



Technical Accounting Alert

Australian Securities and Investments Commission's (ASIC) Regulatory Guide 247: Effective disclosure in an operating and financial review

Introduction

ASIC's Regulatory Guide 247 (RG 247) sets out as ASIC describes it as "... guidance for directors on providing useful and meaningful information to shareholders or unit holders when preparing an operating and financial review (OFR) in a directors' report" that listed entities are required to produce." A copy of the Guide can be downloaded from the ASIC website at [http://asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg247-published-27-March-2013.pdf/\\$file/rg247-published-27-March-2013.pdf](http://asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg247-published-27-March-2013.pdf/$file/rg247-published-27-March-2013.pdf)

However this Guide also has some relevance for non-listed companies given that ASIC has provided its view on when the 'unreasonable prejudice' exemption can be applied, as this exemption (S299 A (3) also applies to non-listed companies who are required to refer in their directors' report - S299 (1) (e) to likely future developments in the entity's operations in future years and the expected results of those operations. It is interesting that ASIC has only focussed on listed entities!

The OFR is required to contain information in the directors report that shareholders 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)).

Information in the OFR must be provided for the consolidated entity where consolidated financial statements are required: s299A(2).

Specific Issues

Background

Section 299A of the Corporations Act which requires an OFR was introduced to address a lack of contextual information explaining the results set out in an entity's annual financial report. An OFR provides an overview that enables shareholders 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 unaccustomed to reading financial reports.

OFR must be self-contained

Must the OFR be a self-contained report? ASIC believes so, although the actual wording of S 299A just requires the information to be included in the Directors' Report, and there is an ASIC Class Order (CO 98/2395) that allows the OFR to be separate to the Directors' Report.

“RG 247.15: All information required under s299A must be included in the body of the OFR itself. An OFR cannot incorporate by reference other documents (outside of the financial report) or rely on the fact that relevant information may have previously been disclosed to the market (e.g. in continuous disclosure announcements) to satisfy the requirements of s299A. Depending on the circumstances, an entity's OFR may need to include more or less detail about an event than has been previously disclosed in a continuous disclosure notice. It may be appropriate to cross-refer to more detail in the financial report to which the OFR is attached, but not the other way around. “

“RG 247 E Table 3: The OFR should be presented in a single, self-contained section of the annual report to assist shareholders in identifying the OFR. It should be presented together with the information required by s299, but can be presented in a separate section 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, ASIC has issued Class Order which permits the OFR to be a document that is included with the directors' report and financial report, and to contain information that is otherwise required to be included in the directors' report (provided that the directors' report includes a clear cross-reference to the OFR).”

One of the difficulties is that many large listed companies tend to include extensive detail on operations, financial position, strategy and future prospects in their Chairman's and Chief Executive Officer's separate Reports. However RE 247 makes it clear that where this occurs, the Directors' Report needs to cross reference to the specific section (pages) of those Reports.

For 30 June 2013 annual reports, there may well be a need to significantly re-structure the various Reports as the following statement from a large listed company, is unlikely to comply with ASIC's thinking:

Future developments

Other than matters included in this report or elsewhere in the Financial Report, likely developments and business strategies of the operations of XXX and the expected results of those operations have not been disclosed as the directors believe that the inclusion would most likely result in unreasonable prejudice to XXX.

ASIC Example disclosures voluminous and duplicate information provided elsewhere

Whilst the RG states that the examples given in this guide, are simply that, examples, and are not exhaustive, they are intended to provide an illustration of the main principles that ASIC believes should be contained in a typical listed company's OFR. So despite the caveats stating that are not intended to be used as a template for OFR disclosure and should be tailored and presented to take into account the circumstances of an entity, there is no escaping the reality that ASIC expects a significant step up in disclosure. The current but clearly soon to be revised Grant Thornton CLEARR example OFR is brief at 177 words and with a prejudicial exemption. In comparison RG 247 runs to just over 1300 words, and a cross reference in the OFR to other sections of the annual report with a prejudicial comment at around 50 words just won't cut it!

Key principles to follow in an OFR

“RG 247.27: An OFR should:

- a concisely present key information about an entity's operations and financial position for the relevant reporting period, including highlighting and summarising particular aspects of any key 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 247.30: An OFR should present:

- (a) a narrative—providing tailored information about an entity's results and financial position. Information in the OFR should be consistent with and complement the financial report; and*
- (b) an analysis—providing a reasoned and meaningful description of the underlying drivers of, and the reasons for, an entity's performance, rather than simply restating information that may be readily determined from the financial statements."*

"RG 247.40: Information about an entity's operations and financial position should be tailored to reflect the individual circumstances of the entity and the business environment in which it operates."

"RG 247.42: An informed understanding of an entity's operations should generally be presented in the context of the entity's business model, and this model should be clearly articulated. This includes explaining the key features of the business model—that is, how the entity makes money and generates income or capital growth for shareholders, or otherwise achieves its objectives. Any key dependencies should be disclosed. These are factors relied on to make money or achieve the entity's objectives. An example would be a dependency on an important contract. The significance of particular segments to the business as a whole should also be made clear."

"RG 247.43: 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 reporting segments, such as new businesses, new major products, new markets, new competitors, acquisitions, discontinued operations, changes in exchange rates, 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."*

Non-IFRS information in the OFR allowed

"RG 247.48: 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 shareholders and other users of financial reports.

RG 247.49: If non-IFRS financial information is included in an OFR, it must not be 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."

How does ASIC see the 'unreasonable prejudice' exemption in s299A(3) applying?

Despite the direct quotes from RG 247 that make it clear that the prejudicial exemption should be rarely used, the example wording that ASIC uses does actually contain a prejudicial exemption on future prospects relating to the outcome of a tender!

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

Disclosure of business strategies and prospects—Upgrades and important contracts

Looking ahead, the company is currently engaged in a competitive tender process to supply the Chinese government with x million Model A widgets over the next 10 years. If successful, manufacture and supply are expected to commence next year, significantly affecting future revenues. Given both the competitive nature of the tender, and the fact that the process is ongoing, we have utilised the exemption in s299A(3) and have not disclosed further details.”

The real difficulty is as summarised in the earlier Grant Thornton submission on the RG 237 draft which states:

“Whilst Grant Thornton broadly supports the proposals in the Consultation Paper for better disclosure of business strategies and future prospects as non-mandatory guidance, we believe that the ‘prejudicial’ exemption will remain a particularly contentious area given that the ‘prejudicial’ exemption from disclosing business strategies and prospects for future financial years’ is a directors’ opinion, and not ASIC’s, as to whether it is likely to result in unreasonable prejudice to the company.”

Given the demise of the Financial Reporting Panel which could have been adapted to be a much less expensive avenue for settling disputes between ASIC and companies on financial reporting issues, we question whether it is cost effective for ASIC to take Court action where it believes that directors have not properly formed their view that a prejudicial exemption is appropriate. Instead we suggest that if the Government accepts ASIC’s view that there should be greater disclosure of business strategies and future prospects, this should be a matter for Corporations Law reform. We note that the 2010 Corporations Act amendments to the Directors’ Report for limited by guarantee companies significantly increased detailed disclosures of objectives, strategy, and how the company measures performance, without a prejudicial let out.”

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: s299A(3). However ASIC warns that this exemption is not open ended!

“RG 247.66 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 the exemption should be evaluated and established by the directors before any required information is omitted. It would be rare for an entity to disclose no information at all about its business strategies and prospects in reliance on the exemption.”

“RG 247.67 We think a useful approach to considering whether the publication of information would result in unreasonable prejudice is to identify the adverse consequences that are likely to occur (i.e. the prejudice), and then consider whether these consequences are unreasonable. We suggest that the consequences would be unreasonable if, for example, 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.”

“RG 247.72 However, it would be rare to establish that unreasonable prejudice is likely to result from 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).”

Omitting information

RG 247.76 If information has been omitted under the exemption in s299A(3), the OFR must disclose this under the terms of that provision. To assist shareholders, entities may also consider disclosing a short, high-level summary of the type of information that has been omitted, and the reasons for the omission, where possible. By explicitly stating that there is information of a certain category that has been omitted from the OFR, and on what basis, shareholders are better able to understand the context of the disclosures made in the OFR. It is not expected that the summary and reasons for disclosure would be of such detail as to disclose information that would be likely to result in unreasonable prejudice.

Audit implications

Whilst the OFR is not required to be audited, the OFR is caught by the definition in Auditing Standard ASA 720 *Other information in documents containing audited financial reports* and this requires auditors to read the OFR to ensure there are no material inconsistencies with the audited financial report and that the OFR contains no material misstatements of fact (RG 247.37).

Action required

Consider for listed companies whether the previous OFR needs to be modified for ASIC's RG 247 thinking.

Further information

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Partner, or a member of the National Audit Support team at nationalaudit.support@au.gt.com.