COPY 1

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

CONTENTS

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 new[1], 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).

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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 Entities

Definitions

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 up-graded. 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 Australia[2], 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.

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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).

37. Where disclosing entities are required to provide half-yearly reports, they must reconcile half-yearly to annual results in a note to the annual accounts.

38. Directors and auditors of disclosing entities should be subject to similar reporting obligations and/or liabilities for annual reports as for half-yearly reports.

39. Exempt proprietary companies should be required to include a set of accounts in their annual return. The ASC should make this information available on its DOCIMAGE database.

40. Exempt proprietary companies should include key financial data, as well as accounts, in their annual return, whether or not they have appointed an auditor.

PART D

COMMENTARY ON THE RECOMMENDATIONS

Entities Subject to the Reporting Requirements: Recommendation 1

Non-listed public companies

The Committee proposes that non-listed public companies with 50 or more members and/or holders of debentures, or otherwise with total assets in excess of $10 million, comply with the enhanced disclosure obligations. The Committee believes that public companies of any significant size or asset backing should be subject to the discipline of disclosure to better protect the interests of their existing, and potential, members and creditors. Members may find this information useful for various reasons, whether or not an active external market exists for their shares (eg in the exercise of their voting and other rights, pursuant to the Corporations Law or the company's constituent documents). In addition, non-listed public companies may benefit from the proposal for abbreviated prospectuses (Recommendation 16).

Proprietary Companies

Proprietary companies are prohibited from raising money from the public; they have restrictions on the right to transfer shares; and they must limit their members to no more than 50. Given this, it might be argued that continuous disclosure/interim reporting requirements are not necessary. However, the Committee notes that there is still the potential for considerable external involvement in these companies (eg public companies holding shares in non-exempt proprietary companies or holding debt securities in exempt or non-exempt proprietary companies). Therefore, the Committee is of the opinion that where proprietary companies control substantial funds (gross assets in excess of $10 million), it is in the public interest that they be required to keep the market informed of material matters.

Public Sector Corporations that Carry on a Business

Overseas studies suggest that there could be considerable benefits from imposing the recommended disclosure system on public sector corporations. These benefits include:

- enhancing the performance of management by imposing the "discipline" of greater information flows on them;

- assisting Government decisions regarding the allocation of public funds, which could in turn have efficiency benefits for the economy as a whole;

- allowing controllers of public sector corporations to make quicker and more accurate adjustments in operating policies; and

- increasing the capacity of public sector corporations, where appropriate, to privatise operations by imposing similar requirements to private sector counterparts.

The Committee also believes that as the information about public sector corporations could impact on the economy as a whole, the proposed disclosure system would be in the public interest.

Collective investment schemes

The Committee, in conjunction with the Australian Law Reform Commission (ALRC), has been requested by the Federal Attorney-General to review the regulation of collective investment schemes including, but not confined to, prescribed interests. The ALRC/Advisory Committee's Issues Paper No 10 *Collective Investment Schemes* (September 1991) raises the question of whether all or some of these enhanced disclosure proposals should be applied to those forms of collective investments which are not prescribed interests. This matter will be considered in the context of that review.

Exemption of wholly-owned subsidiaries: Recommendation 2

The Committee proposes that a wholly-owned subsidiary to which accounting relief is provided by the ASC, pursuant to s 313(6) of the Corporations Law, should be exempted from the enhanced disclosure regime. The Committee believes that this exemption would significantly lessen the reporting obligations for corporate groups, while the interests of equity and debt investors in subsidiaries would be protected by the requirement that cross-guarantees be in place: ASC Instruments 240/91 and 241/91.

Material Matter: Recommendation 4

The Committee favours adopting the general test of materiality as found in the Corporations Law s 1022(1), in addition to the more specific market tests employed in ASX Listing Rule 3A(1). On one interpretation, the s 1022(1) test is sufficiently wide to include the Listing Rule tests, but to overcome any doubt, and as a guidance to disclosing entities, all these tests are included.

The s 1022(1) test will equate continuous disclosure with prospectus disclosure, providing investors with similar information. It will inform and thereby protect those investors in secondary market trading who do not have the benefit of a prospectus.[3] This requirement will also assist disclosing entities to issue abbreviated prospectuses (Recommendation 16).

Possible Exemptions from Continuous Disclosure: Recommendation 6

Material matters: Carve-outs

The Committee favours the inclusion, in the Corporations regulations, of a list of items exempted from the continuous disclosure requirement (carve-outs). These exemptions would be developed and amended over time, but initially at least might include the following:

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3. Refer Corporations Law eg s 1018(2)(5) and s 1030(1A) (as proposed in the Corporations Law Amendment Bill (No2) 1991).

- any item of intellectual property which, if disclosed, could provide commercial competitors with information that would significantly benefit them to the detriment of the disclosing entity;

- information as to the impact of external political, economic or social developments, except where its effect on the disclosing entity is uncharacteristic of the effect generally experienced by other disclosing entities engaged in the same industry or business.

Approval by members

The Committee considered, but resolved not to support, any provision allowing all or a proportion of the members of a company or other disclosing entity, to exempt it from disclosure. The Committee notes that such an exemption power is available to members in the context of takeovers (Corporations Law s 619), but points out that takeover bids are concerned with the composition of the membership of companies. The proposed disclosure has a wider application (eg for the benefit of creditors or debenture holders).

Sealed envelope disclosures: Recommendation 7

The Ontario Securities Act, which provides for continuous disclosure, contains an exemption for "sealed envelope" disclosures. In lieu of disclosure, a reporting issuer may, pursuant to Policy Release 40 (1987), file a Form marked "confidential" with the Commission, including stated reason for non-disclosure (refer Annexure 2). If the issuer wants this information to remain confidential, it must advise the Commission in writing every ten days from the date of filing of the Form.

The Advisory Committee does not favour this approach in Australia. It believes that greater certainty would be achieved by introducing specific categories of exemption or "carve-outs" from disclosure (Recommendation 6). In addition, the Australian securities market is considerably larger than its Ontario counterpart, making the administrative responsibilities associated with such a system unduly onerous.

Time Limits on Disclosure: Recommendations 8 and 18

Table 1 (below) indicates the differences between the Advisory Committee and the ASX concerning the time limit on disclosures. The Committee takes the view that a requirement for "immediate" disclosure of all material matters could promote the release of unreliable information or place too onerous a task upon management. Instead, the Committee proposes an optional two-step disclosure system to ensure that the market is promptly informed, with a further two business days to provide full details. The Committee also believes that a time limit of 75 days, rather than 3 months, for lodging half-yearly reports would be more appropriate, in the interests of reasonable timeliness.

TABLE 1
TIME LIMITS ON DISCLOSURE

Type of Disclosure	ASX	Committee
Material Matters	"immediately"	mandatory 24 hours (press release) and optional further 2 days (full details)
Half-Yearly Reports	3 months	75 days

ASC and ASX Continuous Disclosure Obligations: Recommendation 9

The Committee's proposals concerning continuous disclosure would not impose significant additional burdens for listed public companies. Given that the tests of "material matter" in Recommendation 4 encompass ASX Listing Rule 3A(1) (as proposed to be amended in the ASX June 1991 Paper), listed companies could simultaneously satisfy the Listing Rule requirements in complying with their statutory obligations. The ASX would retain a key role in monitoring compliance by listed companies with the Listing Rule and, in consequence, the statutory reporting obligations.

ASC and ASX Disclosure Systems: Recommendations 10 and 26

A disclosure system relying upon the ASX Listing Rules could, at best, be only partially effective. In particular, the Listing Rules:

- apply only to a limited number of companies;

- suffer from uncertainty concerning their enforceability both generally and against individual directors (eg Hillhouse v Gold Copper Exploration NL (No 3) (1988) 14 ACLR 423); and

- of themselves, impose no criminal or civil liability in the event of their breach. Individual investors would have no recourse against defaulting directors.

In contrast, statutory requirements for continuous disclosure, utilizing the ASC DOCIMAGE database, would ensure a more comprehensive, accurate and easily accessible reporting and information retrieval system. These requirements should also be supported by appropriate criminal liabilities and civil remedies.

Reporting Obligations and Liabilities of Directors: Recommendations 11-13

To be effective, a continuous disclosure regime must impose reporting obligations, together with consequential liability for breach, on those persons in the disclosing entity best placed to ensure compliance. The Committee notes that various provisions of the Corporations Law could apply to the issuers of continuous disclosure documents.[4] However, these provisions do not impose an initial compliance obligation. Instead, specific legislative reporting obligations, combined with specific liability provisions, need to be introduced.

In principle, the reporting obligations and liabilities for continuous disclosure should rest on the directors of the disclosing entity and not on the entity itself. This policy would encourage directors to ensure compliance with the reporting obligations and avoid possible detriment to innocent investors or creditors of a disclosing entity against which damages might otherwise be awarded. This reflects an approach already found in the Corporations Law (eg s 205(5)).

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4. These include ss 995 (misleading or deceptive conduct), 999,1000 (false or misleading statements in relation to securities); s 1308(4)-(6) (false or misleading statements in lodged documents) and s 1309 (false information).

The Committee realises that directors may legitimately lack sufficient knowledge, or the opportunity, to identify all material matters for disclosure. Therefore, it believes that to impose a strict liability regime may be too harsh; yet, conversely, to limit the disclosure obligations and consequential liabilities to information of which directors are subjectively "aware" may create an incentive to avoid becoming informed.

The Committee favours creating a combined (objective) "due diligence" and consequential (subjective) "awareness" test for imposing continuous disclosure reporting obligations and liabilities on directors. Under this proposal, directors of a disclosing entity would be required:

- to take all reasonable steps to ensure that the disclosing entity has suitable internal mechanisms in place to identify, and notify directors of, all material matters (the "due diligence" requirement); and
- to accurately disclose (ie free of materially false or misleading statements or omissions) material matters of which they are, or by virtue of the "due diligence" requirement, should be "aware": cf Corporations Law s 1024(4).

Any person who suffers consequential loss from the failure of directors to comply with either of these obligations should be entitled to recover damages from any defaulting director, regardless of whether the director has been convicted of any offence in respect of the contravention: cf Corporations Law s 1005. However, and subject to compliance with the due diligence obligations, a defendant director should have available similar defences as those applicable under the prospectus provisions.[5]

A Statement of Material Matter may contain the content of, reference to, or rely upon, the advice or opinion of an "expert", or otherwise name a particular person. The Committee believes that these persons should be liable only in the same manner as under the prospectus provisions.[6]

These civil liability provisions create a legal relationship between the directors of a disclosing entity and private parties contracting in its securities. They go beyond

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5. See the Corporations Law ss 1007, 1008, (1008A, as proposed in the Corporations Legislation Amendment Bill (No2) 1991), 1011, 1012.
6. See the Corporations Law ss 1099, 1010.

the contractual "privity of contract" doctrine, but may be justified by the reliance that market participants, including the contracting parties, would place on this publicly disclosed information. Liability provisions of a similar nature are found in the tort remedies for negligent misstatements (the Hedley Byrne v Heller principles). Contracting parties may still pursue separate civil remedies in contract, where appropriate.

Abbreviated Prospectuses: Recommendation 16

The Committee believes that, in principle, prospectus issuers should be entitled to incorporate, by reference, information previously disclosed in any Statement of Material Matter. This would significantly reduce the cost and length of most prospectus documents, given that the s 1022 tests of materiality are also employed for continuous disclosure (refer Recommendation 4). It may also lessen any tendency for issuers to favour "large parcel" offerings to institutional or other substantial investors merely to take advantage of the exemption from prospectuses under s 66 of the Corporations Law.

An abbreviated prospectus should set out a list, and the dates of issue, of all Statements of Material Matter lodged in the period since the last fully audited Report. The prospectus should also contain a summary of each of these Statements (refer Annexure 1: Statement of Material Matter, Item 4)

An abbreviated prospectus should state that full details of the information incorporated by reference is recorded on the ASC database, and that these details will be distributed by the disclosing entity, upon request, at no charge. This requirement allow all potential investors to obtain complete information without impediment.

The Committee believes that the right to issue abbreviated prospectuses should not apply to a primary offering of securities, unless the issuer has been a disclosing entity for at least one year immediately prior to the date of the prospectus. Given the lack of any external market-based price, potential investors in primary floats should be given comprehensive information to assess the merits of the offer, except where the issuer has been subject to the enhanced disclosure requirements for a reasonable period.

The introduction of enhanced disclosure requirements also raises the question of the circumstances where further relief from the statutory requirements to prepare a prospectus might be warranted, particularly with secondary trading. This issue will be considered further in the context of the Committee's current review of the Prospectus provisions of the Corporations Law.

No Mandatory Quarterly Reports: Recommendation 17

The ASX October 1990 Paper called for submissions concerning mandatory quarterly reports. However, as reported in the ASX June 1991 Paper, the matter has not been pursued further by the ASX, as the proposal failed to gain enough support from respondents. The ASX has indicated that it may prepare a further discussion paper on the matter.[7] The ASX also expressed concern regarding the costs in maintaining such a system.

While the Committee is of the opinion that there could be considerable merit associated with quarterly reporting - in particular, speeding the process by which underlying economic realities are translated into securities prices - it agrees that quarterly reporting should not be required at this stage. The Government should first assess whether the proposals in this Report, once in practice, provide adequate information. The Committee feels that where a system of continuous disclosure is operating effectively, the benefits associated with statutory quarterly reporting may be substantially reduced relative to the costs of their preparation.

Individual and Consolidated Accounts: Recommendation 20

The Corporations Law s 316 requires a company to provide annual financial statements. Financial statements (as defined under s 9) include the accounts of the entity and, where applicable, consolidated accounts pursuant to Part 3.6, Division 4A.

The Committee recommends that half-yearly reports should be prepared on an individual *and*, if applicable, consolidated basis. By contrast ASX Listing Rule 3B only requires listed entities to provide half-yearly reports on an individual *or*, if applicable, consolidated basis. The Committee supports a dual requirement for the following reasons:

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7. ASX June 1991 Paper, p20.

- consolidated accounts do not necessarily allow all interested persons to make fully informed assessments of their investment in a disclosing entity. In particular, investors may have an interest primarily in the assets of a particular entity, and only limited or residual interests in group assets. Consolidated accounts do not distinguish between these types of interests;

- in order to prepare consolidated accounts, disclosing entities must necessarily prepare individual accounts; and

- it is desirable to ensure consistency between half-yearly and annual reports.

Statements of Cash Flows and Financial Position: Recommendation 22

The Committee is in agreement with the ASX's position, as outlined in its June 1991 Paper, that half-yearly reports should include a statement of cash flows (once an applicable standard has been developed: refer to AAS Exposure Draft 52), and a balance sheet. This might be phased in over a suitable period, say, 2 or 3 years.

Auditor Involvement: Recommendation 24

There has been considerable debate concerning the role (if any) that auditors should have in the provision of half-yearly reports. While most large companies already have continual auditor involvement, the Committee feels that a requirement for small companies to provide fully-audited half-yearly reports would place an unreasonable financial burden on them. However, if there was no auditor involvement, management may have considerable opportunities to manipulate reported results (eg averaging or smoothing income figures over time), making half-yearly reports less reliable. The Committee believes that a statutory requirement for, at least, a limited review of half-yearly reports would act as a middle ground; and that the desirability of full audits for half-yearly reports could be re-examined at a later stage.[8]

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8. The ASX in its October 1990 and June 1991 Papers considered the introduction of limited review of half-yearly reports by auditors prior to their release, but has deferred its decision pending the reaction to the AARF's Auditing Practice Exposure Draft 34 (October 1990). The Foundation is still in the process of finalizing a practice statement.

Auditor liability: Recommendation 33

At common law, auditors are subject to a duty of care, and consequential civil liability stemming from any breach of that duty, to various classes of persons.[9] The Committee believes that these common law principles, as they may be developed from time to time, should apply in this context.

Enforcement: Recommendations 14 and 34

The ASC should be given adequate intervention powers to ensure compliance with the statutory continuous disclosure and half-yearly reporting obligations. The Committee notes the existing mandatory and prohibitory injunction powers available to the ASC under s 1324 of the Corporations Law, which may be adequate in this context.

In addition, the ASC should have suitable civil recovery powers. The Committee notes that the Commission may seek restitutionary orders under the Corporations Law s 1325, or undertake representative public interest actions under the ASC Act s 50. The Committee believes that the ASC's powers should be extended to cover breaches of the enhanced disclosure requirements.

Annual Reporting Requirements: Recommendations 39 and 40

Exempt proprietary companies are currently exempted from filing their annual accounts with the ASC: Corporations Regulations 3.8.02. There appears to be two principal justifications for this exemption from lodgement:

- privacy; and
- practicality.

The Committee has considered whether the financial details of exempt proprietary companies should become a matter of public record. The Committee notes the statutory restrictions on the membership and fund raising activities of

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9. See, for instance, Capro Industries plc v Dickman [1990] 1 All ER 568; 1 ACSR 636; Morgan Crucible Co plc v Hill Samuel Bank Ltd [1991] 1 All ER 148; 4 ACSR 207.

these companies: Corporations Law ss 69, 116. However, it believes that as these companies enjoy the privilege of limited liability, they should be required to disclose the contents of their annual accounts. This information may be of interest to existing or prospective creditors and other persons who deal with these companies. The current requirements concerning the preparation of key financial data is consistent with this policy of disclosure.

The Committee has also considered whether these further disclosure requirements would be workable, both for exempt proprietary companies and the ASC. It notes that exempt proprietary companies must prepare annual accounts in accordance with Part 3.6 Div 4 and Schedule 5 of the Corporations Law. To require that a copy of these accounts be lodged with the annual return would not impose a material addition burden upon them.

The Committee has been advised that the ASC has the capacity to include these accounting details on its DOCIMAGE database, and that the proposed changes are administratively workable.

The Committee has considered whether exempt proprietary companies that have appointed an auditor should be obliged to include key financial data in their returns. It believes that given the recommendation that all exempt proprietary companies include accounts in their annual returns, it would be anomalous if some of these companies could omit the key data explaining these accounts. The Committee favours a uniform policy of dual disclosure.

Annexure 1

STATEMENT OF MATERIAL MATTER

Item 1 : Reporting entity

State the full name, Australian Company Number, and address, of the principal office in Australia of the disclosing entity.

Item 2 : Date of Material Matter

Item 3 : Press Release

State the date and place (s) of issue of the press release (if any), and attach a copy hereto.

Item 4 : Summary of Material Matter

Provide a brief but accurate summary of the nature and substance of the material matter.

Item 5 : Full Description of Material Matter

Supplement the summary required under Item 4 with a disclosure which should be sufficiently complete to enable a reader to appreciate the significance of the material matter without reference to other material. Management is in the best position to determine what facts are significant and must disclose those facts in a meaningful manner.

The description of the significant facts relating to the material matter will therefore include some or all of the following: dates, parties, purpose, terms and conditions and financial or dollar values of transactions; description of any reassessment of the reporting entity's financial condition or value of assets; reasons for any material matter, and a general comment on the probable impact of the material matter on the disclosing entity or any other entity it "controls". Specific financial forecasts would not normally be required.

Copies of relevant contracts or other documents may be annexed to this Statement.

The above list merely describes examples of some of the facts which may be significant. The list is not intended to be inclusive or exhaustive of the information required in any particular situation.

Item 6 : Contact Officer

State the name and business telephone number of one or more senior officers of the disclosing entity who are knowledgeable about the material matter, or an officer through whom each relevant senior officer may be contacted.

Item 7. : Statement of Director

Include a statement in the following form signed by a director of the disclosing entity: -

> "The foregoing accurately discloses the material matter referred to herein."

Also include date and place of making the statement.

[Statement of liability for misrepresentations or material omissions].

Annexure 2

OVERSEAS REQUIREMENTS

Various overseas countries require issuers of public securities (through listing rules and/or Government regulations) to keep the market constantly informed of material changes in anticipated performance. North American countries, in particular, have developed detailed requirements for continuous disclosure and interim reporting.

USA

Continuous disclosure

The Securities Exchange Commission (SEC) by virtue of Rule 13a-11 requires publicly-owned companies to file current reports on Form 8-K upon the happening of material events. These events include:

- changes in control of the registrant (within 15 calendar days);
- the acquisition or disposition of assets (within 15 calendar days);
- bankruptcy or receivership (within 15 calendar days);
- a change in auditor (within 5 business days);
- resignations of directors (within 5 business days);
- change in fiscal year (within 15 calendar days); and
- "other events" (no time limit).

While the SEC has cautioned that material developments in addition to those specifically required under 8-K are subject to prompt disclosure by way of press release or otherwise[1] there is some doubt as to whether the Commission imposes

1. SEC Release No. 34-8995 (October 15, 1970).

an affirmative disclosure duty beyond the line-items required to be disclosed by the Exchange Act or SEC rules.[2]

The New York Stock Exchange (NYSE) imposes a broader disclosure requirement than the SEC. It requires listed companies to release quickly to the public, any news or information which might reasonably be expected to materially affect the market for their securities [Section 202.05]. This is described by the Exchange as "one of the most important and fundamental purposes of the listing agreement". The rule also states that a listed company should act promptly to dispel unfounded rumours which result in unusual market activity or price variations.

Interim reports

Section 13(a)(2) of the *Exchange Act* requires most publicly-owned companies to provide quarterly reports. These reports are generally filed on Form 10-Q, within 45 days of the issuers' fiscal quarter-year end [rule 13a-13b]. 10-Q filings must include income statements (most recent quarter, year-to-date and corresponding periods of the previous fiscal year) and balance sheets (end of current quarter and end of preceding quarter) [Reg. S-X, 210.10-01c]. Registrants are not required to prepare 4th quarter 10-Q statements, although they are encouraged to do so. Certain public companies are exempted from filing 10-Q reports (eg investment companies filing reports under rule 13a-12) while certain others (eg particular life insurance companies, mutual life insurance companies and mining companies) are not required to complete part 1 of the report.

There SEC does not require that 10-Q statements be sent to shareholders. Nevertheless, many U.S. companies adopt this practice.

There is also no requirement for 10-Q statements to be audited. However, in the *Accounting Standards Release* No. 177 (1975), the SEC announced a requirement that certain registrants (those exceeding a pre-specified size or trading volume) must disclose selected quarterly data in a note to their annual reports [Reg. S-K, Item 302]. This note must include a reconciliation of the four quarterly results to annual results, and be reviewed by an auditor on a "limited review" basis.

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2. Refer to Hazen, (1989), *The Law of Securities Regulation,* West Publishing Co., Minnestota, pp 353-354.

An feature of 10-Q filings is a discussion and analysis of interim period results by management (requirements regarding the nature and scope of this are contained in Reg. S-K, Item 303). A similar requirement exists in the case of annual filings.

The NYSE requires the majority of listed companies to file quarterly reports.[3] In contrast to the SEC requirements, there is no specific time limitation for reporting - companies being required to supply statements "as soon as possible" [Section 203.02]. There is no requirement for fourth quarter earnings reports, but items of an unusual or recurrent nature should be reflected separately in the full year earnings release. The Exchange has the power to exempt companies from having to provide quarterly reports if they would be impractical or misleading (eg due to seasonal factors).

The large majority of U.S. State Corporations' Acts do not require privately-owned companies to publish interim reports (quarterly or half-yearly). Those exceptions are Colorado, New York, Texas and Utah.

Canada

Continuous disclosure

Section 74 of the Ontario *Securities Act* (which applies to most of the public issues of shares or debt in Canada) requires reporting issuers, upon a material change in their affairs, to immediately issue and file a press release outlining the nature and substance of the change, as well as file a report with the Ontario Securities Commission (OSC) as soon as is practicable and in any event within ten days of the date on which the change occurs. The prescribed form of disclosure is set out in the Commission's "Form 27". There are two exceptions to this rule:

- where the issuer feels that such a disclosure would be "unduly detrimental" to the company;

- where the material change consists of a decision to implement a change made by senior management of the issuer who believe that confirmation by the board of directors is probable and senior management of the issuer has no reason to believe that persons with knowledge of the material

3. A similar requirement exists in the case of the American Stock Exchange.

change have made use of such knowledge in purchasing or selling securities of the issuer.

In either of the above circumstances the reporting issuer may defer issuing a press release, and file a Form 27 marked "confidential" with the Commission. This filing must include stated reasons for non-disclosure. If the issuer wishes for this to remain confidential it must advise the Commission in writing every 10 days after the date of filing until it decides to generally disclose the change.

The Canadian National Policy Statement No. 40 (1987) outlines those matters that the Commission considers "material" (part d) and provides examples of certain instances where disclosure might be detrimental to an issuer's interests (part g).

Interim reports

Section 76(1) of the Ontario *Securities Act* requires every reporting issuer to file reports for the period commencing at the beginning of their fiscal year and ending three, six and nine months respectively before the date at which that year ends (the exception being mutual funds which report semi-annually).[4] Each filing must be made within 60 days of quarter year-end. Section 78 of the Act requires that they be sent to all security holders other than of debt instruments (this can be contrasted to the U.S. position noted above).

The OSC does no prescribe a form for quarterly reporting, although section 7 of the Regulations to the *Securities Act* (hereafter "the Regulations") provides that they must consist of an income statement and a statement of changes in financial position. Further, where the issuer is primarily engaged in the business of investing, it must file a statement of changes in net assets for the period. Section 8 of the Regulations states that quarterly reporters must also provide comparative statements to the end of the corresponding period in the last fiscal year. There is no requirement for these to the subject of a full audit or a limited review (Regulations - section 9).

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4. The Canada Corporations Act does not deal with the issue of interim reporting, and there is no equivalent of US Exchange Act. Most of the other Canadian states or provinces require semi-annual reporting by public companies.