

COMPANIES AND SECURITIES ADVISORY COMMITTEE

The Companies and Securities Advisory Committee ("the Advisory Committee") is established under the Australian Securities Commission Act 1989.

Section 148 of this Act specifies the functions of the Committee:

"148(1) - The Advisory Committee's functions are, on its own initiative or when requested by the Minister, to advise the Minister, and to make to the Minister such recommendations as it thinks fit, about any matter connected with:

- (a) a proposal to make a national scheme law, or to make amendments of a national scheme law;
- (b) the operation or administration of a national scheme law;
- (c) law reform in relation to a national scheme law;
- (d) companies, securities or the futures industry; or
- (e) a proposal for improving the efficiency of the securities markets or futures markets."

The members of the Committee as of the date of this Report are:

- Mark Burrows (Convenor)
- Don Argus
- Tim Besley
- Kevin Driscoll
- William Gurry
- Leigh Hall
- Tony Hartnell
- Dick Lester
- Wayne Lonergan
- John McIntosh

The members of the Executive of the Committee involved in the preparation of this Report are:

- John Kluver (Executive Director)
- Mark Blair

COMPANIES AND SECURITIES ADVISORY COMMITTEE

**REPORT ON
AN ENHANCED STATUTORY DISCLOSURE SYSTEM**

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Summary

In June 1991 the Federal Attorney-General, Michael Duffy, requested the Companies and Securities Advisory Committee to examine the need for a legislatively-based continuous disclosure regime, and the nature of any such scheme. The Committee was asked to report within 2 months.

In response the Committee has prepared this Report, in four Parts:

Part A outlines the general disclosure requirements imposed by the Corporations Law and the Australian Stock Exchange (ASX) Listing Rules.

Part B discusses the rationale for an enhanced statutory disclosure system. The benefits of the proposed system include the protection of the interests of equity and debt investors, the promotion of efficient management, and a better functioning capital market.

Part C details the specific policy recommendations of the Advisory Committee for improving the quality of disclosure. The Committee's proposals have three main elements:

- an affirmative obligation on directors of "disclosing entities" to make a timely disclosure of any "material matter" to the ASC and, where applicable, to the ASX. A draft pro-forma Statement of Material Matter is set out in Annexure 1;
- a requirement for disclosing entities to lodge detailed half-yearly financial reports; and
- more comprehensive annual disclosure requirements for disclosing entities and exempt proprietary companies.

Part D provides a commentary on various recommendations contained in Part C.

In preparing its Report, the Committee noted the content of two ASX Papers: "Improved Reporting by Listed Companies" (October 1990) (hereafter the ASX October 1990 Paper) and "Proposed Listing Rule Amendments To Become

Operative Late 1991" (June 1991) (hereafter the ASX June 1991 Paper). The Committee also reviewed continuous disclosure and interim reporting requirements in overseas jurisdictions, including the United Kingdom, the USA, and Canada. A summary of the North American provisions is set out in Annexure 2.

PART A

EXISTING DISCLOSURE REQUIREMENTS

The Corporations Law

Continuous Disclosure

The Corporations Law does not contain a comprehensive scheme for the full and accurate disclosure of material matters on a timely basis. Various provisions require disclosure in particular circumstances: for example, fundraising pursuant to a prospectus (Part 7.12 Division 2); entry into schemes of arrangement (Part 5.1); undertaking or responding to takeover bids (Part 6); or written offers or invitations concerning securities (ss 1079(1), 1080). However, there is no general continuous disclosure requirement for the benefit of those engaged in the secondary trading of securities.

Interim Reporting

While the idea of introducing a legislative requirement for Australian public companies to furnish interim reports is not new¹, the Corporations Law does not generally require companies or trusts to lodge either quarterly or half-yearly reports. However one exception is found in s 1058, which requires directors of specified borrowing corporations to lodge quarterly and half-yearly reports.

Annual Reporting

There is a general requirement for companies to lodge annual returns with the ASC: s 335. Exempt proprietary companies must prepare accounts in accordance with the Corporations Law Part 3.6 Div 4, but need not attach these to their annual returns: Corporations Regulation 3.8.02. However, exempt proprietary companies that have not appointed an auditor must include key financial data in their annual returns: Corporations Regulation 3.8.01(r).

1. On 18 November, 1976 the then Opposition introduced the *Companies and Securities Industry Bill* to Federal Parliament. The Bill proposed that public companies provide quarterly reports within 6 weeks of their quarter-year end. The Bill lapsed.

ASX Listing Rules

Continuous Disclosure

The Australian Stock Exchange (ASX) Listing Rule 3A(1) provides that a listed company or trust must notify its home exchange "immediately" of any information concerning its activities or those of its subsidiaries that is either:

- necessary to avoid the establishment of a false market in its securities; or
- likely to materially affect the price of those securities.

The ASX June 1991 Paper proposes to add a further category of information to be disclosed:

- information that is of material significance for interested parties wishing to be apprised of the financial position and/or performance of the company or trust.

The ASX June 1991 Paper also proposes to extend the reporting obligations to "entities" with which the company or trust is "associated" (as opposed to merely its subsidiaries). The purpose of this extension is to ensure that, to fully comply with Rule 3A(1), listed entities must take into account their interests in these other entities.

Interim Reporting

The ASX Listing Rule 3B(1) states that a listed company (other than a trust or a mining exploration company) must provide the Home Exchange with a consolidated half-yearly report within 3 months of the company's half-year end. These reports must be prepared according to ASX statements (see Appendix 3 of the Listing Rules), although they need not be audited.

ASX Listing Rule 2F(6) states that the management company of a listed trust must forward audited half-yearly accounts to unit holders within 2 months of the half-year end in the case of a property trust, and 3 months in the case of all other

trusts. A number of rules specify the contents of these reports (eg Listing Rules 2F(6), 2F(7) and 3(2C)).

ASX Listing Rule 3B(5) states that a mining company must lodge a quarterly report with the Home Exchange within one month of the company's quarter year-end, including full details of production, development and exploration activities. ASX Listing Rule 3B(10) requires a mining exploration company to also complete a working capital report within one month of its quarter year-end.

The ASX June 1991 Paper proposes the following additional requirements for half-yearly reporting by listed entities:

- a cash flow statement, once an accounting standard has been introduced;
- a condensed balance sheet describing major items of current and non-current assets and liabilities;
- segmental information; and
- greater detail regarding receipts/outlays and revenue/expenses for the half year.

Annual Reporting

The ASX Listing Rules 3C(1) requires a listed company to issue a printed annual report to its shareholders, and lodge that annual report with the Home Exchange within 4 months of the end of the company's financial year. The details to be included in the annual report are set out in Listing Rules 3C(2) and 3C(3), and also, in the case of mining companies, Listing Rule 3M. Listing Rules 3B (2B), 3B (2C) and 2F(6) set out the annual reporting requirements for unit trusts.

PART B**RATIONALE FOR AN ENHANCED DISCLOSURE SYSTEM****Forms of Disclosure**

The Committee favours the introduction of a statutory-based enhanced disclosure system, having three principal elements:

- an affirmative obligation on directors of "disclosing entities" to make a timely disclosure of any "material matter" to the Australian Securities Commission (ASC);
- a requirement that disclosing entities lodge comprehensive half-yearly financial reports; and
- a requirement that disclosing entities include further consequential details in their annual returns and that all exempt proprietary companies lodge accounting records and key financial data in their returns.

Given these proposals, the majority of the Committee feels that a quarterly reporting requirement is not warranted at this stage. However quarterly reporting should be kept under constant review.

Enhanced disclosure will benefit a variety of users, including:

- existing and potential equity holders;
- existing and potential secured or unsecured creditors;
- existing and potential secured or unsecured debenture holders; and
- the management of the disclosing entity.

Benefits of Continuous Disclosure

A statutory-based system of continuous disclosure will promote investor confidence in the integrity of Australian capital markets and provide benefits to

market participants, and management, in various interrelated ways. It will:

- overcome the inability of general market forces to guarantee adequate and timely disclosure by disclosing entities;
- encourage greater securities research by investors and advisors, thereby ensuring that securities prices more closely, and quickly, reflect underlying economic values;
- ensure that equity and loan resources in the Australian market are more effectively channelled into appropriate investments, and that funds are withheld or withdrawn from poorly performing disclosing entities. This will promote capital market efficiency;
- assist debtholders in monitoring the performance of disclosing entities and thereby determine whether, or when, to exercise any right to withdraw or reinvest their loan funds, or convert debt to equity;
- act as a further, or substitute, warning device for holders of charges over corporate assets, that breaches in covenants may have taken place, or the risk of default has increased;
- assist potential equity or debt holders of disclosing entities to better evaluate their investment alternatives;
- lessen the possible distorting effects of rumour on securities prices;
- minimize the opportunities for perpetrating insider trading or similar market abuses;
- improve managerial performance and accountability by providing the market with more timely indicators of corporate performance;
- encourage the growth of information systems within disclosing entities, thereby assisting directors in their decision making and compliance with their fiduciary duties; and
- reduce the time and costs involved in preparing takeover and prospectuses documents.

Benefits of Half-Yearly Reports

A comprehensive periodic reporting system would complement and enhance the benefits derived from continuous disclosure. Half-yearly reports would:

- act as a partial summary of, and a checking mechanism on compliance with, the continuous disclosure obligations;
- assist in assessing the longer-term implications of prior disclosure statements;
- promote a more informed assessment of the likely future financial performance of disclosing entities;
- require disclosing entities to disclose various facts which in combination, though not necessarily individually, may be material in assessing the value of their securities; and
- help investors to more accurately compare the performance of various disclosing entities through standardised reporting criteria.

Benefits of Enhanced Annual Reports

An upgraded annual reporting requirement would:

- complement the proposed changes to continuous and half-yearly reporting; and
- ensure that the ASC database contains comprehensive financial information on all Australian companies.

PART C**THE RECOMMENDATIONS**

The Committee recommends the introduction of statutory-based continuous disclosure and half-yearly reporting requirements for all disclosing entities, and an upgrading of certain annual reporting requirements. The information disclosed is to be placed on the ASC ASCOT/DOCIMAGE database. The Committee's specific recommendations are as follows:

Reporting EntitiesDefinitions

1. "Disclosing entities" should comprise:
 - * all listed companies/trusts;
 - * all other public companies with 50 or more members and/or holders of debentures (as defined in s9 of the Corporations Law). In determining the number of members or debenture holders, beneficial holdings are to be excluded (cf Corporations Law, s213 (10));
 - * all companies with total (gross) assets in excess of \$10 million (or such other figure as may be prescribed);
 - * prescribed interests with total (gross) assets in excess of \$10 million (or such other figure as may be prescribed); and
 - * public sector corporations that carry on a business (cf Trade Practices Act, section 2A).

The above categories are not mutually exclusive.

"Total assets" for the purpose of this Recommendation includes assets that are held by the disclosing entity in the capacity of trustee.

In the case of any trust/prescribed interest arrangement involving a trustee and a management company, the disclosing entity is the management company.

Exemption from being a Disclosing Entity

2. A wholly-owned subsidiary to which accounting relief is provided by the ASC should be exempted from the continuous disclosure and half-yearly reporting obligations where its parent is a disclosing entity.

Continuous Disclosure Obligations

Material Matters

3. Subject to the exemptions in Recommendations 5-6, all disclosing entities must report all beneficial or adverse "material matters".
4. A "material matter" should be:
 - * any change in, or reassessment of, the disclosing entity of which equity or debt investors would reasonably require disclosure, for the purpose of their making an informed assessment of the assets and liabilities, financial position, profits and losses, or prospects of the disclosing entity: cf Corporations Law s 1022(1); and
 - * any matter that is likely to materially affect the price of the disclosing entity's debt or equity securities or is necessary to avoid the establishment or continuation of a false market in those securities: cf ASX Listing Rule 3A(1).

In determining a "material matter", a disclosing entity should take into account any change or reassessment in any other entities which it "controls" (as determined by the consolidated accounts requirements: Corporations Law, Part 3.6, Division 4A).

Exemptions

5. "Material matters" to be disclosed need not include proposed changes until a relevant binding contract, or other arrangement, is entered into (notwithstanding that it may contain conditional terms), except where confidentiality cannot be maintained: cf London Stock Exchange Rules - Section 5, Chapter 2 para 1.2; Ontario Securities Commission Policy No. 40 - "Timely Disclosure". In respect of takeovers and other merger negotiations, the principle of secrecy found in ASX Rule 3R(1) should be maintained. This information should not be divulged outside a disclosing entity and its advisors in such a way as to place any person or class of persons in a privileged dealing position.
6. The legislation should provide for possible exemptions from disclosure (carve-outs) in the regulations. The legislation might also empower the ASC to grant other specific exemptions upon application.
7. The Ontario system of "sealed envelope" disclosure to the Stock Exchange and/or the Securities Commission is considered to be inappropriate for the Australian setting.

Form of Disclosure

8. An optional two-step disclosure system is proposed. Upon directors of a disclosing entity becoming aware of a "material matter", they should, as soon as it is practicable and in any event within 24 hours, either:

(a) lodge a completed Statement of Material Matter with the ASC; or

(b) issue, and lodge with the ASC, a press release outlining the material matter.

If directors choose option (b) they must subsequently lodge the Statement of Material Matter with the ASC within 2 business days of the initial press release.

A draft pro-forma Statement of Material Matter is set out in Annexure 1 to this Report.

9. A listed company or trust should be required to lodge a copy of the completed Statement of Material Matter and, if applicable, the associated press release with the ASX, no later than the time of lodging with the ASC.
10. The ASC should, within 5 business days of receiving a Statement of Material Matter, make that Statement available on its DOCIMAGE database.

Reporting Obligations and Liabilities

11. A director of a disclosing entity shall contravene the legislation if he or she is aware that the entity has:
 - failed to provide a timely disclosure of a material matter;
 - the information released contains false or misleading statements; or
 - the information released contains a material omission.

Directors should also be subject to a "due diligence" obligation to reasonably ensure that they are made aware of material matters.

12. A person who suffers detriment in consequence of a contravention of the continuous disclosure obligations may seek civil remedies from any defaulting director, whether or not the director has been convicted of an offence in respect of that contravention.
13. Where criminal or civil action is taken against a director for failing to comply with the continuous disclosure obligations, the director should have similar defences to those which apply in the issue of a prospectus.

Enforcement

14. The ASC should be given appropriate remedial powers to enforce compliance by directors of disclosing entities with the statutory continuous disclosure obligations, and obtain civil remedies for affected persons.

Commencement

15. The legislation should be introduced on a graduated basis to enable sufficient time for internal reporting systems to be developed or upgraded. The continuous disclosure requirements could be placed initially on listed companies, given their existing obligations under Listing Rule 3A(1). Other disclosing entities could be required to comply from a stipulated later date.

The continuous disclosure requirements should apply to all "material matters" taking place from the date of application of the legislation to the disclosing entity. The legislation should not have a retrospective effect.

Abbreviated Prospectuses

16. Securities issuers should be entitled to incorporate in their prospectuses, by reference, information previously disclosed in any Statement of Material Matter. The prospectus should include a summary of this information, as provided for in the Statement. However, such abbreviation should not be permitted for primary offerings unless the issuer has been a disclosing entity for at least one year immediately prior to the lodgement date of the prospectus.

No Mandatory Quarterly Reporting

17. While the Committee sees some merit in companies providing quarterly reports, there should be no statutory requirement for them at this stage. However, companies may, at their discretion, prepare and publish quarterly reports. A statutory quarterly reporting requirement could be a matter for future review.

Half-Yearly Reporting Requirements

Obligation to report

18. All disclosing entities that are required to lodge annual reports under the Corporations Law should also be required to lodge half-yearly reports with the ASC (and if listed, also with the ASX), within 75 days of their fiscal half year-end. This requirement should also apply to public sector corporations that carry on a business.

Disclosing entities that currently do not have to provide annual reports under the Corporations Law, should not be required to supply reports on a half-yearly basis.

19. In principle, half-yearly reports should include:
- * a profit and loss statement;
 - * a balance sheet;
 - * a list, and the dates of issue, of all Statements of Material Matter lodged during the reporting period, and a summary of each of these Statements (refer Annexure 1: Statement of Material Matter, Item 4); and
 - * a qualitative assessment of half-yearly results by directors.
20. Half-yearly reports for a disclosing entity should be prepared on an individual, and where applicable a consolidated, basis.
21. Half-yearly reports should be made in accordance with a resolution of directors, and signed by at least two of them.
22. When the Australian Accounting Standards and Public Sector Accounting Standards Boards introduce a requirement for a statement of cash flows in financial statements (refer to their Exposure Draft No. 52), this should be applied to half-yearly as well as annual reports. Unless otherwise recommended in the proposed Standard, this should be phased in over a suitable period, say 2 to 3 years.

23. As a general rule, half-yearly reports should be based on accounting principles and practices consistent with those used in annual reports. More specifically, the following provisions of the Corporations Law should be extended to half-yearly reports: s 297 (accounts to comply with prescribed requirements); s 298 (financial statements to accord with applicable accounting standards); and s 299 (additional information to give a true and fair view). However, specific footnote disclosures (eg statements of accounting principles) in the immediate prior annual report need not be repeated in the subsequent half-yearly report. Any change in the accounting principles or practices from those used in the prior annual report should be clearly stated, as well as the reason(s) for the change.
24. Half-yearly reports need not be fully audited, although disclosing entities may choose to do so. In the absence of a full audit, these reports should be subject to a limited review by auditors: cf AARF Proposed Statement of Auditing Practice, Exposure Draft 34 - "Review Engagements". While it is preferable that this review be undertaken prior to release of half-yearly reports, it is recognized that such a requirement would add to any cost burden associated with their preparation. It is therefore recommended that, in the first instance, a disclosing entity should at least be required to have a limited review of half-yearly results undertaken by an independent auditor at year end, and to include a statement of opinion on the half-yearly report by the auditor involved, in the annual report.
25. Where a half-yearly report is subject to either a full or lesser form of audit, the disclosing entity must include a statement by the auditor that describes the extent, and limits, of the audit.
26. The ASC should make half-yearly reports available on its DOCIMAGE database within 5 business days of their being lodged. There should be no statutory obligation on disclosing entities to generally distribute copies of half-yearly reports, although members could require this by ordinary resolution.

Outstanding matters

27. A number of specific accounting-related issues arise from the implementation of the proposed half-yearly reporting requirements. These include:

(a) the precise form and content of half-yearly reports (financial statements, comparative information, management discussion);

(b) those half-yearly items that should be disclosed by means of a footnote to annual accounts; and

(c) procedures to be undertaken by an auditor during a limited review.

Such matters have been the subject of studies in Australia², and overseas (the U.S. Financial Accounting Standards Board). The Committee is of the opinion that these matters of detail should be referred to the Australian Accounting Standards Board.

Exemptions from Half-Yearly Reporting

28. Those disclosing entities that are specifically exempted from annual reporting requirements should also be exempted from having to provide half-yearly reports.

Reporting Obligations and Liabilities

29. The half-yearly reporting obligation should rest with directors of the disclosing entity. Any director of an entity that is required to lodge half-yearly reports shall contravene the legislation if he fails to take all reasonable steps to comply with, or to secure compliance with, or knowingly has been the cause of any default under any statutory requirement relating to, a half-yearly report: cf Corporations Law s 318.

2. AARF Discussion Paper No. 15 (1990): "Timing and Frequency of Financial Reporting"; the Auditing Standards Board of the AARF: "Review Engagements" (Exposure Draft 34 (October 1990)).

30. Where criminal actions are taken against a director for failing to comply with half-yearly reporting obligations, he should have the benefit of similar defences to those which apply to the release of annual accounts.
31. A person who suffers detriment from a contravention of the half-yearly reporting obligations may seek consequential civil remedies from any defaulting director, whether or not the director has been convicted of an offence in respect of the contravention: cf Corporations Law s 1005.
32. Where civil actions are taken against a director for failing to comply with half-yearly reporting obligations, he should have the benefit of similar defences to those which apply to the issue of a prospectus.
33. To the extent of their involvement, auditors should be liable to those persons who rely on their audit or limited review.

Enforcement

34. The ASC should be given appropriate powers to enforce compliance with the half-yearly reporting obligations, and to obtain civil remedies for affected persons.

Commencement

35. The half-yearly reporting requirement should apply to all private sector disclosing entities from the first half year ending not less than six months from the date of commencement of the legislation. It may be necessary to phase in half-yearly reporting obligations for public sector corporations.

Annual Reporting Requirements

36. Annual accounts of disclosing entities should contain a list, and the dates of issue, of all Statements of Material Matter lodged in the period since the last half-yearly report, and a summary of each of these Statements (refer Annexure 1: Statement of Material Matter, Item 4).