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The following principles have been prepared as an adjunct to the Shareholder Friendly Report example which was developed in 2005 by AICD in conjunction with PricewaterhouseCoopers. Examples of how each principle could be applied in practice are provided in the Policies & Papers section of www.companydirectors.com.au

Principles Of Good Communication With Shareholders

The principles set out below are intended to provide practical guidance to company directors and others regarding the preparation of simplified reports in a wide variety of companies, where the intended audience is mainly retail shareholders. Adherence to the principles is regarded as good practice when producing simplified reports.

Principle 1: A Simplified Report should present a balanced view

It is important that companies present a balanced view of their activities; not only the good points. As such, simplified reports should not be viewed in the same light as "marketing documents".

This principle should apply not only at one point in time but also in relation to successive simplified reports. In this regard, information provided by companies should not seek to change past measures used to highlight performance merely because the company is no longer seen in a favourable light.

Principle 2: A Simplified Report should be in plain English

Australia has one of the highest proportions of adult share ownership in the world. According to a 2004 ASX survey, 55 percent of adult Australians (8 million people) include shares as an asset class in their investment portfolio. Many of these investors are not financially sophisticated – often they are "mum and dad" investors. Companies should have regard to the nature of their existing and potential shareholders in the preparation of simplified reports. In particular, language used should not be overly technical and a glossary of abbreviations and terminology should be provided. Where measures are used, definitions should be provided as to what the measures are. Shareholders should not need to rely on expert advice to understand or interpret a simplified report.

Principle 3: A Simplified Report should be written specifically to inform shareholders about company performance

A major purpose of annual reports, whether in full or simplified statutory form, is to inform shareholders about the performance of a company. Not only should reports assist shareholders with their investment evaluation, they should also serve as an account of the stewardship of the board and management.

Principle 4: A Simplified Report should be designed to provide a clear understanding of the components of the financial results of the business, rather than just statements which comply with regulatory requirements

One of the major drawbacks of existing concise reports is that they have a conformance focus; to the point where much of the information contained in them is incomprehensible to most shareholders. When designing summarised financial statements, a goal should be to ensure they are understandable and presented in a more 'user friendly' format than existing statutory layouts. In this regard it should be considered whether there is important shareholder information that needs to be included or explained, even though regulatory standards might not require it.

In order to ensure the integrity of simplified reports, it is important that financial totals contained in summarised financial statements are reconciled to the financial statements contained in the full statutory annual report.

Principle 5: A Simplified Report should set out key highlights

Ideally key shareholder information should be provided at the beginning of a simplified report. This would often include overviews of both financial and operational highlights.

The presentation of highlights should include pertinent financial and non-financial measures, relevant to the company and the main industries in which it operates. Of particular relevance are key business drivers.

Examples of widely used ratios include:

- Earnings before interest, taxes depreciation and amortization (EBITDA) margin = EBITDA/Revenue;
- Earnings per share; and
- Return on equity.

Examples of ratios useful in certain industries include:

- cost to income ratios for banks;
- percentage of seats filled and revenue per passenger kilometres for airlines; and
- average revenue per user (ARPU) for telecommunication companies.

Those measures used should be defined (refer to Principle 2), and presented in tables and graphs where they lend themselves to this. The analysis should include a 5 year history, where it exists.

Principle 6: Company performance should be described against stated corporate strategies, although companies should assess what level of strategic disclosure is appropriate in their circumstances

Companies should disclose the broad strategy that follows from their corporate objectives. This should occur in such a way investors remain confident with the direction of the company, but does not jeopardise business interests of the company. As a guiding principle, companies should not knowingly disclose aspects of their strategy in the name of good communication that would hurt the company's business through the actions of its competitors.

Principle 7: Companies should consider their own circumstances when deciding whether to include financial forecasts or projections

Forward looking information can assist shareholders in understanding management expectations regarding future corporate performance. It also has the potential to lower a company's cost of capital on the basis there is less uncertainty for investors.

The future is of course uncertain, and actual results can differ materially from earlier expectations. The ability to forecast results accurately will be influenced by various factors including the industry in which a company operates and its size. In those circumstances where the company's environment is relatively volatile, the board and management may quite understandably be reluctant to provide forward looking information. This problem is exacerbated so long as there remains no legislative safe harbour for such formation (ie an extended statutory business judgment rule).[1]

ASIC has issued Policy Statement 170 "Prospective Financial Information" to guide the provision of forward looking or "prospective" financial information in prospectuses, including a discussion on reasonable grounds for prospective financial information and how prospective financial information should be disclosed. Many of these principles are equally applicable to forward looking statements in simplified reports.

[1] AICD has argued for an extension to the statutory business judgement rule contained in section 180(2) of the Corporations Act.

Principle 8: A Simplified Report should include summarised divisional reports

Divisional summarised reports for diversified or multinational companies give shareholders insights into what is occurring within key areas of the company's business, which are not apparent from aggregated information. It is envisaged that divisional reports will typically be prepared on the basis of existing organisational lines. In some cases it may be considered more meaningful in assessing the risks and returns of a company to present information on another segmented basis (eg on a geographical basis). In any event, the divisional reports should be written as performance reports, and in a format consistent with the CEO's Review of Operations.

Principle 9: A Simplified Report should include Reviews by the Chairman and the CEO

It is customary for periodic reports to contain reviews by the Chairman and/or CEO. In view of the role of boards, a Chairman's review might usefully focus on corporate strategy and governance, while the review by the CEO in contrast would typically focus on operations and risk management. In some cases it may be considered desirable to combine these reviews (eg where there exists an Executive Chairman). Whether they are separate or combined, the reviews should include an evaluation of past performance, current direction and an outline of quantified future targets, key assumptions and sensitivities.

Principle 10: Consideration should be given to the appropriateness of a directors' declaration and/or an auditor's report

A directors' declaration can help to assure shareholders that in the board's opinion the report is presenting a true financial picture of the company and that the company is not at risk of insolvent trading. Ideally there should be a directors' declaration which states that the summarised financial statements and notes contained in the simplified report are consistent with the full annual statutory financial reports from which they are derived and which give a true and fair view and the financial position and the performance of the company and its consolidated entities.

An auditor's report can help give shareholders greater confidence that, from an independent standpoint, the summarised financial statements give an accurate reflection of the company's financial affairs as presented in the fully compliant annual report. To the extent there is an auditor's report, it should make it clear that:

- in relation to the summarised financial statements, auditors are examining whether the summarised financial statements are consistent with the company's full financial report; and
- in relation to the audit work on the Chairman's and CEO's reports, auditors are not auditing this information, instead merely identifying where such information contradicts disclosures in the summarised financial report.

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