



ASIC

Australian Securities & Investments Commission

REPORT 334

Response to submissions on CP 187 Effective disclosure in an operating and financial review

March 2013

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 187 *Effective disclosure in an operating and financial review* (CP 187) and details our responses to those issues.

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.

Disclaimer

This report 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.

This report does not contain ASIC policy. Please see Regulatory Guide 247 *Effective disclosure in an operating and financial review* (RG 247).

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A Overview/Consultation process

- 1 In Consultation Paper 187 *Effective disclosure in an operating and financial review* (CP 187), we sought feedback on our proposed guidance on providing useful and meaningful information to investors when preparing an operating and financial review (OFR) in a directors' report.
- 2 This report highlights the key issues that arose out of the submissions received on CP 187 and our responses to those issues.
- 3 This report is not a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 187.

Responses to consultation

- 4 We received 25 responses to CP 187 from companies, industry bodies, accounting firms, accounting and auditing standard setters and other interested parties. We are grateful to respondents for taking the time to send us their comments. We are also grateful to the individuals who discussed specific issues with us during the consultation process.
- 5 For a list of the 24 non-confidential respondents to CP 187, see the appendix. Copies of the non-confidential submissions are on the ASIC website at www.asic.gov.au/cp under CP 187. We also received one confidential submission.
- 6 The majority of respondents were supportive of ASIC issuing guidance.
- 7 On some issues, there were mixed responses and different views expressed. A number of respondents raised concerns about, or asked for clarification on:
 - (a) the intended audience and purpose of an OFR in the overall reporting framework;
 - (b) the disclosure levels within an OFR, as compared with a prospectus, and clarification on references to Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228);
 - (c) the examples of disclosure in Tables 1 and 2;
 - (d) the disclosure of business strategies and prospects, including risks;
 - (e) the use of the unreasonable prejudice exemption in s299A(3) of the *Corporations Act 2001* (Corporations Act); and
 - (f) whether environmental, social and governance (ESG) issues should be included in an OFR.

B The intended audience and purpose of an operating and financial review

Key points

Concerns were expressed about our expectation that an OFR should contain information that has already been released in disclosure notices. Several respondents commented that documents should be able to be incorporated in an OFR by reference. There were also concerns about the potential length of an OFR.

We received feedback that it was inappropriate to use the term 'investors' rather than 'members'.

Purpose of an OFR

- 8 The draft regulatory guide indicated the level of disclosure that an OFR should contain, including bringing together relevant matters covered in previous disclosure notices.
- 9 We received feedback questioning the relevance of an OFR, given current concerns about the usefulness of annual reports and the breadth of other disclosures that are already in the market.
- 10 Further feedback was received that other documents should be able to be incorporated into an OFR by reference, and that having to repeat information already contained in disclosure notices would involve unnecessary duplication. Concerns were also expressed that implementing ASIC's proposals would increase the length of an OFR.

ASIC's response

As a result of the feedback received, we have reordered and reworded significant sections of the overview of the regulatory guide to clarify our views.

We do not consider it appropriate to incorporate documents outside the financial report by reference, because the purpose of an OFR is to distil the essence of key documents and announcements throughout the year (appropriately updated to the OFR date), rather than repeating them in full. Additionally, incorporation by reference is not permitted by the legislation.

We remain of the view that an OFR allows members to find relevant information on an entity in a single location, rather than having to piece together information from other sources, such as various past continuous disclosure announcements.

We also remain of the view that a complying OFR need not necessarily increase the length or complexity of the annual report.

Users of OFRs

- 11 The draft regulatory guide stated that our guidance was for ‘investors’.
- 12 We received feedback that this term was inappropriate because it suggested a wider class of persons than the term ‘members’, which is used in s299A.
- 13 There was also concern that the regulatory guide referred to other users of financial reports, such as prospective investors and analysts—also beyond the scope of s299A.

ASIC’s response

As a result of the feedback received, we have changed the term ‘investors’ to ‘shareholders or unit holders’ throughout the regulatory guide, and references to other users of financial reports, such as prospective investors and analysts, have been removed.

C More specific guidance on OFR content

Key points

We received feedback that it was inappropriate to make reference to sections of RG 228.

We received mixed responses on our proposal to include examples of 'inadequate' and 'better' disclosure.

We received feedback that there should be no requirement for disclosure of any forward-looking statements in an OFR. Concerns were also expressed about our proposed risk disclosure, including the terminology that we used.

Respondents expressed concerns with ASIC's interpretation of the requirements for relying on the unreasonable prejudice exemption, including our suggestions for record keeping.

Concerns were expressed with our statement that an informed assessment of an entity's operations will often require information on the performance of other businesses in the same sector.

Most respondents who commented on integrated reporting agreed that this should not be included in the regulatory guide.

- 14 We received significant feedback on Section C (Operations and financial position) and Section D (Business strategies and prospects for future financial years) of the draft regulatory guide. The major issues raised and our responses are summarised in this section.

References to RG 228

- 15 The draft regulatory guide made references to sections of Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228) for further guidance on explaining an entity's business model and for guidance on the clear, concise and effective presentation of information.
- 16 We received feedback that references to RG 228 were inappropriate and that these implied that ASIC expected prospectus-level disclosure in an OFR (despite statements in the draft regulatory guide that this was not ASIC's expectation).

ASIC's response

As a result of the feedback received, we have deleted all of the references to RG 228 and, where appropriate, incorporated the relevant material from RG 228 directly into the regulatory guide.

We have retained the statement in our guidance that ASIC does not expect prospectus-level disclosure in an OFR, and we explain the difference between the level of disclosure required in a prospectus compared with an OFR.

Examples of disclosure

- 17 Tables 1 and 2 of the draft regulatory guide contain examples of disclosure about an entity's operations and financial position (Table 1) and about its business strategies and prospects (Table 2), demonstrating the disclosure we consider is likely to be inadequate compared with disclosure we would consider to be more appropriate.
- 18 Feedback on the inclusion of examples was mixed, with both support for their inclusion as a useful illustrative tool, but also expressing concerns about providing examples that were detailed enough to be useful and that would not be used as templates.

ASIC's response

We have decided to retain the examples of disclosure, because we consider that they provide a practical illustration of the principles outlined in the regulatory guide.

We have made some changes to the examples in response to the submissions received, including by expanding the examples in Table 1 to include 'disclosure of financial position'.

We continue to clarify that the examples:

- are for illustrative purposes only;
- are not intended to be used as a template;
- are not exhaustive; and
- do not cover all principles or all disclosures in an OFR.

Disclosure of forward-looking information and risks

- 19 The draft regulatory guide states that information on business strategies and prospects for future financial years should focus on matters that have a significant impact on the future financial performance and position of the entity. It further indicates that an OFR should outline the entity's key business strategies and risks that could adversely affect the achievement of the financial performance or outcomes described.
- 20 We received feedback that there should be no requirement for disclosure of any forward-looking statements in an OFR and, in particular, for any such information extending beyond the period of one year. There was further

feedback that this section was too prescriptive, or did not provide enough clarity on our expectations in this area.

- 21 There was also concern that our proposed risk disclosure was too extensive, and that the terminology used had no common definition.

ASIC's response

We clarify, in the regulatory guide, that the legislation requires there to be a forward-looking element in an OFR extending beyond a period of one year, and, more explicitly, explain that no numerical financial forecasts are expected.

We have redrafted our guidance on risk disclosure in response to the submissions received, and to more clearly describe our expectations. In particular, an OFR should only include a discussion of the risks that could affect the entity's achievement of the financial prospects disclosed, and should not contain an exhaustive list of generic risks that might potentially affect a large number of entities.

We have revised the terminology to refer to 'material business risks' (rather than 'key risks') to be consistent with Principle 7 of the ASX Corporate Governance Principles. While Principle 7 itself does not require disclosure of material business risks, the revised supplementary guidance to Principle 7 acknowledges that material business risks may need to be disclosed in some circumstances, including in the preparation of an OFR.

Unreasonable prejudice exemption

- 22 The draft regulatory guide outlines our interpretation of the 'unreasonable prejudice exemption' in s299A(3). Section 299A(3) requires that, if material is omitted from an OFR in reliance on this exemption, the OFR must say so. Where possible, we encourage directors to disclose a high-level summary of the type of information omitted and the reasons for the omission.
- 23 We further state that directors may find it helpful to keep an internal record that identifies the information that has not been disclosed, and explains the basis on which disclosure of the excluded information would be likely to result in unreasonable prejudice to the entity.
- 24 We received feedback from a number of respondents that ASIC is attempting to extend the requirements of the legislation by encouraging disclosure of a high-level summary of the type of information omitted. Some concerns were also expressed about our suggestions for internal record keeping.

ASIC's response

We have now better explained, in the regulatory guide, our expectations when relying on the exemption in s299A(3), including that we do not expect disclosure of commercially sensitive information. We have provided an example in Table 2 of the type of high-level summary that we suggest could be included in an OFR.

We have also reworded our guidance on internal record keeping to clarify that this is not a requirement under the legislation but, rather, something that directors may find helpful in demonstrating how an entity has complied with its obligations.

Other businesses in the same sector

- 25 The draft regulatory guide stated that an informed assessment of an entity's operations will often require comparative information on the performance of other businesses in the same sector (to the extent that this information is available).
- 26 We received feedback that it was inappropriate to require such information, because there are difficulties in identifying which other entities to use, and the timing of the release of results by other entities often coincided, making it difficult to obtain their results.
- 27 Respondents also queried whether it was appropriate to comment on the performance of other entities, and suggested that this requirement may go beyond the requirements of the law.

ASIC's response

As a result of the feedback received, we have deleted the statement referring to the performance of other businesses in the same sector.

Integrated reporting and environmental, social and governance issues

- 28 In CP 187, we stated our view that it would be premature to include any guidance on integrated reporting because the concept is still emerging, and there is no legislative requirement to include such information. We indicated that the regulatory guide could be amended in the future to incorporate developments in integrated reporting.
- 29 The majority of responses received agreed that, while integrated reporting is generally accepted as a worthwhile concept, it would be premature to include it in the regulatory guide at this stage.

- 30 Additional feedback was received from a number of respondents that we should encourage entities to report on their environmental, social and governance (ESG) issues.

ASIC's response

We have not included any guidance on integrated reporting in the regulatory guide.

We have also not included any requirements to report on ESG matters, because this would arguably impose requirements beyond the scope of the legislation.

We have included a reference to ESG in the 'risks' section, where it is stated that an OFR should include a discussion of environmental and other sustainability risks that could affect the entity's achievement of its financial performance or outcomes. We consider this reference does not attempt to extend the legislation, and suitably reflects the circumstances in which a discussion of ESG issues could reasonably be required in an OFR.

Appendix: List of non-confidential respondents

- ANZ Banking Group Limited
 - Auditing and Assurance Standards Board
 - Australian Accounting Standards Board
 - Australian Council of Superannuation Investors
 - Australian Institute of Company Directors
 - Australian Unity Limited
 - Chartered Secretaries Australia
 - Deloitte Touche Tohmatsu
 - Ernst & Young
 - Global Reporting Initiative Focal Point Australia
 - Grant Thornton
 - Group of 100
 - Hermes Equity Ownership Services
 - International Corporate Governance Network
 - Joint Accounting Bodies
 - KPMG
 - Origin Energy
 - Pacific Brands
 - PricewaterhouseCoopers Australia
 - Qantas
 - Regnan Governance Research and Engagement Pty Ltd
 - Telstra
 - Westworth Kemp Consultants
 - William Ferguson
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