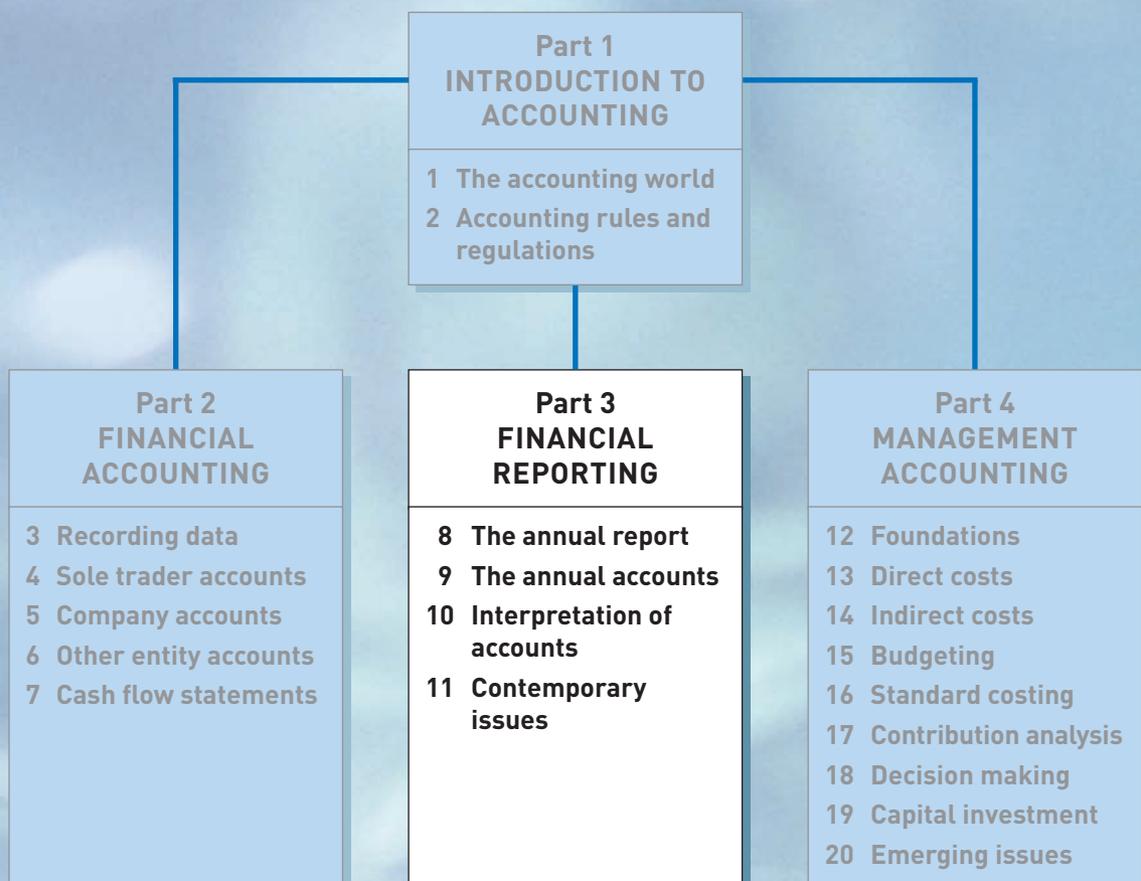


FINANCIAL REPORTING

Part 3

In Part 3 we deal with the subject of *financial reporting*. The distinction between financial accounting (as covered in Part 2) and financial reporting is blurred. Indeed, at one time no such distinction would be made. However, financial accounting is now regarded as a rather mechanical and technical process that ends with the preparation of the profit and loss account, balance sheet and a cash flow statement. Financial reporting is more concerned with how accounting data can best be communicated to users of financial statements in accordance with legal and professional requirements.



Does more mean less?

Narrative reporting taking over annual reports

Kevin Reed

Narrative reporting is taking up a greater proportion of annual reports, according to **Deloitte's research**.

While the size of annual reports grew by just 2% on 2007 to an average 96 pages, narrative reporting makes up 54% of the reports, which is a 3% increase on the previous year.

Annual reports are 35% longer than they were in 2005.

'The main message from this year's survey is the realisation of how much the narrative reporting requirements have grown like topsy over the years,' said Deloitte audit partner Isobel Sharp.

'New requirements have been bolted on and new extensions will be

added in 2008/9. The result is that the narrative sections of annual reports can have similarities with the famous Ronnie Corbett monologues, namely lots of diversions.

'Unfortunately new rules governing narrative reporting mean that this is unlikely to change in the future.'

A new requirement for a directors' responsibility statement, introduced by the Financial Services Authority and emanating from the EU Transparency Obligations Directive, was met only by 54% of relevant companies.

Accountancy Age, 24 October 2008.

Source: Reproduced with permission from Incisive Media Ltd.

Questions relating to this news story can be found on page 194 ➔

About this chapter

The Companies Act 2006 requires companies to prepare accounts for each financial year. They are then obliged to send a copy of the accounts to every shareholder and every debenture holder of the company. The Act also requires them to report on other aspects of their operations along with a number of legislative and professional requirements. The additional information is usually provided in report form. The reports and the accounts and are then combined to form one document.

A copy of the report and accounts must also to be filed with the Registrar of Companies, i.e. sent to him; he then makes it available for public inspection. This process is what accountants mean when they talk about 'disclosure of information' or 'published accounts'.

Annual reports and accounts can be quite lengthy. Those for a relatively small plc, for example, can easily stretch to 50 pages while those for a large international plc may go well beyond 100 pages. So for shareholders and debenture holders there is an awful lot to read. In addition, much of the content is complex, highly technical and full of jargon. It is very difficult to believe that most annual report and accounts mean very much to the average shareholder and there is, in fact, some strong empirical evidence to suggest that very few are actually read.

In this book we have provided you with the necessary background information and knowledge that should enable you make sense of a company's annual report and accounts. But even so you probably need some additional help in order to see how the material we have covered so far in this book relates to the published information. We provide that help in two chapters as the subject is too big to cover in one chapter. In this chapter we deal with 'reports' and in the next chapter the 'accounts'.

In both chapters we will be primarily concerned with the published reports and accounts of public limited liability companies and we will be making frequent references to examples extracted from such a source.

Learning objectives

By the end of this chapter you should be able to:

- list the types of reports found in a company's annual report and accounts;
- separate such reports from the accounts section;
- identify the introductory material;
- outline the contents of a chairman's report;
- explain what is meant by corporate governance;
- specify the nature of a business review;
- identify the main sections of a directors' report;
- summarize the contents of a directors' remuneration report.

Why this chapter is important

This chapter is important for non-accountants because at some time or other in whatever career you pursue you are going to come across company annual reports and accounts. Most entities of any size prepare such a document but by law companies are required to do so. As a result, published reports and accounts tend to act as a model for other types of entities irrespective of their nature and size.

It is highly likely that in your job you will be involved to a lesser or greater degree in the preparation of *the* annual report and accounts. And as you become more senior you will have greater and greater responsibility to ensure that your company complies with legal and professional requirements. Furthermore, given that the company has to produce such a document, you will want to make sure that as far as possible it is readable and understandable. That means you will need to have a good eye for presentation and an ability to spot what reads well and what does not. This chapter will help you to develop your knowledge and skill in what is required.

There is perhaps another reason why this chapter is important. In your private life you will probably want to become a shareholder in a company. One document at least that you will need to study before making an investment is its annual report and accounts; thereafter you will use it to monitor its progress. The chances are that once trained in the mysteries of annual reports and accounts you will find them helpful when making your own personal investment decisions.

Activity 8.1

Obtain the annual report and accounts of three UK public limited liability companies.

Guidance: If some of your friends or relatives have shares in a company they should automatically receive a copy of its annual report and accounts. See if they will let you have it. Otherwise write to the Company Secretary of each company. Most companies will let you have a set without any questions being asked. You may also be able to download some reports from the Internet. Choose commercial or industrial companies. Avoid banking and insurance companies as they have different reporting requirements.

Note: It is important that you do as requested above otherwise you will find it more difficult to work your way through both this chapter and the next one.

Overview

News clip

Longer and longer

A report by Deloitte shows that annual reports have nearly doubled in size over ten years. In 1996 the average length was 45 pages. By 2006 the average length was 89 pages and by 2007, 96 pages (*refer back to the news story on page 178*).

Source: Adapted from *Accountancy Age*, 6 December 2007, p. 1.

You will find that with most annual reports and accounts it is relatively easy to separate the 'reports' from the 'accounts' no matter where they appear in the overall document or what they are called. The reports will usually come before the accounts and they will probably be put into various groupings although there is no statutory requirement to do so. The number of categories adopted can range from only two or three categories to as many as ten.

We will opt for a fairly broad approach in our discussion. As can be seen from Figure 8.1, we have decided to group the report section into the three main categories: (1) introductory material; (2) corporate reporting; and (3) shareholder information.

We start our discussion with the introductory material section. You are likely to find it in the first few pages of any annual report and accounts.

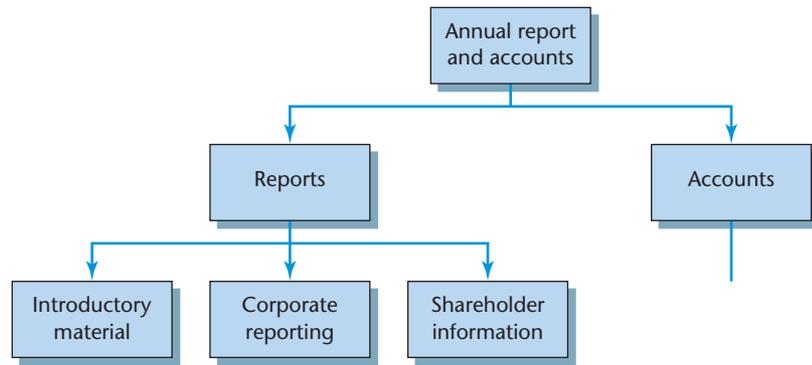


Figure 8.1 Annual reports: structure

Introductory material

There are no statutory or professional requirements that specifically cover the introductory section although what is reported must not conflict with other reports. The section is usually confined to the first few pages of the document (including sometimes the use of the inside page of the front cover). The information provided will probably tell you something about the company: what it does, where it has done it and how it was done, i.e. its history, location and a summary of its financial results.

The information that is likely to be disclosed may be broken down into four broad categories, as shown in Figure 8.2. They are: (1) highlights, i.e. specific matters to which the company particularly wants to draw attention; (2) a financial summary of the results for the year; (3) some promotional material; and (4) the chairman's statement.

We will discuss each of these categories in turn starting with the 'highlights'.

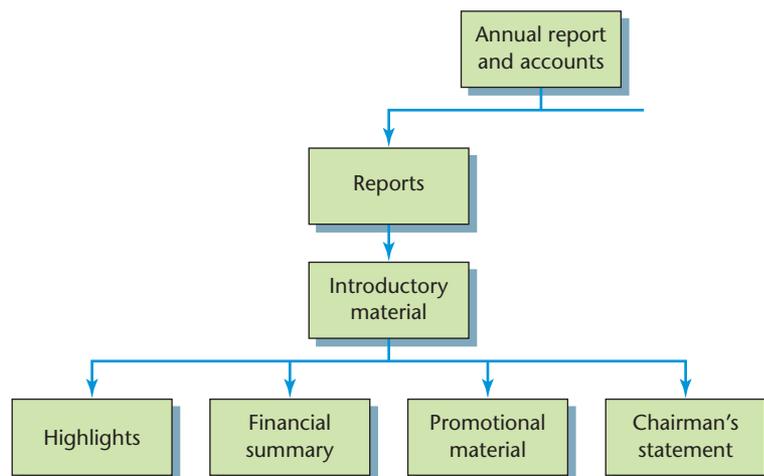


Figure 8.2 Annual reports: introductory material

Highlights

An overview of the company and its performance is useful for those readers who have neither the time nor the inclination to go beyond the introductory material. Such material will probably be outlined in no more than one or two pages but sometimes it may be very brief. Sig plc, for example, in its 2008 Annual Report and Accounts adopts an A4-size page and then uses the inside page of the front cover to report in large white letters on a red background that:

SIG plc is a leading European supplier of insulaton, exteriors, interiors and special-ist construction products.

A four-line sentence (in much smaller white letters) outlining the company's strategy then follows. This in turn is followed by a summary of its three core principles (in much larger letters) and a two-and-a-half-line sentence explaining what these principles enable the Group to do. The contents of the Report and Accounts are then listed in small type at the bottom of the page.

The introductory section of the report includes on page 1 a summary of the Group's performance, on page 2 a list of its activities, on page 3 a review of the year, and on pages 4 and 5 we find the Chairman's statement. So in Sig's case the highlights section is just six pages long (including the inside cover).

By contrast Aggreko's 2008 Annual Report and Accounts uses A5-size pages. The front inside cover is covered in tiny print; it is too small to read and the user is perhaps not meant to do so (as it is probably presentational). Page 1 (and 3) lists the contents. Page 2 summarises 'Our performance'. Pages 4 to 13 then give the reader some information about the company using such headings (in large orange type) as 'What We Do', 'Where We Do It', 'Our Fleet', 'Our Business Models', and 'The Market' (the latter taking up five pages). Pages 14 to 16 are given over to the Chairman's statement. All of this information is included in what is titled the 'Directors' Report' which altogether takes up 52 of the entire 120 page document.

Financial summary

Most companies usually give a brief financial summary of the group's performance for the year. This usually takes up no more than one page. Often it is a combination of numbers and graphs. Devro's 2008 report is a good example. On page 1 under the heading 'Financial Highlights' four small bar charts are given showing data for four years: earnings per share, group revenue, operating profit, and operating profit margin. Underneath is a small table of the 2007 and 2008 results which we have reproduced in Figure 8.3. The information is so compact that there has even been room to include on the same page a list of the contents of the entire document.

Some of the information shown in Figure 8.3 will not mean much to you just yet so you can appreciate just how difficult it must be for those readers who have not had *any* training in accounting.

Promotional material

Many companies take the opportunity of promoting the company's products in their annual report and accounts. This makes sound business sense. Shareholders are also consumers and if there are thousands of them the company might as well encourage them to buy its products.

DEVRO plc	FINANCIAL HIGHLIGHTS	
	2008	2007*
Dividends per share	4.45p	4.45p
Operating profit before exceptional items	£20.6m	£17.7m
– margin	11.2%	11.3%
Exceptional items	£(3.5)m	£0.7m
Profit before tax	£15.3m	£16.2m
Cash generated from operations	£31.3m	£23.4m
Capital expenditure	£12.7	£11.1m
Net debt	£24.0m	£27.3m
Gearing	21.5%	28.7%

* on a continuing operations basis

Figure 8.3 Introductory material: example of a financial summary

Source: Devro plc, *Annual Report and Accounts*, 2008.

A good example of how this can be done is A.G. Barr plc, the soft drinks manufacturer best known as the makers of *Irn Bru*. Its 2009 report and accounts is particularly striking. The 87-page report is bound in a double-page-thick front and back piece thereby giving it an extra eight pages in a vivid multi-colour display of its range of products. Barr then goes even further than most companies. The last page of the document and the two inside pages of its double back cover is given over to a remarkable display of 25 reproductions of its products in what can only be described as the ‘beer mat’ format. By contrast J. Smart & Co (Contractors) PLC, a much smaller company than Barr, has a very slim and sober presentation. Its 2008 report and accounts does not have any introductory material of any kind, still less any promotional material! But then construction companies are not into the mass consumer market.

Activity 8.2

Consult your copies of the three sets of annual reports and accounts that you obtained when completing Activity 8.1. Read through the introductory material. Write down the content of each company’s material in just a few words in three adjacent columns. Then compare your results for the three companies. On a scale of 1 to 5 (5 being the highest) rate how informative you find each company’s introductory material section.

Chairman’s statement

Most company chairmen like to include a report or statement of their own in the annual report. There are no statutory, ASB/IASB or Stock Exchange requirements for chairmen to publish a report so the format and content will vary from company to company. A relatively brief chairman’s report is shown in Figure 8.4.

You will probably find the chairman’s statement in the first few pages of the annual report. You can expect it to be anything from one to four pages in length. It will be largely narrative in style although there will almost certainly be some quantitative information. Research evidence suggests that chairmen’s statements are the most widely read section of an annual report, perhaps because they are mainly narrative.

Chairmen tend to adopt an upbeat approach about the recent performance of the company and they are usually extremely optimistic about the future. You must, therefore, read their reports with some degree of scepticism and you should check their comments against the detailed results contained elsewhere within the overall annual report and accounts. Nevertheless, chairmen have to be careful that they do not become too optimistic. Their remarks can have a significant impact on the company’s share price and they might have to answer to the Stock Exchange authorities if they publish misleading statements.

J. Smart & Co. (Contractors) PLC

CHAIRMAN'S REVIEW

ACCOUNTS

Group profits for the year before tax, including an unrealised deficit in revalued property, as required by the International Financial Reporting Standards, were less than last year turning out at £5,849,000. This compares with the figure for last year of £8,144,000 which includes an unrealised gain in revalued property. If the impact of revalued property on the figures is disregarded then a truer reflection of Group Performance emerges in the form of an underlying profit before tax of £8,504,000 (including £3,890,000 profit from property sales) for the year under review which would compare with a figure for the previous year of £6,200,000 (including £2,129,000 profit from property sales).

The Board is recommending a Final dividend of 10.50p nett making a total for the year of 13.50p nett which compares with 13.15p nett for the previous year. After waivers by members holding approximately 51% of the shares, the Dividends will cost the Company £664,000.

Profit adjusted for pension scheme deficit, dividends paid and fair value reserve when added to opening shareholders' funds brings the total equity of the Group to £97,314,000.

TRADING ACTIVITIES

Group turnover increased by 27%, own work capitalised decreased by 53% and other operating income increased by 4%. Total Group profits decreased by 28%. Underlying Group profits excluding an unrealised deficit in revalued property increased by 37%.

Turnover in contracting increased but a small loss was sustained. Private housing sales declined again. Sales in precast concrete manufacture increased slightly and a small profit was made.

The mixed commercial and residential development in McDonald Road, Edinburgh continues apace. We have completed the residential Joint Venture with Kiltane Developments Ltd (formerly Keane Developments Ltd) at Duff Street, Edinburgh. Over 50% of the flats have been sold.

FUTURE PROSPECTS

Rental income is expected to increase.

We have almost completed the second and final phase of our Joint Venture with Walker Group at Prestonfield Park, Edinburgh, comprising five Industrial Units, four of which are let or pre-let and one of which is partly let.

We have commenced a second speculative office block at Glenbervie Business Park, Larbert and a medium sized speculative industrial unit which is capable of sub-division into four smaller units at Bilston Glen, near Edinburgh.

The amount of contract work in hand is more than at this time last year. The majority of this work has been obtained on a negotiated and/or design and construct basis and the balance by traditional competitive tender, however, costs have been rising significantly. Private house sales have stalled.

These are uncertain times which make forecasting difficult. However, disregarding the impact on the Income Statement of including unrealised gains/deficits in revalued property, I anticipate that the underlying profit for the current year will be less than last year.

18th November 2008

J. M. SMART
Chairman

Figure 8.4 A chairman's statement

Source: J. Smart & Co. (Contractors) PLC, *Annual Report and Accounts*, 2008.

The contents of a typical chairman's statement could include the following items:

- *Results.* A summary of the company's results for the year covering turnover, pre- and post-tax profits, earnings per share and cash flow.
- *Dividend.* Details about any interim dividend paid for the year and any proposed final dividend.
- *Prospects.* A summary of how the chairman sees the general economic and political outlook and the future prospects for the company.

- *Employees.* A comment about the company's employees including any notable successes, concluding with the Board's thanks to all employees for their efforts.
- *Directors.* A similar note may be included about the Board of Directors including tributes to retiring directors.

We now turn to what we have called the 'corporate reporting' section of a company's annual report and accounts.

Activity 8.3

Referring to your three sets of annual reports and accounts, find the chairman's statement and in each set go through them very carefully. Are there any items not included in the summary shown above?

List the main contents of each chairman's statement.

Corporate reporting

Some companies call this section of the annual report and accounts 'the directors' report' but this can be a little confusing as the Companies Act uses the same term to refer to a much narrower type of report. We have, therefore, called this section 'corporate reporting' and classified it into three broad categories (as can be seen in Figure 8.5): (1) corporate governance; (2) the statutory directors' report; and (3) the directors' remuneration report.

Corporate governance

Strictly speaking the Companies Act 2006 requires much of the material disclosed in this section to be included in a statutory directors' report although it is permitted to present it elsewhere within the overall report and accounts. Many companies do just that and we will do the same because it simplifies our discussion.

As far back as 1991 the accounting profession, the Financial Reporting Council and the London Stock Exchange set up a committee (known as the Cadbury Committee) to examine what has become to be known as 'corporate governance'. The term refers to the way that companies and other entities are controlled and managed. The Committee

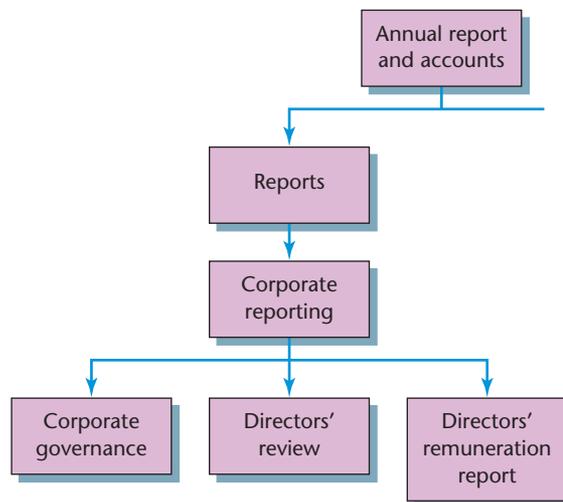


Figure 8.5 Annual reports: corporate reporting

reported in 1992 and since that time there have been a number of other influential committees that have worked on the practice and development of ‘corporate governance’.

While shareholders own companies, they appoint directors to run the companies for them. So it seems reasonable that the shareholders want to be assured that the directors know what they are doing, how they are going about it, and how successful they have been. Nonetheless, Parliament has largely left the business and financial communities to deal with the matter and there has not been any detailed legislation. The specific requirements are laid down by the London Stock Exchange for all listed companies in a document called the *The Combined Code*.

The Code is extremely detailed. It deals with both companies and institutional shareholders. In this chapter we are particularly interested in what the company and the directors have to disclose in their annual report and accounts. The details are included in Schedule C of the Code: *Disclosure of corporate governance arrangements*. There are two and a half pages listing the disclosure requirements so no doubt you will appreciate why this helps to increase the size (and weight) of annual reports and accounts. In summary, the main disclosure requirements are as follows.

- Application of the Code’s principles.
- Compliance or not with all the Code’s principles and if not, which, for how long and why.
- Details of the Board’s operations including the names of the chairman, deputy chairman, chief executive, senior independent director, independent non-executive directors and the names and members of the nomination, audit and remuneration committee members.
- The Chairman’s commitments along with any changes.
- Evaluation of the Board’s performance, its committees and the directors.
- Ways the Board keeps in contact with shareholder opinion.
- Description of the work of the nomination committee (i.e. to the Board) and the (directors’) remuneration committee.
- Directors’ duties in the preparation of the accounts and the auditors’ reporting responsibilities.
- Statement by the directors that the company is a going concern (this is particularly important at a time of recession).
- A review of internal control procedures.
- Reasons why there is no internal audit function (if that is so), duties and responsibilities of the audit committee, the appointment or otherwise of the external auditor and details of the external auditor’s non-audit services.

There are also various clauses covering the disclosure of some additional information on the company’s website about the nomination, remuneration and audit committees, the appointment of non-executive directors and the use of remuneration consultants. Similarly, additional information about the election of directors and the appointment of the external auditor has to be given in papers sent to shareholders.

Even in summary the above list of disclosure requirements is formidable. In order to give you some ideas of what is required Figure 8.6 shows the main headings used in two annual reports and accounts: those of Cairn Energy plc and Devro plc.

Activity 8.4

Once again turn to your three sets of annual reports and accounts. Check whether there is a specific corporate governance statement. Read each one. Then copy the headings into adjacent columns, listing as far as possible similar items on the same line opposite each other.

Cairn Energy plc 2008	Devro plc 2008
Opening paragraph (not titled)	1 Statement
The board	2 Board composition 8 Directors' training and development
Performance evaluation	9 Board performance evaluation
Independence of non-executive directors	
Hamish Grossart	9 Board performance evaluation
Board committees	3 Board and committee proceedings
1 Audit committee report	5 Report from audit committee 6 Auditor independence
2 Remuneration committee report	4 Directors' remuneration
3 Nomination committee report	10 Report from the nomination committee
Succession planning	
Organisational planning	
Directors' attendance at board and board committee meetings	
Relations with shareholders	7 Relationship with shareholders
Annual general meeting	
Directors' responsibility statement	
Going concern	13 Going concern
Internal control	12 Internal control
1 Strategic direction	
2 Operating management	
3 Risk management	
4 Assurance	11 Financial reporting
Compliance with the Combined Code	14 Compliance with the Code

Note: Devro presented its corporate governance statement in numbered paragraphs (as above). These have been placed as closely as possible to Cairn's paragraph headings.

Figure 8.6 Corporate governance statements: two examples

Sources: Cairn Energy plc, *Annual Report and Accounts*, 2008; Devro plc, *Annual Report and Accounts*, 2008.

Directors' report

The Companies Act 2006 requires company directors to prepare a report for each financial year. You will usually find it towards the end of the corporate governance section. The report is likely to be a very long one and to make up a high proportion of the overall annual report and accounts. No set format is required but it will probably be presented as a series of paragraphs under appropriate headings. The content of each paragraph will be mainly narrative but it is likely that some statistical information will also be included.

The information required to be disclosed by the Act is specified in three sections. The details are summarized below.

General contents

The general disclosure requirements are fairly minimal. However, the Secretary of State has the authority to put forward other requirements by way of ‘regulations’ so it is possible that over time this section will grow as new issues arise. The current requirements are as follows.

- The names of those persons who have been directors during the year.
- The principal activities of the company in the course of the year.
- The amount recommended by the directors to be paid by way of dividend.

Business review

The business review is likely to take up most of the directors’ report. Its purpose is to provide information to members of the company in order to help them assess how successful the directors have been in performing their duty in promoting the success of the company. Among the mandatory items to be included in the business review are the following.

- A fair review of the company’s business.
- A description of risks and uncertainties facing it.
- A balanced and comprehensive analysis of its development and performance of the company’s business during the year.
- A similar analysis of the company’s business position at the end of the year.
- The main trends and factors likely to affect its future development, performance and position.
- The disclosure of information relating to the company’s policies, the impact and effectiveness of such matters as the environment, the company’s employees, and social and community issues.
- Information about persons who have essential contractual or other arrangements with the company.
- An analysis of the company’s business incorporating key financial, environmental, employee and performance indicators.
- A reference to, and some additional explanations of, amounts included in the annual accounts.
- The steps taken to make sure that the auditors get all the information that they need in order to prepare their report.

Auditors

The 2006 Companies Act has six subsections dealing with matters that relate to the auditors. The following matters are of particular relevance.

- The directors’ report must contain a statement that the directors are aware that all relevant information has been given to the auditors, i.e. all the information that they need in order to be able to complete their report.
- The directors have taken steps to be aware of all relevant information that the auditors might need and that the auditors in turn are aware of that information.

The statutory and listing disclosure information required in a directors’ report is quite formidable. This part of the annual report and accounts can take up many pages. This is not the case with Cairn Energy plc’s 2008 annual report and accounts. It is only four pages long but even so there is a lot of technical detail to absorb, as can be seen from the main headings reproduced in Figure 8.7.

Opening paragraph (not titled)
Results and dividend
Principal activities and business review (there is a detailed separate business review)
Change of control
Directors
Share capital
Voting rights
Restrictions on voting
Variation of rights
Transfer of shares
Major interests in share capital
Charitable and political donations
Creditor payment policy and practice
Financial instruments
Election/re-election of directors
Powers of the directors
Articles of association
Disclosure of information to auditors
Reappointment of auditors
AGM 2009

Figure 8.7 Directors' report: main headings for Cairn Energy plc 2008

Source: Cairn Energy plc, *Annual Report and Accounts*, 2008.

Activity 8.5

Search through each of your three sets of annual reports and accounts. Find the section called 'Business Review' (or some such title). List the headings used in the review. Does it include all the requirements that we have listed in the above section? What is missing? If some items are missing try to find them elsewhere in the respective report and accounts.

Directors' remuneration report

The Companies Act 2006 requires that the directors of a quoted company must prepare a directors' remuneration report for each financial year. The Act does not explain the purpose of such a report so we can only go off its title.

It seems reasonable to assume that the purpose of a directors' remuneration report is to let shareholders know what the company is paying the directors to act on the shareholders' behalf. In practice the directors determine their own pay although it has to be approved by the shareholders. They very rarely object or get anywhere if they try to do so. The total amount paid to the directors may be very large indeed. It will usually be made up of a complex package of fees, salaries, bonuses, pension contributions and share options.

The Act itself does not go into much detail about what should be disclosed but the Secretary of State has the power to do so by ‘regulation’. The current disclosure requirements are similar to those that have been required for many years. We outline some of the main requirements below.

Information not subject to audit

- Names of directors and others involved in the consideration of the directors’ remuneration.
- Statement of the company’s policy on directors’ remuneration.
- A performance graph plotting total shareholder return against a broad equity market index.
- Details of the directors’ service contracts.

Information subject to audit

- Amount of each director’s emoluments and compensation.
- Each director’s share option arrangements.
- Long-term incentive schemes for directors.
- Pensions.
- Excess retirement benefits of directors and past directors.
- Compensation for past directors.
- Sums paid to third parties for a director’s services.

The above requirements can lead to a very lengthy directors’ remuneration report. For example, Robert Wiseman Dairies’ report is 10 pages long and Cairn Energy just over 12 pages. Directors’ remuneration reports are presented mainly in a narrative style in paragraphs under relevant headings. There can, however, be some quantitative and statistical data and (as required) at least one performance graph.

We do not have the space here to reproduce an actual directors’ remuneration report but what we have done in Figure 8.8 is to extract the main headings used in Devro’s directors’ remuneration report. Its report is a relatively short one: it is only four pages long!

Activity 8.6

Once more turn to your three sets of annual reports and accounts. Find the directors’ remuneration report. Read through each one. List all the main headings in each report in three adjacent columns. Try to put similar headings opposite each other. Is there a regular pattern? Or are there some items that are specific to one company? Note the differences.

Shareholder information

Following on from the directors’ remuneration report you will then almost certainly come across the ‘accounts’. We will come back to this section in the next chapter. After the accounts you may then find some miscellaneous information that is of particular relevance to the shareholders. If it is not at the back of the report then it may be included in the introductory section. The shareholder information is likely to include the following information.

Opening paragraph (not a heading)
Composition of the non-executive directors' remuneration committee
Policy on non-executive directors' remuneration
Composition of the executive directors' remuneration committee ('the committee')
Compliance
Company policy on contracts of service
Performance graph total shareholder return
Shareholding qualification
External directorships
Auditable information
Company pensions policy regarding executive directors
Directors' detailed emoluments
The Devro 2003 performance share plan
Directors' interests

Figure 8.8 Directors' remuneration report: main headings for Devro plc 2008

Source: Devro plc, *Annual Report and Accounts*, 2008.

Administrative matters

This may include notice of the annual general meeting, when the dividend may be paid, details about online shareholder services and share dealing, the names and addresses of the company officers and advisers, a financial calendar, and a list of the principal companies of the group.

Financial summary

A summary of the financial results over the last five years (possibly ten) may be included in this part of the annual report and accounts. It will probably give some quantitative and statistical data and some graphs depicting the main results covering such items as the revenue earned, profits, capital expenditure and number of employees. Such a summary is sometimes included in the accounts section of the overall annual report and accounts.

Glossary of terms

Some companies provide a list of the financial and technical terms used in their annual report and accounts.

Activity 8.7

List the shareholder information included in each of your three sets of annual reports and accounts. In most companies this information will be at the back but some of it may be at the front. Are there any items not included in the text above? If so, add them to the list outlined in the text.

Questions you should ask

In previous chapters we have stressed that the accounting information presented to you will have been prepared by your accountants and that you are unlikely to be involved in the detailed preparation. This chapter is different. The matters with which we have been dealing will be the responsibility of a large team of non-accountants with the assistance of the accountants. So what do you need to ask if you are involved in preparing your company's annual report? We suggest the following.

- What information is legally and professionally required and where should it be shown?
- What corporate governance information and other matters are we duty bound to disclose and where is the best place to put it?
- Are we sure that any statements made are in line with the financial data presented in the annual accounts?
- Do we have some evidence to justify any predictions we make about our future prospects?
- Are we presenting too much information to our shareholders and if so, can we cut it back?
- Is the design, format and general content of the material likely to encourage users to read it?
- Do the various reports contain any jargon and if so, can we either cut it out or reduce it?
- Are the publicity pages likely to annoy our shareholders?

Conclusion

A company usually publishes an annual report and accounts. It then supplies a copy to each shareholder and files one with the Registrar of Companies for public inspection. In this chapter we have examined the annual *report* section of an annual report and accounts. The next chapter examines the annual *accounts* section.

In order to make our study of an annual report a little easier, we have suggested that it can be broken down into three main sections. The first few pages usually contain some introductory material about the company such as its objectives and a summary of the financial year. In consumer-orientated companies there may also be many pages advertising the company's products. A chairman's report may be considered to be part of this section. You will probably find it towards the end of the introductory material. It will normally be narrative in style and upbeat in tone. The Chairman usually summarizes the financial performance for the year and reviews the prospects for the following year.

Following the introductory section most annual reports and accounts contain what we have called a 'corporate reporting' section although other terms are used. This section may be broken down into a number of categories. We have identified three: the corporate governance of the company, the directors' report and the directors' remuneration report. Much of the information disclosed in this section is now mandatory as part of the London Stock Exchange listing requirements but some of it is also a statutory requirement.

Thereafter there will almost certainly be a detailed section dealing with the ‘accounts’ (discussed in the next chapter) and following the accounts a brief section outlining some administrative matters that are of particular relevance for the shareholders. Such matters include company names and addresses, details of the AGM, a financial summary, and sometimes a glossary.

Key points

- 1 A company’s annual report and accounts contains a great many reports and statements, some of which are voluntary and some of which are mandatory. In this chapter we have dealt with annual reports.
- 2 It is possible to identify three main sections of an annual report, although the detailed content and structure varies from company to company. The length of such reports also varies depending partly on the size of the company and partly on its type, e.g. whether it is a manufacturing or a service-based company.
- 3 The introductory section contains some details about the company, a summary of its financial results for the year, the chairman’s statement details about the governance of the company and possibly some publicity material.
- 4 The specific reports that follow include a directors’ report and a directors’ remuneration report.
- 5 The annual accounts will normally then be presented followed by the last few pages of the overall document containing some miscellaneous information largely for the benefit of the shareholders.

Check your learning

The answers to these questions can be found within the text.

- 1 List three items that may be included in the introductory section of a company’s annual report.
- 2 What mandatory requirement covers the contents of a chairman’s statement?
- 3 List three items that will normally be included in a chairman’s statement.
- 4 Identify three main sections under which the ‘report of the directors’ may be classified.
- 5 What is meant by corporate governance?
- 6 What is *The Combined Code*?
- 7 Name six of its provisions.
- 8 What three items should be included in the general contents section of a directors’ report?
- 9 What is a business review?
- 10 Identify six items that it should include.

- 11 What information about the auditors should directors include in their report?
- 12 What is a directors' remuneration report?
- 13 Name six matters that should be included in it.
- 14 Identify three items that may be included in 'shareholder information'.

News story quiz

Remember the news story at the beginning of this chapter? Go back to that story and reread it before answering the following questions.

Research over many years has indicated that most users of annual reports and accounts have difficulty in coping with quantitative information. They are much happier when the information is presented in a narrative style. For this reason it is not surprising that the chairman's report is thought to be more widely read than most of the other reports.

Questions

- 1 Is it possible for financial statements to be presented in such a way that non-trained users will be able to understand them?
- 2 To what extent do you think that narrative reporting makes financial statements more understandable?
- 3 Does more information lead to less understanding?

Tutorial questions

- 8.1 'A limited liability company's annual report should be made easier to understand for the average shareholder.' Discuss.
- 8.2 Examine the argument that annual reports are a costly irrelevance because hardly anyone refers to them.
- 8.3 Should companies be banned from including non-financial data in their annual reports?

Further practice questions, study material and links to relevant sites on the World Wide Web can be found on the website that accompanies this book. The site can be found at www.pearsoned.co.uk/dyson