WHITE PAPER

March 2017

Debunking the myths in annual reporting

Rachel Crossley
Senior Reporting Consultant

emperor

We often get asked: What's the purpose of the report? Why should we invest so much time and effort in producing it? And does anyone actually care?

Introduction

The annual report has long been one of the most important documents a company publishes during the year - a single communication providing a comprehensive overview of an organisation's activities and financial performance.

But over the past decade, annual reports have evolved and become more complex in line with ever changing and increasing regulations, requirements and expectations, putting companies under pressure to invest more time and resources into producing their reports.

So for some companies, the annual report is viewed as a chore which takes them away from the 'real' business of running the company.

But companies' perceptions of the annual report, its purpose and relevance, often do not reflect the reality of today's reporting.

In this white paper, we look at the five myths we come across most frequently when talking to companies, provide evidence to refute them and make suggestions to help those preparing reports to ensure their reporting is relevant, engaging and meets the needs of investors.

Myth #1 – No one reads the annual report anyway

This is the argument we hear most frequently, particularly from smaller companies. But it simply isn't true. Admittedly, very few people will take the time to read the report cover to cover – and with some reports coming in at over 200 pages, who can blame them?

But a well-written and transparent annual report provides an insight into a company's business drivers, strategy, financial performance and governance – so is a valuable resource and important source of information for investors and other stakeholders (employees, customers, suppliers, partners) alike. Indeed, a recent EY survey into analysis of non-financial performance found that 77% of institutional investors considered the annual report to be an essential or important source of non-financial information when making an investment decision.

The report is an especially valuable communications device for smaller companies, where additional sources of information, including analyst research and media coverage, are generally much more limited.

Supporting this argument, the FRC's 2015 report *Improving the Quality of Small Company Reporting* found that, contrary to the views of companies, investors view annual reports as important documents, both as a source of trustworthy information to help in making investment decisions and as a way of holding companies to account.

> **Investors told us that good quality reporting is a key factor when evaluating investment decisions involving smaller quoted companies. .....Our survey of private investors indicated that 87% consider the annual report to be an important source of information for taking investment decisions (FRC).**

With the introduction of MiFID II on the horizon, we expect smaller companies to struggle even more to gain attention from analysts and journalists. The annual report therefore is a key opportunity for companies to communicate their equity story to the investment community.

77%

of institutional investors considered the annual report to be an essential or important source of non-financial information when making an investment decision (EY).

Emperor tip:

Most readers will have limited time to read your annual report. So ensure that the report is accessible and engaging for different types of readers by communicating at different levels of detail: summaries and highlights; charts, tables and infographics; and boxed-out information and detail. We call this the 30/3/30 principle.

30 seconds

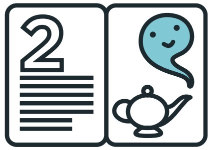
The quick read, bullet point overview or introductory paragraph that briefly describes a story or narrative.

3 minutes

Greater detail, longer paragraph, chart or supporting metric that gives more detail, often with referencing.

30 minutes

The long read, body copy supported by pull out quotes, metrics and imagery that brings themes to life.



Myth #2 – The annual report is only a backwards-looking document

Historically, annual reports simply provided an overview of activities and performance during the preceding financial year so were indeed backwards-looking documents. And annual reports do continue to review past performance and are important documents of record.

However, over the past few years, investors, regulators and others have criticised the short-term nature of company reporting and called for a longer-term perspective that articulates management's vision, strategy and plans for the future. Recent regulations, including the introduction of the Strategic Report in 2013 and the requirement for companies to publish a longer-term viability statement in 2015, have encouraged companies to look to the future and present a more forward-looking perspective.

In response, companies are increasingly discussing not only past performance but also their future plans in their annual reports. According to PwC 50% of FTSE 350 companies disclosed forward-looking strategy data and 44% forward-looking markets data in 2015. And last year 88% of the companies they surveyed presented forward-looking information in the strategic report.

Most companies don't provide much detail or look very far ahead, so there's still some way to go but we're heading in the right direction.

Emperor tip:

Use the annual report as an opportunity to:

- **communicate your vision for the future;**
- **discuss future opportunities and business drivers;**
- **describe the risks that could affect future performance; and**
- **present your progress against longer-term strategic objectives.**

88%

PwC reported last year that 88% of the companies they surveyed now present forward-looking information in the strategic report.

50%

of FTSE 350 companies disclosed forward-looking strategy data in 2015 (PwC).

Myth #3 – Investors do not care about sustainability reporting

Companies often wonder whether there is any point in reporting on sustainability issues as they believe investors are only interested in their financial performance.

But, as we have pointed out, investors are being urged to take a longer-term perspective, and according to a recent PwC survey, 63% of investors think that business success will be defined by more than financial profit.

And changes in consumer and employee behaviour mean companies that pay attention to managing and measuring their environmental and social impacts increasingly view this as a source of competitive advantage – 74% of global CEOs think that measuring and reporting total non-financial impacts contributes to long-term success (based on a 2016 PwC survey of 1,300 CEOs).

Indeed, EY research shows that companies publishing a sustainability report identify a range of business benefits – from reputational benefits to increased employee engagement and improved access to capital.

So increasingly investors do care about sustainability reporting and how companies are managing and measuring their non-financial impacts – and recent Goldman Sachs research showed that corporations that are leaders in social and governance policy have been outperforming the general stock market by 25% since August 2005.

But current sustainability reporting, particularly in the annual report, is often not relevant and does not meet the needs of investors. A review of sustainability sections shows that all too often these report on charitable donations, sponsorships, and local community events while investors are interested in those sustainability issues which are material to the long-term success of the company, such as their environmental impacts, how they are managing scarce resources or how they engage, train and develop their employees.

Emperor tip:

Conduct a materiality assessment to identify those sustainability issues which matter most to the company and its stakeholders, then measure your performance and focus reporting on those key areas.

58%

of consumers said they are more likely to buy products or services in the knowledge that the provider is mindful of the environment and society (NMI).

50%

Half of the UK workforce now seeks to work for organisations that have a positive impact on the world (Global Tolerance).

Myth #4 – Governance reporting is full of boilerplates – just write what you wrote last year

There is certainly a perception that governance reports are full of standard disclosures as this comment from Mike Everett, the Governance & Stewardship Director from Standard Life Investments illustrates:

> **"The Governance report remains largely boilerplate and often does not provide the reader with a feel for how the board operates. Regulations dictate that certain items have to be disclosed but governance reports have become too boilerplate.**

However, the events of the last few years, including the global financial crisis and company scandals such as with Tesco, VW and BHS, have demonstrated shortcomings in corporate governance and highlighted the importance of good and effective governance.

Governance reporting has therefore come under greater scrutiny than before as investors, regulators and governments want to ensure that companies have effective governance practices in place. The UK government's Corporate Governance Reform Green Paper published last November aims to ensure that the UK's governance framework remains fit for purpose.

The FRC is currently also looking at the importance of corporate culture in delivering long-term business and economic success, and the role of Boards in shaping, monitoring and overseeing culture.

Investors seek to understand how the Board operates, the issues being discussed and activities undertaken. As Matthew Fell, Chief of Staff at the CBI said a recent FRC event: **"To get a better understanding of Board effectiveness, it is about how the Board is run coming through in the narrative of the annual report."**

As a result of these developments, governance reporting is a key area of focus that has evolved considerably over the past five years.

While there are certainly still many reports out there that contain standard or boilerplate disclosures, good practice reporters have moved away from reporting purely on policies and responsibilities and are instead focusing on the activities the Board and its committees have undertaken during the year and how these relate to key strategic and operational developments.

Reflecting this trend, companies are increasingly using case studies to bring the governance section to life – according to PwC, 32% of the FTSE 100 used governance case studies in 2016.

Emperor tip:

Make your governance report more engaging and relevant through the use of simpler language and case studies, and through discussion of Board and committee activities around topical issues including:
- **succession planning;**
- **remuneration;**
- **corporate culture; and**
- **diversity.**

32%

of the FTSE 100 used governance case studies in 2016 (PwC).

Myth #5 – Annual reports are getting longer and less relevant each year

This is definitely a tricky myth to dispel! Without a doubt reports have grown significantly in length and complexity over the past 20 years, partly due to a raft of new rules and regulations that require additional disclosures in the annual report.

However, in recognition of concerns raised by shareholders, the FRC launched its Clear and Concise initiative in 2014 to promote good communication in corporate reporting and ensure that annual reports provide relevant information to shareholders by "cutting the clutter".

As a result, many of the companies we speak to are looking at ways to reduce the length of the annual report by:

- focusing their reporting on areas that are material to the business;
- reducing duplication by creating clear linkages and cross-references between key sections of the report; and
- moving unnecessary or additional information online or into other communications materials.

And these steps are starting to have an impact – according to PwC, 48% of FTSE 100 companies linked strategy with key performance indicators last year (up from 30% in 2013) and 45% linked strategy with risks (2013: 34 %) while the average FTSE 350 annual report length remained unchanged in 2016 compared to 2015, albeit at 154 pages.

A number of companies have even achieved significant reductions in length, for example Anglo American.

Anglo American cut the length of the front end of their report in 2014 by 42 pages – cuts included removing detailed industry analysis and reducing the length of the performance, people and portfolio reviews.

So we may not be there yet but we are certainly seeing signs of progress. And going forward, new reporting regulations, such as the Modern Slavery Act introduced last year, require information to be disclosed online rather than in the annual report, which should also help to make a difference.

48%

of FTSE 100 companies linked strategy with key performance indicators last year (PwC).

154 pages

Average FTSE 350 annual report length in 2016, unchanged from 2015 (PwC).

Emperor tip:

Reduce your report length by moving standard disclosures, detailed policies and procedures from the annual report to your corporate website instead, where they can also be updated during the year if necessary.

“Annual reports are an important source of information for investors. They provide us with real understanding of a business and its drivers, its financial strength, and the quality of management. The quality of these reports really matters. My message to companies is that improving the quality of your reporting will make you more attractive to investors.

Jessica Ground
Global Head of Stewardship, Schroders, cited in FRC Consultation: *Improving the quality of Reporting by smaller Listed and AIM Quoted Companies*

Conclusion

Despite all the myths and misinformation, annual reports remain a valuable source of information for investors and other stakeholders.

So see the report as an opportunity to communicate with the investment community and tell your equity story in a meaningful way - presenting the investment case, reporting on material issues and performance, and highlighting governance practices and corporate culture.

And make the most of the information in your annual report by reappropriating it across other communications channels such as your corporate website, investor presentation and company newsletter and using it to reach out to other audiences, like your employees or customers.

About us

We love what we do. Emperor is founded on a culture that has at its core the idea of creating great work and delivering a great experience for everyone involved in that work, that's our clients, our people and our partners. It's that simple.

Reporting

We're experts in producing corporate reports that people want to pick up, read and act on. When a direct, skilfully executed approach is needed, we're trusted to deliver. But it's the way we listen to and work with our clients that makes our approach different.

Engagement

Continued engagement is the key to a brand's success, externally and internally. Communication is a constant, so it's vital to keep conversations dynamic, alive and relevant. We design campaigns to perform in today's connected, multi-channel world. We plan, measure and optimise effectiveness, harnessing creativity for a practical purpose to get measurable results.

Digital

No one else in our field works with such a variety of clients across such a breadth of digital services. But whatever the brief, we're always focused on what matters most to you. That's reaching and inspiring the audience you want to reach, while offering you a superior service experience throughout.

Brand

The strongest brands have a positive influence on everything about a business, from a customer's first impressions to the way an employee performs. We build them collaboratively to create something which captures your company's unique culture.

Let’s talk

If you have any questions or would like to learn more about how we can help you differentiate your brand and communications, we’d love to talk with you.

rachel.crossley@emperor.works
emperor.works

LONDON
Zetland House
5–25 Scrutton Street
London EC2A 4HJ
+44 (0)20 7729 9090

EDINBURGH
4th Floor
Charlotte House
2 South Charlotte Street
Edinburgh EH2 4AW
+44 (0)131 220 7990

BIRMINGHAM
Crosby Court
28 George Street
Birmingham B3 1QG
+44 (0)121 262 3830

BICESTER
St Edburg’s Hall
Priory Road
Bicester
Oxfordshire OX26 6BL
+44 (0)1869 324111

DUBAI
Office 501, Block B
Business Village
Deira, Dubai
PO Box 123885, UAE
+971 (0)56 150 8292