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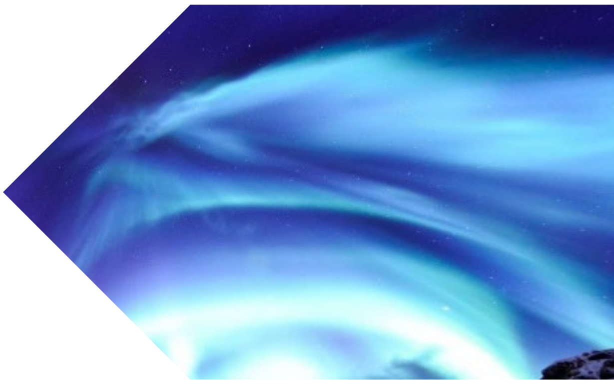
CREATING EFFECTIVE OPERATING AND FINANCIAL REVIEWS



Understand what is required to create impactful, useful operating and financial reviews, in line with legislation and related guidance.

The Operating and Financial Review (OFR) is a key document that supports and complements the annual financial report of listed entities. It is the entity's opportunity to tell their story, providing explanations for the performance during the year and how it has set the organisation up for the future.

The requirements for the OFR are set out in s.299A of the *Corporations Act (2001)*, however the simplicity of the requirements in the Act, hide the complexities that can arise in preparing a comprehensive OFR. The requirements are the same no matter the size of the listed company.

ASIC released ASIC Regulatory Guide RG 247 *Effective disclosure in an operating and financial review* which provides further guidance on their expectations of how the requirements of s.299A will be complied with. This further emphasises that although less details may be sufficient for smaller listed companies, there are still minimal requirements that need to be addressed by the OFR.

ASIC FOCUS

OFR disclosures have been included as an area of focus in the ASIC semi-annual Financial Reporting and Auditing Focus areas for a number of years and they have been taking actions against entities based on inadequate disclosures in the OFR. As a result of the ASIC financial statement review for June 2022 – June 2023, 18 companies were required to enhance their disclosures around business risks in the OFR.

It is important to understand what the requirements are and ensure that you comply with ASIC's expectations, so that you can minimise your risk of being subject to ASIC actions.

The contents of the OFR is generally broken down into the following sections:

- Review of operations and financial position
  - *Financial Performance*
  - *Financial Position*
- Business strategy and prospects
  - *Business strategies*
  - *Prospects, including risks*

REVIEW OF OPERATIONS AND FINANCIAL POSITION

This section of the OFR looks backwards at what has happened to the entity during the year. It predominantly looks at events that have impacted the statement of profit or loss or anything that has resulted in a significant change in the statement of financial position.

The review of operations and financial position is designed to supplement the financial report and provide a narrative around what has occurred during the year, to better help users contextualise what is in the financial report.

Accordingly, it should provide an explanation of the underlying drivers of performance and not just state what has happened during the year.

Ideally where there have been forecasts or estimates provided in the prior year OFR, or other public documents, the OFR will also include a discussion of how performance compares to that prior year's forecast.

The following examples demonstrate the difference between a poor quality OFR commentary and a better quality and more detailed commentary.

> The Group Revenue of $35,382,442 in FY23 (2022: $32,165,090) has increased 10% during the year.

This disclosure fails to analysis why the revenue has increased during the period.

> The Group Revenue of $35,382,442 in FY23 (2022: $32,165,090) has increased 10% during the year. This growth has been driven by an increase in demand for product X as the market continues to acknowledge its superiority over competitors' products. This has been offset by a reduction in sales of product Y as the Group lost a key distributor during the year.

This disclosure provides an explanation of what has driven the performance for the each major product line and including explaining factors that have offset the performance

Financial Position

When discussing the change in the financial position for the year, it is important to discuss all the drivers of that change, not just focus on the items that have impacted the profit for the period. This might include a discussion of the following:

- Debt transactions
- Equity raisings
- Business combinations
- Demergers
- Significant asset acquisitions or disposals
- Changes in working capital accounts

Each entity is going to have different drivers of change in its financial position, but it is important that you provide sufficient detail so that the users can understand what has occurred during the year.

BUSINESS STRATEGY AND PROSPECTS

The second part of the OFR is forward looking in nature and looks at the entity's strategies and prospects for the future.

Although there is no set time frame required by the Act, it does say that the discussion should be on prospects and how the strategies impact the entity in future 'years' therefore it would be prudent to assume that the discussion needs to look further forward than just the next twelve months.

Although this talks about future prospects, you are not required to include financial forecasts in the OFR and a discussion is sufficient.

Business Strategy

The business strategy should outline what the key plans of the business are, and the level of detail required should reflect the size and complexity of the business. It would be very rare that you are unable to provide some level of discussion about the company's strategy.

Some entities seek to rely on the 'unreasonable prejudice' exemption to not disclose anything about their business strategy. This is unlikely to be appropriate in most circumstances, especially if any information on the business strategy is already available in the public domain. (See below for further discussion on the 'unreasonable prejudice exemption'.)

Material business risks

In addition to the future Prospects, the OFR should also include consideration of the material business risks that may stop your entity from being able to achieve their strategies.

This is a key area where ASIC has had significant issues as part of their annual report review program. The general view of ASIC tends to be that whilst entities are inclined to provide reviews of their business strategies and the potential positive future, they tend to not give sufficient consideration to the material business risks. It is important that the OFR is unbiased and therefore discusses the reality that these risks exist and the challenges that they pose to your entity.

The risks included in the OFR should be explained in context.

- Why has this risk been chosen?
- Why/How could it materially impact your ability to meet your business strategies?
- What, if anything, has the company done to try and mitigate or manage this risk.

Consider also discussing how the risk has changed over time, is the risk more or less heightened compared to the prior year, and what your expectations are as to how the risk will change in the future.

When discussing risks you should ensure that the risks are entity specific risks that will materially impact your ability to achieve your strategy, and not a generic list of risks that may impact all entities, and may not have a significant impact on you.

For instance, increasing interest rates can be a general business risk, however, if your business does not have significant debt and/or customer demand is not significantly driven by increasing interest rates, it may not actually be a material risk to your entity and your ability to meet your strategy.

Although ASIC does not want to see a long list of generic risks, there will be material business risks that are pervasive to a wide range of entities. In the current environment it is important that companies consider whether the following are material business risks:

- Cybersecurity
- Environmental, Social and Governance (ESG) issues, including climate-related risks

If these are material business risks, you should ensure they are adequately discussed.

NON-IFRS INFORMATION

It is not uncommon for entities to use bespoke measures of performance such as 'normalised profit' or other similar measures in their OFR. These can be really useful and important measures for entities to use, as it allows you to consider what you may perceive as 'core' earnings and reflect the elements that management focus on when looking at how the business is performing. If non-IFRS measures are used by management and Boards to manage the business's performance, then it is absolutely appropriate that they are disclosed in the OFR when you are discussing performance.

However, these are considered non-IFRS measures because they are not determined in accordance with the Accounting Standards. Therefore, to ensure that the use of non-IFRS information is not misleading, ASIC has provided guidance in ASIC Regulatory Guide 230 *Disclosing non-IFRS financial* *information*. RG 230 requires that the Non-IFRS information be appropriately explained and presented to ensure that it is not misleading. The key elements of this guidance is to ensure that the presentation of non-IFRS information meets the following guidelines:

- *Prominence*
  Non-IFRS information should have equal or lesser prominence than the corresponding IFRS information.

- *Appropriate Label*
  Clearly identify the non-IFRS information and making it clear that it is not calculated in accordance with accounting standards.

- *Calculation methodology*
  Explain how the non-IFRS information is calculated.

- *Reconciliation*
  Provide a reconciliation between the non-IFRS measure and the corresponding IFRS measure, showing each of the key reconciling items.

- *Usefulness*
  An explanation should be provided as to why the directors consider the non-IFRS information to be useful, and be entity specific and not boiler plate.

- *Consistency*
  Non-IFRS information should be calculated in the same way each year. Any changes in approach should be explained. Additionally, it should be consistent with the corresponding IFRS information, and if IFRS information has been restated the related non-IFRS information should also be consistently restated.

- *Unbiased*
  Non-IFRS information should be unbiased and not be used purely to remove 'bad news' from the IFRS measure.

- *One-off items*
  Items should not be described as 'one-off' or 'non-recurring' if they have occurred in the past or are likely to occur again in a future period.

- *Assurance*
  It should be clearly stated whether the non-IFRS information has been audited or reviewed.

Refer to RG 230 for further information on the use of non-IFRS financial information.

INTERACTION WITH CONTINUOUS DISCLOSURE REQUIREMENTS

The OFR should not replicate disclosures that are made in ASX announcements and other continuous disclosures that the entity makes and neither can one be a substitute for the other. Each type of document has a specific role to play in informing the needs of users.

Given that the OFR provides a summary of what has happened during the year, it may be that you don't need to provide the extent of the details that you have provided in other market announcements during the year, which may be quite granular. A higher-level summary may be sufficient for users to understand what has happened and the relevance to the overall change in financial position and performance for the year. However, you should also not rely on the fact that there has been a market announcement to avoid providing any details at all. For example, consider the following:

> The Group undertook a capital raising on 24 March 2024 - refer to ASX announcement for further details.

This does not provide readers of the OFR with sufficient details of the capital raising or provide any context of the purpose of the capital raise.

> On the 24 March 2024, the group issued two million shares at $1 a share, to raise $2 million to fund the expansion of the production facilities in Melbourne. The Shares were issued to X Co who have increased their shareholding to 15%. The closer alignment with X Co is beneficial to the Group as it allows us to build a strategic alliance and engage with them on the use of their advanced production techniques.

This provides the reader of the OFR with an overview of the details of the capital raising and the rationale for it as well. It is likely that that this level of detail is included, the OFR would also include a broader discussion about the expansion of the production facilities as well.

> On the 24 March 2024, the group issued 2 million shares at $1 a share, to raise $2 million. <Duplicate details from ASX announcement here>

Replicating the ASX announcement is likely to provide too much detail for the OFR which is unlikely to be necessary for users to understand the rationale and key details of the capital raising for the purpose of the OFR.

There may, however, be instances where it is appropriate to go into additional details in the OFR compared to what has been included in a previous market announcement, especially if there are further developments or context that may be required.

RELATIONSHIP BETWEEN OFR AND PROSPECTUSES

ASIC does not expect that an OFR will include the same level of detail as that which is included in the Prospectus. When people are viewing the OFR they have the benefit of receiving it as part of the annual reporting suite and the additional information provided there in, compared to a prospectus which is more of a stand-alone document.

However, companies do need to be mindful of information that they have disclosed in the prospectus when preparing the OFR. Where the company has discussed future strategies and opportunities in its prospectus, it is appropriate that the OFR provides an update on the implementation of those strategies and how the business has maximised those opportunities.

THE USE OF THE UNREASONABLE PREJUDICE EXEMPTION

The Act does provide entities with relief from providing information about business strategies and future prospects if that is likely to result in 'unreasonable prejudice' against the entity. However, you should consider carefully before applying this exemption.

In order to apply this exemption you should be able to justify why the disclosure of information would cause unreasonable prejudice against your entity. This is important because it could help you to narrow down the specific information that should be excluded rather than making wide sweeping claims of unreasonable prejudice. For example, it may be possible to provide a high level overview of a strategy or contract, without going into specific details, which may alleviate the need to rely on the exemption.

When considering whether to apply that exemption it is important to consider what information is already available in the public domain. For example, it is not reasonable to claim that information that has been disclosed in other publicly available documents, such as prospectuses and investor presentations should be excluded from the OFR on a basis of unreasonable prejudice, as that information is already publicly available.

If the entity does rely on the unreasonable prejudice exemption it must state that it is doing so. Best practice would be to explain the type of information that has been excluded and the reason that the exemption has been applied.

AUDITORS OBLIGATIONS

Your OFR is not subject to audit. Your auditor will read your OFR prior to the finalisation of the audit of the annual financial report to ensure that there are no material inconsistencies between the financial statements and the 'other information' (the Directors' Report in this instance). This is a requirement to ensure that there is nothing that has been missed in preparing the financial statements, rather than to check the OFR.

Some auditors will provide feedback and comments on the disclosures in the Directors' report, but ultimately, it is your decision as to what you disclose and the Auditor does not have any responsibility for the appropriateness of those disclosures. Accordingly, you should not rely on your auditors to determine that your disclosures are sufficient.

NEXT STEPS

The OFR is an important part of your annual reporting suite, and an important tool to tell your company's story, as well as being an ASIC area of focus. Therefore, it is worthwhile considering what you are intending to disclose in your upcoming OFR and ensure that you are consistent with the principles of the ASIC RG 247 *Effective disclosure in an operating and financial review*. This will minimise the risk of ASIC taking action against you in the future.

For further assistance, please contact your local Moore Australia advisor, who can assist you in drafting your OFR in line with ASIC expectations along with your other annual reporting obligations.