



Annex 29

GUIDELINES ON THE ANNUAL REPORT

Table of Contents

PART I. DRAFTING, APPROVING, AND PUBLISHING THE ANNUAL REPORT.....	303
1. <i>The Importance of the Annual Report for the Company</i>	304
2. <i>Preparing Information for the Annual Report</i>	304
3. <i>Procedures for the Approval and Publication of Annual Reports</i>	305
4. <i>The Annual Report's Structure</i>	307
PART II. A MODEL STRUCTURE OF THE ANNUAL REPORT	307
1. <i>The Cover Page</i>	307
2. <i>Overview</i>	307
3. <i>The Address of the Company's Chairman of the Supervisory Board</i>	308
4. <i>Information about the Company</i>	308
5. <i>Management's Discussion and Analysis</i>	309
6. <i>Market Share, Sales, and Marketing</i>	310
7. <i>Securities and Equity</i>	311
8. <i>Corporate Governance Structures and Principles</i>	312
9. <i>Environmental, Social, and Economic Sustainability</i>	313
10. <i>The Revision Commission's Conclusions and Report</i>	313
11. <i>The External Auditor's Opinion</i>	314
12. <i>Financial Statements, Notes, and Comments</i>	314

Part I. Drafting, Approving, and Publishing the Annual Report

The purpose of these guidelines is both to summarize the standards and requirements of current Russian legislation, and to succinctly present good corporate governance practices relative to drafting annual reports for Open Joint Stock Companies. This document consists of two parts. The first part



contains general recommendations on procedures for drafting, approving, and publishing the annual report, while the second part contains specific guidelines and recommendations regarding the structure and content of annual reports.

1. The Importance of the Annual Report for the Company

The annual report is more than just a legal requirement — it should be seen first and foremost as an information tool for the company's shareholders. It may also serve to highlight the company's accomplishments and help attract potential investors. The annual report should, however, present a balanced view. Balance requires that the company not only focus on successes, but on setbacks as well. The manner in which information about the company is presented, how that information is grouped, and the key elements of the document's layout and structure can all have a significant impact on readers. The specific structure chosen by the company will of course depend upon the nature of its business activities, and the specific goals and objectives chosen for the annual report. Ultimately, it is the information contained in the annual report that will define its quality.

2. Preparing Information for the Annual Report

a) Defining the aims of the company's information disclosure policy

The principal aims and purposes of disclosing information in the annual report should be clearly defined at the outset of the preparation process, and might include any of the following:

- To demonstrate to shareholders the ability of management to respond successfully to changes in the external business environment;
- To convince potential investors of the benefits of investing in the company;
- To convince key stakeholders of the company's ability to withstand industry crises; and
- To inform the markets of the company's earnings, how earnings were generated, and future performance potential.

b) Defining the target audience

Defining the target audience and its expectations in terms of disclosure is important. The potential target audience may include one or more of the following groups: shareholders, potential investors, state and local authorities, customers,

Annex 29. Guidelines on the Annual Report

suppliers, creditors, and employees. At a minimum, the following questions about the target audience must be addressed:

- Who is the intended recipient?
- What level of knowledge and skills in the fields of management, finance, and marketing, and the company's industry and sector does the potential reader have?
- What effect should the report have on the reader?
- What information about the company is the most important to potential readers?

c) Defining responsibility

The Supervisory Board should ultimately be responsible for supervising the drafting of the report. Nevertheless, it is advisable to establish a separate committee or charge a specific person with the responsibility for preparing the information and drafting the report.

d) Defining the contents

In terms of preparing the information to be included in the report, it should be borne in mind that the report should do more than simply recite the company's recent financial achievements — it should reflect the dynamics of the company's current and future development. For example, today's market and potential investors not only require information about the company's recent profits, but also information about the company's investments in R&D, its market share, capital expenditures, technological innovations, and a description of its corporate governance, social, and environmental policies. The prevailing practice today is to divide the annual report into various sections for quick reference. If the company intends to attract foreign investment, the report should be drafted in a number of languages, ideally in English.

3. Procedures for the Approval and Publication of Annual Reports

In Russia, procedures for the preparation and publication of annual reports of Open Joint Stock Companies are regulated by:

- The Federal Law of December 26, 1995, No. 208 on Joint Stock Companies;
- The Federal Law of November 21, 1996, No. 129 on Accounting and Book-keeping;

The Russia Corporate Governance Manual

- The Order of the Ministry of Finance of the Russian Federation of November 28, 1996, No. 101 on Procedures for the Publication of Financial Statements by Open Joint Stock Companies;
- The Federal Commission for the Securities Market (FCSM) Resolution of May 31, 2002, No. 17/ps on Approving the Regulations on Additional Requirements for Preparing, Calling, and Conducting the General Meeting of Shareholders; and
- The FCSM Resolution of April 04, 2002, No. 421/r on Recommendations to the Application of the Code of Corporate Conduct (hereinafter the FCSM Code).

The principal requirements of Russian law regarding the approval and publication of annual reports can be summarized as follows:

- The executive body is responsible for the annual report;
- The data contained in the annual report must be verified by the company's Revision Commission, and certain companies are also required to have their annual financial statements verified by an independent External Auditor;²¹⁴
- The annual report has to be preliminarily approved by the company's Supervisory Board, but not later than 30 days before the date of the Annual General Meeting of Shareholders (AGM);
- The annual report must be signed by the General Director, as well as the chief accountant, and contain a specific statement regarding its preliminary approval;
- Companies are required to disclose their annual reports to shareholders;
- The publication of financial statements is subject to AGM approval, but good corporate governance practices dictate that they be publicly disclosed, ideally through the company website as well; and
- The annual financial statements must be published no later than June 1st of the year following the reporting year.²¹⁵ The publication of financial statements shall mean public disclosure through publication in the mass media, and they are deemed publicly disclosed in the event of actual publication in at least one

²¹⁴ Law on Auditing, Article 7, Clause 1, Paragraph 2 provides that companies must have an annual, external audit conducted by a certified independent External Auditor (or a licensed audit company), when the company is incorporated as an Open Joint Stock Company, or has revenues for the reporting year greater than 500,000 times the minimum wage, or has a book value of assets as of the year-end greater than 200,000 times the minimum wage.

²¹⁵ Order of the Ministry of Finance of the Russian Federation, No. 101 on Procedures for the Publication of Financial Statements by Open Joint Stock Companies, 28 November 1996, Section 1.1.

Annex 29. Guidelines on the Annual Report

printed media as may be set forth by the charter or decision of the General Meeting of Shareholders (GMS).

4. The Annual Report's Structure

Until recently, there was no legal regulation of the structure of annual reports in Russia. Lately, the trend has been to toughen regulations in this area. The FCSM Regulation No. 17/ps on Approving the Regulations on Additional Requirements for Preparing, Calling, and Conducting the General Meeting of Shareholder contain requirements for the contents of annual reports. The FCSM Code also includes certain recommendations with this regard.

In accordance with requirements of FCSM Regulation No. 17/ps and the FCSM Code recommendations, the annual report should contain a statement of the company's industry position and business; disclose the company's sales and financial performance; report on the payment of dividends; include detailed information about the company's securities; list extraordinary transactions and related party transactions; disclose information about the company's Supervisory Board and the executive bodies, as well as information regarding remuneration; and finally, disclose information regarding the company's corporate governance practices, and its employee, social, and environmental policies.

Part II. A Model Structure of the Annual Report

1. The Cover Page

The cover page should be attractive, professional, and designed to reflect the principal idea and the main focus of the company's business, and should include, if applicable, the following:

- The company's logo or trademark; and
- The company's slogan or motto.

2. Overview

This section should provide the reader with a brief overview of key events and issues that have had an impact on the company — both with respect to the past financial year and in the foreseeable future.

3. The Address of the Company's Chairman of the Supervisory Board

The address of the company's Chairman of the Supervisory Board (commonly referred to as the Chairman's report) must be balanced and targeted specifically at its intended audience. A principal theme or topic should be chosen, and typically, the following items should be included:

- A general discussion of the company's financial results and highlights;
- An overview of the company's share performance and the payment of dividends;
- The company's principal achievements during the year;
- A brief overview of the general business environment and the company's principal markets;
- The company's business strategy and plan, and product initiatives and innovations; and
- Principal changes in the company's management structure.

4. Information about the Company

This section is critical, especially for potential investors. It is necessary to bear in mind that much of the intended audience does not necessarily possess sufficient historical or up-to-date information about the company. Accordingly, this section should provide a sufficiently comprehensive description of the company, and might include the following main points:

- A brief history of the company, its products or services, and a description of its governance structure (consider presenting the company's structure in the form of a diagram);
- The company's organisational structure, including any subsidiaries and related companies;
- An overview of the main events of the year that affected the company's development and success;
- A brief review of the company's key markets and product groups;
- An overview of its production capacity and output, where applicable; and
- Any other information, including contact and reference information about the company, and information about its achievements and policies that might be deemed interesting or attractive for potential investors.

5. Management's Discussion and Analysis

Financial information about the company, including the utilization, sale, and purchase of assets, is essential for both current shareholders and potential investors alike. Therefore, in this section entitled Management's Discussion and Analysis (MD&A) it is advisable to provide a comprehensive picture of the company's assets and financial situation, and disclose this information to an even greater degree than that currently required by law. For example, certain business transactions between the company and its senior executives or major shareholders should be disclosed. As another example, it may be desirable to present net profit figures both as a total net profit, and net profit broken down by products or market segments. In addition, detailed information regarding changes in asset composition, an analysis of the company's liquidity, its profit margin and debt to equity ratio, and the percentage of export earnings relative to the total earnings of the company for the year should be included. The sections presenting the financial results and condition of the company should contain both current and historical data covering, for example, the preceding three-year period. Since the company's executives often have the most complete information about the company's financial situation, the annual report should include management's discussion and analysis of the results and the factors affecting its financial situation, and the current trends that are likely to affect the company's financial strength in the future. The following topics should be addressed in detail:

- A review of significant business transactions entered into or contemplated for the future;
- An analysis of the factors contributing to the discrepancy between planned and actual results;
- A thorough presentation of the company's accounting methods and policies, including the legal basis on which the annual report was prepared, which accounting standards were utilized in preparing financial statements beyond Russian Accounting Standards (RAS), e.g. International Financial Reporting Standards (IFRS) or U.S. GAAP, and any deviations from these standards, methods for asset reporting (for example, depreciation and amortization of assets), and methods for cost and tax accounting;
- Inflation figures and foreign currency calculations and accounting, if applicable;
- An analysis of any restructuring of the company and the effects of such restructuring;

- A detailed and comprehensive analysis of the company's financial results, including, but not limited to, presentation of data on sales, product costs, operational profits broken down by business units, products or market segments, a breakdown of operational and non-operational income and expenses, earnings before tax, depreciation, and amortisation, net profit, taxes on profit, and earnings per share;
- A detailed and comprehensive analysis of the company's financial condition, including, but not limited to, a presentation of data regarding the company's balance sheet, such as information on the composition of current assets including inventories, payables and receivables, equity structure, the debt to equity ratio, details as to current and long-term liabilities and debt repayment, and changes in the company's policy regarding asset and debt management;
- The company's liquidity and sources for additional funding for current and long-term operations; and
- A detailed description of the company's risk management system, including a description of the principal risks associated with the company's business operations, e.g. market price and interest rate fluctuations, and an overview of the procedures employed for managing and minimizing such risks, including the setting aside of additional reserves and the purchase of insurance policies.

6. Market Share, Sales, and Marketing

In general, this section should enable the reader to obtain a comprehensive understanding of the company's sales and marketing position in its principal markets. Further, this section should provide adequate information about management's activities and efforts aimed at strengthening the company's position. To facilitate the reader's understanding, it is especially appropriate and desirable in this section to utilize tables, graphs, and diagrams to present and illustrate the data, and additionally, it may prove useful to provide references to the financial statements and cash flows when explaining how certain events or decisions affected the financial results of the company. Consider providing a detailed analysis of the following:

- Key market trends, both macro- and micro-economic;
- Summarize the company's competitive environment and changes in its market share;
- Present sales data expressed in unit volumes and in monetary figures, and by market segments and products as applicable;

Annex 29. Guidelines on the Annual Report

- Present detailed product and price information, including new products, sales, and pricing policies;
- Provide a summary of the company's relationship with its principal suppliers; and
- Summarize management's efforts to counteract negative developments in the company's markets, and efforts aimed at maximizing the company's competitive advantages.

7. Securities and Equity

This section is primarily addressed to shareholders and potential investors. It should include information about the company's ownership structure, and a description of the main principles of the company's dividend policy and disclosure of dividends paid or reasons for non-payment. The aim of this section is to give shareholders and potential investors a thorough understanding of the current value of the company's shares, existing stock market trends, and associated risks. Characteristically, this section utilizes an abundance of charts and graphs to present the data. It is important as well to note that, in accordance with Russian law, the company must disclose information on shareholders who own 20% or more of the company's shares. However, this is insufficient information for understanding the true ownership structure of the company. Therefore, it is also recommended that information on shareholders who own as little as 5% or more of the company's shares be disclosed. While disclosing this information, the company should also disclose any information in its possession about indirect ownership of the company's shares. The following issues should be covered:

- Information regarding the issuance of company securities and its capital share structure, including information on the number of outstanding shares, a list of major shareholders, and any share buyback plans or other acquisitions and divestitures implemented by the company;
- Any steps undertaken by management to raise the market capitalization of the company;
- Current and historical trading data for the company's shares, including maximum and minimum prices and volume of shares traded over a specified period; and
- A description of the company's dividend policy and payments of dividends.

8. Corporate Governance Structures and Principles

In general, shareholder protection mechanisms, good board practices, disclosure and greater transparency, as well as the establishment of adequate risk management and internal control mechanisms, lead to more than just an increased flow and volume of investment capital — they should also lead to increasing operational and managerial efficiency, increasing growth and profits, and enhancing reputation. For these reasons, it is imperative that the annual report include a section on the company's corporate governance policies and procedures.

In addition to providing a diagram of the company's governance structure, the annual report should contain the company's statement of firm and continuing commitment to corporate governance principles and practices. Further, it is worthwhile to consider providing a list of corporate governance principles that the company has adopted and adheres to, and provide a detailed accounting of the company's efforts and successes in satisfying such principles during the reporting period. While no list can be considered completely exhaustive, the following items regarding the corporate governance policies and practices should be considered for inclusion in the annual report:

- The company's statement of firm commitment to the most progressive principles and practices of corporate governance;
- A statement of compliance with the principles of the FCSM Code and regulations;²¹⁶
- Details regarding the composition of the Supervisory Board, including background information for each member, and a statement as to which directors are independent;
- A statement regarding the company's remuneration policy, and the details of the individual remuneration of Supervisory Board members and senior executives during the reporting period;
- A statement regarding the existence and competencies of any Supervisory Board committees, and details of their relationship and interaction with the company's Supervisory Board;
- A disclosure of the company's risk management and internal control systems, and a statement of compliance therewith;
- A detailed disclosure of all material related or interested party transactions entered into or that were being considered during the reporting period;
- A disclosure regarding the existence and role of the Audit Committee or Revision Commission in ensuring transparency and full information disclosure;

²¹⁶ For an example of a detailed statement of compliance, see the IFC Russia Corporate Governance Project's website under www.ifc.org/rcgp.

Annex 29. Guidelines on the Annual Report

- A disclosure of the process for evaluating the performance of the company's Supervisory Board and executive bodies, including information regarding any performance evaluations conducted during the reporting period; and
- A statement regarding the adoption of a code of ethics and adherence thereto.

9. Environmental, Social, and Economic Sustainability

The establishment and implementation of an environmental policy is one area in which, regardless of the existence or absence of mandatory disclosures and practices, the companies themselves should be proactive, and voluntarily develop and disclose their policies, projects, and related expenses. As to personnel, labor, and social policies, the annual report should consider including a discussion of the following topics:

- The main areas in which the company has concentrated its efforts, especially in terms of its environmental policy, and its principal achievements;
- The social expenses incurred by the company and contributions to any charities;
- The number of employees and current changes being experienced or implemented;
- Its primary goals and important steps taken in terms of personnel development; and
- Wages and growth rate for wages.

10. The Revision Commission's Conclusions and Report

Pursuant to Russian law, the Revision Commission's report regarding the results of its inspection of the business and financial performance of the company must contain a verification regarding the accuracy of the data contained in the annual report and financial statements of the company. While the Revision Commission typically conducts an annual audit and inspection of the previous year's results, Russian law also provides certain circumstances and procedures for conducting extraordinary audits at different times during the year.

The scope of duties and responsibilities of the Revision Commission include the following:

- An inspection of the financial documents and reports, and an analysis of the accuracy and completeness of the company's accounting, tax and statistical reporting;

- An analysis of the company's financial condition, specifically, its solvency, asset liquidity, debt to equity ratio, net assets, and charter capital;
- Developing recommendations for management;
- Conducting an inspection of the timeliness and correctness of payments; and
- Verifying the reliability of data included in the annual reports of the company and the annual financial statements.

11. The External Auditor's Opinion

It is important to note that the company must under legally defined circumstances employ the services of an independent External Auditor whose opinion would be included as a separate section of the company's annual report. The focus of the External Auditor's opinion is on whether or not the financial statements of the company are prepared, in all material respects, in accordance with an identified financial reporting framework, and whether they can be relied upon. It gives shareholders, managers, employees, and market participants an independent opinion about the company's financial position and, if performed properly, should attest to the accuracy of the statements. An independent external audit conducted by a publicly recognized accounting firm normally enhances the company's credibility and prospects for attracting investment.

12. Financial Statements, Notes, and Comments

The financial statements are to present a true and fair view of the company's financial position to enable shareholders and other market participants to gauge the company's performance and assess the stewardship of the executive bodies. Any comments and presentation of financial statements should contain an explanation of the principles used in preparing those financial statements, and their effect on the key performance indicators of the company. The company should disclose and provide detailed comments regarding the following:

- The balance sheet;
- The profit and loss statement;
- The statement of changes in owners' equity
- Its cash flow statement
- The notes to the financial statements; and
- Explanations to financial statements.