



Annual Report time again!

It all comes round again far too quickly. And, as with Christmas presents for your Dad, it can be difficult to think of something new or different... or even to know whether you really need to try. Last year's tartan socks didn't get any complaints, after all...

We've previously written about how the front half of an annual report can be brought to life if you approach it as an opportunity to tell a coherent story, rather than as a collection of compliance statements. No doubt you remember every word of that (ho, ho, ho) so instead of repeating ourselves here are some ideas that might help your story to be even more coherent.



Good practices to consider...

Have a clear idea of who you're writing for. It's easy to say shareholders, of course – but is it really, and if so what does that mean? In practice there aren't many of them who will be waiting eagerly for the annual report – by the time it's published the real money people will have lost interest, and it's mainly the governance types who will scour the pages for evidence of compliance. But when we've helped companies tell their story better, the appreciative feedback has come from other constituencies – staff, suppliers, local governments, big customers and others that hadn't previously been thought of.

Treat the governance section of the report as an opportunity to increase readers' confidence in the way the business is led. And if you can't tell a good story around some aspect, think hard about whether it's the story-telling or the reality that is the problem.

Try to communicate the strength of the collective experience of your board – and how it is relevant to your business, its challenges and your future strategy. You've no doubt put a lot of effort into getting the right board in place. You should have a good story to tell – so tell it!

Things to avoid...

Acting as if shareholders are the only stakeholder to have an interest in the annual report. Yes, they matter – especially those with lots of votes – but that'll be quite a small number of readers. There's already so much effort going into the annual report's preparation that it's worth making just a little bit more to make it useful to other sorts of reader. (And don't let competitors be an easy excuse for saying as little as possible. It's quite rare for an annual report to say much that a half-awake competitor doesn't already know.)

Describing the board in such formal terms that it seems detached from the way the business is managed. Giving priority to its box-ticking activities as if that's what it's there for. And papering over weak points in the governance with vague words, rather than addressing the weakness.

Simply sticking in a very abbreviated CV below the mugshot. Yes, it will set out the bare facts. But it won't explain the relevance of that experience to setting the strategic direction, and how it helps you oversee different parts of the business and the risks.

Good practices to consider...

Explain better the relevance of director experience to the committees' work. For example, you've probably got well-qualified financial specialists on the Audit Committee – but its risk responsibilities benefit from people with operational experience too, so don't overlook the chance to explain how the mix brings strength.

Show that a rigorous board effectiveness review has been done, whether externally or by self-assessment. Explain the process you used to show that it was more than a fireside chat, and highlight the more important improvement areas that you're going to be working on (unless they really are too embarrassing to describe in public). Readers will much prefer to see that you can be self-critical and are looking for ways to get better than to think you are complacent.

Set out which part of the board structure is responsible for monitoring risk exposures. Is it the full board – or is that just for principal risks? Is it the committees – or is that just risk management process oversight? This is often a confused area and you can increase credibility by sounding less confused than others, so that the reader knows who is monitoring risks and who is looking at the effectiveness of each part of the risk management framework.

Make it clear which parts of the governance structure include (partly or wholly) independent oversight.

Set out the various sources of assurance that the board draws on, how far they are independent and how much and what sort of assurance they provide. That helps the reader get a better picture of the sources of comfort for the directors.

Things to avoid...

Naming the members and leaving it at that (and stretching to labelling the financial expert because you have to). That leaves the reader having to refer back to the (not very helpful) bios. Why not share some sense of how each individuals' experience is helping a committee do its job? And if you can't tell a good story around this, why not?

Simply stating that the "board is effective" or even "fully effective". All bodies (organisational or human) have room for improvement. Even when a board is working well, it is buffeted by events and has to respond to change. At times it can seem as if investors expect perfection, but actually they're much more alarmed by complacency. If you say everything is fine, they are likely to be suspicious of the thoroughness of the process. This might not have mattered in times past, as investors showed little interest in the report – but it's changing.

Providing bland statements of responsibilities which fail to spell out who at the board level is actually overseeing changes in financial and operational risk exposures – the board will cover the principal risks, but who is looking at the rest? Or which suggest that "risk management oversight" falls to the Audit Committee. It's never that simple – different risks can fall under different committees. And it's rarely made clear what they each do to look at those specific areas of risk management.

Portraying committees which are wholly or largely composed of management as part of the governance framework without making the level of independent director involvement evident. If a Risk Committee is a management committee, that's quite different from an independent oversight committee, even if it is formally a committee of the board.

Just referring to Internal Audit – they are a big source of comfort, but there will be others eg health & safety, environmental, project experts, reserves auditors, compliance monitoring, tax... (But don't go so overboard that it sounds as if you're unable to distinguish quantity from quality.)

Good practices to consider...

Give more thought to explaining how you know the different parts of the risk governance and assurance structures fit together into a coherent whole – and that they are working effectively. The big investment firms are going to be looking much more critically at this sort of thing this time round.

Consider very carefully the statements made by the Audit Committee to support its report on the reporting and control environment and on the controls around significant reporting risks. Start thinking about it early so you can organise additional assurance if necessary.

Things to avoid...

Failing to recognise that expectations are rising here. Brief and bland references to having discussed the effectiveness of the external audit process are no longer sufficient. What exactly did you do apart from ask the FD if he'd had a good audit? And what about the effectiveness of everything else the board depends on, such as internal audit, risk management and the other things listed in the box above?

Leaving it till the last minute and then sticking in the same sort of boilerplate language that served in previous years. Statements such as "management operates an appropriate control environment" or "the risk identified by the auditors has been appropriately controlled" could come back to haunt you – so make sure you have good grounds for what you say around each major reporting risk.

If you have any questions on the issues covered here, please contact Richard Sheath at richard.sheath@independentaudit.com

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