cutting through complexity

Reporting Update

April 2013, 13RU-002

Regulatory guide on operating and financial review disclosures in directors' report

ASIC released Regulatory Guide 247 *Effective disclosure in an operating and financial review* (regulatory guide or RG247) on 27 March 2013. This regulatory guide provides guidance for directors of listed entities in complying with s299A of the Corporations Act 2001, and aims to promote better communication of more meaningful information to shareholders that both supplements and complements the financial report.

RG247 provides principles, illustrative examples and guidance for preparing an operating and financial review (OFR) that forms part of the directors' report, rather than an exhaustive checklist of requirements. ASIC does not intend for this guidance to significantly increase the length of the OFR, nor does it expect an OFR to contain the same level of disclosure as a prospectus. Each OFR should however be tailored to each entity's specific facts and circumstances.

This regulatory Guide applies to the OFR's of listed entities issued after 27 March 2013 and as such is applicable for 30 June 2013 reporting periods.

KEY POINTS

- **ASIC has issued final guidance on preparing operating and financial reviews by listed entities**
- **Principles based guidance to improve the effectiveness of OFRs**
- **Guidance on how to apply the unreasonable prejudice exemption from disclosing strategies and prospects**
- **ASIC does not expect OFRs to contain same level of information as a prospectus**
- **Applies for 30 June 2013**

ACTION POINTS

- **Review current OFR practices for compliance with the regulatory guide**
- **Consider current use of the unreasonable prejudice exemption from disclosing strategies and prospects**

Legislative requirements and regulatory focus

Corporations Act requirements on operating and financial review

Section 299A(1) of the Corporations Act 2001 (the Corporations Act or the Act) requires the director's report[1] of listed entities to include information that investors would reasonably require to make an informed assessment of an entity's:

- operations
- financial position, and
- business strategies, and prospects for future financial years.

This information is often referred to as an operating and financial review (OFR), management discussion and analysis or management commentary.

Further, s299A(3) allows an entity to omit disclosures of business strategies and prospects that would likely result in unreasonable prejudice to the entity if disclosed (s299A(3) exemption). Should an entity omit such information, the Corporations Act requires the directors' report to disclose this fact.

ASIC regulatory focus

The OFR was added to ASIC's surveillance program in December 2010 and has remained a key area of focus since. ASIC has continuously expressed a need for improvement in the quality and depth of discussion in the OFR and has expressed concerns around the application of the s299A(3) exemption in providing information on business strategies and future prospects.

In response to these concerns and the inconsistency in the quality of the OFR's of listed entities, ASIC released RG247. The regulatory guide is not intended to be an exhaustive list of information required to be disclosed in an OFR in order to meet the Corporations Act requirements. Rather, RG247 provides directors with principles, illustrative examples and considerations to assist in preparing an OFR that meets the requirements of the Act and aims to promote better communication of more meaningful information.

[1] ASIC Class Order 98/2395 *Transfer of information from directors' report* regulates when information required by the Corporations Act in the directors' report can be included outside the directors' report. Where the requirements of this class order are met, the OFR can be excluded from the directors' report when it forms part of the document that includes both directors' report and financial report i.e. Annual Report.

What does RG247 say?

RG247 provides key principles, illustrative examples and considerations when preparing an OFR. The regulatory guide acknowledges that some of the information required in an OFR might already be provided in other documents outside the annual report, however this does not relieve an entity from addressing these disclosures in the annual report under the Corporations Act.

General guiding principles

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.[2]

In adhering to this principle, RG247 highlights some *good disclosure practices* that should be considered when preparing the OFR including:

- locating the OFR in a single location in the annual report
- information is consistent with and complements the financial report
- information is consistent with other documents such as continuous disclosure announcements
- disclosures are balanced and unambiguous
- information is presented in a clear, concise and effective manner
- information is not false or misleading.

ASIC emphasises that the OFR need only include information that shareholders would '*reasonably require*' to make an informed assessment of an entity's financial performance, position, business strategies and future prospects and provides guidance on what to consider in making this assessment.

[2] RG247.25

Satisfying Corporations Act requirements

The objectives of the OFR requirements are to provide shareholders with a narrative and analysis to supplement the financial report and assist shareholders in understanding the operations, financial position, business strategies and prospects of an entity.[3]

Corps Act requirement	RG247 key principles/considerations
Operations of the entity *(s299A(1)(a))*	• Discuss significant factors affecting total income and overall expenses for the group and major operating segments • Ensure information is useful and meaningful and not just a self evident analysis of income statement items • Ensure it is clear why particular operating segments are significant to the business • Provide information to assist a user to understand the entity's business model • Where non IFRS financial information is included, consideration is given to the requirements of RG230
Financial position of the entity *(s299A(1)(b))*	• Discuss significant changes in assets and liabilities from major business acquisitions or disposals • Discuss changes in funding or dividend strategy • Disclose any solvency issues or uncertainties about the entity as a going concern • Provide information about the impact of unrecognised/undervalued assets or exposures such as off-balance sheet items • Discuss any unusual contractual conditions impacting on financial position
Business strategies and prospects for future financial years *(s299A(1)(c))*	• Set out the entity's business objectives and strategies for a period extending beyond the next financial year, focusing on strategies which may have a significant impact on the financial performance or position of the entity • Include a discussion of the significant plans that form part of these strategies and the significant factors on which achievement of these strategies depends • Provide a balanced discussion on future prospects including material business risks that could adversely affect the future financial outcomes described • Specify how the company will control or manage risks relating to factors within management's control • No forecasts need to be provided. Should they be, consider guidance within RG170 *Prospective financial information*.

Omitting information on strategies and future prospects

The s299A(3) exemption provides relief for entities from including information on business strategies and future prospects in their OFR where this information is expected to result in unreasonable prejudice to the entity or any member of its consolidated group. ASIC has provided guidance in RG247 to help determine when the exemption can be used.

In considering whether the exemption should be used, it is ASIC's view that consideration should be given to the following:

Is the information already publicly accessible?

[3] RG247.5

Where information on business strategies and prospects has been disclosed elsewhere by the entity or can be inferred from other documents available to the public, it is unlikely that such information would result in unreasonable prejudice.

Where this information is not already publicly available, an entity considers the adverse consequences of providing this information. The regulatory guide notes it would be rare that an entity could not disclose any information on business strategies and prospects.

What are the adverse consequences that are likely to occur if the information is provided?
Identify the adverse consequences that are likely to occur and whether these consequences are unreasonable. In ASIC's view, the consequences would be unreasonable if the information gives a third party a commercial advantage, resulting in a material disadvantage to the entity.

If an entity concludes these adverse consequences are unreasonable, there is unreasonable prejudice and an assessment of its likelihood must be undertaken.

Is it likely that this information will result in unreasonable prejudice?
To be likely, it must be "more than a possibility" or "more probable than not". A mere possibility of unreasonable prejudice is not sufficient to meet the s299A(3) exemption requirements.

When assessing likelihood, consider 'whether' and 'how' the information may be used by third parties and weigh up any detriment against the value of this information to shareholders.

Have appropriate disclosures been made?
Where an entity concludes that unreasonable prejudice is likely and information is omitted from the OFR, the entity must disclose that fact. ASIC recommends that this disclosure include a summary of the types of information omitted and the reasons for its omission.

Next steps

This regulatory guide applies to the OFR's of listed entities issued after 27 March 2013 and as such is applicable for 30 June 2013 reporting periods.

Whilst a regulatory guide does not have the force of law, it outlines ASIC's interpretation of how to comply with the Corporations Act requirements. Non-compliance with the regulatory guide may result in ASIC taking action over the non-compliance. As a result, entities are encouraged to review their OFRs for 30 June 2013 in light of the regulatory guide and, where necessary, make changes to current practice.

KPMG has undertaken a review of current market practice of the ASX200 compared to the guidance and considerations within RG247, with the objective of providing observations of current practice, examples of good disclosure and key opportunities for improvement. Our publication *Operating and financial reviews – review of practice* will be available on the KPMG Australia website shortly. To obtain a copy of this publication, please contact your KPMG adviser.

If you require assistance in applying the requirements of RG247 please contact one of our specialists below.

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