



How to Read Board of Directors Report of Listed Company



The capital market authority would like to point out that this manual is indicative only. It is not a replacement to any related rules or regulations or instructions. It is not by any chance considered as a reference to any procedures or legal responsibilities arising from related parties.

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Introduction

This booklet aims to assist the shareholder to achieve the following:

- 1- Optimal use of the Board of director's report.
- 2- Focusing on the important issues and raising questions about them.
- 3- Promoting shareholders understanding of a company's activities, reform of its board of directors, and performance.

This booklet will address topics and questions related to reading and evaluating board of director's report.

Board of Director's Report

The Board of Director's (BOD) report is a report that must be provided by each joint stock company listed on the Saudi Stock Exchange to investors according to the listing rules issued by the Capital Market Authority along with the financial statements of the company.



This report is considered to be an important source of information and data needed by investors to identify the main activities of the company, the nature of its investments, the restructuring of management, and the level of performance during the fiscal year. Investors rely on this report when it comes to their investment decisions, in addition to the other financial data.

It is an annual letter from the board of di-

rectors to shareholders and investors, which includes a range of basic information about the company's activities highlighting projects done in addition to the analysis of the operational and financial results. On the other hand, the report provides a clear vision about the structure of the company's board and the extent of its commitment to the corporate governance regulations

Corporate Governance

Corporate governance is the system that specifies the rights and responsibilities of various parties such as the board of directors, managers, shareholders and other stakeholders in the company.

General assembly meetings

The Board of directors of a listed company reviews the board of director's report in the annual general assembly for the purpose of disclosure and approval by the assembly. The report includes specific items such as; but not limited to; dividend policy, remunerations of members of the board of directors, and related party transactions.

Board of Director's Report and your Investment Decision

One of the main investment principles refers to the need to avoid investing in a company where the investor is unaware of its activities. As a first step to identify the company's activity is through board of director's report which is considered as an annual basic reference. In addition, it includes other essential information on company activity. For example; a summary of company's assets, financial obligations to others, liabilities, and the results of the company's financial performance, as well as leading the company's strategic, operational, and structural decisions.

Why read the board of director's report?

Because the report is issued by the listed company at the end of the fiscal year and includes the company's activity, restructuring of its board of directors, its performance, its operating and business results, and main strategic decisions taken during the year.

How to Get the Report

There are different ways to get the annual report. The Investor can get it from the website of the Saudi stock exchange (Tadawul) under the company's profile, from the company's official website, or by visiting the company's headquarters.



Board of Director's Report and the Financial Statements

The Board of director's report contains the chairman's message, information about the company's activities, and a summary of major strategic and operational decisions. In addition to a summary of the company's assets and liabilities, it is an analytical review for the operational results and the current and expected risk. On the other hand, the report is considered to be a very important source to identify

the company's commitment to the provisions of the corporate governance regulation. The report should include the implemented provisions of these regulations as well as the provisions which have not been implemented and the justification for not implementing them. The financial statements also contain annual profit and loss on the current financial situation, income, changes in shareholders' equity, and cash flows.

An Overview of Some Sections of the Reports

- **Chairman's Message:** a message from the top of the company to investors, which includes the most prominent business transactions over the past year, a preview of the company's expansion plans, and the board of director's expectations on company performance. In addition, the message may include a description of major challenges and opportunities faced by the company or will face in the coming years. It should be noted that the chairman message focuses –most often- on the fundamental aspects that have an impact on the development of the company.

- **Chartered Accountant Report:** this report gives a clear cut picture on the position of the company's management to enable the accountant to get all the data and clarifications acquired. Also, it points out to any penalties charged to the company and how compatible the company's accounts are to reality.

- Board of director's report is not a part of the annual financial statement of the company.
- Board of director's report provides information about that company.
- Board of director's report is a letter from the board to the shareholders on the company's performance.

- **Descriptions of the Principle Activities of the Company:** the first and most important thing to be addressed by the company in its board of director's report is a description of its business areas. It's important to describe a company's activities and acknowledge the profitability and level of risk of each activity separately which will help the investor to have a better investment decision. Also, such description shows the level of contribution

of these activities to the company's business results. In addition, it describes the expansion of these activities by being involved in new projects or the merger/acquisition of other companies.

We must point out that the message which can be delivered in the report may differ from what might appear in the financial statements, for example:

The company may include in the report what's been achieved as an increase in profits over the past year. Undoubtedly, this will be good news about the company, whereas the investor may find out by reading the report that the increase was due to non-operational profits, such as the sale of land owned by the company, or shares of another company contributed to the company's founding, which may not be repeated again next year.

The most important parts that must be read in the report are the main activities and their impact on the company.

- 1- Company's risk level and how to manage it.
- 2- Company's level of commitment to corporate governance regulation
- 3- Annual audit results of the effectiveness of the internal control procedures of the company
- 4- Description of company's significant plan and decisions as well as future prospects.

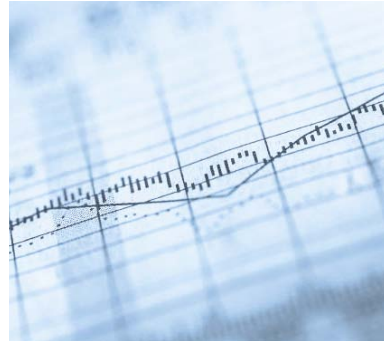
One of the benefits of reading the report is to compare it to the actual performance of the company and its future prospects.

- **Company's Risks:** identifying risks related to the activities of the company and measuring the severity of each activity, which would assist in making investment decisions. It has been required by the listing rules that companies are obliged to disclose the risk associated with its activities and the extent of their impact on a company's future and current performance according to the listing rules.

▪ **Summary of Financial Ratios:** in addition to the financial statements attached to the annual report which describes in details the company's performance for the past fiscal year, the report also contains a summary of assets and liabilities of the company's business results which will give investors access to key information. (1)

- A table or graph showing the assets and liabilities of the company (short or long-term) for the last five financial years. The table shows the most important assets and liabilities.
- Analysis of the geographic areas inside and outside the Kingdom in which the company is based in and where it receives its revenues.
- Differences in the operating results of the previous year, if any.

(1) Related range of booklets can be found at the awareness center on the capital market authority website such as (reading financial statements which explains the financial indicators which will lead to conclusions on the company's current financial status.



The most important current assets

- Cash and its equivalent.
- Short term investments.
- Stock.
- Accounts receivable.

The most important current liabilities

- Debt of commercial suppliers.
- Investors accrued undistributed profits.
- Zakat and taxes.
- Short term loans.

The most important non-current assets

- Lands and buildings.
- Equipments.

The Most important non current liabilities

- Long term loans not to be paid during the next financial period but are still an obligation on the company.

- **Company's Dividend Policy:** each company should disclose in the report its dividend policy whether there is a profit or not during the financial period, this should be stipulated in the company's law. Dividend policy provides an idea of the cases upon which the board of directors recommends distributing dividends among shareholders in addition to the mechanism of distribution. The Board of directors' number one responsibility is when it comes to recommending the distribution of dividends.

Upon the approval of the general assembly meeting, the distribution of dividends could be either in form of money or shares. Information about the distribution of dividends is considered one of the most important elements to be taken into consideration when assessing the company.

There is some information that investors should be aware of regarding the distribution of dividends.

- **Maturity Date:** the date when shareholders of the company are entitled to divi-

dends and this is at the end of the trading day.

- **Distribution Date of Dividends:** The date in which dividends are deposited in the shareholders accounts that are entitled to those profits.

- **Description of Interests for Board of Directors and Senior Executives in the Company's Shares:** the report should include a description of any interest and subscription rights of directors, senior executives and their relatives in the shares or debt instruments of the company or any of its subsidiaries, together with any change to such interest or rights during the last financial year. This information helps with identifying the interests of the board of director's members and senior executives associated with the company, work nature, and any change during the last financial year

- **Borrowings and Commitments:** the report also provides information on borrowings whether repayable, outstanding, or paid. This kind of information helps to identify the company's obligations which allow investors to assess the financial risks of those loans and

the company's ability to fulfill these obligations. Moreover, the company discloses in its report any outstanding statutory payment on account of any zakat, taxes, fees or any other charges to irregular bodies.



- **Board of Directors and its Meetings:** the board of directors represents shareholders in managing the company. The company's board shall assume all the necessary powers for the company's management. The ultimate responsibility for the company rests on the board even if the company sets up committees or delegates some of its powers to a third party.

The board has several responsibilities which includes setting appropriate strategies to achieve a company's objectives and overseeing the implementation for those strategies. The

board should also lay down rules for internal control systems and supervise them. In order for the board to achieve their objectives they should be qualified and have the necessary knowledge and skills to be members of the board. Along with this, each member should allocate sufficient time to carry out tasks entrusted to them as members of the board.

An independent member of the board of directors is a member who enjoys complete independence.

The report contains the compensation of the board of directors and the classification of its members along with a description of its main committees. In addition to the number of meetings the directors held during the last financial year and the attendance record of each meeting. The board holds regular meetings to enable board members to carry out their responsibilities and to develop strategies, policies and a system of implementing them. Information regarding the number of meetings of the directors allows investors to tell how serious are the members about their

role at the company. The report provides information about the independence of board members. Such as, the number of independent members which shall not be less than two members, or one-third of the members, whichever is greater.

Where members of the board of directors are considered representatives for shareholders, shareholders should take into account when electing candidates, the efficiency in carrying out tasks entrusted to whoever will become a member of the board.

Independent members shall not be less than two members, or one-third of the members, whichever is greater.

- **Board Committees:** the board of the company shall set up committees that carry out specific responsibilities such as the audit committee, the nomination and remuneration committee and any other committees which help board of directors to perform its duties. These committees will enhance the efficiency and effectiveness of the board and will help in studying all cases referred by the board and

make recommendations when needed.

Corporate governance regulation mandated an appropriate number of committees in accordance with specific functions and responsibilities. Also, the capital market authority mandated all listed companies to obtain the approval of the general assembly for rules for appointing the members of the Audit Committee and nomination and remuneration committee and define the term of their office and the procedure to be followed by the Committee.

The report provides a brief description of the jurisdictions and duties of the board's main committees indicating their names, the chairman of the board, names of their members, and the aggregate of their respective meetings. Such information helps the reader to evaluate the effectiveness of these committees.

- **Remuneration and Compensation of Board Members and Senior Executives:** listed companies disclose in the board of directors report compensation and remuneration paid

to members of the board of directors and top executives. This is done in the form of a table summarizing remuneration and compensation received by members of the board and the top five executives (The CEO and the chief finance officer shall be included if they are not within the top five) during the past year.

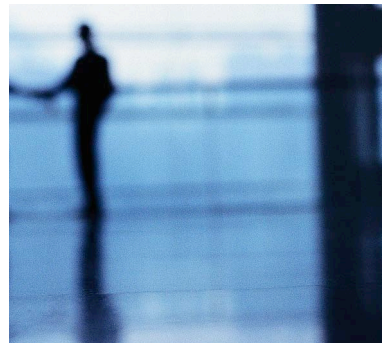
Compensations may be in the form of salary or allowances for attending meetings, or benefits, or a certain percentage of the profits.

- **Conflict of Interests:** it's important to highlight and disclose any related party transactions because such personal interest may override the company's interest. Shareholders must approve such transactions at the general assembly meeting before they occur (to be renewed yearly).

Corporate governance regulation and corporate law also includes the necessary procedures to obtain the approval of the general assembly meeting on the related party transactions and disclosing it in the annual report. It's important to note that disclosing such a

transaction doesn't mean that it's been approved by the shareholders.

Given the importance of such information, the company's management shall include in the disclosure a description of the nature of transactions, name of the member involved, value of the contract, conditions and duration.



- **Declarations About the Financial Status and the Internal Control System:** the Capital Market Authority requires that all listed companies include the following declarations in their board of directors report:

- Appropriate accounting books have been maintained.
- The system of internal control is sound in design and has been effectively implemented.

- There are no significant doubts concerning the issuer's ability to continue as a going concern.

If any of the statements above cannot be made, the report must contain a statement clarifying the reasons.

Disclosure of related party transaction must include:

- Name of member.
- Condition and duration of contract.
- Value of the contract.

In the case of no such contract, the board of director's report shall include a declaration of that. Taking into account that any such contract shall be subject to the corporate governance regulations and Saudi corporate law.

- **Corporate Governance Regulation:** issued by the board of the capital market authority, the regulation includes a number of articles that aim to reach the highest level of disclosure for investors. The regulation includes the following in details:

1. Shareholders and the general assembly meeting
2. Disclosure and transparency
3. Board of directors and conflict of interest.

The regulation also requires that a company should disclose the implemented provisions of the corporate governance regulations as well as the provisions which have not been implemented and the justification for not implementing them.

- **Punishments or Penalties Imposed on the Company:** In the case of any punishments or penalties, the company must disclose such in the board of directors report in order to allow investors to be aware of it.

Judiciary bodies include the capital market authority, ministry of trade and industry, Saudi Arabia monetary agency or any other regulatory or supervisory body.

- **Internal Control Procedures:** given the importance of internal control, this is one of the most important issues in protecting the assets of the company and achieving its objectives. The company's board of directors should annually check the effectiveness of these procedures through an annual audit report of the effectiveness of the internal control procedures.

Sound procedures for the financial, operational and administrative controls have potential to reduce the risk of misusing a company's assets which could affect its reputation and profit. Therefore, it is important to review these procedures on an annual basis to verify the effectiveness and competencies and to make the necessary adjustments if needed.

Questions:

In summary, the following are a set of questions that once answered, you will be familiar with what is happening in the company.

1- What is the main activity of the company?

- Is there a clear message from the company or strategies about its growth and development of its business? (For example: new products or acquisition of other companies).

2- Does the company deal with risk appropriately?

- What are the risks facing the company and how are they dealing with it? Does the company have a mechanism to address them?
- Did the company review the internal control procedures? What are the results? Are there any recommendations?

3- Are there clear policy and mechanisms for the distribution of dividends?

4- Is the company committed to loans and the other obligations?

5- How does the company evaluate the performance of the board of directors?

- Are there any regular meetings for the board of directors? Are they achieving what they planned for?

6- Did the company declare that proper accounting books have been maintained? Is the system of internal control sound in design and has it been effectively implemented? Are there any significant doubts concerning the issuer's ability to continue as a going concern?

7- What is the company's level of commitment to corporate governance regulation?

- What are the provisions that have not been implemented? And what are the justifications for not implementing them?
- Do all-independent board members enjoy complete independence?

8- Did the company achieve a growth in profits or made losses? And what are the reasons for these losses?

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