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Best practice in annual reporting

Ah, best practice. What should it be? A coherent, compliant and compelling presentation of the past year's performance and the future plans and prospects of the company, articulated in a concise, logical and linked manner for the use of the primary audience. Often what is considered best practice isn't, it is common practice or, specifically, much-copied practice, muddled by trying to do too many things for too many people.

Part of the problem with best practice is that many preparers of annual reports are pathologically risk averse, time-pressured and have a day job to do. This, when short of expert advice and assistance, is a recipe for very average, rather than best, practice reporting.

What is the consequence? "Who else is doing this?" or "Show me an example" are the two commonest responses to any suggestion. And these words often come from companies who proudly state that one of their core values is... Innovation. The problem is compounded by less practised advisers then needing to find examples to present, rather than substantiating their advice through clear knowledge and expertise.

What is being copied?

The first answer is what lots of others are doing – plagiarise with pride – if everyone is off in this direction it must be best practice. It is herd or bait-ball mentality – safety in numbers, don't need to think about it, it'll do.

The next is award-winners – blinded by glory – must be good, can't go wrong, don't need to think about it, it'll do.

Another is apparent exemplars – resting on someone else's laurels – everybody knows they are good, therefore do what they do, don't need to think about it, it'll do.

Plagiarise with pride

Two instances to illustrate the point. Business models and diversity assertions.

Business models

Business models have been around in annual reports since the 2014 publication season. With nothing to copy then, there was a wide range of distinctive and unique approaches. Ten years on, about two thirds are very alike, discussing similar inputs/resources and similar outputs (often termed 'value') benefitting similar stakeholder suspects, with similar nice big numbers. Half of these models also have a circular and directional operational process 'wheel' in the middle.

This is the 'Input Output Washing Machine' – graphically presented and comparable with other business models (because they are copies) but not very useful. What is the compelling reason to invest if companies in the same industry, or even different industries, all seem to be doing much the same thing?

The I/O Washing Machine, with its close cousins the 'Integrated' and 'Stakeholder' business models, are also all about what is going on inside the organisational boundary, not within the organisation's whole value system.

As they are standardised, they don't convey the authentic voice of the particular C-suite and often don't describe how the company makes money.

Where are the points of differentiation and unique sources of advantage? What about external influences, including the competitive position?

There is often more strategic insight to be had from the 'Reasons to invest' summary.

Diversity

Many preambles for disclosures on diversity start with, "It is well known that..." "...companies with diverse boards have been shown to financially outperform their less diverse peers" or "...higher levels of gender diversity of FTSE 350 boards positively correlate with better future financial performance".

The first is based on McKinsey work (2015, 2018, 2020, 2023), the second on that of the London Business School for the FRC (2021).

The awkward problem is that both statements have been shown to be... misleading.

McKinsey by Professors Green and Hand, in the peer-reviewed Econ Journal Watch 2024 (preliminary research first published 2021). McKinsey's tests were "erroneous" and could not be replicated. There were no "statistically significant relations" between diversity and financial performance.

The FRC claim was reviewed by another professor, of Finance, from LBS (Edmans, 2021). He found that of the 180 tests used, 90 each, none for EBITDA and only nine for stock return, shifted the dial. Of those nine, seven positively and two negatively. The FRC had announced a result that wasn't there.

This is not a comment on DEI, but on copying and pasting statements without full knowledge. Errors of fact being perpetuated in a statutory document – not even approaching best practice, think "Fair, Balanced and Understandable" – quite apart from Boards making key strategic decisions based on dodgy research.

Blinded by glory

Everyone loves to win an award, but annual reporting awards are no different from any other sort – there are awards and there are awards.

What are the drivers at work here? Often the answer looks a lot like "To make a profit by selling advertising, sponsorship, dreams, hospitality..." Another is "The client wants to win an award; any award will do, even if we buy it".

Also, if they are self-selecting, are they a truly representative cross-section of the reporting universe?

A couple of cautionary tales about awards.

A winner, chosen by the panel of judges, had produced a "well-written and nicely presented report". The problem was that it incorporated several regulatory non-compliances, and five clear legal howlers, which the judges knew about but ignored. It was, however, for a governance award, not a Booker or a Turner.

In the words of Donald Sutherland's Pinkley, "Very pretty, Colonel, but can they fight?"

A short-list of four, for another governance award, included a company with the second-worst governance disclosures ever reviewed (in a sample measured in hundreds). Ironically, the short-list had been compiled by a Proxy Agency.

Resting on someone else's laurels

This is the best bet of the three, but has a couple of caveats.

The first caveat is that many companies can exhibit a flash of genius in one part of their reporting, whilst doing the opposite in others. Copying their errors along with their gems is not advisable.

The other is that, although there are things that can be copied successfully, most of them are easier, even better, understood from first principles. We are talking here about things such as structure, logic, linkage and design.

One FTSE100 was famously thought to be a reporting exemplar, year after year. A particularly glaring statutory non-compliance was identified. They were quite assertive in their defence, until the problem was equally assertively pointed out on page xx, column y. Much shuffling of feet, red faces and umming and erring ensued. Funnily enough, they had copied their own error, year-on-year.

Conclusion

One company is not the same as another – different sectors, different drivers, different cycles, different business models, different strategies, different measures, different risks, different cultures, different values.

If you know what you are looking for then there are nuggets to be found and used.

If, however, you know what to look for then you know what you are doing and really didn't need to spend all that time and effort looking in the first place.

If you aren't sure, find someone who is and do it, together.

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