Annual reporting in 2016/17:

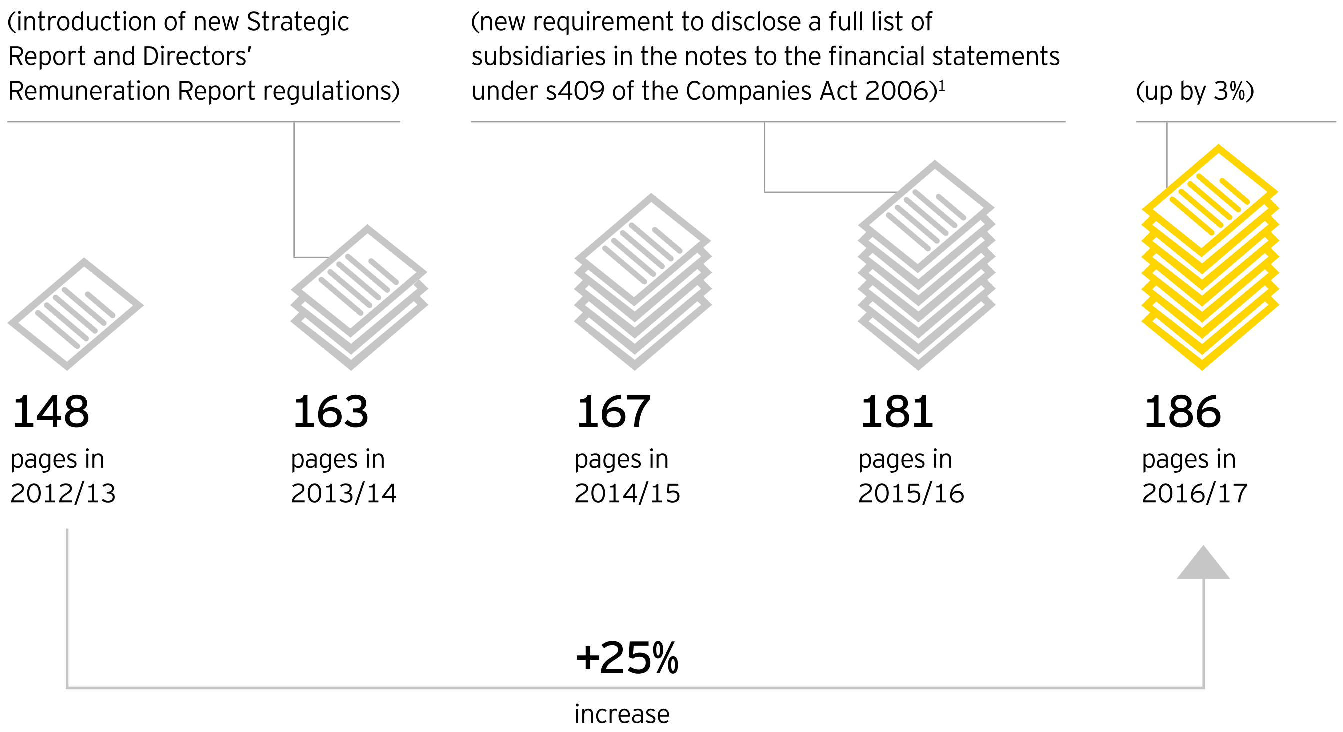
broad perspective, clear focus

Executive summary

Building a better working world

Annual reports have continued to steadily increase in length. Looking ahead, the implementation of the EU Non-Financial Reporting Directive into UK law, as well as proposals by the Government for companies of a significant size to explain how their directors comply with s172 of the Companies Act to have regard to the interests of stakeholders, will result in more disclosure. The challenge for preparers to keep reports clear and concise remains.

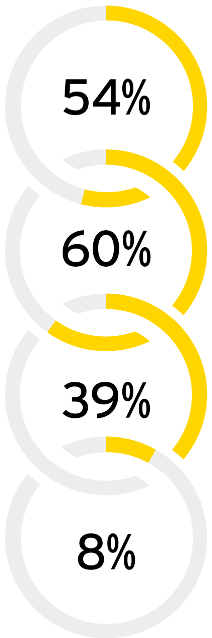
Average length of ARAs



[1] Concession that was available under s410 Companies Act 2006 whereby companies could list only their 'principal' subsidiaries and other significant holdings in their annual report and file a complete list with their annual return was removed. For periods commencing on or after 1 January 2016 the address of the registered office of each subsidiary or significant holding was also required to be disclosed.

Linkages

Links between strategy, KPIs, risks and remuneration are increasingly prevalent but consideration of the linkage across the whole piece can still be improved in the majority of reports.



54% show link between strategy and KPIs (up from 50% last year).

60% show link between strategy and risks (up from 42% last year).

39% show link between strategy and remuneration (up from 24% last year).

8% Link all the way through from strategy to KPIs, risks and remuneration (down from 12% last year).

Purpose, business model and risks

Companies are increasingly expected to articulate a broad purpose, which drives strategy and encapsulates value creation beyond just financial value. While 41% articulate a broad purpose, it is also important to link this to the strategic objectives to ensure the purpose is 'lived'.

There is still scope for business models to explain better how the company makes money and its competitive advantage. More companies are using the 'inputs, processes and outputs' format to present their business models and articulating, at a high level, the value they create for different stakeholders.

The quality of risk disclosures has improved in a number of respects, but there is still a tendency for rather generic descriptions of principal risks and their potential effects on the business. More companies made risk disclosures relating to disruption, cyber-security and Brexit.

41%
of reports communicate a broad purpose, but only about half of these companies clearly linked this to their strategic objectives

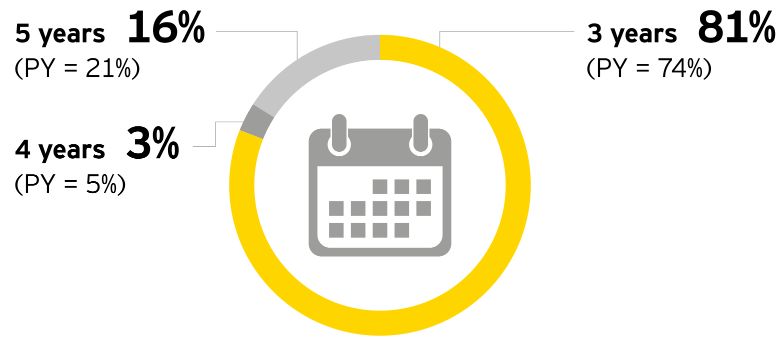
31%
of reports disclose information around potential disruption risks to the business

43%
of reports include cyber-security as a principal risk (up from 31% last year)

93%
of reports disclose some form of information around Brexit and the impact on their business (up from 25% last year)

Viability statements risk becoming increasingly bland and boilerplate. More companies chose a three-year period and the majority still lack useful disclosure of scenarios tested, including quantification and assumptions.

Time period chosen for the viability statement:



Wider stakeholder engagement, sustainability and culture

81%
of companies explain who their wider stakeholders are

14%
of companies do not have any non-financial KPIs (unchanged since prior year)

The Government's response to its consultation on corporate governance reform further emphasises the responsibility that companies have for wider stakeholder engagement. Our review found that many companies explain who their stakeholders are and in some cases how the company engaged with them but very few disclose topics discussed or issues raised and the company's response. Stakeholder engagement is also rarely discussed in the governance report.

The majority of sustainability reporting is still done in a separate section rather than integrated throughout the report. Performance metrics used in the sustainability section only overlap with the main KPIs in 18% of reports. We suggest that a better approach is to integrate the sustainability content with the strategy and therefore have one set of broad KPIs.

Corporate culture has been a key area of focus for regulators and other stakeholders, and while discussion of culture features in more reports, the information could better include insight into how the board monitors and gets assurance on culture.

Governance reporting

Governance reporting should be focused on decisions, actions and outcomes, rather than roles and processes alone. Preparers should consider structuring their governance reports differently – for example, by not limiting themselves to the structure used in the UK Corporate Governance Code ('the Code') and also moving standing information to appendices or the website (regulations permitting) to avoid repetition and help articulate the governance story better.

Compliance with the Code is slightly lower than previous years. However, less than 5% report non-compliance with more than two provisions. We concur with the FRC's view that there is room for improvement in the quality of explanations for non-compliance.

We continue to see improvement in board evaluation disclosures.

Information on shareholder engagement lacks insight into topics discussed and any actions taken as a result of engagement.

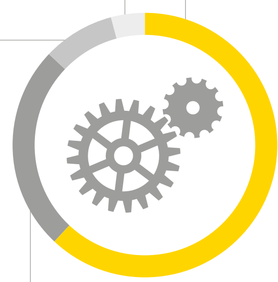
As a result of the EU Audit Reform, there are a number of changes impacting audit committees including new recommended disclosures. Although not yet applicable to the sample in our review, a number of audit committees have complied and provided disclosures ahead of time, in areas such as composition, performance and effectiveness.

Remuneration committee reports faced particular scrutiny as many policies were up for binding vote this year. This meant that many companies published their policies in full, contributing to an increase in average length. Some companies voluntarily published CEO-to-average employee pay ratios.

Compliance with the UK Corporate Governance Code

4%
Non-compliance with more than two provisions

9%
Compliance with all but two provisions



62%
Compliance with all provisions

25%
Compliance with all but one provision

Future trends in reporting

Investors and others obtain information about companies from a variety of sources. However, annual reports remain the primary source of holistic information about a company, particularly for investors making an initial investment decision. There is scope for improvement in the consistency and balance of messaging across preliminary results announcements, analyst presentations and the ARA.

The move to a fully digital annual report is not quite imminent. The majority of companies (69%) still produce their ARA in simple PDF format only. Digital enhancements shouldn't just be an end in themselves, for example, to improve the look and feel of content. The focus should be on enabling higher quality engagement with shareholders and stakeholders.

In line with calls for reporting to be more holistic and consider the needs of a wide set of stakeholders, EY has proposed a proof of concept framework – The Long Term Value (LTV) Framework – to understand, measure and communicate the broader value companies create through their investments in their purpose, brand, intellectual property, products and employees, environment and communities. This framework is being tested via The Embankment Project – a pilot involving 20 global companies from across the investment chain – asset creators (companies), asset managers and asset owners.

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Recent and upcoming reporting requirements

Improvement is needed on clearly identifying or labelling Alternative Performance Measures (APMs) used, the clarity of explanations provided on why each APM has been used, the balance of emphasis between APMs and IFRS figures, the ease of finding reconciliations and the basis/rationale for deductions and add-backs made from statutory results.

Although it is not mandatory to include the Modern Slavery Act statement in the ARA, some companies have included a summary of the steps taken to prevent or tackle modern slavery issues and a reference to the website disclosure.

If they haven't already done so, companies should also be aware of and start preparing for the following new disclosures:

- Additional disclosures in the audit committee's report primarily arising from the EU Audit Reforms (periods commencing on or after 17 June 2016).
- Increased disclosure in the Strategic Report arising from the EU Non-Financial Reporting Directive.
- Gender pay gap disclosure (from April 2017, website only).

Further detail on all the points raised in this executive summary can be found in the full report.

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