one place, together with explanations if there are longer-term directors on the board
- overview of the board diversity policy and talent management
- discussion of conflicts of interest, with clear examples
- evidence of the board taking responsibility for the report being fair, balanced and understandable.

Best Board Disclosure FTSE100 – Marks and Spencer Group plc Annual Report

Marks and Spencer Group plc Annual Report

Best Board Disclosure FTSE250 – Provident Financial plc Annual Report

Provident Financial plc Annual Report
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2.3 Audit and risk reports

Audit and risk reports should provide a clear description of how the company manages audit and risk issues. It should include detailed disclosure of the work of the audit committee, for example how it ensures a high quality audit, how it manages the external auditor and an analysis of the issues that it has discussed with the auditor. It should also include an explanation of how non-audit services and fees are managed, and how the audit committee has assessed the external auditor’s independence. It should also provide insights as to how the audit committee satisfied itself that the report and accounts are fair, balanced and understandable.

Risk reporting should include a detailed description of the process of risk governance within the organisation and how the effectiveness of this is tested. There should be meaningful discussion of the specific risks arising out of the company’s strategy and its operations, and evidence that risk management is seen as integral to strategy and operations, rather than a compliance necessity. There should be a clear explanation of the company’s strategic and operational risks, its risk management policies, procedures, controls and mitigation, with evidence of dynamic risk management, integral to strategy and operations.

The best audit reporting includes:

- insights into the main issues the audit committee considered during the year, including detail on key judgement areas
- a description of accounting issues and how assurance had been obtained, including the use of external expertise if used
- a clear explanation of how external auditor independence is assessed
- a list of all material issues – and any less significant issues if they add to an understanding of material issues
- an overview of internal audit, including noting the audit committee’s responsibilities for the appointment and removal of the head of internal audit.

The best risk reporting includes:

- an overview of the risk management process; details of any improvements made to these processes during the year and any plans for improvements the following year
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- details of current and future risks, including information about impact and likelihood, and any lessons learnt from crystallised risk
- clear links between strategy and the principal risks
- clear links between KPIs and risk management
- a description of how risk management is integrated and embedded within the business.

FTSE100 Best Audit and Risk Disclosure – GKN plc Annual Report
GKN plc Annual Report

FTSE 250 Best Audit and Risk Disclosure – Halma plc Annual Report
Halma plc Annual Report

2.4 Remuneration reporting

Remuneration reports should include a clear explanation of how remuneration policy is explicitly linked to the delivery of strategy. They should provide details of why particular targets have been chosen, including consideration of any negative behaviours which the choice of any particular metric may encourage and the steps the committee has taken to manage such risks. Reports should include acknowledgement of the economic environment and evidence of timely, open and constructive engagement between companies and investors, particularly where changes are proposed to remuneration circumstances. The best reports will also show how remuneration aligns executive interests with those of long-term shareholders and how it achieves the desired culture throughout the organisation. Reports should also give clear explanations of how, why and when flexibility, discretion and judgement have been incorporated into the remuneration policy and used by the remuneration committee. The report should provide genuine insights rather than bland disclosures.
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The best remuneration reports include:

- a clear introduction from the committee chairman, including an overview of performance and how that has impacted outcomes; and demonstrating an understanding that how performance is generated is as important as what level of performance is desired
- remuneration linked effectively with strategy and KPIs, and a clear link between performance and payments with an explanation of why particular performance measures have been chosen
- an explanation of previous year’s performance and details of executives’ performance over the year
- detailed disclosures on how discretion works, including why specific metrics have been chosen for the schemes
- an description of the different markets in which the company is engaged, and the impact that these have on pay arrangements
- details of recruitment policy, including the approach to external appointments and remuneration for joiners and leavers
- information on the committee’s advisors, by whom they are appointed, and a clear overview of committee discretion
- details of engagement with institutional investors and other shareholders
- a link to disclosures of broader workforce pay.

FTSE 100 Best Remuneration Report – Smith and Nephew plc Annual Report
Smith and Nephew plc Annual Report

FTSE 250 Best Remuneration Report – Lonmin plc Annual Report
Lonmin plc Annual Report

2.5 Sustainability and stakeholder reporting

Annual reports should provide evidence that long-term stakeholder interests and non-financial factors are critical and inextricably linked to a company’s strategy, objectives and ultimately its business sustainability. This requires a well thought-through interpretation of materiality, quantifying the activities and the associated risks, so that only business-critical content is included.
Effective and appropriate choice of KPIs and disclosure of performance against them is important. There should also be good evidence that sustainability and stakeholder activities are incorporated into governance structures, signalling their strategic importance.

Excellent sustainability and stakeholder reporting includes:

- sustainability reporting flowing throughout the report, demonstrating leadership of the issue from the top
- a clear commitment to sustainability and stakeholders in the CEO’s report
- evidence that the company continues to think about how externalities affect the business and the future challenges it may face
- sustainability linked with strategy and risks, and included in KPIs
- details of specific issues rather than discussion in general terms
- a clear explanation of a sustainability governance structure and a description of stakeholder engagement activities
- discussion of building a sustainable workforce through talent management, recruitment and retention, strategic resource planning, and fair rewards for sustained performance
- references to additional information on the company’s website and the sustainability report.

FTSE100 Best Sustainability and Stakeholder Disclosure – Johnson Matthey plc Annual Report

Johnson Matthey plc Annual Report

FTSE250 Best Sustainability and Stakeholder Disclosure – Rathbone Brothers plc Annual Report

Rathbone Brothers plc Annual Report
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3 Examples of the best annual reports

The companies that were shortlisted and the winners of the 2014 ICSA Excellence in Governance Awards 2014 can be found at:

ICSA Excellence in Governance Awards 2014
ICSA is the chartered membership and qualifying body for professionals working in governance, risk and compliance, including company secretaries.

We seek to develop the skills, effectiveness and profile of people working in governance roles at all levels and in all sectors through:

- A portfolio of respected qualifications
- Authoritative publications and technical guidance
- Breakfast briefings, training courses and national conferences
- CPD and networking events
- Research and advice
- Board evaluation services
- Market-leading entity management and board portal software.

Guidance notes are prepared by the ICSA policy team to support the work of company secretaries and other governance professionals working in the corporate and not-for-profit sectors, and in NHS trusts.

Guidance notes offer authoritative advice, interpretation and sample materials for the many issues involved in the management and support of boards. As such, they are invaluable for those helping their organisations to build trust through good governance.

There are over 100 guidance notes available to ICSA members at www.icsa.org.uk/guidance

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