



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 247

Effective disclosure in an operating and financial review

March 2013

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 shareholders or unit holders 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 regulatory guide was issued in March 2013 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	4
	What is an operating and financial review?	4
	The importance of an OFR	5
	Presenting an OFR	6
	Purpose of this guide	7
	Structure of this guide	8
	Other matters	8
B	Preparing an operating and financial review	9
	Information about an entity's business	9
	Narrative and analysis	10
	Information reasonably required by shareholders	10
C	Operations and financial position	12
	The statutory requirements	12
	Tailored information	12
	Operations	13
	Financial position	14
	Non-IFRS financial information	14
	Examples of disclosure	15
D	Business strategies and prospects for future financial years	17
	The statutory requirement	17
	Discussion of business strategies and prospects	17
	Use of the unreasonable prejudice exemption	20
	Examples of disclosure	23
E	Presenting the narrative and analysis	25
	Good disclosure practices	25
	Key terms	27
	Related information	29

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 shareholders or unit holders 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.

A high-quality OFR is important in meeting the information needs of shareholders and unit holders.

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

What is an operating and financial review?

Annual reporting disclosure requirements for listed entities

- RG 247.1 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)).

- RG 247.2 The financial report provides information about an entity's financial position and performance.

The operating and financial review

- RG 247.3 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 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)).

Note 1: 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.

Note 2: In this guide, the term 'shareholders' is used to refer to shareholders or unit holders, as applicable.

- RG 247.4 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'.
- RG 247.5 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.

The importance of an OFR

- RG 247.6 An OFR is an important document in meeting the information needs of shareholders. While an entity's financial report provides useful information about the entity's financial position and performance, it will rarely provide all of the information needed to readily assess the entity's financial position and to appreciate the underlying 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 247.7 Australia's regulatory regime often allows listed entities to access capital from investors without requiring the entity to issue a prospectus. Effective periodic disclosure is part of the framework on which this capital-raising regime is built. The OFR requirements are a significant part of that regime.
- RG 247.8 The OFR performs a different role to market announcements and other periodic disclosures made by listed entities for the following reasons:
- (a) the OFR supplements and complements the financial report in the manner described in RG 247.6;
 - (b) together with the financial report, the OFR allows shareholders to find relevant information on the entity in a single location, rather than having to piece together information from various past continuous disclosure announcements that shareholders may not have necessarily read;
 - (c) depending on the specific circumstances of an entity, the OFR may contain a more or less detailed explanation and analysis of 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 without a supporting narrative; and
 - (d) the OFR promotes consistency of disclosure because the legislation requires all listed entities to address particular matters in the OFR. In contrast, while larger listed entities often prepare and publish investor presentations and briefings, these are generally directed at sophisticated investors and, in many cases, are not prepared at all by smaller entities.
- RG 247.9 The OFR forms part of the annual report, which is one of the key sources of information about entities and therefore plays an important role in promoting

the accountability of boards. It provides the information required for shareholders to determine whether to continue to invest in the entity.

- RG 247.10 The importance of the OFR (also known as ‘management commentary’ or ‘management discussion and analysis’) in helping shareholders 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). These documents discuss the importance of management commentary.

- RG 247.11 For Australia to maintain its reputation of having an internationally competitive financial market, it is important that the disclosure in an OFR by Australian entities effectively meets the needs of shareholders. High-quality OFR disclosure is important to ensure both confident and informed investors, and fair and efficient markets.

Presenting an OFR

- RG 247.12 The OFR requirements should be applied so that an OFR appropriately reflects the entity’s individual circumstances and the business environment in which it operates.
- RG 247.13 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 prospectus (or Product Disclosure Statement (PDS) in the case of a managed investment scheme).
- RG 247.14 The scope and depth of information that needs to be provided under s299A is considerably less than the information required in a prospectus or PDS, given that an OFR:
- (a) is provided to shareholders (who may already have some level of familiarity with the entity);
 - (b) is designed to be read in conjunction with the financial report; and
 - (c) provides information about an entity that is subject to an observable market price and continuous and periodic disclosure obligations (although the fact that these disclosures have been made cannot be regarded as a substitute for complying with s299A: see RG 247.15).

- 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.
- RG 247.16 We recommend that the OFR is presented in a clear, concise and effective manner, with a focus on the quality rather than quantity of information: see Section E. In many cases, providing the level of information and analysis that an OFR requires to satisfy s299A need not increase the length or complexity of the annual report. In particular, entities should focus on the key information required by the Corporations Act and ensure that this information is not lost among less important detail, such as unnecessary repetition or the overuse of photographs.
- RG 247.17 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 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).

Purpose of this guide

- RG 247.18 This regulatory guide is for listed entities, their directors and preparers of OFRs. It is designed to assist them in ensuring that an OFR satisfies the requirements of s299A. It emphasises the need for directors to take into account the circumstances of the entity in ensuring that the OFR provides useful and meaningful information for shareholders: see RG 247.12.

Note: References in this guide to 'directors' include directors of the responsible entity of a listed managed investment scheme, because s285(3)(b) treats directors of a responsible entity as directors of the listed managed investment scheme for the purposes of Ch 2M of the Corporations Act.

- RG 247.19 There may be instances where the OFR should include relevant matters concerning a related entity. In particular, it may be necessary to consider including in the OFR of a listed managed investment scheme information on significant matters relating to the responsible entity or its operations that scheme members may 'reasonably require'.

- RG 247.20 The purpose of our guidance is to:
- (a) promote better communication of useful and meaningful information to shareholders; and
 - (b) assist in understanding the existing OFR requirements.

Structure of this guide

- RG 247.21 This regulatory guide contains the following guidance:
- (a) Section B discusses the overall principles that should guide the preparer of an OFR;
 - (b) Sections C and D give guidance on each of the requirements contained in s299A, including the information that must be disclosed in an OFR on the 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 247.22 Our guidance is focused on the preparation of an OFR. As for all continuous, ongoing, periodic or transaction-specific disclosure documents, whether an entity needs to prepare disclosure on a particular matter will depend on its circumstances.
- RG 247.23 Examples given in this guide are not exhaustive and are intended to provide an illustration of the main principles outlined in this guide. They are not intended to cover all principles or all disclosures to be included in an OFR, and are not intended to be used as a template for OFR disclosure. There are many other ways to present an OFR that may be equally valid to those shown in the examples. The OFR should be tailored and presented in a manner that conveys the information required by s299A, taking into account the circumstances of an entity.
- RG 247.24 The responsibility of assessing whether the OFR requirements are satisfied lies ultimately with the directors.

B Preparing an operating and financial review

Key points

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

An 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 247.25–RG 247.27);
- present a narrative and analysis about the entity's results and financial position (RG 247.28–RG 247.30); and
- contain information that shareholders would reasonably require to make an informed assessment of the entity's operations, financial position, and business strategies and prospects for future financial years (RG 247.31–RG 247.33).

Information about an entity's business

RG 247.25 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. 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.

Note: See paragraph 4.380 of the 2003 Explanatory Memorandum and paragraph 5.2 of the 2010 Explanatory Memorandum.

RG 247.26 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 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;

Note: See RG 247.15 for further discussion of the level of detail to be included about matters that have been previously disclosed in continuous disclosure notices.

- (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.

Narrative and analysis

RG 247.28 An OFR, prepared under s299A, should:

- (a) contain disclosures tailored to the information needs of shareholders, adapting over time to ensure that the OFR evolves along with the changing needs of shareholders; and
- (b) provide a narrative overview that enables shareholders 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 247.29 The wording of the OFR requirements demonstrates 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 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.

Information reasonably required by shareholders

RG 247.31 Under s299A(1), the OFR in a directors' report must contain information that shareholders in the entity would 'reasonably require to make an informed assessment' of the matters set out in s299A(1)(a)–(c).

- RG 247.32 Information that shareholders would ‘reasonably require’ needs to be determined by considering the specific circumstances of the entity. Examples of considerations that may be relevant in determining the level of detail that shareholders ‘reasonably require’ include the size of the entity, the age of the entity, the industry in which the entity operates, the complexity of the business, and the performance, activities, strategies and prospects of the entity in the relevant reporting period. Consideration should also be given to the functions that an OFR should perform: see RG 247.6–RG 247.11.
- RG 247.33 An OFR should highlight, analyse and 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 247.34 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 other guidance

- RG 247.35 Preparers of OFRs should note that the information requirements for 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 247.36 Other 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 IASB’s IFRS practice statement *Management commentary*, available from the AASB’s website.

Audit

- RG 247.37 An OFR prepared under s299A is not required to be audited—however, auditing standards define an OFR (as part of the directors’ report) as ‘other information’ in a document that contains an audited financial report. Auditing Standard ASA 720 *Other information in documents containing audited financial reports* 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.

C Operations and financial position

Key points

Information about an entity's operations involves an explanation of the underlying drivers of its results, and of key developments in the reporting period. An OFR should also discuss significant factors affecting the entity's results.

Discussion of an entity's operations should include an explanation of the entity's business model and its effect on the entity's operations.

A discussion of results for the key operating segments and major components of the overall result would also assist shareholders 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. We have highlighted a number of matters that are relevant to understanding an entity's financial position that could be discussed in the OFR. A discussion of exposures not recognised in the financial statements would also assist shareholders 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 247.38 An OFR must contain information that shareholders would reasonably require to make an informed assessment of:

- (a) the operations of the entity reported on (s299A(1)(a)); and
- (b) the financial position of the entity reported on (s299A(1)(b)).

RG 247.39 In particular, an OFR should provide an overview that enables shareholders to understand an entity's business performance and the factors underlying its results and financial position.

Tailored information

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.

Operations

- RG 247.41 An OFR should describe and provide a review of the operations that the entity undertakes, including the results of these operations, and give details of any significant changes during the reporting period. This will satisfy the statutory requirement that an OFR must contain information that shareholders would reasonably require to make an informed assessment of the operations of the entity. A review of operations is a requirement of s299, and we consider that, in practice, this information will also assist in satisfying s299A(1)(a).

Note: Information required by s299 that is contained in the OFR does not need to be repeated elsewhere in the directors' report to satisfy s299: see Table 3.

- 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 operating segments to the business as a whole should also be made clear.

Underlying drivers of performance

- 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.
- RG 247.44 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: see, for example, 'Disclosure of operations—Profit' in Table 1.

Financial position

- RG 247.45 An 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 will satisfy the statutory requirement that an OFR must contain information that shareholders would reasonably require to make an informed assessment of the financial position of the entity. The OFR should explain the accounting information and other detail contained in the financial report (rather than simply repeating it). For example, this might include explaining:
- (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) any doubt about the solvency of the entity, or any issues or uncertainties about the entity as a 'going concern'.
- RG 247.46 An OFR should prominently highlight any qualification by the entity's auditor, or 'emphasis of matter' paragraph, provide the circumstances and explain in clear terms the concerns underlying the audit opinion. The OFR can include a cross-reference to further detail included in the financial report.
- RG 247.47 Some examples of matters that would be relevant to understanding the entity's financial position that could be disclosed in an OFR include:
- (a) the impact of any unrecognised or undervalued assets or exposures not required or permitted to be reflected in the financial report under accounting standards, such as material off-balance sheet items, intangible assets, or financial instruments; and
 - (b) unusual contractual conditions, such as when revenues will only be earned if certain threshold conditions are met.

Non-IFRS financial information

- 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.

Examples of disclosure

RG 247.50 Table 1 provides some examples of disclosure about an entity's operations and financial position. These examples illustrate, for a given entity, disclosure that is likely to be inadequate, compared with disclosure that may be more appropriate. The examples are not intended to represent the entire disclosure required for the relevant entity about its operations and financial position.

Note: The relevant entity 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.

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

Examples of disclosure likely to be inadequate	Examples of better disclosure with a level of detail more likely to be appropriate
Disclosure of operations	
<p>The company manufactures widgets in Australia, with customers in both Australia and China.</p> <p><i>[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.]</i></p>	<p>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.</p> <p>The company is a key participant in its market, holding a market share of approximately 30%. With a very diverse customer base, the company does not have any dependencies on key customers.</p> <p>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.</p> <p>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.</p> <p><i>[Comment: 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.]</i></p>
Disclosure of operations—Profit	
<p>Profit has increased by 10% this year compared with last year.</p> <p><i>[Comment: There is a lack of analysis of the underlying drivers of the profit increase.]</i></p>	<p>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 set out in last year's OFR.</p> <p>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.</p>

Examples of disclosure likely to be inadequate	Examples of better disclosure with a level of detail more likely to be appropriate
Disclosure of operations—Sales	
<p>Sales of Models A and B were above expectations.</p> <p><i>[Comment: There is a lack of analysis of actual results or comparison with last year's expectations.]</i></p>	<p>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.</p> <p>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).</p> <p><i>[Comment: 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.]</i></p>
Disclosure of financial position	
<p>The company's net assets increased by \$2,204,365 to \$24,623,110 (net assets increased by \$897,900 to \$22,418,745 in the previous year).</p> <p><i>[Comment: This merely repeats the information in the financial report, and there is a lack of analysis of the underlying drivers of the increase.]</i></p>	<p>The company's net assets increased by 10%, compared with the previous year, which is consistent with and largely attributable to the current year's profit after tax.</p> <p>During the year, inventory levels have largely remained comparable with last year, reflecting management's increased focus on more efficient production processes, cost control and obsolescence. Total inventory obsolescence provisions have reduced by 5%, despite the lower-than-anticipated sales and the resultant upgrade commissioned for Model A. The company's production has also benefited from the implementation of new quality control testing processes, the benefits of which are expected to flow into reduced warranty provisions in the future. Total warranty provisions this year have remained stable.</p> <p>The company's receivables and cash flow management also continue to support overall strength in working capital. The increase in overall sales during the year has only resulted in a slight increase in trade receivables as at year end. With a diverse customer base, the company continues to focus on receivables management and, as at year end, only 1% of customers are in arrears.</p> <p>Redundancy payments totalling \$725,000 were made during the year, to some extent affecting the company's cash position as at year end. However, continued strength in the sales of Model B in the first quarter of the new year indicates that stronger operating cash inflows will offset some of the impact on financial position as a result of the recent restructuring.</p>

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. To satisfy this requirement, an entity may need to bring together some aspects of its past continuous disclosure announcements.

Unless an entity is relying on 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 entity's prospects in terms of future financial performance and financial outcomes; and
- the material business risks that could adversely affect the achievement of the financial performance or financial outcomes described.

If an entity intends 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 247.51 An OFR must contain information that shareholders 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 247.52 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 247.65–RG 247.78.

Discussion of business strategies and prospects

- RG 247.53 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 247.54 Section 299A does not specify any particular time period for which business strategies and prospects should be described. However, the fact that s299A

requires strategies and prospects to be discussed for future financial ‘years’ indicates that something more than a discussion centred on the next financial reporting period is required. The relevant time period will depend on the individual circumstances of the entity, taking into account factors such as the age of the entity, the business in which it is engaged, the industry in which it operates and the types of commitments it enters into. For example, a shorter period may be appropriate for a start-up entity, while a longer period may be appropriate for a more established entity that has been engaged for many years in a business that primarily involves long-term contractual commitments.

Note: We do not expect that a discussion of prospects for future financial years would need to contain numerical financial forecasts: see RG 247.60.

- RG 247.55 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 is an opportunity to bring together key disclosures that have been presented to the market on an ongoing basis, including relevant updates.
- RG 247.56 In our view, even information that has already been disclosed (e.g. through continuous disclosure announcements) may be reasonably required to be included in the OFR so that shareholders can 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, shareholders 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 247.57 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 247.58 Unless an entity is relying on 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, its plans to enter new markets or to expand production capacity and market share in existing markets, or its plans to raise funds for the acquisition of a new asset.
- RG 247.59 Because only information that is reasonably required to make an ‘informed assessment’ about the matters in s299A 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. It is

therefore unlikely that an entity would need to disclose commercially sensitive information to satisfy this requirement. Some practical considerations in determining whether the unreasonable prejudice exemption would be available are contained in RG 247.75.

Prospects for future financial years

- RG 247.60 An OFR should contain a discussion of the entity's prospects for future financial years. This is a narrative explaining the financial performance and financial outcomes the entity expects to achieve overall, taking into account its disclosed business strategies and any other relevant factors. We do not expect an OFR to contain numerical financial forecasts. If, in rare circumstances, an entity chooses to present financial forecasts in its OFR, our guidance in Regulatory Guide 170 *Prospective financial information* (RG 170) on the presentation of prospective and hypothetical information should be considered.
- RG 247.61 It is important that a discussion about future prospects is balanced. It is likely to be misleading to discuss prospects for future financial years without referring to the material business risks that could adversely affect the achievement of the financial prospects described for those years. By 'material business risks', we mean the most significant areas of uncertainty or exposure, at a whole-of-entity level, that could have an adverse impact on the achievement of the financial performance or outcomes disclosed in the OFR. Equally, it may be appropriate to disclose factors that could materially improve the financial prospects disclosed.
- RG 247.62 An OFR should:
- (a) only include a discussion of the risks that could affect the entity's achievement of the *financial* prospects disclosed, taking into account the nature and business of the entity and its business strategy; and
 - (b) not contain an exhaustive list of generic risks that might potentially affect a large number of entities.
- RG 247.63 An OFR should include a discussion of environmental and other sustainability risks where those risks could affect the entity's achievement of its *financial* performance or outcomes disclosed, taking into account the nature and business of the entity and its business strategy. For example, environmental risks that may affect an entity's achievement of its financial prospects would be more likely for an industrial entity than for a financial services entity.
- RG 247.64 Each risk that is disclosed should:
- (a) be described in its context (e.g. why the risk is important or significant, and its potential impact on the entity's financial prospects);

- (b) include any relevant associated analytical comments (e.g. whether the risk is expected to increase or decrease in the foreseeable future); and
- (c) where the risk relates to factors within the control of management, specify how these factors will be controlled or managed by the entity.

Use of the unreasonable prejudice exemption

How does the exemption in s299A(3) apply?

- RG 247.65 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).
- 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.

What is ‘unreasonable prejudice’?

- 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.

When is unreasonable prejudice likely?

- RG 247.68 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 247.69 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.

- RG 247.70 We suggest that entities should consider both ‘whether’ and ‘how’ information may be used by third parties when determining whether an unreasonable prejudice would be likely to result from disclosing certain information.

Confidential information

- RG 247.71 Entities may often consider that the disclosure of specific confidential 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 may be possible to establish a basis for this view.
- 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).
- RG 247.73 During the reporting period, 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 of the entity should consider whether that information should now be disclosed, taking into account the passage of time and the current circumstances.

Note 1: It should also be considered, even if the information does still satisfy one of the exceptions in ASX Listing Rule 3.1A, whether that information should be disclosed in the OFR under s299A.

Note 2: If an entity is listed on an alternative exchange market, and has omitted information from continuous disclosure announcements on the basis of an exception under that alternative exchange market’s listing rules, the entity should similarly consider whether that information should now be disclosed in the OFR.

Practical considerations

- RG 247.74 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 247.75 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 shareholders; 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 shareholders.

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.

RG 247.77 There is no statutory requirement to keep internal records of the matters outlined in RG 247.76—however, directors may 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.

RG 247.78 These records would assist in demonstrating how an entity has complied with its obligations under s299A.

Examples of disclosure

RG 247.79 Table 2 provides some examples of disclosure about an entity's business strategies, and prospects for future financial years, illustrating, for a given entity, disclosure that is likely to be inadequate compared with disclosure that may be more appropriate. The examples are not intended to represent the entire disclosure required for the relevant entity on its business strategies and prospects.

Note: The relevant entity 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.

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

Examples of disclosure likely to be inadequate	Examples of better disclosure with a level of detail more likely to be appropriate
Disclosure of business strategies and prospects—Growth	
<p>The company intends to expand with the market for widgets. We have a number of strategies in mind to achieve this growth.</p> <p><i>[Comment: There is a lack of detail about the basis for the expected growth and the proposed strategies to achieve that growth.]</i></p>	<p>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:</p> <ul style="list-style-type: none"> • 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).
Disclosure of business strategies and prospects—Upgrades and important contracts	
<p>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.</p> <p><i>[Comment: More information could be disclosed about business strategies and prospects that is useful to shareholders, 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.]</i></p>	<p>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.</p> <p>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.</p> <p>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</p>

Examples of disclosure likely to be inadequate	Examples of better disclosure with a level of detail more likely to be appropriate
	<p>about the possible impact of the potential contract on the company's business strategy and future prospects. We are relying on the exemption on the basis that disclosure of the potential financial impact on the company arising from the outcome of the tender process is premature, and would be likely to result in other tender competitors gaining a commercial advantage, which would jeopardise the company's prospects.</p>
Disclosure of business strategies and prospects—Material business risks	
<p>The company is subject to a number of risks. The company regularly reviews the possible impact of these risks and seeks to minimise this impact through a commitment to its corporate governance principles and its various risk management functions.</p> <p><i>[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.]</i></p>	<p>The material business risks faced by the company that are likely to have an effect on the financial prospects of the company, disclosed in paragraph X of this OFR, and how the company manages these risks include:</p> <ul style="list-style-type: none"> • 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 expect the risk of experiencing similar foreign exchange losses to continue, although 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 the Chinese 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 Q of the OFR), we are currently investigating other options. We consider this is 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.

E Presenting the narrative and analysis

Key points

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

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 247.80 One of the objectives of the OFR requirements is that an 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 247.81 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	<p>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.</p> <p>While the OFR is part of the directors’ report under the Corporations Act, ASIC has issued Class Order [CO 98/2395] <i>Transfer of information required to be in the directors’ report</i>, 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).</p> <p>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.</p>

Good disclosure	Explanation
Complementary and consistent information	<p>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.</p> <p>If there are inconsistencies, these should be adequately explained. For example, comments on prospects and expected future growth should be consistent with the assumptions underlying the 'going concern' and asset impairment testing in the financial report.</p> <p>The OFR should also be consistent with information disclosed in other documents, such as continuous disclosure announcements.</p>
Balanced and unambiguous disclosure	<p>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.</p> <p>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.</p> <p>Misleading disclosure (including disclosure that misleads by omission) may place the directors of the entity at risk of contravening s1308.</p>
Clear, concise and effective presentation	<p>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.</p>

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	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
directors	Includes directors of the responsible entity of a listed managed investment scheme
entity	The entity or the 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
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 part of the directors' report that must contain the information required under s299A of the Corporations Act
OFR requirements	The requirements in s299A(1)(a)–(c) of the Corporations Act
reporting period	The financial year to which the financial statements in the annual report relate

Term	Meaning in this document
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)
shareholders	Shareholders or unit holders of a listed entity, as applicable

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

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

Regulatory guides

RG 170 *Prospective financial information*

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

Auditing Standard ASA 720 *Other information in documents containing audited financial reports*

Group of 100 Incorporated *Guide to review of operations and financial condition*

IASB, IFRS practice statement *Management commentary*