



The Annual Report, 10K Report & Proxy Statement[©]

More Important Financial Statements

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Background – Chaka Patterson



- Partner at Alston & Bird (and former Partner at Jenner & Block and Jones Day)
- Professor at University of Chicago Law School
- Former General Counsel of a Fortune 1000 Global Education Company
- Former Treasurer & VP for Investor Relations of a Fortune 100 Energy Company
- JD from Harvard Law School
- MBA from University of Chicago Booth School of Business

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— More Key Financial Statements

Financial Statements Beyond the Income Statement, Balance Sheet, and Cash Flow Statement

- **Annual Report:** summarizes a business's economic activity for the prior year, while also using storytelling to convey its progress toward initiatives and goals.
- **Proxy Statement:** a document containing the information the Securities and Exchange Commission (SEC) requires companies to provide to shareholders so they can make informed decisions about matters that will be brought up at an annual or special stockholder meeting.

— What is the Annual Report

- The Annual Report is a publication a public corporation is required by law to publish annually.
 - It describes the company's operating and financial conditions so that current and potential shareholders can make informed decisions about investing in it.
- The US Securities and Exchange Commission (SEC) requires public firms also to produce a 10-K report, which informs investors of a business's financial status before they buy or sell shares.
 - While there's similar data in both an annual and 10-K report, the two documents are separate.

— What is the Annual Report

- 10-K reports are organized per SEC guidelines and include full descriptions of a company's fiscal activity, corporate agreements, risks, opportunities, current operations, executive compensation, and market activity.
 - You can also find detailed discussions of operations for the year, as well as a full analysis of the industry and marketplace.
- 10-K reports are longer and denser than annual reports

— What Information is Found in the Annual Report

- **Letter to shareholders:** provides a broad overview of the company's activities and performance over the course of the year, as well as a reflection on its general business environment.
- **Management's discussion and analysis (MD&A):** This is a detailed analysis of the company's performance, as conducted by its executives.
- **Audited financial statements:** Commonly included statements include balance sheets, cash flow statements, and income statements.
- **A summary of financial data:** This refers to any notes or discussions that are important to the financial statements listed above.
- **Auditor's report:** This report describes whether the company has complied with generally accepted accounting principles (GAAP) in preparing its financial statements.
- **Accounting policies:** This is an overview of the policies the company's leadership team relied upon in preparing the annual report and financial statements.

— Key Takeaways from the Annual Report

- **Allows lawyers to determine whether the company is:**
 - fairly following its accounting policies, including with respect to depreciation and amortization
 - appropriately capitalizing or expensing costs
 - fairly conducting impairment tests on goodwill
 - accurately identifying risks to the business
- Allows lawyers to know what's important to your clients because your clients discuss their most important initiatives in the MD&A section of the annual report
- Conduct a Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis to determine how to add value to your clients and how to due diligence contractual counterparties and litigation adversaries

Goodwill Impairment Test

- **Goodwill Impairment** is when the value of a business's goodwill decreases, which can impact its balance sheet and income statement.
- The rules for a company's Goodwill Impairment Testing will be outlined in the **10K Report**.
- **Here is an example:**
 - Company BB acquires Company CC for \$15 million, with a goodwill of \$5 million
 - After a year, Company BB finds that Company CC's revenue has declined, and its assets are now worth \$7 million
 - This means that the value of the goodwill has decreased from \$5 million to \$2 million
 - The \$3 million impairment is recorded as a non-cash expense on the income statement, which lowers net profits (see sample income statement on next slide)
 - The balance sheet is updated to reflect the reduced goodwill value

Goodwill Impairment Test Example

Income Statements



FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

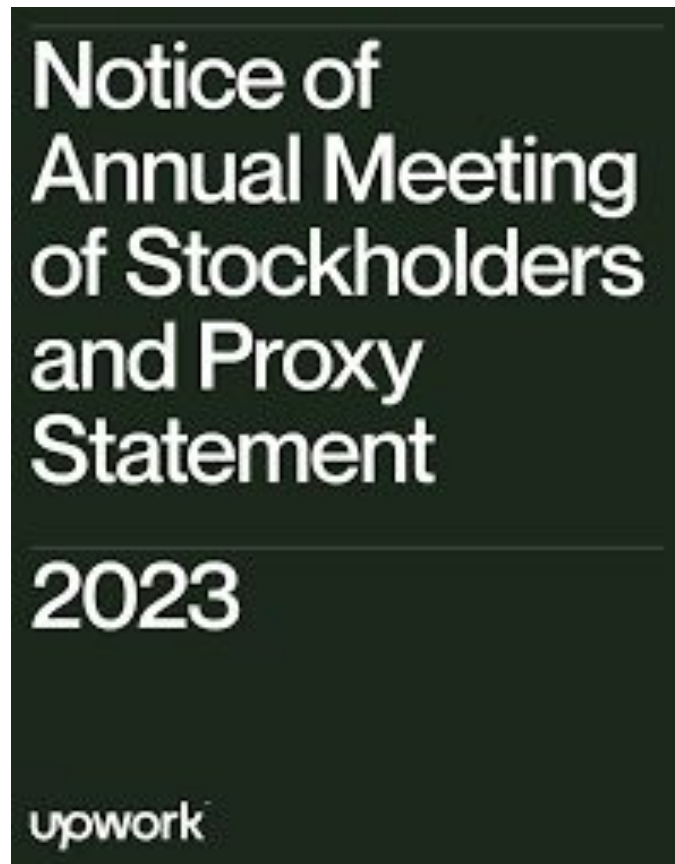
INCOME STATEMENTS

(In millions, except per share amounts)

Year Ended June 30,	2012	2011	2010
Revenue	\$ 73,723	\$ 69,943	\$ 62,484
Operating expenses:			
Cost of revenue	17,530	15,577	12,395
Research and development	9,811	9,043	8,714
Sales and marketing	13,857	13,940	13,214
General and administrative	4,569	4,222	4,063
Goodwill impairment	6,193	0	0
Total operating expenses	51,960	42,782	38,386

— What Information is Found in the Proxy Statement?

- Notice of Annual Meeting of Stockholders
- Key Business Highlights
- Executive Officers and Key Employees
- Executive Compensation Philosophy, Equity Compensation Plan and Executive Compensation Tables
- Corporate Governance Practices
- Board Composition, Committees, and Bios
- Nomination Process and Director Qualifications
- Proposals: Election of Directors, Appointment of CPA Firm, Say on Pay, Approval of Restated Certificate of Incorporation
- Report of the Audit, Risk, and Compliance Committee



Key Takeaways from the Proxy Statement

- ✓ Monitor/make sure Shareholder Proposals satisfy all requirements to appear in Proxy
- ✓ Even if defeated, Shareholder proposals provide a window into Shareholder thinking and potential litigation or books and records demands
- ✓ Say-on-Pay: GC/CFO/CHRO/Chair of BOD Compensation Committee should be well coordinated each year to ensure positive vote
- ✓ Ensure Report of Audit, Risk, and Compliance Committee is Consistent with Risks and other Factors disclosed in the 10-K
- ✓ Can use the compensation information to look for “red flags” in how company is meeting the financial metrics that allow management to achieve compensation targets
- ✓ Can use compensation information to negotiate your own pay



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