

*Michael Duffy\**

## TOWARDS BETTER DISCLOSURE OF CORPORATE RISK: A LOOK AT RISK DISCLOSURE IN PERIODIC REPORTING

### ABSTRACT

Disclosure is a primary form of investor protection and is fundamental to market efficiency. Knowledge of the risks facing them is integral to the successful operation of business enterprises and is also of benefit to their investors. Whilst continuous disclosure is a policy that should provide a good basis for risk disclosure, periodic disclosure of risk has received significantly less attention. This is because periodic disclosure is more traditionally an area for disclosure in financial accounts than for management discussion and analysis. However, this may be changing, particularly due to the enactment of s 299A of the *Corporations Act 2001* (Cth) in 2004 and ASIC's more recent interpretations of that section.

### I INTRODUCTION

Traditional periodic disclosure has not paid significant attention to highlighting risk factors. Despite risk being an inherent part of the business enterprise, traditional periodic disclosure has focused heavily on numerical financial reporting, to the detriment of management discussion and the analysis of the figures and the risks involved in the business. It has been internationally accepted that substantial narrative reporting, including the disclosure of risk, is important to promote investor protection.<sup>1</sup> There are signs that this is feeding through to Australia, evidenced by the enactment of s 299A of the *Corporations Act 2001* (Cth) in 2004. This is particularly so, given ASIC's interpretation of s 299A as mandating an Operating and Financial Review ('OFR') and its recently proposed guidance on OFRs generally.<sup>2</sup>

---

\* Lecturer, Department of Business Law and Taxation, Monash Business School, Monash University.

<sup>1</sup> See, eg, Turnbull Report Institute of Chartered Accountants in England and Wales, *Internal Control: Guidance for Directors on the Combined Code* (Accountancy Books, 1999).

<sup>2</sup> Australian Securities and Investments Commission, '12-228MR ASIC Proposes Guidance for Operating and Financial Reviews' (Media Release, 17 September 2012) <<http://asic.gov.au/about-asic/media-centre/find-a-media-release/2012-releases/12-228mr-asic-proposes-guidance-for-operating-and-financial-reviews/>>; see also Australian Securities and Investments Commission, *Effective Disclosure in an Operating and Financial Review* (27 March 2013) <<http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-247-effective-disclosure-in-an-operating-and-financial-review/>>.

## II THE IMPORTANCE OF RISK DISCLOSURE

Risk disclosure is a subset of general disclosure. General disclosure is an important form of investor protection. Risk disclosure is a form of ‘bad news’ rather than ‘good news’ disclosure, and thus tends to weigh stock prices down rather than elevate them. Risk disclosure is necessary for the same reasons as general disclosure. Arguments for risk disclosure include those based on promoting informational efficiency in primary and secondary markets, regulation achieving fairness and confidence in markets, as well as the plausible reduction of opportunities for insider trading.<sup>3</sup>

The importance of recognising and managing risk is partly exemplified by the development of risk management as a discipline in itself. The area of risk management has evolved substantially during the last 50 years. Historically, companies have insured to deal with risk. In turn, this has gradually led to insurers taking an interest in the insured risk themselves, which has prompted businesses (sometimes with the encouragement of government) to make business premises and products safer. In the past, corporations were somewhat reactive in the area of risk management. The evolution of risk management escalated in the 1970s and 1980s, with businesses introducing or contributing to product standards and quality assurance.<sup>4</sup> This can also be seen as a reaction to changes in law including the expansion of tort law beginning with the celebrated decision in 1932 of *Donoghue v Stevenson*<sup>5</sup> in England, as well as the subsequent introduction of a great deal of reforming legislation.<sup>6</sup> The world’s first risk management standard was AS/NZS 4360:1995 published by Standards Australia in 1995.<sup>7</sup> The Canadians followed in 1997 with their standard CAN/CSA-Q850-9 7.<sup>8</sup>

In 1992, in the UK, *The Financial Aspects of Corporate Governance* (the ‘Cadbury Report’) was released, focusing attention on the disclosure of risk data by UK companies as part of the overall agenda of reforming UK corporate governance.<sup>9</sup> It was authored by the Committee on the Financial Aspects of Corporate Governance, which was set up in response to a number of high profile corporate failures in the

---

<sup>3</sup> See Mark Blair and Ian M Ramsey, ‘Mandatory Corporate Disclosure Rules and Securities Regulation’ in Gordon Walker, Brent Fisse and Ian M Ramsay (eds), *Securities Regulation in Australia and New Zealand* (LBC Information Services, 2nd ed, 1998) 55.

<sup>4</sup> See, eg, British Standards Institution, Quality Standard BS 5750 (1979).

<sup>5</sup> [1932] AC 562.

<sup>6</sup> Such as, in Australia, the *Trade Practices Act 1974* (Cth).

<sup>7</sup> Standards Australia, Risk Management Standard, AS/NZS 4360:1995 (1995) <<http://infostore.saiglobal.com/store/details.aspx?ProductID=381545>>.

<sup>8</sup> Canadian Standards Association, Risk Management Guidelines, CAN/CSA Q850-97 (1997) <[http://www.techstreet.com/products/944628?product\\_id=944628&sid=-goog&gclid=CLukoQqnMACFYIrvQodE1gArQ](http://www.techstreet.com/products/944628?product_id=944628&sid=-goog&gclid=CLukoQqnMACFYIrvQodE1gArQ)>.

<sup>9</sup> Committee on the Financial Aspects of Corporate Governance, *The Financial Aspects of Corporate Governance*, (1 December 1992) European Corporate Governance Institute <<http://www.ecgi.org/codes/documents/cadbury.pdf>>.

UK.<sup>10</sup> After the companies failed, it was found that various governance irregularities had gone undetected for a period of time. These failures occasioned losses for creditors of the defunct companies, including the loss of pension assets. The report committee was chaired by Adrian Cadbury and set out recommendations on the arrangement of company boards and accounting systems to mitigate corporate governance risks and failures.<sup>11</sup>

In 1998, the UK Department of Trade and Industry launched the Modern Company Law Review, a review of UK company law that led to the mandatory OFR in 2004.<sup>12</sup> This required more extensive reporting of risk. The voluntary OFR had originally been introduced in 1993 by the UK Accounting Standards Board ('ASB') and first recognised the importance of qualitative non-financial information. It has two parts: firstly the operating review looking at operating results, profit and dividends and secondly the financial review covering items such as capital structure and treasury policy. The mandatory OFR was, however, replaced in 2006 to 'reduce the corporate red tape burden.'<sup>13</sup> It was replaced with a business review to meet the mandatory European Union requirements for narrative reporting (see below).<sup>14</sup>

In 1999, the Institute of Chartered Accountants in England and Wales, in consultation with the London Stock Exchange, published *Internal Control: Guidance for Directors on the Combined Code* (the 'Turnbull Report').<sup>15</sup> This report called for stronger internal financial controls and better monitoring of risk.<sup>16</sup> It sought to provide a conceptual framework for companies to disclose risk and to inform directors of their obligations under the UK Combined Corporate Governance Code.<sup>17</sup> It was focused on keeping good 'internal controls' in UK companies, having good audits and checks to ensure the quality of financial reporting and catching any fraud before it became a serious problem. A revised version of the document was released in 2005.<sup>18</sup>

---

<sup>10</sup> These included Maxwell Communications, Polly Peck and Bank of Credit and Commerce International.

<sup>11</sup> Committee on the Financial Aspects of Corporate Governance, *The Financial Aspects of Corporate Governance*, (1 December 1992) European Corporate Governance Institute <<http://www.ecgi.org/codes/documents/cadbury.pdf>>.

<sup>12</sup> Robert AG Monks, *Modern Company Law for a Competitive Economy: The Strategic Framework* (February 1999) LENS Investment Management <<http://webarchive.nationalarchives.gov.uk/20121029131934/http://www.bis.gov.uk/files/file23279.pdf>>

<sup>13</sup> Paul Grant, 'OFR Revival Hopes Sparked by International Standard' (2006) *Accountancy Age* 1, 1.

<sup>14</sup> *Ibid.*

<sup>15</sup> Turnbull Report Institute of Chartered Accountants in England and Wales, above n 1.

<sup>16</sup> *Ibid* [10]–[12].

<sup>17</sup> Financial Reporting Council, *The UK Corporate Governance Code* (2012).

<sup>18</sup> Financial Reporting Council, *Internal Control: Revised Guidance for Directors on the Combined Code* (October 2005) Financial Reporting Council UK <<http://frc.org.uk/getattachment/5e4d12e4-a94f-4186-9d6f-19e17aeb5351/Turnbull-guidance-October-2005.aspx>>.

According to the Turnbull Report, a company's objectives, its internal organisation and the environment in which it operates are continually evolving and, as a result, the risks it faces are continually changing. A sound system of internal control, therefore, depends on a thorough and regular evaluation of the nature and extent of the risks to which the company is exposed.<sup>19</sup> Following such evaluation, it is submitted that consideration must be given as to how such risks are to be disclosed to investors.

Though focused on internal control systems, the Turnbull Report also noted the importance of communication of these matters to shareholders:

Boards should review whether they can make more of the communication opportunity of the internal control statement in the annual report. Investors consider the board's attitude towards risk management and internal control to be an important factor when making investment decisions about a company. Taken together with the Operating and Financial Review, the internal control statement provides an opportunity for the board to help shareholders understand the risk and control issues facing the company, and to explain how the company maintains a framework of internal controls to address these issues and how the board has reviewed the effectiveness of that framework.<sup>20</sup>

The Turnbull Report also provided guidance on how to deal with risk. It noted that a company's board should consider the following factors when deliberating:

- the nature and extent of the risks facing the company;
- the extent and categories of risk which it regards as acceptable for the company to bear;
- the likelihood of the risks concerned materialising;
- the company's ability to reduce the incidence and impact on the business of risks that do materialise; and
- the costs of operating particular controls relative to the benefit thereby obtained in managing the related risks.<sup>21</sup>

The Turnbull Report made it clear that a company's board should, in its annual report, make disclosure of the risk management systems themselves:

The annual report and accounts should include such meaningful, high-level information as the board considers necessary to assist shareholders' understanding of the main features of the company's risk management processes and system of internal control, and should not give a misleading impression.<sup>22</sup>

In 1993 the UK Accounting Standards Board (ASB), backed by the London Stock Exchange, issued a statement recommending that large companies should include an

---

<sup>19</sup> Ibid [4].

<sup>20</sup> Ibid preface 2.

<sup>21</sup> Ibid [16].

<sup>22</sup> Ibid [33].

OFR in their annual reports. The OFR would identify factors affecting past performance as well as future trading including aspects particularly subject to uncertainty. In 2003 the ASB revised its guidelines for preparing an OFR and published these factors, whilst in the same year the European Union issued a directive requiring medium and large sized companies to report on the principal risks and uncertainties facing their business and to publish relevant key performance indicators.<sup>23</sup> A statutory instrument was enacted in March 2005 amending the *Companies Act 1985* (UK) so that listed companies would be required by law to publish an OFR.<sup>24</sup> Just nine months later, however, the government enacted another statutory instrument, *Statutory Instrument 2005/3442* (UK),<sup>25</sup> repealing *Statutory Instrument 2005/1011* (UK) and moved to a less prescriptive approach. Nevertheless, a ‘business review’ is still required according to s 417 of the *Companies Act 2006* (UK) and this requires, amongst other things, identification of the principal risks and uncertainties facing the business, though in a less prescriptive format.<sup>26</sup> Since the new UK government came to power in 2010, there has also been discussion of reinstating of the OFR.<sup>27</sup>

In the United States, the Securities and Exchange Commission (‘SEC’) has required Management Discussion & Analysis (‘MD&A’) disclosures for decades. In response to a study recommending an enhanced role for MD&A in corporate disclosure,<sup>28</sup> the SEC expanded its requirements in 1980 and said that MD&A should be a critical component of the ‘integrated information package’ to be disclosed in annual reports to shareholders, as well as in quarterly and annual securities filings.<sup>29</sup>

---

<sup>23</sup> European Parliament and Council, European Parliament and Council Directive 2003/51/EC <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:178:0016:0022:en:PDF>>.

<sup>24</sup> *Statutory Instrument 2005/1011* (UK); *Companies Act 1985 (Operating and Financial Review and Directors’ Report etc.) Regulations 2005* (UK).

<sup>25</sup> *Statutory Instrument 2005/3442* (UK); *Companies Act 1985 (Operating and Financial Review) (Repeal) Regulations 2005* (UK).

<sup>26</sup> European Parliament and Council, European Parliament and Council Directive 2003/51/EC <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:178:0016:0022:en:PDF>>.

<sup>27</sup> Department for Business Innovation and Skills (UK), *The Future of Narrative Reporting – A Consultation* (August 2010) UK Government <[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31440/10-1057-future-narrative-reporting-consultation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31440/10-1057-future-narrative-reporting-consultation.pdf)>; see also Department for Business Innovation and Skills (UK), *The Future of Narrative Reporting: A New Structure for Narrative Reporting in the UK* (October 2012) Department for Business Innovation and Skills <<http://www.bis.gov.uk/assets/biscore/business-law/docs/f/12-979-future-of-narrative-reporting-new-structure.pdf>>.

<sup>28</sup> United States Advisory Committee on Corporate Disclosure, *Report to the Securities and Exchange Commission* (1977) (vol 1) 365–79.

<sup>29</sup> J W Gleason, ‘SEC Disclosure Requirements for Forward Looking or Predictive Information, With Emphasis on Projections and Management’s Discussion and Analysis’ in A K Austin (ed) *Advanced Workshop on Problems in Securities Disclosures* (New York Practising Law Institute, 1990) 400, 400.

In Australia, there is movement towards better risk disclosure, particularly with the mandating by the regulator of an OFR pursuant to s 299A of the *Corporations Act 2001* (Cth). Before considering these developments, it is useful to review the traditional basics of periodic disclosure in Australia.

### III THE RUDIMENTS OF AUSTRALIAN PERIODIC DISCLOSURE AND IMPLICATIONS FOR RISK DISCLOSURE

Periodic disclosure in Australia is mandated by legislation and also by the ASX Listing Rules. All public companies (and certain other entities) must prepare a financial report and a directors' report.<sup>30</sup> Financial periods relate to either the full financial year or half-year. Whether it is the entity's financial year or half-year can be changed by resolution of the directors. A typical financial year lasts for 12 months.<sup>31</sup> However, the first financial year of a company following registration may be for a period up to 18 months.<sup>32</sup>

The current requirement for periodic disclosure is the preparation and dissemination of the 'annual report', which includes an audited financial report and a directors' report.<sup>33</sup> Under s 295 of the *Corporations Act 2001* (Cth), the financial report for a financial year consists of the financial statements for the year, notes to the financial statements and the directors' declaration about the statements and notes. The notes are disclosures required by the regulations, notes required by the Australian Accounting Standards Board's accounting standards ('AASBs')<sup>34</sup> and any other information necessary to give a true and fair view.<sup>35</sup>

#### *A Financial Statements*

The production of annual financial statements in relation to an entity or, where required, a consolidated entity are required and governed by the AASBs.<sup>36</sup>

Paragraph 8 of AASB 101 states that a financial report is comprised of a statement of financial position (formerly 'balance sheet') as at the end of the period, a statement of comprehensive income for the period, a statement of changes in equity for the period, a statement of cash flows (formerly cash flow statement) for the period, and notes comprised of a summary of significant accounting policies and other explanatory information. When an entity applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements,

---

<sup>30</sup> *Corporations Act 2001* (Cth) s 292.

<sup>31</sup> *Ibid* s 323D(2).

<sup>32</sup> *Ibid* s 323D(1).

<sup>33</sup> *Ibid* ss 295–301.

<sup>34</sup> The AASB accounting standards governing the preparation of financial statements must be understood in light of ongoing changes and revisions to the standards.

<sup>35</sup> *Corporations Act 2001* (Cth) s 295(3).

<sup>36</sup> *Ibid* s 295(2).



or reclassifies items in its financial statements, it must also produce a statement of financial position as at the beginning of the earliest comparative period.<sup>37</sup> The principle financial documents are examined below.

### *B Statement of Financial Position ('Balance Sheet')*

A balance sheet reflects the fact that the business entity is distinct from its proprietors. Funds provided by the proprietors ('equity' or 'proprietorship') are thus seen as a stake in the assets of the business claimed by the proprietors.<sup>38</sup> There are also funds provided by outside sources ('liabilities'), which are also a claim on the business. These are debts incurred through external financing. A popular conception of the balance sheet is the equation:

$$\text{Assets} = \text{Liabilities} + \text{Equity Capital}$$

A balance sheet lists the assets in the enterprise separate to the liabilities and equity capital. It draws a distinction between current and non-current liabilities, the former usually being payable within 12 months of the end of the last financial year. Likewise, current assets are those that would in the ordinary course of business be consumed or converted into cash within 12 months of the end of the last financial year. This includes cash and usually includes stock. Non-current assets include fixed assets used to produce income such as business premises, but may also include intangible assets, such as intellectual property and goodwill.

The balance sheet gives no information about risk, except perhaps where there is provision for doubtful debts. Generally it is assumed that liabilities will be paid and assets will keep their value.

### *C Statement of Comprehensive Income ('Profit and Loss Statement')*

Whilst a balance sheet shows the company as at a certain date, the profit and loss statement shows the results of operating over a period. As such, it is a summary of the financial transactions occurring between the dates of the periodic balance sheets. A profit and loss statement has an appropriation statement, which shows the operating profit for the financial year as well as the balance of retained profits at the beginning of the financial year. It shows any transfers from reserves as well as transfers to reserves and payments of dividends. It then shows a final figure being the balance of profits retained at the end of the financial year or distributed as dividends.

If the closing balance of retained profits is higher than that brought forward at the start of the year then this will increase shareholder equity and will be reflected in an increase in net assets. As a statement summarising transactions during a period, this statement does little to communicate risk.

---

<sup>37</sup> Australian Accounting Standards Board, Accounting Standard AASB 101 <[http://www.aasb.gov.au/admin/file/content105/c9/AASB101\\_09-07\\_COMPsep11\\_07-12.pdf](http://www.aasb.gov.au/admin/file/content105/c9/AASB101_09-07_COMPsep11_07-12.pdf)>.

<sup>38</sup> Ibid.

### D *Statement of Cash Flows*

Whilst a balance sheet is a snapshot in time and a profit and loss account shows whether there is a profit during the period, these documents do not disclose, for instance, whether trade debtors are paying their accounts. If not, there could be a cash flow shortage necessitating bank financing or even causing insolvency (which is assessed on whether a business can meet its debts as and when they fall due). The cash flow statement remedies this by providing a statement of cash inflows and outflows for the business for the financial period.<sup>39</sup> The statement of cash flows communicates liquidity risk.

### E *True and Fair View*

Section 297 of the *Corporations Act 2001* (Cth) requires that financial statements give a 'true and fair' view of the financial performance of the company. Prior to amendments made in 1991 there was a duty placed on directors to ensure compliance with accounting standards, but this was subject to the overarching requirement that the accounts give a true and fair view. A true and fair view might arguably require warnings as to significant risk. From 1991 to 1998, as a result of the *Corporations Legislation Amendment Act 1991* (Cth), the *Corporations Law* stated that if financial statements did not give a true and fair view then the directors must add information and explanations sufficient to give a true and fair view.<sup>40</sup> These notes could conceivably contradict the financial statements themselves, although in most cases compliance with the accounting standards should lead to a true and fair view.

The 1998 amendments confirmed the position.<sup>41</sup> The obligation on directors to add notes was removed, however, as the reporting obligation was instead placed on the corporate entity.<sup>42</sup> Sections 297 and 305 set out the true and fair view requirement and legislative notes to these sections state that if financial statements prepared in accordance with accounting statements do not give a true and fair view, then additional information must be included in the notes. This is confirmed by ss 295(3) and 303(3)(c), which state that the notes to the financial statements include not only notes required by the accounting standards and regulations, but also any other information necessary to give a true and fair view.

Robert Austin and Ian Ramsay comment that the problem with these provisions is that if directors believe compliance with the standards in a particular case leads to the financial statements not giving a true and fair view, they are unlikely to be persuaded that the problem can be addressed by adding a reconciling note even

---

<sup>39</sup> *Corporations Act 2001* (Cth) s 95A.

<sup>40</sup> *Corporations Legislation Amendment Act 1991* (Cth).

<sup>41</sup> *Company Law Review Act 1998* (Cth).

<sup>42</sup> The effect of this is that directors do not have absolute liability for the statements. Their responsibility is to take all reasonable steps to secure compliance. This may require substantial reliance on information provided by others and there may be some scope for directors to argue delegation and reliance defences (such as those that exist in s 189 and s 190 of the *Corporations Act 2001* (Cth)).



though this may legally protect them.<sup>43</sup> They conclude that it would be wise for financial statements to cross-refer to the note wherever it appears, in the directors' opinion, that the financial statement does not give a true and fair view.<sup>44</sup>

Today, s 297 of the *Corporations Act 2001* (Cth) is the provision requiring that the financial statements and notes for the financial year give a true and fair view of the financial position and performance of an entity and, if consolidated financial statements are required by the accounting standards, the financial position and performance of the consolidated entity be provided. These provisions date from 1998, but prior to that the requirement was that the balance sheet give a true and fair statement of the state of affairs of the company at the end of the financial year and that the profit and loss account give a true and fair view of the profit and loss of the company for the financial year. After 1998, the requirement was that the true and fair view be of the 'financial position and performance' of the company. This was intended to be wider than the old requirement, covering the same fields of disclosure but also mandating that attention be given to the company's whole operations, including cash flows.<sup>45</sup>

The existence of significant risk factors may be relevant to the question of a true and fair view. For instance, if there is a significant risk that accounts will not be paid, due to the questionable solvency of trade debtors or if future cash flows are at risk, then this is something that might be noted in the notes to accounts, to the extent it is not described in the accounts themselves, in order to give a true and fair view. It seems also that this type of information, or some description of it, should also be included in the directors' report (see below), as s 298(1A) makes it clear that where the financial report contains additional information intended to give a true and fair view of financial performance it must also set out the directors' reasons for forming the opinion that this additional information was necessary to give a true and fair view. It is also implicit in this argument that this type of risk factor information should be included in the directors' report pursuant to the requirements of ss 299 and 299A.

#### F *Declaration of Solvency*

The directors' declaration states whether, in the directors' opinions, there are reasonable grounds to believe that the company can pay its debts, as well as whether the financial statements comply with accounting standards and give a true and fair view. Under s 295A, the directors give the declaration after the chief executive officer and chief financial officer have declared to the directors that financial records of the company have been properly maintained, that the financial statements and notes comply with the accounting standards and that they give a true and fair view.

The directors' declaration as to solvency clearly contemplates a warning of risk (although, in practice, if there is a significant risk of insolvency it is likely that directors would have to consider placing the company into administration).

---

<sup>43</sup> Robert P Austin and Ian M Ramsay, *Ford's Principles of Corporations Law* (Butterworths, 13th ed, 2007) 548.

<sup>44</sup> *Ibid.*

<sup>45</sup> Explanatory Memorandum, Company Law Review Bill 1998 [13.31].

### G *Financial Records*

Financial statements are based upon the financial records of the company kept in accordance with the requirements of s 286 of the *Corporations Act 2001* (Cth). That section requires companies to keep written financial records that correctly record and explain its transactions, financial position and performance, such that would enable true and fair financial statements to be prepared and audited. These must be kept for seven years.<sup>46</sup> Section 286 requires records that ‘correctly record and explain ... performance’. Austin and Ramsay note that this could include matters external to the company’s particular circumstances, such as adverse movements in commodity prices or exchange rates, but suggest that it is unlikely that the legislature intended that these be recorded by companies.<sup>47</sup> If it is proven that the company failed to keep financial records as required by s 286, there can be a presumption for certain purposes that the company was insolvent throughout the period of such failure.<sup>48</sup>

### IV DIRECTORS’ REPORT

In addition to the directors’ declaration, a directors’ report, pursuant to ss 298–300A of the *Corporations Act 2001* (Cth), is required. Since the introduction of the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth) (‘CLERP 9 Act’) directors are required to provide information that is divided into three components. These are:

- general information as required by s 299, plus additional general requirements set out in s 299A for listed companies;
- specific information as required by s 300, plus additional specific requirements set out in s 300A for listed companies; and
- a copy of the auditor’s independence declaration, as required by s 307C.

Details of the first two requirements (which may describe risk) are as follows.

#### *A General Information*

The general information required by s 299 includes:

- a review of operations and results of operations;
- details of any significant changes in the company’s state of affairs;

---

<sup>46</sup> *Corporations Act 2001* (Cth) s 286(2).

<sup>47</sup> Robert P Austin and Ian M Ramsay, *Ford’s Principles of Corporations Law* (Butterworths, 13th ed, 2007) 541.

<sup>48</sup> *Corporations Act 2001* (Cth) s 588E(4).

- principal activities of the company and any significant change in these;
- details of matters arising since the end of the year that has or may significantly affect the entity's future operations, future results or future state of affairs;
- likely developments in the entity's future operations and the expected results of those operations; and
- if the entity's operations are subject to any particular and significant environmental regulation, details of the entity's performance in relation to that regulation.

Both ss 299(d) and (e) relate to future matters and may be argued to include risk factors for the business.

There are specific offences under ss 1308 and 1309, some of which may apply to a directors' report. Offences include the making of false or misleading statements, knowingly omitting material in a manner that makes a statement false or misleading and making false or misleading statements or omission of material where the person has not taken reasonable steps to ensure accuracy. An omission to state risk factors in otherwise favourable representations may fall into this category. A breach of these sections can lead to criminal liability and injunction or damages under s 1324. It does not appear to lead to other civil liability (such as under s 1041I).

### *B Specific Information*

Section 300 requires disclosure of various pieces of specific information. These include:

- dividends paid or recommended;
- the names of directors and their period of directorship;
- for financial years after 2004, the names of officers;
- for financial years after 2004, the names of all partners or directors of the company's auditor;
- share options given by the company;
- indemnities and insurance paid for officers;
- details of any statutory derivative action application made under s 237;<sup>49</sup> and
- for public companies that are not wholly owned subsidiaries of other companies, details of each director's qualifications, experience and special responsibilities and the number of board and board committee meetings attended by the director.<sup>50</sup>

---

<sup>49</sup> Ibid s 300(15).

<sup>50</sup> Ibid s 300(10).

It is possible that some of this information will include express or implied information about risk. For example, details of a statutory derivative action, though impacting chiefly on the parties sued may have some reputational risk for the company.

In addition, s 300A sets out the requirements for the remuneration report of directors and senior managers, however this is not strictly relevant to risk as analysed in this article.

#### V CHIEF EXECUTIVE OFFICER'S AND CHIEF FINANCIAL OFFICER'S DECLARATIONS

The CLERP 9 Act also introduced the requirement that an ASX-listed company's chief executive officer and chief financial officer each provide a written declaration to the board of directors that:

- (a) the financial records of the company, disclosing entity or registered scheme for the financial year have been properly maintained in accordance with s 286; and
- (b) the financial statements and the notes referred to in paragraph 295(3)(b), for the financial year comply with the accounting standards; and
- (c) the financial statements and notes for the financial year give a true and fair view (see section 297); and
- (d) any other matters that are prescribed by the regulations for the purposes of this paragraph in relation to the financial statements and the notes for the financial year are satisfied.<sup>51</sup>

#### VI HALF-YEARLY REPORT

There is also the requirement of a half-yearly report, which was introduced in 1991 and also includes an audited financial report and directors' report.<sup>52</sup> Under the ASX Listing Rules, companies must also provide a preliminary annual report within two months of the end of the accounting period.<sup>53</sup> This tends to predate the final annual report (which is released approximately one month after the preliminary annual report) so that the preliminary report is significantly more price sensitive.

Unlike the United States and Europe, there is no general requirement to provide quarterly reports, although this has been discussed and some companies provide this information voluntarily.<sup>54</sup> There are some exceptions to this general rule, such that

---

<sup>51</sup> Ibid s 295A.

<sup>52</sup> Ibid ss 302–306.

<sup>53</sup> Australian Securities Exchange, *Listing Rules* (as at 1 December 2013) r 4.3B.

<sup>54</sup> See generally Gill North, 'Periodic Disclosure Regulation: Enhancements to Enable All Investors to Make Informed Decisions' (2009) 27 *Company and Securities Law Journal* 23, 28, 30. During the 'dotcom' boom of the early 2000s,

certain type of start up companies listed on the ASX may be required to make quarterly disclosure for their first two years, under ASX Listing Rule 4.7B. Mining entities are required to make quarterly disclosure under chapter 5 of the ASX Listing Rules. In any event, the advent of continuous disclosure appears to have removed some of the pressure for quarterly reporting.<sup>55</sup> Similarly, surveys have suggested that quarterly reporting may involve excessive time and cost, cause an information overload and cause undue focus on short term performance.<sup>56</sup> On the other hand quarterly reporting may provide more timely highlighting of risk (though continuous disclosure should ideally achieve this).

## VII MANAGEMENT DISCUSSION AND ANALYSIS AND S 299A REQUIREMENTS

Related to the issue of disclosure of risk is the longstanding debate in Australia about whether there should be a requirement for US-style MD&A in annual reports of listed companies.<sup>57</sup> The MD&A section of a company in the US and Canada typically includes a description of business operations and a description of risks and uncertainties.<sup>58</sup> This sort of 'soft information' is less verifiable yet, ironically, it is often this soft information (particularly information about earnings prospects and the risks in relation to same) that may arguably influence investors more than hard information.<sup>59</sup> Criticisms of annual reports and other disclosures that fail to contain MD&A include:

- failure to describe goals and strategies;
- lack of meaningful segmented disclosure;
- insufficient interpretation of financial results, especially regarding conditions likely to affect future earnings;

---

the ASX imposed quarterly cash flow reporting requirements and ASIC and ASX agreed that these should be continued until a company had demonstrated a positive cash flow for four quarters, given the continuing lack of compliance by many high tech companies with the continuous disclosure requirements. See Australian Securities and Investments Commission, '01/284 ASIC Cracks Down on Continuous Disclosure' (Media Release, 13 August 2001) <<http://asic.gov.au/about-asic/media-centre/find-a-media-release/2001-releases/01284-asic-cracks-down-on-continuous-disclosure/>>.

<sup>55</sup> Companies and Securities Advisory Committee, ASIC, *Report on Continuous Disclosure* (1996) Appendix 3, question 30.

<sup>56</sup> *Ibid.*

<sup>57</sup> Craig Callum and Larelle Law, 'Soft Information Disclosure Requirements under the Corporations Law' (2001) 29 *Australian Business Law Review* 149.

<sup>58</sup> J E Boritz, *Approaches to Dealing with Risk and Uncertainty* (1990) Canadian Institute of Chartered Accountants <[https://docs.google.com/a/monash.edu/file/d/0B2ccgmZijI4UYTI0N2FmNmQtNDQ4OS00YzFhLTk0MjctNDYyNDk5Nzk0YzRk/edit?hl=en\\_US](https://docs.google.com/a/monash.edu/file/d/0B2ccgmZijI4UYTI0N2FmNmQtNDQ4OS00YzFhLTk0MjctNDYyNDk5Nzk0YzRk/edit?hl=en_US)>.

<sup>59</sup> See generally Rob McQueen, 'The Corporate Image – The Regulation of Annual Reports in Australia' (2001) 1 *Macquarie Law Journal* 1, 74.

- exaggerated claims regarding future prospects which bordered on advertising;
- excessive aggregation of income statement items; and
- absence of information on stock prices and valuation data.<sup>60</sup>

In Australia the view has been expressed that the continuous disclosure laws, given the exceptions thereto, are inadequate to ensure disclosure of soft information and that MD&A should be prescribed in periodic disclosure<sup>61</sup>. The draft second Corporate Law Simplification Bill in fact provided for an obligation to:

Discuss and analyse the matters members need to be informed about if they are to understand the overall financial position [of the entity including]:

- (a) results of operations (both overall and in key industry and geographical segments);
- (b) key strategic initiatives adopted;
- (c) major commitments entered into and sources of funding for those commitments;
- (d) Unusual or infrequent events and transactions;
- (e) Likely future developments in the business; and
- (f) Trends or events (both internal and external) that have had a significant effect or are likely to have a significant effect on the business.<sup>62</sup>

These proposals were not met with unanimous support and were eventually abandoned. Nevertheless, the HIH Royal Commission, noting the recommendations of the UK Company Law Review, recommended that the Corporations Law be amended to require the inclusion of an OFR in the annual report which should be audited.<sup>63</sup> The Commissioner, Justice Neville Owen, noted in his policy recommendations:

It is imperative that all matters to be disclosed in the audit report are expressed in plain English, comprehensible to readers who lack accounting qualifications. A further approach was recommended in the UK Company Law Review. This approach required public and large private companies to publish an operating and financial review as a part of their annual report. The review would contain such information as the directors decide is necessary to obtain an understanding of the business. It would include details of the company's performance, plans,

---

<sup>60</sup> Neil Campbell, 'Compulsory Disclosure of "Soft" Information' (1993) 22(3) *Canadian Business Law Journal* 321, 324.

<sup>61</sup> Justin Mannolini, 'Convergence or Divergence: Is there a Role for the Eggleston Principles in a Global M&A Environment?' (2002) 24 *Sydney Law Review* 336, 350.

<sup>62</sup> Draft Second Corporate Law Simplification Bill 1996 (Cth) s 299(1); see Australian Parliament, *Issues Arising from the Bill* <[http://www.aph.gov.au/Parliamentary\\_Business/Committees/Joint/Corporations\\_and\\_Financial\\_Services/Completed\\_inquiries/1996-99/2nd\\_simp/report/c02#300](http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/1996-99/2nd_simp/report/c02#300)>.

<sup>63</sup> Commonwealth HIH Royal Commission, *Report of the HIH Royal Commission* (2003), Recommendation 13.



opportunities, corporate governance and management risks. The Company Law Review recommended that the auditor should review the operating and financial review. I am of the opinion that such a document, which would be the subject of audit, would significantly assist in addressing the short-comings of audited accounts presented in accordance with the historical cost convention and other standards which can impede the utility of the accounts as a transparent assessment of the financial progress of the company. Such an approach would enhance the increased audit report disclosure which I have discussed above.<sup>64</sup>

Section 299A was inserted into the *Corporations Act 2001* (Cth) by the CLERP 9 Act in 2004 and introduced a partial MD&A approach. Section 299A required that the directors' report contain

information that members of the company would reasonably require to make an informed assessment of

- (a) the operations of the entity reported on; and
- (b) the financial position of the entity; and
- (c) the entity's business strategies and prospects for future financial years.<sup>65</sup>

Prior to this, only a handful of companies in Australia provided MD&A narratives and these were chiefly subsidiaries of US companies and those listed on overseas exchanges.<sup>66</sup> One commentator noted at the time that

[p]otential investors and other interested parties are too often faced with a black hole when it comes to getting a meaningful assessment of a business' performance and prospects whether in the private or the public sector.<sup>67</sup>

The requirement for companies to disclose a review of operations and financial condition can be seen to result from the recommendations of the HIH Royal Commission, developments in England and some influence from the US MD&A.<sup>68</sup> The rationale for its introduction was to address a lack of contextual information that explained the results set out in a company's financial statements. Accordingly, the review of operations and financial condition was introduced to provide stakeholders with an overview that would enable them to understand a business's performance and the factors underlying its financial position.<sup>69</sup>

---

<sup>64</sup> Ibid 7.2.6.

<sup>65</sup> *Corporations Act 2001* (Cth) s 299A(1).

<sup>66</sup> See McQueen, above n 59, footnote 17.

<sup>67</sup> See McQueen, above n 59, footnote 17, quoting Scott Henderson, commenting on the question of compulsorily requiring such analyses in annual reports.

<sup>68</sup> See Gregory Allan, 'The HIH Collapse: A Costly Catalyst for Reform' (2006) 11(2) *Deakin Law Review* 137.

<sup>69</sup> Explanatory Memorandum, Corporations Amendment (Corporate Reporting Reform) Bill 2010 (Cth).

As noted, s 299A of the *Corporations Act 2001* (Cth) was inserted as part of the CLERP 9 Act.<sup>70</sup> According to the explanatory memorandum to that Act:

The preparation of an operating and financial review is increasingly being accepted in the world's capital markets as an integral part of good corporate governance and high quality financial reporting. As such, it is a means of providing users of financial statements with an analysis of a company's business as seen through the eyes of the directors.<sup>71</sup>

The section had regard to international developments, which may include the popularity of MD&A in the United States.<sup>72</sup>

The provisions are expressed to be based upon what members of the listed entity would reasonably require to make an informed assessment of the matters therein. Austin and Ramsay note that this adoption of a 'reasonable member requirements' test for annual disclosure 'accelerates the convergence between periodic disclosure and disclosure for fundraising purposes, where the governing disclosure principle is the "reasonable investor" test under section 710.'<sup>73</sup> The wording in s 710 refers to information that 'investors and their professional advisors would reasonably require to make an informed assessment of' the investment. Similarly, the wording in s 299A refers to information that 'members of the listed entity would reasonably require to make an informed assessment of' the investment. This convergence may accelerate the reporting of risk in periodic disclosure as the reporting of risk factors is already commonplace in fundraising documents.

The explanatory statement for s 299A goes on to say that:

The content requirements for the review have been expressed in broad terms. The purpose of this is:

- to enable directors to make their own assessment of the information needs of members of the company and tailor their disclosures accordingly; and
- to provide flexibility in form and content of the disclosures as the information needs of shareholders, and the wider capital market, evolve over time.<sup>74</sup>

Hence, there seems to be a discretion and flexibility given to directors to assess the information needs of members and contemplation of the fact that these may evolve over time.

---

<sup>70</sup> Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act No 103 of 2004.

<sup>71</sup> Explanatory Memorandum, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth), [5.305].

<sup>72</sup> See Thomas Hazen, *The Law of Securities Disclosure* (West Publishing, 3rd ed, 1995) 154.

<sup>73</sup> Robert P Austin and Ian M Ramsay, *Ford's Principles of Corporations Law* (Butterworths, 13th ed, 2007) 555.

<sup>74</sup> Explanatory Memorandum, Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth), [5.306].

Lastly, the explanatory memorandum brings into the picture best practice guidance by the Group of 100 Inc ('G100'), which is an association of senior finance executives from Australia's business enterprises. The explanatory memorandum states that '[i]t is expected that, in considering the issues to be addressed in their review, directors will have regard to best practice guidance such as that prepared and published by the Group of 100 Inc (G100).'<sup>75</sup> The G100 guidance material is also supported by the ASX for the purpose of complying with ASX Listing Rule 4.10.17 (see below). The G100 guidance may be used for the purpose of satisfying the legislative requirements. On the basis of the G100 guidance material, the issues that could be discussed and analysed in the report include:

- corporate overview and strategy;
- review of operations;
- investments for future performance;
- review of financial condition;
- risk management;
- corporate governance.<sup>76</sup>

*A ASIC Requirements under the Corporations Act 2001 (Cth) s 299A*

It should be noted that ASIC requires companies to present OFRs as part of listed companies' obligations under s 299A of the *Corporations Act 2001* (Cth). ASIC interprets this section as requiring listed companies to present OFRs (also known as 'management commentary' or 'management discussion and analysis').<sup>77</sup> An idea of the sort of information that ASIC expects as OFR or MD&A can be gleaned from its review of 30 June 2010 financial reports and focuses for 31 December 2010. ASIC criticised the level of MD&A, noting that:

- (i) Most of the companies reviewed appear to have provided what they considered to be minimum disclosures, but which would not appear to comply with the obligation to provide information members would reasonably require.
- (ii) The OFR often lacked information and explanations that would provide users with an understanding of the drivers of an entity's performance. Instead, general descriptive comments that repeated movements evident from the financial report (e.g. revenue increased by 3%) were given, that provided users with little or no information about the specific activities, transactions and events that gave rise to the results.

---

<sup>75</sup> Ibid [5.307].

<sup>76</sup> Group of 100, *Guide to Review of Operations and Financial Condition* (2003) <[http://www.group100.com.au/publications/g100\\_Review\\_Operations2003.pdf](http://www.group100.com.au/publications/g100_Review_Operations2003.pdf)>.

<sup>77</sup> Australian Securities and Investments Commission, '10-282AD ASIC's Review of 30 June 2010 Financial Reports and Focuses for 31 December 2010' (Media Release, 22 December 2010) <<http://asic.gov.au/about-asic/media-centre/find-a-media-release/2010-releases/10-282ad-asics-review-of-30-june-2010-financial-reports-and-focuses-for-31-december-2010/>>

- (iii) Most entities did not provide key performance indicators, production statistics or similar information.
- (iv) Most entities did not present the OFR information in a single section of the financial report. This could increase the focus of the company and its directors on the completeness and quality of the OFR information, and assist users of the annual report in locating the information.
- (v) Most entities provided more analysis in investor presentations or analyst briefings lodged with ASX. Directors should consider giving more detail in the OFR, which is part of the annual report. However, undue prominence should not be given to an alternative profit measure compared to the statutory profit.<sup>78</sup>

In 2012, ASIC released proposed guidance on the OFR.<sup>79</sup> In the proposed guidance it was noted, in relation to general periodic disclosure under s 299, that:

While an entity's financial report provides useful information to investors about the entity's financial position and performance, it will rarely provide all the information needed to readily assess the underlying drivers of the entity's financial performance and to properly understand the reasons for the entity's results. It will also provide little, if any, information about expected future performance.<sup>80</sup>

ASIC also noted international recognition of the importance of high quality OFRs, including the view of the International Organisation of Securities Commissions ('IOSCO') that OFRs

enable management to explain the factors that have affected an entity's financial condition and results of operations for the historical periods covered by the financial statements, as well as management's assessment of the factors and trends that are anticipated to have a material effect on the company's financial condition and results of operations in the future.<sup>81</sup>

---

<sup>78</sup> Ibid.

<sup>79</sup> Australian Securities and Investments Commission, '12-228MR ASIC Proposes Guidance for Operating and Financial Reviews' (Media Release, 17 September 2012) <<http://asic.gov.au/about-asic/media-centre/find-a-media-release/2012-releases/12-228mr-asic-proposes-guidance-for-operating-and-financial-reviews/>>.

<sup>80</sup> Australian Securities and Investments Commission, *Effective Disclosure in an Operating and Financial Review* and attached draft Regulatory Guide (17 September 2012) <[http://www.asic.gov.au/asic/pdfflib.nsf/LookupByFileName/cp187-published-17-September-2012.pdf/\\$file/cp187-published-17-September-2012.pdf](http://www.asic.gov.au/asic/pdfflib.nsf/LookupByFileName/cp187-published-17-September-2012.pdf/$file/cp187-published-17-September-2012.pdf)>.

<sup>81</sup> Ibid 10, quoting Technical Committee of IOSCO, *Principles for Periodic Disclosure by Listed Entities* (February 2010) <<http://www.iosco.org/library/pubdocs/pdf/ioscopd317.pdf>>.

Significantly, proposal C5 of ASIC's proposed OFR guidelines includes an analysis of business risks. It provides as follows:

We propose that the information required under s299A(1)(c) on business strategies and prospects for future financial years should focus on the areas that are likely to affect the future financial performance and position of the entity. We consider that the OFR should usually include:

- (a) an outline of the entity's key business strategies, and its plans that are a significant part of those strategies; and
- (b) disclosure of the main risks that could adversely affect the successful fulfilment of the business strategies of the entity.<sup>82</sup>

The rationale for the proposal is evident in the following statement from ASIC:

We consider that a discussion about an entity's prospects for future financial years would benefit from a consideration of the risks that could affect the entity's financial position and performance.<sup>83</sup>

This would, however, be subject to an exemption, where disclosure of such risks would cause unreasonable prejudice for the entity as set out in s 299A(3). Unreasonable prejudice is described in the draft regulatory guide as including the situation where disclosure would give third parties such as competitors, suppliers and buyers, a commercial advantage resulting in material disadvantage to the disclosing entity.<sup>84</sup> ASIC states in its proposed draft Regulatory Guide that it is likely to be misleading to discuss prospects without referring to the main risks that could adversely affect the achievement of the financial outcomes described. It states that:

Any discussion of risks should be tailored to the entity rather than using a standard description. The discussion of risks may include:

- (a) *internal risks* — for example, an entity's ability to meet future demand for its products or services, corporate restructures and cost management strategies initiated by management; and
- (b) *external risks* — for example, the economic risks affecting an entity, the impact of commodity prices, and possible legislative changes.<sup>85</sup>

---

<sup>82</sup> Australian Securities and Investments Commission, *Effective Disclosure in an Operating and Financial Review* and attached draft Regulatory Guide (17 September 2012) <[http://www.asic.gov.au/asic/pdfflib.nsf/LookupByFileName/cp187-published-17-September-2012.pdf/\\$file/cp187-published-17-September-2012.pdf](http://www.asic.gov.au/asic/pdfflib.nsf/LookupByFileName/cp187-published-17-September-2012.pdf/$file/cp187-published-17-September-2012.pdf)>13.

<sup>83</sup> *Ibid.*

<sup>84</sup> *Ibid.* 39.

<sup>85</sup> *Ibid.* 37–8.

It goes on:

Other considerations that may be relevant for disclosure of risks include:

- (a) *key risks* — identifying the key risks that are relevant to an entity. Care should be taken to avoid disclosure of an excessive number of risks. Each risk should:
  - (i) be described in its context (e.g. why is the risk important or significant, and what is its potential impact on the entity's financial results?); and
  - (ii) include any relevant associated analytical comments (e.g. is the risk expected to increase or decrease in the foreseeable future?); and
- (a) *risk aversion and risk management* — a description of the directors' level of appetite for risk, any changes in the risk appetite, and any current or planned risk management practices.<sup>86</sup>

ASIC issued its Regulatory Guide 247, 'Effective Disclosure in an Operating and Financial Review' in March 2013.<sup>87</sup> Whilst not as extensive as the draft regulatory guide, in terms of mandating the identification of risk, it still goes some way in this direction.

In paragraph 247.61, ASIC states:

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.<sup>88</sup>

Further, in paragraph 247.62, ASIC states:

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.<sup>89</sup>

---

<sup>86</sup> Ibid 38.

<sup>87</sup> Australian Securities and Investments Commission, *Regulatory Guide 247 Effective Disclosure in an Operating and Financial Review* (March 2013) <<http://www.asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-247-effective-disclosure-in-an-operating-and-financial-review/>>.

<sup>88</sup> Ibid [247.61].

<sup>89</sup> Ibid [247.62].



It follows that ASIC takes the view that proper compliance with s 299A includes disclosure of the material business risks that could adversely affect an entity's financial position and performance, although this would not extend to generic risks that potentially affect a large number of entities.

### *B ASX Requirements on s 299A Review of Activities*

The ASX Listing Rules also include discussion and analysis disclosure guidelines. Listing Rule 14.10.17 requires a review of activities and operations from the reporting period.<sup>90</sup> Whilst the ASX does not specify the review's required content, it states that it supports the G100 Incorporated's Guide to the Review of Operations and Financial Condition.<sup>91</sup> Interestingly, the G100 guidance, issued in 2003, suggests detailed disclosures about risk management and states the following:

Shareholders and other users of financial reports are interested in the various risk exposures of the company and the way in which those risks are managed. The Review should contain a discussion of the company's risk profile and risk management practices if these are not dealt with elsewhere in the Annual Report. Discussion of risk management practices in relation to borrowings, interest rates and exchange rates is appropriately dealt with under treasury policy. However, a company is also subject to other risks which need to be discussed.

Disclosures about risks facing the company enable users to see the business through the eyes of directors and enable users to understand the company's risk profile and risk management strategy. All relevant aspects of risk management and mitigation, to the extent they are not already dealt with elsewhere in the Review or in the Annual Report, should be discussed. The discussion of risk and risk management should be in a manner which is consistent with how the respective risk exposures are identified and managed. The discussion should include the significant risks and uncertainties facing the company, its core businesses and segments, the strategies and processes applied for managing those risks and the potential impact of these risks on financial performance. ... The discussion of the risk profile, management and mitigation of risk other than those relating to treasury policies may include:

- legal and regulatory compliance;
- fraud;
- availability of staff and other resources;
- occupational health and safety;
- changes in technology and other operational risks;
- environmental issues; and
- product liability.<sup>92</sup>

---

<sup>90</sup> Australian Securities Exchange, *Listing Rules* (1 December 2013) r 4.10.17.

<sup>91</sup> G100, above n 76. As noted, the Explanatory Memorandum, *Corporate Law Economic Reform Program Bill 1999* (Cth) paragraph 5.308 also approved the G100 material.

<sup>92</sup> G100, above n 76.

Therefore, it is not clear that the ASX requires risk factors themselves to be enumerated, though this may occur in identifying the risk profile of the company.

### *C Accounting Standards on Review of Activities*

AASB 1039 also requires discussion and analysis to assist the understanding of members.<sup>93</sup> It provides for same for non-listed companies while noting that listed companies already have that obligation under s 299A. The accounting standards do not go so far as to require a section on risk factors or risk management.

### *D Extra Requirements of Periodic Disclosure: ASX Corporate Governance Principles and Risk*

In March 2003 the ASX Corporate Governance Council published its *Principles of Good Corporate Governance and Best Practice Recommendations* ('the Principles'). These embodied ten principles of sound corporate governance. The Principles cover such matters as the structure of the board, independent directors, board committees, financial reporting, timely disclosure, respecting rights of shareholders, recognising and managing risk, enhanced performance, fair remuneration and recognising the interests of stakeholders. The Principles operate on an 'if not, why not' basis, which essentially means that where the principles are not complied with, the company must state in its annual report which principles are not being complied with and the reasons for the non-compliance. This is required by the ASX listing rules. The Principles were amended in August 2007 and were reduced in number to eight with Principle 8 being combined with Principles 1 and 2 and Principle 10 being included in Principles 3 and 7. They were again revised in March 2014. Of significance too for this analysis was expansion of Principle 7 to require companies to report on whether it has recognised and managed risk.

Principle 7 has been formulated to require the establishment of a sound risk management framework and periodic review of the effectiveness of that framework. The first specific recommendation is the establishment of a board risk management committee (recommendation 7.1). The second is the annual review of the entity's risk management framework (recommendation 7.2). The third is the disclosure of whether the entity has an internal audit function, and if not, disclosure of its processes for ensuring the effectiveness of its risk management and internal control processes (recommendation 7.3). The fourth is the disclosure of whether the entity has any material exposure to economic, environmental and social sustainability risks, and if it does, how it manages or intends to manage those risks (recommendation 7.4).<sup>94</sup> The Principles state that if the Board of a listed entity considers that a Council recommendation is not appropriate to its particular circumstances it is

---

<sup>93</sup> Australian Accounting Standards Board, Accounting Standard AASB 1039.

<sup>94</sup> Australian Securities Exchange Corporate Governance Council, *Corporate Governance Principles and Recommendations* (27th March 2014) Australian Securities Exchange <<http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf>>

entitled not to adopt it. If it does not adopt it, however, it must explain why it has not adopted the recommendation.<sup>95</sup>

## VIII CONCLUSION

The importance of internal recognition of risk is exemplified in recent decades by the development of the area of risk management. Specific external disclosure of risks to shareholders in periodic reporting is a more recent and developing phenomenon. It is important given the role of disclosure as a form of investor protection and the need to continually update investors beyond initial prospectus warnings of risk. Conventional accounting presentation does not generally mandate disclosure of specific risks, though risk may be implied in some measures and it may be that the 'true and fair view' standard will require such disclosure. The amendment of the *Corporations Act 2001* (Cth) in 2004 to include s 299A and the requirement of a review of activities encompassing prospects for future years should on the face of it lead to greater risk disclosure. This is particularly so in view of ASIC's interpretation of the section as requiring an OFR that discloses inter alia, the main risks that could adversely affect the successful fulfilment of the business strategies of the entity. Further, ASX Listing Rules require disclosure of details of risk and risk management systems as do the ASX Corporate Governance Principles. It may be concluded from these developments that the trend of regulation seems to be moving toward greater periodic disclosure of risk and risk factors.

---

<sup>95</sup> Ibid.

