CONSULTATION PAPER 187

Effective disclosure in an operating and financial review

September 2012

About this paper

This consultation paper is for listed entities and their directors, and preparers of financial information.

It seeks feedback on our proposed guidance for directors on providing useful and meaningful information to investors when preparing an operating and financial review (OFR) in a directors' report.

Our proposed guidance is set out in a draft new regulatory guide attached to this paper.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 17 September 2012 and is based on the Corporations Act as at the date of issue.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

Contents

The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on effective disclosure in an operating and financial review. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section D, 'Regulatory and financial impact'.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 23 November 2012 to:

Crystal Kwan
Executive Assistant, Financial Reporting & Audit
Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2001
facsimile: 02 9911 2403

By email: policy.submission@asic.gov.au

What will happen next?

Stage 1	17 September 2012	ASIC consultation paper released
Stage 2	23 November 2012	Comments due on the consultation paper
Stage 3	March 2013	Regulatory guide released

A Overview

Key points

This consultation paper sets out our proposals to give new guidance on how to prepare an operating and financial review in a directors' report of a company, registered managed investment scheme or disclosing entity that is listed (listed entity).

An OFR is an important part of a directors' report for listed entities required under s299A of the Corporations Act. It should contain an analysis and narrative to supplement and complement the information in the entity's annual financial report. A high-quality OFR is important in meeting the information needs of current and prospective investors in the entity.

Our proposed guidance, set out in the draft new regulatory guide attached to this paper, is intended to assist listed entities when preparing their OFR.

Operating and financial review

1 An operating and financial review (OFR)—sometimes referred to as 'management discussion and analysis' or 'management commentary'—forms part of a listed entity's directors' report, and provides information about the entity's operations and activities. It supplements and complements the information contained in the entity's annual financial report.

2 Section 299A of the *Corporations Act 2001* (Corporations Act) sets out the requirements for disclosure in an OFR for listed entities (including listed managed investment schemes), and it is this provision that we are considering in the draft regulatory guide attached to this paper. Section 299 sets out the requirements for disclosure in directors' reports, generally, and is not considered in the draft guide.

Note: In this paper, s299 (for example) refers to a section of the Corporations Act (in this example numbered 299), unless otherwise specified.

3 While an entity's financial report provides useful information to investors about the entity's financial position and performance, it will rarely provide all the information needed to readily assess the underlying drivers of the entity's financial performance and to properly understand the reasons for the entity's results. It will also provide little, if any, information about expected future performance.

Note: The information required by current and prospective investors, as discussed in this paper, will also be useful for other users of financial reports, such as analysts.

4 The OFR should contain an analysis and narrative to supplement and complement the information contained in the financial report. Under s299A(1), an OFR must contain information about the entity's:

(a) operations (s299A(1)(a));

(b) financial position (s299A(1)(b)); and

(c) business strategies and prospects for future financial years (s299A(1)(c)).

5 The OFRs in overseas jurisdictions often contain more analysis of matters such as the underlying drivers of an entity's performance.

6 Further, in Australia, investor presentations and briefings to analysts sometimes provide better information and analysis than the OFR. However, these presentations and briefings are generally provided in a presentation format, without any supporting narrative, and are not a substitute for providing information, explanations and analysis in an OFR, as required under s299A.

7 Our surveillance programs have revealed that, while many entities provide an OFR of reasonable quality, there is room for improvement. In some instances, we have noted the following:

(a) a lack of analytical information in OFRs, even though useful analytical information is provided in other documents, such as briefings to analysts; and

(b) the repetition of information in OFRs that is already contained in the financial report without further analysis or explanation.

8 We have also noted that there is uncertainty in the market about the correct application of the exemption in s299A(3) from the requirement to disclose information about an entity's business strategies and prospects for future financial years, leading to some instances where the exemption has been misapplied.

9 We are aware of concerns that applying the proposed guidance in the draft regulatory guide may make annual reports significantly longer. We consider that providing better information and analysis does not necessarily increase the length or complexity of the information accompanying the annual financial report. Rather, the intention is that information will be provided that is more useful and meaningful to investors.

10 The importance of high-quality OFRs is recognised globally. For example, the International Organization of Securities Commissions (IOSCO) supports the inclusion of OFRs in annual reports so that management can:

> [explain] the factors that have affected an entity's financial condition and results of operations for the historical periods covered by the financial statements, as well as management's assessment of the factors and trends that are anticipated to have a material effect on the company's financial condition and results of operations in the future.

Note: See *Principles for periodic disclosure by listed entities*, IOSCO, February 2010, pp. 8–11.

11 The standard of disclosure in OFRs of Australian companies has a significant role to play in ensuring that investors in Australian companies receive high-quality information.

12 We propose to issue guidance to:

(a) promote better communication of useful and meaningful information to investors; and

(b) assist directors in complying with the disclosure requirements in s299A.

Our proposed guidance

13 An OFR, prepared under s299A, should:

(a) contain disclosures tailored to the information needs of investors, and be flexible in form and content to adapt to their needs, and the needs of the wider capital market, as these evolve over time; and

(b) provide an analytical overview that enables investors to understand the performance of an entity's business and the factors underlying its results and financial position.

Note: See the Explanatory Memorandum for the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (2003 Explanatory Memorandum) at paragraphs 5.305–5.306.

14 Our proposed guidance outlines the principles and considerations that will assist directors to practically apply the OFR requirements. There is already some guidance on the content of an OFR—for example, from the Group of 100 Incorporated (reproduced in ASX Guidance Note 10), from IOSCO and in guidance issued by the International Accounting Standards Board. However, we consider it would be useful for ASIC to issue up-to-date practical guidance on the current Australian legislative requirements.

15 We are aware of the view that a comprehensive OFR may not be required if, for example, an entity has complied with its continuous disclosure requirements. Other sources of corporate information, such as investor presentations, briefings to analysts and media releases that accompany annual results announcements, often include similar information. We consider that appropriate information which appears in these sources should also be presented in the OFR with a clear analysis and narrative. The OFR performs a different role to market announcements, investor presentations and briefings to analysts for the following reasons:

(a) the OFR supplements and complements the annual financial report to provide a reasoned analysis of the operations, financial position, business strategies and prospects of the listed entity;

(b) together with the financial report, the OFR allows investors to find relevant information on the entity in a single location, rather than having to piece together information from past continuous disclosure announcements;

(c) the OFR may contain a more detailed explanation and analysis of the information provided in other formats, such as market announcements, investor presentations and briefings to analysts, which may, for example, be presented in the form of a slide show where supporting discussion and explanations are not available to all users; and

(d) the OFR promotes consistency of disclosure, because the legislation requires all listed entities to address particular matters in the OFR disclosures.

B The nature of an operating and financial review

Key points

We propose to give guidance on:

- the nature of an operating and financial review (see proposal B1); and
- the appropriate level of disclosure required (see proposal B2).

What is an operating and financial review?

Proposal

B1 We propose to give guidance that an OFR should:

(a) contain an analysis and narrative that explain an entity's business; and

(b) provide investors with useful and meaningful information about the entity, together with its annual financial report and other market disclosures, such as continuous disclosure.

See Section B of the draft regulatory guide.

Your feedback

B1Q1 Do you agree with our view of what an OFR is, and broadly what it should contain? If not, please explain why not.

B1Q2 Do you agree with our view that an OFR should be a major source of information about an entity's business to meet the information needs of investors? If not, please explain why not.

B2 We propose that disclosures made outside the OFR do not substitute for proper disclosure in the OFR as a matter of law. In addition, we consider that the OFR disclosures perform an important function that is not fulfilled by other disclosures made by the entity to investors.

See draft RG 000.21–RG 000.26.

Your feedback

B2Q1 Is there other additional guidance that would be useful about the relationship between disclosures in other documents and the disclosures made in the OFR?

Rationale

16 Based on the objectives of s299A, as described in the 2003 Explanatory Memorandum, we consider that an OFR is an important opportunity to provide investors with an analysis and narrative about an entity's business to supplement and complement the information contained in the entity's annual financial report.

Note: See paragraphs 5.299–5.313 of the 2003 Explanatory Memorandum.

17 An OFR is not intended to simply repeat information that may be readily derived from the financial report, but is intended to elaborate on that information, so that the combination of a financial report and a high-quality OFR provides investors with a clear understanding of the entity's historical performance and expected future performance.

18 In addition to annual reports, entities may provide other information to the market, such as investor presentations and briefings to analysts, which has significant relevance to the entity's operations, financial position, business strategies and prospects. Often that information will contain useful analytical material which, in our view, should also be included in the OFR.

19 It will often be necessary for the OFR to include particular elements of information that have already been disclosed in past continuous disclosure announcements, depending on the impact of a transaction or event on the financial performance for the period.

Information that investors would reasonably require to make an informed assessment

Proposal

B3 We propose to give guidance that, while s299A contains similar wording to the prospectus disclosure requirements in s710, an OFR would very rarely contain the scope or depth of detail of a full prospectus. Information intended to form part of an OFR must be selected with the purpose of providing insight into the matters set out in s299A.

See draft RG 000.31–RG 000.34.

Your feedback

B3Q1 Do you agree with our view on the level of disclosure required? If not, please explain why not and suggest alternatives.

Rationale

20 Under s299A(1), the OFR in a directors' report must contain information that investors in the entity would 'reasonably require to make an informed assessment' of the entity's operations, financial position, business strategies, and prospects for future financial years.

21 Despite similarities in the wording of the OFR requirements in s299A and the content requirements for prospectuses in s710, we do not expect an OFR to contain the same level of disclosure, generally, as a full prospectus. An OFR is designed to be read in conjunction with the financial statements and other parts of the annual report, and provides information about an entity that is already listed and would be subject to continuous and periodic disclosure obligations.

C Specific content of the operating and financial review

Key points

We propose to give guidance on:

- the key disclosure requirements for listed entities in s299A(1), including guidelines on the practical implementation of those requirements (see proposal C1);
- when it may be appropriate to use the exemption in s299A(3) to omit certain matters relating to an entity's business strategies and prospects (see proposal C6); and
- how to present the analysis and narrative in an OFR (see proposal C8).

We do not propose to include any guidance on integrated reporting at this stage: see proposal C9.

Operations, financial position and business strategies and prospects for future financial years

Proposal

C1 We propose to give guidance on the matters specified in s299A(1) to clarify :

(a) the type of information that should be considered when providing an analysis and narrative on an entity's operations, financial position, business strategies and prospects; and

(b) the key matters that should be addressed and principles that should be followed when preparing an OFR (rather than setting out detailed checklists of information that must be provided).

See Sections C and D of the draft regulatory guide.

Your feedback

C1Q1 Do you consider that the proposed guidelines on the specified contents of an OFR (as set out in the draft regulatory guide) are appropriate? If not, please explain why not and suggest alternatives.

C1Q2 Do you agree with the examples of disclosure set out in Tables 1 and 2 of the draft guide? If not, please explain why not. If you think that there is a preferable way of illustrating our guidance, please suggest alternatives.

C1Q3 Do you think that there is any other key information that should be included in an OFR that has not been referred to in our draft guidance?

Rationale

22 Under s299A, an OFR must contain information about an entity's operations (s299A(1)(a)), financial position (s299A(1)(b)), and business strategies and prospects for future financial years (s299A(1)(c)).

23 Our proposed guidance on these matters is covered in Sections C and D of the draft regulatory guide, and is intended to encourage useful and meaningful disclosure of an entity's operations, financial position, and business strategies and prospects.

24 Disclosures in the OFR should be tailored specifically to the relevant entity, which may involve providing disclosure that is not addressed in the draft regulatory guide.

25 Given the broad wording of s299A, and the need for an OFR to reflect the particular matters relevant to the entity producing the OFR, our proposed guidance does not provide an exhaustive list of all matters that may be relevant in an OFR. Instead, we focus on the principles that underlie the requirements in s299A, and identify the key matters that are relevant to compliance with this provision.

Operations

Proposal

C2 Our proposed guidance outlines the key requirements in s299A(1)(a) relating to an entity's operations. We propose that an OFR should disclose the underlying drivers of an entity's performance that are relevant to understanding its performance and the factors underlying its results. This may include significant factors affecting:

(a) the total income and income for major operating segments; and

(b) the significant components of overall expenses and expenses for major operating segments.

See draft RG 000.41–RG 000.42.

Your feedback

C2Q1 Do you consider that our proposed guidance on disclosure about an entity's operations (as set out in the draft regulatory guide) is appropriate? If not, please explain why not and suggest alternatives.

C3 We propose that, while the guidance in Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228) is for disclosure in a prospectus, which is more extensive than the disclosure typically required in an OFR, RG 228 may also be useful for preparing disclosure about an entity's business model in the OFR.

See draft RG 000.43–RG 000.45.

Your feedback

C3Q1 Do you agree that the reference to RG 228 in relation to business models is useful? If not, please explain why not and suggest alternatives.

Rationale

26 Under s299A, an OFR must contain information that investors would reasonably require to make an informed assessment of the operations of a listed entity.

27 While an entity's financial report provides useful information to investors about the entity's performance, it will rarely provide all the information needed to readily assess the underlying reasons for the entity's financial performance and to appreciate the reasons for the entity's results.

28 We seek to strike an appropriate balance between giving enough guidance on providing information about an entity's operations for the guidance to be useful, while not being too prescriptive. The OFR needs to be tailored to the individual circumstances of each listed entity.

Financial position

Proposal

C4 We propose that, under the requirement in s299A(1)(b), an OFR should include information that is relevant to understanding an entity's financial position. We consider that this includes:

(a) disclosing the underlying drivers of the financial position of the entity;

(b) disclosing exposures that are not reflected in the financial report (e.g. off-balance sheet arrangements); and

(c) explaining the accounting information and other detail contained in the financial report (rather than simply repeating it).

See draft RG 000.46–RG 000.47.

Your feedback

C4Q1 Do you consider that our proposed guidance on disclosure about an entity's financial position (as set out in the draft regulatory guide) is appropriate? If not, please explain why not and suggest alternatives.

Rationale

29 Under s299A, an OFR must contain information that investors would reasonably require to make an informed assessment of the financial position of a listed entity.

30 While an entity's financial report provides useful information to investors about the entity's financial position, it will rarely provide all the information needed to readily assess the entity's financial position, exposures, and the underlying drivers of its financial position.

31 We seek to strike an appropriate balance between giving enough guidance on providing information about an entity's financial position for the guidance to be useful, while not being too prescriptive. The OFR needs to be tailored to the individual circumstances of each listed entity.

Business strategies and prospects for future financial years

Proposal

C5 We propose that the information required under s299A(1)(c) on business strategies and prospects for future financial years should focus on the areas that are likely to affect the future financial performance and position of the entity. We consider that the OFR should usually include:

(a) an outline of the entity's key business strategies, and its plans that are a significant part of those strategies; and

(b) disclosure of the main risks that could adversely affect the successful fulfilment of the business strategies of the entity.

See draft RG 000.51–RG 000.66.

Your feedback

C5Q1 Do you consider that our proposed guidance on disclosure about an entity's business strategies and prospects (as set out in the draft regulatory guide) is appropriate? If not, please explain why not and suggest alternatives.

Rationale

32 Subject to an exemption for unreasonable prejudice, an OFR should describe the overall business strategies of the entity, where these are relevant to its future financial position and performance.

33 We consider that a discussion about an entity's prospects for future financial years would benefit from a consideration of the risks that could affect the entity's financial position and performance.

34 The OFR is also an appropriate place to disclose the key strengths and weaknesses within the entity that may positively or negatively affect the entity's ability to achieve its business objectives.

35 We indicate that, in most cases, a narrative discussion of the entity's prospects for future financial years will be sufficient, but, where the entity intends to present financial forecasts, the guidance in Regulatory Guide 170 *Prospective financial information* (RG 170) should be taken into account. A sensitivity analysis may also be appropriate.

Use of the unreasonable prejudice exemption

Proposal

C6 We propose to provide guidance on how to determine whether the exemption in s299A(3) applies, including whether there is 'unreasonable prejudice' and whether it is likely to occur.

See draft RG 000.67–RG 000.76.

C7 We also propose that, if information has been omitted in reliance on the exemption (in addition to stating in the OFR that information has been omitted, as required by s299A(3)):

(a) a summary of the type of information omitted and the reasons for the omission should be disclosed in the directors' report, where possible; and

(b) because ASIC may ask for the reasons why information has been excluded, directors may find it helpful to keep an internal record which:

(i) identifies the information that has not been disclosed; and

(ii) explains how disclosure of the excluded information would be likely to result in unreasonable prejudice.

See draft RG 000.77–RG 000.78.

Your feedback

C7Q1 Do you agree with our interpretation of the exemption requirement? If not, please explain why not.

C7Q2 Do you agree that, when information has been omitted in reliance on the exemption, a summary of the type of information omitted and the reasons for the omission should be disclosed, where possible? If not, please explain why not.

C7Q3 Do you agree with the final example of disclosure (relating to the use of the unreasonable prejudice exemption), which is set out in Table 2 of the draft regulatory guide? If not, please explain why not.

C7Q4 Are there other matters of practical guidance that should be included? If so, please describe these matters and explain why you think they should be included.

C7Q5 Do you agree with our suggestion for internal record keeping? If not, please explain why not.

Rationale

36 The Corporations Act provides an exemption in s299A(3) from disclosing information relating to an entity's business strategies and prospects for future financial years, if disclosure is 'likely to result in unreasonable prejudice' to the entity (or, if consolidated financial statements are required, to the consolidated entity or any entity that is part of the consolidated entity).

37 We are concerned that there may be uncertainty in the market about the correct application of this exemption, particularly whether the disclosure of information would be likely to result in unreasonable prejudice.

38 In our view, the wording of the exemption in s299A(3) requires consideration of whether there is unreasonable prejudice and whether it is likely to occur. We propose providing guidance on how to interpret these considerations.

39 In assessing whether unreasonable prejudice is likely to occur, the entity should identify the adverse consequences that are likely to occur as a result of the disclosure, and then consider whether such consequences would be unreasonable. We also state that it would be rare for an entity to be able to rely on the exemption to disclose no information at all about its business strategies and prospects.

40 If information has been omitted in reliance on the exemption, we encourage that, where possible, a summary of the type of information omitted and the reasons for the omission should be provided in the directors' report. We would not expect these disclosures to be lengthy and detailed.

41 We consider that it may be helpful for directors to keep an internal record which identifies the information that has been omitted, and explains why disclosure of that information would be likely to result in unreasonable prejudice to the entity. This will help to ensure that directors apply the appropriate level of diligence in considering whether the appropriate standard for omitting information has been met.

Presentation of analysis and narrative

Proposal

C8 We propose to set out some good disclosure practices to assist directors in preparing a high-quality OFR.

See Table 3 in Section E of the draft regulatory guide.

Your feedback

C8Q1 Do you consider that the proposed good disclosure practices in Table 3 of the draft regulatory guide are appropriate? If not, please explain why not and suggest alternatives.

Rationale

42 We consider that an OFR should be a self-contained document that supplements and complements an entity's annual financial report.

43 Table 3 of the draft guide sets out some good disclosure practices that we consider are useful and relevant in the context of preparing an OFR. These include that the information in an OFR should:

(a) be presented in a single, self-contained section of the annual report;

(b) complement, and be consistent with, the financial report;

(c) be balanced and unambiguous; and

(d) be presented in a clear, concise and effective manner.

Integrated reporting

Proposal

C9 At this stage, we do not propose to include any guidance on integrated reporting.

Your feedback

C9Q1 Do you agree that it is not appropriate to include guidance on integrated reporting at this stage? If you think guidance should be included, please explain why.

Rationale

44 The concept of integrated reporting is still emerging, and seeks to widen the scope of corporate reporting to include environmental, social governance and employee-related factors. We considered whether integrated reporting concepts should be included in the proposed regulatory guide.

45 In September 2011, The International Integrated Reporting Committee (IIRC) released a discussion paper, *Towards integrated reporting—Communicating value in the 21st century*, which set out the rationale for the possible adoption of integrated reporting.

46 The IIRC has indicated that:

(a) a high-level summary of submissions on the discussion paper has been published;

(b) over 65 organisations are currently participating in a pilot program, where the principles, content and practical application of integrated reporting are being developed, tried and tested by reporting organisations and investors. This program is due to end in October 2013; and

(c) the IIRC is planning to issue an international integrated reporting framework by the end of 2013.

47 In July 2012, the IIRC issued a draft framework outline, setting out a possible high-level reporting framework for integrated reporting.

48 Because the concept of integrated reporting is still emerging, we consider that it would be premature to include this concept in our proposed new regulatory guide. If we were to give guidance at this time, it would be based on best practice rather than on any legislative requirement.

49 We consider it is important that guidance on providing high-quality OFR disclosure in directors' reports is made available to the market sooner rather than later. The proposed regulatory guide could be amended in the future to incorporate developments in integrated reporting. Any amendment would follow appropriate consultation.

D Regulatory and financial impact

50 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us, we think they will strike an appropriate balance between:

(a) improving disclosure in the operating and financial review; and

(b) not requiring the operating and financial review to be significantly longer or more time-consuming for directors than currently.

51 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

(a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;

(b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and

(c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

52 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

53 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:

(a) the likely compliance costs;

(b) the likely effect on competition; and

(c) other impacts, costs and benefits.

See 'The consultation process', p. 4.

List of proposals and questions

Proposal	Your feedback
B1 We propose to give guidance that an OFR should: (a) contain an analysis and narrative that explain an entity's business; and (b) provide investors with useful and meaningful information about the entity, together with its annual financial report and other market disclosures, such as continuous disclosure. See Section B of the draft regulatory guide.	B1Q1 Do you agree with our view of what an OFR is, and broadly what it should contain? If not, please explain why not. B1Q2 Do you agree with our view that an OFR should be a major source of information about an entity's business to meet the information needs of investors? If not, please explain why not.
B2 We propose that disclosures made outside the OFR do not substitute for proper disclosure in the OFR as a matter of law. In addition, we consider that the OFR disclosures perform an important function that is not fulfilled by other disclosures made by the entity to investors. See draft RG 000.21–RG 000.26.	B2Q1 Is there other additional guidance that would be useful about the relationship between disclosures in other documents and the disclosures made in the OFR?
B3 We propose to give guidance that, while s299A contains similar wording to the prospectus disclosure requirements in s710, an OFR would very rarely contain the scope or depth of detail of a full prospectus. Information intended to form part of an OFR must be selected with the purpose of providing insight into the matters set out in s299A. See draft RG 000.31–RG 000.34.	B3Q1 Do you agree with our view on the level of disclosure required? If not, please explain why not and suggest alternatives.
C1 We propose to give guidance on the matters specified in s299A(1) to clarify : (a) the type of information that should be considered when providing an analysis and narrative on an entity's operations, financial position, business strategies and prospects; and (b) the key matters that should be addressed and principles that should be followed when preparing an OFR (rather than setting out detailed checklists of information that must be provided). See Sections C and D of the draft regulatory guide.	C1Q1 Do you consider that the proposed guidelines on the specified contents of an OFR (as set out in the draft regulatory guide) are appropriate? If not, please explain why not and suggest alternatives. C1Q2 Do you agree with the examples of disclosure set out in Tables 1 and 2 of the draft guide? If not, please explain why not. If you think that there is a preferable way of illustrating our guidance, please suggest alternatives. C1Q3 Do you think that there is any other key information that should be included in an OFR that has not been referred to in our draft guidance?

Proposal	Your feedback
C2 Our proposed guidance outlines the key requirements in s299A(1)(a) relating to an entity's operations. We propose that an OFR should disclose the underlying drivers of an entity's performance that are relevant to understanding its performance and the factors underlying its results. This may include significant factors affecting: (a) the total income and income for major operating segments; and (b) the significant components of overall expenses and expenses for major operating segments. See draft RG 000.41–RG 000.42.	C2Q1 Do you consider that our proposed guidance on disclosure about an entity's operations (as set out in the draft regulatory guide) is appropriate? If not, please explain why not and suggest alternatives.
C3 We propose that, while the guidance in Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228) is for disclosure in a prospectus, which is more extensive than the disclosure typically required in an OFR, RG 228 may also be useful for preparing disclosure about an entity's business model in the OFR. See draft RG 000.43–RG 000.45.	C3Q1 Do you agree that the reference to RG 228 in relation to business models is useful? If not, please explain why not and suggest alternatives.
C4 We propose that, under the requirement in s299A(1)(b), an OFR should include information that is relevant to understanding an entity's financial position. We consider that this includes: (a) disclosing the underlying drivers of the financial position of the entity; (b) disclosing exposures that are not reflected in the financial report (e.g. off-balance sheet arrangements); and (c) explaining the accounting information and other detail contained in the financial report (rather than simply repeating it). See draft RG 000.46–RG 000.47.	C4Q1 Do you consider that our proposed guidance on disclosure about an entity's financial position (as set out in the draft regulatory guide) is appropriate? If not, please explain why not and suggest alternatives.
C5 We propose that the information required under s299A(1)(c) on business strategies and prospects for future financial years should focus on the areas that are likely to affect the future financial performance and position of the entity. We consider that the OFR should usually include: (a) an outline of the entity's key business strategies, and its plans that are a significant part of those strategies; and (b) disclosure of the main risks that could adversely affect the successful fulfilment of the business strategies of the entity. See draft RG 000.51–RG 000.66.	C5Q1 Do you consider that our proposed guidance on disclosure about an entity's business strategies and prospects (as set out in the draft regulatory guide) is appropriate? If not, please explain why not and suggest alternatives.

Proposal	Your feedback
C6 We propose to provide guidance on how to determine whether the exemption in s299A(3) applies, including whether there is 'unreasonable prejudice' and whether it is likely to occur. See draft RG 000.67–RG 000.76. C7 We also propose that, if information has been omitted in reliance on the exemption (in addition to stating in the OFR that information has been omitted, as required by s299A(3)): (a) a summary of the type of information omitted and the reasons for the omission should be disclosed in the directors' report, where possible; and (b) because ASIC may ask for the reasons why information has been excluded, directors may find it helpful to keep an internal record which: (i) identifies the information that has not been disclosed; and (ii) explains how disclosure of the excluded information would be likely to result in unreasonable prejudice. See draft RG 000.77–RG 000.78.	C7Q1 Do you agree with our interpretation of the exemption requirement? If not, please explain why not. C7Q2 Do you agree that, when information has been omitted in reliance on the exemption, a summary of the type of information omitted and the reasons for the omission should be disclosed, where possible? If not, please explain why not. C7Q3 Do you agree with the final example of disclosure (relating to the use of the unreasonable prejudice exemption), which is set out in Table 2 of the draft regulatory guide? If not, please explain why not. C7Q4 Are there other matters of practical guidance that should be included? If so, please describe these matters and explain why you think they should be included. C7Q5 Do you agree with our suggestion for internal record keeping? If not, please explain why not.
C8 We propose to set out some good disclosure practices to assist directors in preparing a high-quality OFR. See Table 3 in Section E of the draft regulatory guide.	C8Q1 Do you consider that the proposed good disclosure practices in Table 3 of the draft regulatory guide are appropriate? If not, please explain why not and suggest alternatives.
C9 At this stage, we do not propose to include any guidance on integrated reporting.	C9Q1 Do you agree that it is not appropriate to include guidance on integrated reporting at this stage? If you think guidance should be included, please explain why.

ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 000

Effective disclosure in an operating and financial review

September 2012

About this guide

This guide is for listed entities and their directors.

It sets out our guidance for directors on providing useful and meaningful information to investors when preparing an operating and financial review (OFR) in a directors' report.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This draft regulatory guide was issued in September 2012 and is based on legislation and regulations as at the date of issue.

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

A Overview

Key points

An operating and financial review (OFR) is a key part of annual reporting by listed entities. It must set out information that investors would reasonably require to assess an entity's operations, financial position, and business strategies and prospects for future financial years. This information complements and supports the financial report.

This regulatory guide is designed to assist the directors of listed entities to provide a useful and meaningful OFR.

A high-quality OFR is important in meeting the information needs of current and prospective investors.

What is an operating and financial review?

Annual reporting disclosure requirements for listed entities

RG 000.1 Division 1 of Pt 2M.3 of the *Corporations Act 2001* (Corporations Act) sets out the requirements for annual financial reports and directors' reports. Under s292(1), all companies, registered managed investment schemes and disclosing entities that are listed (listed entities) are required to prepare an annual financial report and a directors' report.

Note: In this guide, s292(1) (for example) refers to a section of the Corporations Act (in this example numbered 292(1)), unless otherwise specified.

RG 000.2 The financial report provides information about an entity's financial position and performance.

The operating and financial review

RG 000.3 For listed entities, the Corporations Act sets out additional requirements for a directors' report. Under s299A(1), a listed entity's directors' report must contain information that investors would reasonably require to make an informed assessment of the entity's:

(a) operations (s299A(1)(a));

(b) financial position (s299A(1)(b)); and

(c) business strategies and prospects for future financial years (s299A(1)(c)).

Note 1: The information required by investors, as discussed in this guide, will also be useful for other users of financial reports, such as prospective investors and analysts.

Note 2: Information must be provided for the consolidated entity where consolidated financial statements are required: s299A(2). For convenience, in this guide, the term 'entity' is used to refer to the entity or the consolidated entity, as applicable.

RG 000.4 The part of the directors' report containing this information is referred to in this guide as an 'operating and financial review' (OFR). The requirements in s299A(1)(a)–(c) are collectively referred to in this guide as the 'OFR requirements'.

The purpose of this guide

RG 000.5 This regulatory guide is for listed entities and their directors. The purpose of our guidance is to:

(a) promote better communication of useful and meaningful information to investors; and

(b) assist directors in understanding the existing OFR requirements.

RG 000.6 The OFR requirements were introduced to provide information and analysis to supplement the financial report and assist investors in understanding the operations, financial position, business strategies and prospects of an entity. Given the broad meaning of the wording used in s299A, we think that considering the purpose of the OFR requirements is helpful in interpreting this provision. Sections B–E of this guide set out our guidance for applying the requirements in s299A.

RG 000.7 We recommend that the OFR is presented in a clear, concise and effective manner: see Section E. We consider that providing better information and analysis does not necessarily increase the length or complexity of the annual report. In particular, we want to ensure that the key information required by the Corporations Act is not lost among less important detail that is not required to fulfil any legal obligations (e.g. there may be unnecessary repetition or overuse of photographs in the annual report that distracts from the key details required by law).

The importance of a high-quality OFR

RG 000.8 An OFR is an important document in meeting the information needs of investors. While an entity's financial report provides useful information to investors about the entity's financial position and performance, it will rarely provide all of the information needed to readily assess the underlying reasons for the entity's financial performance and to appreciate the reasons for the entity's results. It will also provide little, if any, information about business strategies and prospects relevant to future financial performance.

RG 000.9 Australia's regulatory regime often allows listed entities to access capital from investors without requiring the entity to issue a full prospectus. Effective periodic disclosure is part of the framework on which this capital raising regime is built. The OFR requirements, designed to address a number of matters relevant to forming a view about investment in a listed entity, are a significant part of that regime. This is because the OFR should highlight particular aspects of information disclosed through past continuous disclosure. This is a key reason why ASIC is providing guidance in this area.

RG 000.10 The importance of the OFR (also known as 'management commentary' or 'management discussion and analysis') in helping investors to understand information about an entity's business and results is globally recognised. In the United States, for example, a management discussion and analysis must accompany the financial report and, in the United Kingdom, a business review must be included in the directors' report. These requirements promote similar aims of ensuring the availability of management commentary about an entity's business and results.

> Note: In February 2003, the International Organization of Securities Commissions (IOSCO) issued the *General principles regarding disclosure of management's discussion of financial condition and results of operations.* In December 2010, the International Accounting Standards Board (IASB) issued the International Financial Reporting Standards (IFRS) practice statement *Management commentary*, which is available from the website of the Australian Accounting Standards Board (AASB).

RG 000.11 For Australia to maintain its reputation as a financial market in which investors receive high-quality information, it is important that the disclosures in the OFR by Australian entities are effective and of at least a similar standard to other major jurisdictions. The OFRs in overseas jurisdictions often contain more analysis of matters such as the underlying drivers of an entity's performance.

RG 000.12 Further, in Australia, investor presentations and briefings to analysts sometimes provide better information and analysis than the OFR. However, these presentations and briefings are generally provided in a presentation format, without a supporting narrative, and are not a substitute for providing information, explanations and analysis in an OFR, as required under s299A.

RG 000.13 While listed entities may provide current information about an entity's business through various formats, the obligation to provide an OFR that complies with the legal requirements of s299A remains. Other disclosures cannot be regarded as a substitute for complying with s299A.

RG 000.14 To provide useful and meaningful information for the benefit of investors, the OFR should:

(a) provide an analysis and narrative relevant to understanding the underlying drivers of, and reasons for, the financial performance of the entity's business; and

(b) complement the financial report to provide information that investors in the listed entity would 'reasonably require to make an informed assessment' of the matters specified in s299A(1) to the extent outlined in this guide.

Presenting the OFR

RG 000.15 The OFR requirements should be applied in a flexible manner, so that an OFR is tailored to appropriately reflect the entity's individual circumstances and the business environment in which it operates.

RG 000.16 Despite the similarity in wording used in parts of s299A and the prospectus disclosure requirements, we do not expect an OFR to contain the same level of disclosure as a full prospectus: see RG 000.33.

RG 000.17 The OFR should, however, bring together relevant matters covered in previous continuous disclosure notices with an appropriate level of detail.

Structure of this guide

RG 000.18 This regulatory guide contains the following guidance:

(a) Section B discusses the overall aspects that should guide the preparer of the OFR;

(b) Sections C and D give guidance on each of the requirements contained in s299A, including information that must be disclosed in the OFR on an entity's:

  (i) operations (s299A(1)(a)—Section C);

  (ii) financial position (s299A(1)(b)—Section C); and

  (iii) business strategies and prospects for future financial years (s299A(1)(c)—Section D);

(c) Section D also sets out our guidance on the use of the statutory exemption in s299A(3) from the requirement to disclose information about an entity's business strategies and prospects; and

(d) Section E sets out a number of good disclosure practices that may assist in producing an OFR that aligns with the overall objectives of the OFR requirements: see Table 3.

Other matters

RG 000.19 Our guidance is general in nature. As for all continuous, periodic or transaction-specific disclosure documents, whether an entity needs to prepare disclosure on a particular matter will depend on its circumstances.

RG 000.20 Examples given in this guide are not exhaustive—that is, the particular matters that may need to be disclosed in the OFR will vary from one entity to another. The entity may therefore need to consider whether there are additional matters that would ensure that the OFR requirements are met. The responsibility to assess whether the OFR requirements are satisfied lies ultimately with the directors.

B Preparing the operating and financial review

Key points

The operating and financial review is designed to enhance the periodic financial reporting regime so that useful and meaningful information can be made available regularly for the benefit of investors.

This section provides guidance to directors and preparers of OFRs. The OFR should:

- contain key information about an entity's operations and financial position, discuss the impact of relevant events throughout the reporting period and provide an overview of business strategies and prospects (RG 000.21–RG 000.26);
- present an analysis and narrative about the entity's results and financial position (RG 000.27–RG 000.30); and
- contain information that investors would reasonably require to make an informed assessment of the entity's operations, financial position, and business strategies and prospects (RG 000.31–RG 000.37).

Information about an entity's business

RG 000.21 Section 299A of the Corporations Act was introduced to address a lack of contextual information explaining the results set out in an entity's annual financial report. The OFR provides an overview that enables investors to understand an entity's business performance and the factors underlying its results and financial position. The purpose of the OFR requirements is to help ensure that the financial report and directors' report are presented in a manner that maximises their usefulness, with a particular focus on the needs of people who are not experts in reading financial reports.

Note: See paragraph 4.380 of the Explanatory Memorandum to the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (2003 Explanatory Memorandum) and paragraph 5.2 of the Explanatory Memorandum to the Corporations Amendment (Corporate Reporting Reform) Bill 2010 (2010 Explanatory Memorandum).

RG 000.22 The annual financial report and directors' report together form a key element of the periodic disclosure framework for the listed market. The focus of periodic disclosure differs from continuous disclosure. While continuous disclosure ensures the timely release of price-sensitive information, periodic disclosure ensures that the entity provides a regular summary of its present financial position, an analysis of the key developments throughout the relevant reporting period and an overview of the entity's future prospects.

RG 000.23 The OFR should:

(a) concisely present key information about an entity's operations and financial position for the relevant reporting period, including highlighting particular aspects of information disclosed through past continuous disclosure, as needed;

(b) analyse and discuss the impact of transactions and events that have taken place during the reporting period that are relevant to the entity's operations and financial position; and

(c) provide an overview of the entity's business strategies and prospects for future financial years.

RG 000.24 Investor presentations, briefings to analysts and media releases that accompany annual results announcements often include similar information. However, these do not satisfy the obligation to provide an OFR under s299A.

RG 000.25 The OFR performs a different role to market announcements, investor presentations and briefings to analysts for the following reasons:

(a) the OFR supplements and complements the financial report to provide an analysis of the operations, financial position, business strategies and prospects of the listed entity;

(b) together with the financial report, the OFR allows investors to find relevant information on the entity in a single location, rather than having to piece together information from past continuous disclosure announcements;

(c) the OFR may contain a more detailed explanation and analysis of the information provided in other formats, such as investor presentations and briefings to analysts, which may, for example, be presented in the form of a slide show where supporting discussion and explanations are not available to all users; and

(d) the OFR promotes consistency of disclosure, because the legislation requires all listed entities to address particular matters in the OFR disclosures.

RG 000.26 While the requirements for an OFR are additional to the requirements for a directors' report in s299(1)—which include, for example, a review of the entity's operations—we envisage that, in practice, the requirements in s299(1) will be addressed as part of the OFR rather than being presented as a separate report.

Note: See paragraph 5.309 of the 2003 Explanatory Memorandum and paragraph 5.2 of the 2010 Explanatory Memorandum.

Analysis and narrative

RG 000.27 The OFR, prepared under s299A, should:

(a) contain disclosures tailored to the information needs of investors, and be flexible in form and content to adapt to the information needs of those investors, and the wider capital market, as these evolve over time; and

(b) provide an overview that enables investors to understand an entity's business performance and the factors underlying its results and financial position.

Note: See paragraphs 5.305–5.306 of the 2003 Explanatory Memorandum and paragraph 5.2 of the 2010 Explanatory Memorandum.

RG 000.28 The OFR should present:

(a) *an analysis*—providing a reasoned and meaningful description of the underlying drivers of, and reasons for, an entity's performance, rather than simply restating information that may be readily determined from the financial statements; and

(b) *a narrative*—providing tailored information about an entity's results and financial position. Information in the OFR should be consistent with the financial report.

RG 000.29 The wording of the OFR requirements demonstrate a legislative intention that a mere recounting of the key findings set out in the financial report will not satisfy the requirements of s299A.

RG 000.30 The OFR usually contains an analysis and narrative relevant to the operating segments disclosed in the financial report in accordance with accounting standards.

Information that investors would reasonably require to make an informed assessment

RG 000.31 Under s299A(1), the OFR in a directors' report must contain information that investors in the entity would 'reasonably require to make an informed assessment' of the matters set out in s299A(1)(a)–(c).

RG 000.32 Reference to the information required to make 'an informed assessment' suggests that information must be selected with the purpose of providing insight into the matters listed in s299A.

RG 000.33 The terms 'reasonably require' and 'informed assessment' may suggest that an OFR is subject to a similar standard of disclosure to a prospectus prepared under s710 (which uses these same terms). However, while an OFR is a self-contained document describing the entity's performance, the scope and depth of information that needs to be provided under s299A is considerably narrower, given that the OFR:

(a) is designed to be read in conjunction with the financial report; and

(b) provides information about an entity that is subject to continuous and periodic disclosure obligations.

RG 000.34 An OFR should highlight, analyse and, ultimately, provide a meaningful discussion of relevant information about an entity's operations, financial position, and business strategies and prospects for future financial years. Much of the information on which the OFR will draw may have already been provided to the market.

Misleading information

RG 000.35 Care needs to be taken in preparing an OFR that the information included is not 'false or misleading'. The general liability provisions concerning such conduct (e.g. s1308) will apply to the information included in an OFR.

Overlap in s299A(1) requirements and with other guidance

RG 000.36 Preparers of OFRs should note that the information requirements in the matters listed at s299A(1) may overlap with each other. For example, information commonly relevant to 'operations' under s299A(1)(a) may also be relevant in a discussion of the entity's 'financial position' under s299A(1)(b) and its 'business strategies and prospects for future financial years' under s299A(1)(c).

RG 000.37 Other existing guidance may also be relevant in providing information to assist an entity in fulfilling the OFR requirements. For example, a discussion about an entity's operations and financial position may benefit from consideration of the *Guide to review of operations and financial condition*, issued by the Group of 100 Incorporated in 2003 and the IASB International Financial Reporting Standards (IFRS) practice statement *Management commentary*, which is available from the AASB's website.

C Operations and financial position

Key points

Information about an entity's operations involves an explanation of the underlying drivers of its results and key developments in the reporting period.

A discussion of results for the key operating segments and major components of the overall result would also assist investors to understand an entity's results.

Information about an entity's financial position often involves a consideration of the underlying drivers of, and reasons for, that financial position. A discussion of exposures not recognised in the financial statements would also assist investors in understanding the entity's financial position.

Our guidance in Regulatory Guide 230 *Disclosure of non-IFRS financial information* (RG 230) should also be taken into account when disclosing financial information not prepared in accordance with International Financial Reporting Standards (non-IFRS financial information).

The statutory requirements

RG 000.38 An OFR must contain information that investors would reasonably require to make 'an informed assessment of…the operations of the entity reported on': s299A(1)(a). In particular, the OFR should provide an overview that enables investors to understand an entity's business performance and the factors underlying its results and financial position.

RG 000.39 An OFR must also contain information that investors would reasonably require to make 'an informed assessment of…the financial position of the entity reported on': s299A(1)(b).

Tailored information

RG 000.40 Information about the operations and financial position should be tailored to reflect the individual circumstances of the entity and the business environment in which it operates.

Operations

Underlying drivers of performance

RG 000.41 An OFR should include matters that are relevant to understanding an entity's performance and the factors underlying its results—in other words, the underlying drivers and reasons for the entity's performance. This may include significant factors affecting:

(a) the total income and income for major operating segments, such as new businesses, new major products, new markets, new competitors, acquisitions, discontinued operations, changes in exchange rate, changes in hedging policy, changes in economic and market conditions, and changes in accounting policy; and

(b) the significant components of overall expenses and expenses for major operating segments, such as the reasons for changes in impairment losses, restructuring costs, and significant changes in borrowings or borrowing rates.

RG 000.42 This information should be prepared and presented in a way that explains the data in the financial report. For example, statements such as, 'revenue has increased by *x*% on last year' are self-evident from the financial statements. Statements would be more useful and provide more meaningful context if they were accompanied by an explanation of the major reasons for the changes.

Context

RG 000.43 If an informed understanding of an entity's operations needs to be placed in the context of the entity's business model, this model should be clearly articulated. The significance of particular operating segments to the business as a whole should be made clear. Section D of Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228) provides guidance on explaining an entity's business model. While this guidance is for disclosure in a prospectus, and promotes disclosure that is more extensive than the disclosure typically required in an OFR, the matters outlined may still be useful when preparing disclosure about an entity's business model in the OFR.

RG 000.44 An informed assessment of an entity's operations will often require information about past results, or the performance of other businesses in the same sector (to the extent that information is available)—for instance, to explain whether the entity's performance is consistent with longer-term trends.

RG 000.45 It will often be necessary for an OFR to include particular elements of information that have already been disclosed in past continuous disclosure announcements, depending on the impact of a transaction or event on the financial performance for the period.

Financial position

RG 000.46 The OFR should include matters that are relevant to understanding an entity's financial position, including the underlying drivers of, and reasons for, the financial position. This involves explaining the accounting information and other detail contained in the financial report (rather than simply repeating it). For example, this might include:

(a) significant changes in assets and liabilities as a result of major business acquisitions or disposals;

(b) changes in the funding or dividend strategy of the entity; and

(c) reference to any issues or uncertainties about the entity as a 'going concern'. This is particularly important when there is doubt over the solvency of the entity, or its ability to continue as a going concern, including cases where the entity's auditor has included an 'emphasis of matter' or modified its audit opinion. While these matters would already be discussed in the financial report, the OFR provides an opportunity to highlight the circumstances and explain in clear terms the concerns underlying the audit opinion.

RG 000.47 The OFR should also discuss the impact of any unrecognised/ undervalued assets or exposures not reflected in the financial report, such as material off-balance sheet items, that would be relevant to understanding the entity's financial position.

Non-IFRS financial information

RG 000.48 While non-IFRS financial information cannot be included in financial statements, and would only rarely be included in the notes to the financial statements, we recognise that certain non-IFRS financial information may be useful or necessary for investors and other users of financial reports.

RG 000.49 Non-IFRS financial information may be included in an OFR, if care is taken to ensure that it is not presented in a misleading manner. Guidance about how non-IFRS financial information may be presented in a way that minimises the risk of misleading users is contained in Section D of RG 230.

Examples of disclosure

RG 000.50 Table 1 provides some examples of disclosure about an entity's operations and financial position, and the level of detail that may be appropriate.

Table 1: Examples of disclosure about an entity's operations and financial position

Examples of disclosure that is likely to be inadequate	Examples of better disclosure with a level of detail that is more likely to be appropriate
Profit has increased by 10% this year compared with last year. *(Comment: There is a lack of analysis of the underlying drivers of the profit increase.)*	Profit has increased by 10% this year compared with last year, primarily due to a 15% increase in the volume of sales in China, and a strong focus on reducing manufacturing costs, resulting in these costs being 8% lower than last year. This is in line with expectations. Underpinning the increase in sales was a strong marketing campaign (marketing spending was 10% higher than last year), and an increase in our sales force in China by 5%. Profit margins were about 10% lower this year than last year, due to competitive pressures reducing sales prices, but this was more than compensated for by the increase in sales volume.
Sales of Models A and B were above expectations. *(Comment: There is a lack of analysis of actual results or comparison with last year's expectations.)*	Sales of Model A were slightly up on last year (by 2%), which was lower than anticipated by the directors last year (our expectation was 10%). Market feedback is that some features of Model A are not as advanced as certain competitor products. We have started an urgent upgrade of Model A, which is discussed in paragraph V of the OFR. Sales of Model B were up on last year by 20%, which is very encouraging and higher than anticipated last year (our expectation was 15%). The key reason for this increase was the expansion of our distribution networks, including a significant contribution by direct internet sales (accounting for 30% of Model B sales, up from 5% last financial year). *[This level of detail is appropriate where Models A and B are the primary business. We would not expect this detail by model where there are large numbers of models.]*

D Business strategies and prospects for future financial years

Key points

Information on business strategies and prospects for future financial years should focus on what may affect the future financial performance and position of the entity.

Subject to the exemption for unreasonable prejudice in s299A(3), the OFR should describe:

- the overall business strategies relevant to the entity's future financial position and performance;
- the matters that may have a significant impact on future financial performance and condition; and
- the risks that could adversely affect the achievement of the financial outcomes described.

If entities intend to rely on the unreasonable prejudice exemption to omit information, the basis for relying on the exemption needs to be carefully evaluated and established.

The statutory requirement

RG 000.51 The OFR must contain information that investors would reasonably require to make 'an informed assessment of...the business strategies, and prospects for future financial years, of the entity reported on': s299A(1)(c).

RG 000.52 Disclosure of information on business strategies and prospects for future financial years should be considered in light of the exemption from disclosing information that may be unreasonably prejudicial to the entity: s299A(3). However, it will not be possible to rely on this exemption for information that is already in the public domain (whether released by the entity or otherwise). Further details about the use of this exemption are provided in RG 000.67–RG 000.76.

Discussion of business strategies and prospects

RG 000.53 We consider that information on business strategies and prospects for future financial years should focus on matters that may have a significant impact on the future financial performance and position of the entity.

RG 000.54 Section 299A does not specify any particular time period for which business strategies should be described. However, the fact that s299A requires prospects 'for future financial years' to be discussed, indicates that something more than a discussion centred on strategies for the next financial reporting period is required.

RG 000.55 The discussion about business strategies and prospects will need to be tailored to reflect both short-term and longer-term matters relevant to an informed understanding of the business strategies and prospects of the listed entity.

RG 000.56 In most instances, information that is relevant to the discussion of business strategies and prospects will already have been disclosed or can be inferred from past disclosures made by the entity. The OFR discussion in the directors' report is an opportunity to bring together key disclosures that may have been presented to the market on an ongoing basis, including relevant updates.

RG 000.57 In our view, information that has already been disclosed may be reasonably required by investors to make an informed assessment of the entity's business strategies and future prospects. To make an informed assessment of an entity's business strategies and future prospects, investors are likely to need information that provides them with context about the entity as a whole—that is, the OFR sets out the entity's business objectives, how these objectives are to be achieved and significant factors on which the achievement of these objectives depends.

RG 000.58 The discussion of business strategies and prospects will usually be shorter and simpler for smaller entities, given their relative size and generally less complicated operations.

Business strategies

RG 000.59 Subject to the unreasonable prejudice exemption, an OFR should outline the entity's key business strategies, including significant plans that are a part of those strategies. These may include, for example, the entity's intention to develop or discontinue products or services, plans to enter new markets or to expand production capacity and market share in existing markets, or plans to raise funds for the acquisition of a new asset.

RG 000.60 Only information that is reasonably required to make an informed assessment needs to be disclosed. In most cases, it should be possible to provide this level of information about strategy without causing unreasonable prejudice to the entity. For example, it is possible to sensibly discuss a strategy of discounted pricing without providing the exact amount of the discount that will be applied. Some practical considerations in determining whether the unreasonable prejudice exemption would be available are contained in RG 000.75–RG 000.76.

Prospects for future financial years

RG 000.61 It is important that the discussion about prospects is balanced. It is likely to be misleading to discuss prospects for future financial years without referring to the main risks that could adversely affect the achievement of the financial outcomes described. Any discussion of risks should be tailored to the entity rather than using a standard description. The discussion of risks may include:

(a) *internal risks*—for example, an entity's ability to meet future demand for its products or services, corporate restructures and cost management strategies initiated by management; and

(b) *external risks*—for example, the economic risks affecting an entity, the impact of commodity prices, and possible legislative changes.

RG 000.62 Other considerations that may be relevant for disclosure of risks include:

(a) *key risks*—identifying the key risks that are relevant to an entity. Care should be taken to avoid disclosure of an excessive number of risks. Each risk should:

(i) be described in its context (e.g. why is the risk important or significant, and what is its potential impact on the entity's financial results?); and

(ii) include any relevant associated analytical comments (e.g. is the risk expected to increase or decrease in the foreseeable future?); and

(b) *risk aversion and risk management*—a description of the directors' level of appetite for risk, any changes in the risk appetite, and any current or planned risk management practices.

RG 000.63 The OFR would assist investors if key factors relevant to an entity's prospects outside management's control were appropriately identified. For the key factors that are within the control of management, how those factors will be controlled or managed may also be relevant for discussion.

RG 000.64 The OFR is an appropriate place to highlight the key strengths and weaknesses within an entity that may positively or negatively affect the entity's ability to achieve its business objectives.

RG 000.65 In most cases, a narrative discussion of prospects for future financial years will be sufficient. If, in rare circumstances, an entity intends to present financial forecasts in its OFR, our guidance in Regulatory Guide 170 *Prospective financial information* (RG 170) should be considered. If appropriate, a sensitivity analysis could be used to show the potential variability in expected results in the event of changes in key factors that may affect the entity's capacity to deliver on its strategic objectives.

RG 000.66 The word 'prospects' also applies in the prospectus disclosure test, set out in s710, together with the concept of a person acquiring an 'informed assessment' of this matter. Despite this similarity in the wording, we do not generally expect an OFR to contain the same level of disclosure as a full prospectus. For example, while prospectuses commonly include numerical financial forecasts, these would generally not be included in an OFR. An OFR is designed to be read in conjunction with the financial statements and other parts of the annual report, and provides information about an entity that is already listed and would have been subject to continuous and periodic disclosure obligations.

Use of the unreasonable prejudice exemption

How does the exemption in s299A(3) apply?

RG 000.67 The Corporations Act provides an exemption from disclosing information about business strategies and prospects for future financial years if disclosure of that information is likely to result in 'unreasonable prejudice' to the entity or the consolidated entity or any entity that is part of the consolidated entity: s299A(3).

> Note: For convenience, the term 'entity' is used in this section to refer to the entity or the consolidated entity or any entity that is part of the consolidated entity in the context of 'unreasonable prejudice'.

RG 000.68 Relying on the unreasonable prejudice exemption requires consideration of whether there is unreasonable prejudice, and whether it is likely to occur. The basis for relying on an exemption needs to be evaluated and established by the directors before any required information is omitted.

What is 'unreasonable prejudice'?

RG 000.69 We think a useful approach to considering whether the publication of information would result in unreasonable prejudice is to identify the adverse consequences likely to occur (i.e. the prejudice), and then consider whether these consequences are unreasonable. The consequences would be unreasonable if disclosing the information is likely to give third parties (such as competitors, suppliers and buyers) a commercial advantage, resulting in a material disadvantage to the entity.

When is unreasonable prejudice likely?

RG 000.70 The term 'likely' has been interpreted in various ways by the courts.

> Note: See, for example, *Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees' Union* (1979) 42 FLR 331 at 339–340 (Bowen CJ):
>
>> [the word 'likely'] may mean 'probable' in the sense of 'more probable than not'—'more than a fifty per cent chance'. It may mean 'material risk' as seen by a reasonable man 'such as might happen'. It may mean 'some possibility'—more than a remote or bare chance. Or, it may mean that the conduct engaged in is inherently of such a character that it would ordinarily cause the effect specified.

RG 000.71 We consider that, at a minimum, the word 'likely' means 'more than a possibility', or 'more probable than not'. A mere possibility of unreasonable prejudice to the entity is not sufficient to meet this standard. Directors need to consider whether the relevant standard is met for all omitted information.

Confidential information

RG 000.72 Entities may often consider that the disclosure of specific information would be likely to result in unreasonable prejudice to the entity. If the information is confidential because it is commercially sensitive and the disclosure of that information would unreasonably damage the entity's business, it is likely to be possible to establish a basis for this view.

RG 000.73 However, it would be rare to establish that unreasonable prejudice is likely for the disclosure of business strategies and prospects in an OFR if that information has already been disclosed, or can otherwise be inferred from documents or other material already in the public domain (e.g. the entity's announcements to the market). It would also be rare for an entity to disclose no information at all about its business strategies and prospects.

RG 000.74 A listed entity may have omitted information from continuous disclosure announcements under the exceptions to ASX Listing Rule 3.1, as set out in Listing Rule 3.1A. If an entity intends to omit the same information from the OFR, directors and preparers of the OFR should consider, taking into account the passage of time and the current circumstances, whether that information should now be disclosed.

Practical considerations

RG 000.75 We encourage entities to prepare their OFR with the purpose of providing an informed assessment of business strategies and future prospects. They should then assess whether any information should be omitted on the basis of unreasonable prejudice. In other words, entities should not start with the approach that particular information must be omitted. This reflects the intent of the legislation and is likely to lead to a more appropriate application of the exemption.

RG 000.76 Practical considerations in determining whether the exemption is available include:

(a) rather than omitting all information on business strategies and prospects, entities should:

   (i) first identify the information that would reasonably be required by investors; and

   (ii) then identify (and remove if necessary) any specific parts of that information that would give rise to an unreasonable prejudice to the entity;

(b) the disclosure of information that is already contained in continuous disclosure notices, investor presentations, briefings to analysts or other publicly available documents is unlikely to give rise to unreasonable prejudice to the entity;

(c) in many cases, information can be presented at a level of detail that does not give rise to any likely material detriment to the entity;

(d) in assessing the usefulness of information to competitors, consideration should be given to whether competitors are already likely to have access to the information from public or non-public documents or other sources, as well as the ability of competitors to act on the information to cause significant detriment to the entity; and

(e) determining whether any prejudice is unreasonable requires balancing any detriment to the entity against the value of the information to investors.

Record keeping

RG 000.77 If information has been omitted under the exemption in s299A(3), the directors' report must disclose this. Where possible, we also encourage directors to disclose a summary of the type of information omitted and the reasons for the omission. We would not expect these disclosures to be lengthy and detailed.

RG 000.78 We may ask why information has been excluded. Directors may therefore find it helpful to keep an internal record which:

(a) identifies the information that has not been disclosed; and

(b) explains the basis on which disclosure of the excluded information would be likely to result in unreasonable prejudice to the entity.

Examples of disclosure

RG 000.79 Table 2 provides some examples of disclosure about an entity's business strategies and prospects for future financial years, and the level of detail that may be appropriate.

Table 2: Examples of disclosure about an entity's business strategies and prospects for future financial years

Examples of disclosure that is likely to be inadequate	Examples of better disclosure with a level of detail that is more likely to be appropriate
The company manufactures widgets in Australia, with customers in both Australia and China. *(Comment: There is a lack of detail about what the company does, the markets in which it operates, its position in the market, any key dependencies and major events during the year.)*	The company is a manufacturer of technology equipment, producing two types of widgets—Models A and B. Its manufacturing operations are based entirely in Australia, but it distributes its products both in Australia (5%) and overseas (95%)—mostly in China: see Operating Segment Note X for more details of the financial performance of the company's key operations. The company is a key participant in its market, holding a market share of approximately 30%. There are two major competitors and the market is becoming increasingly price competitive. With a very diverse customer base, the company does not have any dependencies on key customers. The directors will continue to review their strategy.

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Examples of disclosure that is likely to be inadequate	Examples of better disclosure with a level of detail that is more likely to be appropriate
	In May, the company announced that it had been the target of an unsolicited takeover offer. The directors believed that this offer significantly undervalued the company. The offer caused some disruption, diverting management time from daily operations, and the company incurred one-off costs of approximately $225,000 in relation to the offer. The offer has since been withdrawn. As part of our cost reduction program, it was necessary to reduce production staff numbers this year—from 80 to 70. Redundancy payments totalling $725,000 explain the higher employee benefits expenses this year. As a manufacturer, the company is subject to a number of environmental laws and regulations. The company believes that it has complied with all of its environmental obligations, and has not received notification of any breaches from the relevant regulatory authorities. *[This level of detail is appropriate where Models A and B are the primary business. We would not expect this detail by model where there are large numbers of models.]*
The company is subject to a number of internal and external risks. The company regularly reviews the possible impact of these risks and seeks to minimise this through a commitment to its corporate governance principles and its various risk management functions. *(Comment: There is insufficient detail about the specific key risks relevant to the company, the reasons for the risk and the steps the company is taking to manage the risk.)*	The company is subject to a number of internal and external risks, and adopts a conservative approach to risk management. We regularly review the possible impact of these risks and seek to minimise their impact through a commitment to corporate governance principles, and various risk management functions. The major risks faced by the company and how we manage them include: • *foreign exchange*—given the reliance on sales in China, where customers are billed in US dollars, this has resulted in foreign exchange losses for the company because of the high Australian dollar this year. This has been mitigated to an extent by partial hedging, and is therefore unlikely to have a significant impact on our financial results. We do not expect any significant change in this risk over the next couple of years; • *technological obsolescence*—given the rapidly changing environment in which the company operates, this could have a very significant impact on our financial results. We address this risk through investment in research and development (further details are included in paragraph W of the OFR) and by constantly monitoring the market. With competitors constantly seeking to enter our market with improved designs, we see this risk increasing in the future; • *reduction in demand from China*—given our reliance on that economy, this could have a very significant impact on our financial results. Based on the views of prominent economic commentators, we do not anticipate any significant slowdown in the Chinese economy for the next few years, but are currently investigating the option of expanding our sales into other emerging economies, such as India; and • *expansion of production capacity*—given that our current production facilities are operating near maximum capacity (as outlined in paragraph X of the OFR), we are currently investigating other options. We consider this unlikely to have any significant impact on our financial results in the next year, but could potentially be significant in future years if suitable options do not become available within the next 12 months.

Examples of disclosure that is likely to be inadequate	Examples of better disclosure with a level of detail that is more likely to be appropriate
The company intends to expand with the market for widgets. We have a number of strategies in mind to achieve this growth. *(Comment: There is a lack of detail about the basis for the expected growth and the proposed strategies to achieve that growth.)*	Based on the expected growth in China, as predicted by a number of prominent economic commentators, and the demand from customers for the latest technology, we expect the market for widgets to increase for the next few years. We have a number of strategies to benefit from this growth, including: • upgrading Model A (explained in paragraph Y of the OFR); • further increasing the sales force; and • further reducing manufacturing costs (explained in paragraph Z of the OFR).
In reliance on s299A(3) of the Corporations Act, we have not disclosed further information on business strategies and prospects, because disclosure of that information is likely to result in unreasonable prejudice to the company. *(Comment: More detail could be disclosed about business strategies and prospects that is useful to users, but not so detailed or specific that it would be likely that other parties could use the information to cause unreasonable prejudice to the company.)*	As discussed elsewhere in the OFR, we have instigated an urgent upgrade of Model A. We have allocated $2.2 million for this upgrade, which will mostly be funded by debt ($2 million), with the remainder to be funded from retained earnings. We expect the upgrade to be completed in the next 12 months, to be followed by a strong marketing campaign with the intention of re-establishing market share that has been lost over the past year. We are continually considering ways of reducing the company's cost of manufacturing. The directors are giving consideration to a major upgrade of production line technology to improve efficiency. The directors expect to receive the results of a feasibility study within the next three months, and the various options will be considered at that time. Because our plant is currently operating near maximum capacity, we are also investigating leasing suitable property close to our current location. We do not intend to develop any new products or expand into any new lines of business at this time.

E Presentation of the analysis and narrative

Key points

Directors and preparers of the OFR should present the analysis and narrative in a way that maximises its usefulness to investors.

As a matter of good practice, an OFR should present information in a single section, and in a manner that is:

- complementary to and consistent with the annual financial report;
- balanced and unambiguous; and
- clear, concise and effective.

Good disclosure practices

RG 000.80 One of the objectives of the OFR requirements is that the OFR should be ‘presented in a manner which maximises usefulness to all users, having particular regard to the needs of people who are unaccustomed to reading financial reports’.

Note: See paragraph 4.380 of the 2003 Explanatory Memorandum.

RG 000.81 Table 3 sets out some good disclosure practices that we consider would be useful and relevant in the context of preparing an OFR.

Table 3: Good disclosure practices for presenting information in an OFR

Good disclosure	Explanation
Single, self-contained section	The OFR should be presented in a single self-contained section of the annual report to assist users in identifying the OFR. It should be presented together with the information required by s299, but should generally be presented separately from the directors' report. Including the OFR in a single self-contained section will also assist preparers of the OFR in ensuring they have provided all the relevant information. While the OFR is part of the directors' report under the Corporations Act, Class Order [CO 98/2395] *Transfer of information from the directors' report* permits the OFR to be transferred into a document that is included with the directors' report and financial report (provided the directors' report includes a clear cross reference). However, [CO 98/2395] does not permit the transfer of information required by s299A into the financial report. There is no provision that allows the OFR to incorporate information by reference to other documents that do not form part of the annual report, such as briefings to analysts.

Good disclosure	Explanation
Complementary and consistent information	The information in the OFR should complement, and be consistent with, the information in the financial report. This may involve providing a narrative explaining various sections of the financial report—such as segment reporting, business combinations, asset acquisitions and impairment testing—in a way that is relevant to the entity's operations, business strategies and prospects. If there are inconsistencies, these should be adequately explained. For example, comments on prospects and expected future growth rates should be consistent with the assumptions underlying the 'going concern' and asset impairment testing in the financial report. The OFR should also be consistent with information disclosed in other documents, such as continuous disclosure announcements.
Balanced and unambiguous disclosure	Disclosure must be balanced and unambiguous. Representations or statements about a future matter should be made only if there are reasonable grounds for making the representation or statement. Selective disclosure may include a failure to give 'bad news' equal prominence to 'good news', or providing non-IFRS financial information that is not appropriately explained: see Sections A and D of RG 230. Misleading disclosure (including disclosure that misleads by omission) may place the directors of the entity at risk of contravening s1308.
Clear, concise and effective presentation	While not a specific legislative requirement, we consider that a useful and meaningful OFR should present information in a clear, concise and effective manner. Information is 'clear, concise and effective' if it highlights key information, uses plain language, explains complex information, and is presented in a logical order. Tables 3 and 4 in RG 228 suggest a number of methods to assist in the clear, concise and effective presentation of information in the context of a prospectus, and some of these methods may be useful for an OFR.

Examples of disclosure

RG 000.82 Table 1 in Section C and Table 2 in Section D of this guide contain hypothetical examples (for a simple manufacturing company) of disclosure that is likely to be inadequate compared with examples of better disclosure with a level of detail that is more likely to be appropriate.

RG 000.83 The examples are intended to provide an illustration of the main principles outlined in the guide, but do not cover all of the principles, and are not intended to be used as a template for OFR disclosure. As stated in this guide, it is essential that an OFR is tailored to the individual circumstances of each entity. There are many other ways to present an OFR that may be equally valid to those shown in the examples.

Key terms

Term	Meaning in this document
2003 Explanatory Memorandum	Explanatory Memorandum for the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003
2010 Explanatory Memorandum	Explanatory Memorandum for the Corporations Amendment (Corporate Reporting Reform) Bill 2010
AASB	Australian Accounting Standards Board
accounting standards	As defined in s9 of the Corporations Act (also referred to as 'Australian accounting standards')
ASIC	Australian Securities and Investments Commission
[CO 98/2395]	An ASIC class order (in this example numbered 98/2395)
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
entity	The entity or consolidated entity, as applicable. In Section D, the term also refers to any entity that is part of the consolidated entity in the context of 'unreasonable prejudice'
financial report	The documents referred to in s295 and 303 of the Corporations Act—that is, financial statements, notes to the financial statements and the directors' declaration about the statements and notes
financial statements	The statements required by accounting standards—that is, the statement of financial position, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows Note: This excludes the directors' declaration and the notes to the financial statements.
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards issued by the IASB
IOSCO	International Organization of Securities Commissions
listed entity	A company, registered managed investment scheme or disclosing entity that is listed
non-IFRS financial information	Financial information not prepared in accordance with IFRS
OFR (operating and financial review)	The review required under s299A of the Corporations Act
RG 230 (for example)	An ASIC regulatory guide (in this example numbered 230)
s299A (for example)	A section of the Corporations Act (in this example numbered 299A)

Related information

Headnotes

annual report, business strategies and prospects, directors' report, disclosure, entities, financial position, listed entities, OFR, operating and financial review, operations

Class orders and pro formas

[CO 98/2395] *Transfer of information from the directors' report*

Regulatory guides

RG 170 *Prospective financial information*

RG 228 *Prospectuses: Effective disclosure for retail investors*

RG 230 *Disclosing non-IFRS financial information*

Legislation

Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003

Corporations Act, Pt 2M.3, s9, 295, 299, 299A, 303, s306(1), 710, 1308

Cases

Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees' Union (1979) 42 FLR 331

Other references

ASX Listing Rules 3.1 and 3.1A