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Annual Reports: What a difference a yearly report makes

Craig McGuire - 12 Jul 2004 00:00

Companies are now producing their second annual reports in the post-Sarbanes-Oxley era, and can better gauge how much information, and what kind, to use. By [Craig McGuire](#).

To measure the profound impact 2002's Sarbanes-Oxley Act has had on financial and corporate communications in the US, take a look at the opening lines of Tyco International's past three annual reports.

In the 2001 report, with news yet to emerge that former Tyco CEO Dennis Kozlowski and his cronies had bilked the company out of more than \$600 million, the opening line in the letter to shareholders read: "Fiscal 2001 was of outstanding performance for Tyco International."

With the scandal in full bloom the following year, the opening line was dramatically different: "The past year was terrible for Tyco, its investors, and its employees," according to incoming CEO Edward Breen.

Finally, with the storm subsiding in 2003, Breen stated: "What a difference a year makes," prefacing a sobering report that was more nuts and bolts than those of years past.

"Tyco's annual reporting exemplifies how, for many companies, the annual report is now less a marketing tool and more a document of transparency," says Bradley Smith, director of marketing at Shareholder.com.

Whereas last year most IR pros grappled with unknowns as they tried to decipher Sarbanes-Oxley, there is more confidence in corporate America this year.

"In predictable ways, transparent reporting didn't increase, but rather stood still or contracted as corporations held their breath and hoped the scrutiny would subside," says Andrew Maydoney, VP at Sametz Blackstone Associates, an annual report specialist in Boston. "Today there is a consistent [demand] for transparency, accountability, and integrity."

With IR pros facing regulations, fallout from shareholder insurrections, and suspicious regulators, there seems to be less of a tendency to be, well, cute.

"What is different this year is there is less marketing, less gloss with many annual reports, which means many are just smaller publications," Bradley adds. "Many large corporations, like Microsoft and eBay, have scaled back the branding elements of their reports to more concisely deliver required information."

Many companies today have sought to soothe their savage shareholders by adding healthy

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helpings of corporate governance information into the annual. The annual is the defining document for a company's yearly performance, with more exposure and a longer shelf life than any other document produced.

As such, if a company has not done so already, experts suggest adding corporate governance sections to a report. They should be separate of the letter to shareholders and aimed at providing details on the independence and makeup of the company's various boards and committees, says Christian Hodges, founder/principal of Ashton Partners, a New York-based agency.

"One client, a leading provider of automobile salvage and claim services, added a letter from its chairman directly after the CEO's letter to stockholders that outlined key areas of its corporate governance program," Hodges says. "This letter highlighted the independence of the company's director, the diverse experience of the individual board members, the addition of increased financial-statement transparency, and the separation of the chairman and CEO duties, which, incidentally, had been separate at this particular company for years."

As Sarbanes-Oxley mania subsides, Hodges expects these sections to be less pronounced than they are today, yet they will likely always have more presence than prior to the act.

Perhaps the most common practice for navigating the act this year is fusing a scaled-down version of the annual, sans hyperbole, with the company's 10-K (the document all publicly traded companies must file annually with the SEC).

"The lingo for this is a '10-K wrap,' which is where they print a few pages of positioning statements - CEO letter to shareholder, key points - and bind those pages around the 10-K," Bradley explains.

"I saw this technique used with a few of our clients, including one in the storage networking industry that went from a longer report in 2002 that included many graphics and customer examples, to a much simpler 10-K wrap for its 2003 report," Hodges says. "Because the 10-K is a completed, fully edited document already on file with the SEC, using it eliminates the possibility of inconsistencies and reduces the overall editing time."

While wrapping isn't necessarily a new phenomenon, new deadline pressures ensure it will be a more widely used strategy.

"Small companies with limited resources are particularly concerned with meeting the new, shorter deadlines," says Michelle Marks, principal of Ideas On Purpose, a New York-based firm. "But the biggest effects of Sarbanes-Oxley will come this year. With deadlines even shorter, all but the largest companies will reconsider making financials available in a form other than a 10-K."

"One of our clients, Octel, opted to produce a full report for 2003, growing the financial section by adding two notes," Marks says. "But it is now debating the merits and realities of including the financials in 2004. So, we are discussing a 10-K with a narrative section as an alternative."

Still, despite all of its advantages, from the perspective of communications, using a sophisticated document such as a 10-K, rather than interpreting the information for shareholders, has its drawbacks.

"It's a disadvantage to investors as the language used in the 10-K is generally more arcane and jargon-filled than the typical financial section of an annual report," Marks says. "However, companies of all sizes are re-evaluating priorities and communications channels, and we may see a change in approach across the board this year."

Inevitably, no matter what form a company's annual report takes this year, delivering it through multiple channels is not only important for actually disseminating the information, but also in demonstrating to regulators that it is sincere in its efforts to comply with regulations.

"We will see more aggressive web distribution each year moving forward," Marks predicts.

"Our clients distribute annual reports to all shareholders via the company's transfer agent, along with annual meeting notice and proxy card," says Gerald Freisleben, president of Foley/Freisleben LLC. "We're responsible, in most cases, for maintaining the content on the IR section of clients' corporate websites, so certainly the annual reports can be found there in downloadable PDF format. Other methods we recommend include electronic transmission and CD-ROM."

Technique tips

Do fully review the requirements of Sarbanes-Oxley, as they relate to annual reporting, including its new deadlines

Do consider adding corporate governance elements to your annual report

Do develop your 10-K filing and annual report in tandem to reduce the possibility of inconsistencies

Don't limit disclosure of key information out of fear of Sarbanes-Oxley

Don't downplay the importance of the annual as a communications vehicle

Don't reduce the distribution of your annual report

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