



**ASIC**

Australian Securities & Investments Commission

# The ongoing relationship between a company and its shareholders

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University of Sydney*

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## Opening

The theme of my address is ‘What should be the ongoing relationship between a company and its shareholders?’

There are many issues that could be discussed when speaking about shareholder engagement – the role of the board, institutional investors, shareholder activists, proxy advisers and the continuous disclosures that are made by listed companies between annual reporting dates to keep the market informed of material changes. But these I fear need to be topics for another evening (or perhaps several evenings!) given time constraints.

So what I really wanted to focus on this evening are the issues of annual reporting by listed companies and the annual general meeting (AGM). Among other things this is because the Corporations and Markets Advisory Committee or CAMAC has considered both issues recently and the Financial Reporting Council (FRC) has also considered issues around reporting over a number of years. In the interests of transparency, I should note that I am a member of both bodies. But, of course, I should be clear that I am making this presentation tonight on behalf of ASIC and am not representing the views of the FRC or CAMAC.

## Annual report

The annual report is important because it is the principal document for consideration at the AGM and provides information for shareholders on the state of the company and the stewardship of the board.

All companies (other than some small proprietary companies), as well as registered managed investment schemes, must prepare an annual report, comprising:

- a financial report
- a directors’ report
- an auditor’s report.

### Financial report

The *Corporations Act 2001* prescribes the content of the financial report, including various declarations by directors and others concerning solvency and compliance with accounting standards.

### Directors’ report

The directors’ report must include (in addition to certain specific information):

- general information about the operation of the company, including its principal activities and outcomes during the year, and some forward looking information
- information to assess the operations, financial position, business strategies and future prospects of the company (known as the operating and financial review (OFR)).

The obligation to provide an OFR was introduced in response to a recommendation in the HIH Royal Commission report (April 2003) that an OFR be included in annual reports. It was argued that:

such a document ... would significantly assist in addressing the shortcomings of audited accounts presented in accordance with the historical cost convention and other standards which can impede the utility of the accounts as a transparent assessment of the financial progress of the company.

It is worth noting that ASIC has recently issued regulatory guidance about this existing legal obligation to help improve the quality of OFR reporting in Australia. We see the OFR as key information for shareholders. Perhaps this is something worth revisiting in any questions later.

### **Auditor's report**

The report by an independent auditor must indicate to shareholders whether the auditor is of the opinion that the financial report is in accordance with the statutory requirements.

## **Usefulness of the annual report**

The usefulness of the annual report, in its current format, remains controversial. For instance, a survey in 2012 by Allens Linklaters of its listed clients indicated support for the proposition that the format and content of annual reports should be reviewed in order to make company information more accessible to investors. Allens Linklaters commented that:

For retail investors in particular, the annual report is the primary source of information regarding a company's activities and strategies. However, the complexity and volume of the information can be overwhelming, leading to suggestions that companies' reports should be made available electronically and designed in a manner that makes relevant information more accessible to investors.

Similar comments were also made in a Parliamentary Inquiry which ultimately led to a Parliamentary report in 2008 called *Better shareholders – Better company*.

In June 2009, the UK FRC published *Louder than words: Principles and actions for making corporate reports less complex and more relevant*. That paper argued that the primary purpose of the annual report is to provide

shareholders with information that is useful for assessing the stewardship of the board and management, and for making their future investment decisions. However, it was noted that assessing a company's performance and prospects can be made more difficult if key relevant information in an annual report is obscured by information 'clutter'.

The more specific issue of complexity of financial reporting has also been topical. The Australian FRC recently consulted on this topic and in October 2012 summarised various themes which emerged from the consultation, including general support for better use of developments in information technology and delivery to enable users to access more efficiently their desired information. The paper also set out various recommendations based on the findings of the consultation, including support for ASIC's proposal to foster more meaningful OFRs in annual reports. The FRC has also suggested better disclosure in the OFR might be a first step if integrated reporting is to be introduced in Australia.

So what should be done about all of this? Another paper by the UK FRC, *Thinking about disclosures in a broader context* (October 2012), discussed ways to improve the quality of information disclosed in annual reports and to curtail a piecemeal approach to reporting. In particular, the paper covers the reduction of 'clutter' in reports by avoiding duplication in disclosures and using tests of materiality more rigorously.

That paper also proposed a 'road map' for a disclosure framework structured around four questions:

- *What information do users need?* – the aim is to ensure that disclosures are relevant and targeted to the needs of users
- *Where should disclosures be located?* – the aim is to develop placement criteria to provide structure for the financial report so that disclosures are organised in a way that is more informative to the reader and can be consistently applied
- *When should a disclosure be provided?* – the aim is to reduce the disclosure burden through the application of the concepts of proportionality and materiality
- *How should disclosures be communicated?* – the aim is to develop a set of principles for good communication that will assist in improving the quality of disclosures.

I would argue these are very sensible questions to be asking when thinking about disclosure rules generally. More broadly, these questions seem consistent with ideas from behavioural economics that people do not always process information rationally.

To my mind it follows careful thought needs to be given to both the information that users of accounts need and how it is presented. To give you

an example – accounts reflect historical performance, yet numerous studies show that past performance of a firm is not necessarily predictive of future performance. So why should the market so carefully focus on accounts compared to say the OFR, which talks about future prospects, risks and strategies?

I will let you ponder on these issues further as I now want to move to the related topic of the AGM.

## The AGM

I should briefly reflect on the role of the AGM as part of the shareholder engagement process before embarking on further discussion.

All public companies must hold an AGM. The AGM serves various purposes in the general engagement between companies and shareholders, and is a mechanism for accountability of those in control of the company to the owners.

In particular, the AGM is a forum for:

- *reporting*: to inform shareholders about various financial and other matters (e.g. through consideration of the annual report)
- *questioning*: to provide an opportunity for shareholders to ask questions or make comments on various matters (e.g. management of the company, remuneration or audit issues)
- *deliberating*: to provide an opportunity for shareholders to discuss the matters on which they will be called to vote at the meeting
- *decision making*: to enable shareholders to vote on a limited range of matters at the AGM, including:
  - the annual report
  - the remuneration report
  - the election of directors
  - the appointment of the auditor and the fixing of the auditor's remuneration
  - other permissible resolutions concerning the company.

And how successful is the AGM in doing all of this?

One participant in last year's Allens Linklaters Listed Client Survey 'CAMAC Review of Annual General Meetings' (2012) noted that an AGM is:

... a nineteenth century activity but no one has yet found a sensible way of improving it.

This is an interesting comment and perhaps one that might be understood in the context of:

- the very large size of many public companies (some with 400,000+ shareholders)
- relatively low AGM attendances – only 5% of the top 200 companies draw more than 500 shareholders to their AGM
- the digital age, electronic communications and continuous disclosure obligations – higher levels of continuous disclosure combined with companies using more corporate briefings, teleconferences and webcasts have arguably rendered the AGM less relevant.

So what then are some alternatives to the present system of AGMs? A recent CAMAC discussion paper sets out at least four alternatives for public comment:

- Leave it as is.
- Limit the AGM to the deliberative and decision-making functions.
- Separate out the decision-making function of the AGM.
- Abolish the requirement for an AGM.

Let me discuss each of these options (apart from the status quo option) in turn.

### **Limit the AGM to the deliberative and decision-making functions**

- The AGM would be restricted to the discussion of, and voting on, the remuneration report, election of directors, and other resolutions on the agenda.
- This makes some sense as questions/comments at the AGM can be too late to influence outcomes of resolutions given proxy voting.
- Alternative means could be used to ensure reporting to, and questioning by, shareholders. For instance:
  - web-based corporate briefings
  - a forum for shareholders to ask directors/management questions on an ongoing basis, with answers published on the company website.

### **Separate out the decision-making function of the AGM**

- The reporting, questioning and deliberative functions of the AGM would remain in place, but without the need for the decision-making function of the AGM to be completed at the same time as the meeting.
- Voting would be available after the AGM.

- This would allow shareholders (particularly retail shareholders) to reflect on questions and answers from the AGM.
  - The argument is that this would facilitate better-informed decision making, which would not be dependent on whether they were physically able to attend the meeting.
- However, the downside is that it would mean that the AGM will not achieve any final outcomes, and that shareholders will need to rely on follow-up announcements to find out what decisions have been made.

### **Abolish the requirement for an AGM**

- It would then be a matter for each company to decide whether to hold an AGM.
- Query how the reporting, questioning, deliberative and decision-making functions of the AGM would otherwise be achieved?
  - *Reporting and questioning:* Along with continuous disclosure:
    - additional information could be provided in the annual report, and
    - comments/questions by shareholders and responses from the company could be disseminated electronically (e.g. via posting to the company's website).
  - *Deliberative:* The traditional argument for requiring a physical meeting of shareholders is the opportunity to discuss proposed resolutions before the vote is taken.
    - In practice, the outcomes of voting on many resolutions put at the AGM may already have been determined by pre-meeting proxy voting.
  - *Decision-making:* Most resolutions at AGMs are also determined without the need for a physical meeting by proxy votes.
    - With moves to encourage more voting by institutional investors, this is likely to increase.
- If AGMs are abolished, resolutions could still be put to shareholders in writing, and shareholders could vote in writing or via the internet – which is not greatly different from current proxy voting processes.
- Abolishing the requirement for an AGM would be a world first.
- One problem is that people who talk about the abolition of the AGM don't tend to focus on the next stage, which is 'what should take its place'? But more on that later.

There are many other things I could discuss about the AGM, including possible improvements to its format through online or virtual meetings or changes to its timing, method of voting and so forth. But as there is not time

for me to discuss these in detail tonight, all I can do is refer you to CAMAC's excellent paper *The AGM and shareholder engagement*.

## Further discussion

So let me try and draw some of these issues together. From all of this I would make the following points for the purposes of further debate and discussion:

- Disclosure (including accounting disclosures) should focus on what information users want and how they make decisions. The issue is particularly important and difficult given different users may want different amounts and types of information.
- Annual reports should contain useful narrative information to users about what might happen to the company in the future, not just what has happened to it in the past.
- Listed companies need to ensure their investor communication is balanced. Smaller retail shareholders should have the opportunity to participate in communications if they want (either through the AGM or other means) and communication should not be solely focused on institutions.
- Wherever possible we should embrace new technology as an opportunity to improve communication and reduce cost.

I look forward to your comments on these important issues and I'm happy to answer any questions.