

THE USE OF NON-STANDARD PRICE QUERIES BY THE ASX IN THE ENFORCEMENT OF AUSTRALIA'S CONTINUOUS DISCLOSURE REGIME

Cary Di Lernia

Abstract

A crucial element of market regulation in Australia geared towards achieving and maintaining market integrity is the obligation of listed and other disclosing entities to continuously disclose material information to the market: ASX Listing Rule 3.1. ASX Compliance (a wholly-owned subsidiary of ASX Ltd) fulfils the ASX's market oversight obligations by monitoring and enforcing compliance with the market's operating rules. If concerned that less than transparent behaviour may have been responsible for unusual movement in a company's share price or trading volumes the ASX may issue a query to the company concerned. Details of the response and the query sent by the ASX are then made available through the announcements platform on the ASX website. This paper analyses corporate responses for the period January 2009 to December 2010 and explains corporate practice surrounding a specific subset of such queries with a view to informing best practice in the area.

1. Introduction

Information is the lifeblood of the market. In an informed market, investors have confidence because they have full possession of the information they need to make an informed investment decision. This ultimately builds market liquidity and depth.

The integrity of the price discovery process is essential to the operation of modern financial markets. More specifically, the provision of material information relating to the existence of listed organisations is crucial in maintaining investor confidence in securities markets. Australia's continuous disclosure regime requires the release of material information to ensure the market is fully informed and that uninformed investors are not disadvantaged by the lack of availability of information which might affect their investment decisions. Other important goals including allocative efficiency and more widely the encouragement of international capital flows into Australia are also served by the continuous disclosure regime.

While the full extent of compliance may never be known¹, analysis of company management of the continuous disclosure obligation provides insights into the nature of compliance with the regime, which is important to shareholders and potential investors, as well as regulators. This paper analyses company responses to a specific subset of ASX price and volume queries, which constitute an important point at which to understand corporate compliance and best practice surrounding lower level enforcement of the continuous disclosure regime.

2. The enforcement regime

The crucial element of financial market regulation in Australia geared towards achieving and maintaining market integrity is the obligation of listed and other disclosing entities to continuously disclose material information to the market. The continuous disclosure obligation is found in Listing Rule 3.1 of the Australian Securities Exchange listing rules and currently states:

Once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information.

¹ This is due to the potential lack of a perceptible effect of non-disclosure, for example, withholding material information a reasonable person would expect to be released which remains confidential until released at a later date, and which has no impact on security prices or trading volumes.

There are a number of legitimate exceptions which companies might avail themselves of to avoid the need for disclosure in certain circumstances.² Inadequate disclosure of material information concerning the future and fortunes of listed companies can detract from the integrity of the market and its ability to provide a fair and efficient mechanism for participation in securities markets. Reduced confidence in corporate credibility and the fairness of financial markets can affect market liquidity. Longer-term flow on effects may also be felt throughout the economy in the form of higher interest rates and fewer growth opportunities.³

It follows that the enforcement of the continuous disclosure regime is of great importance and as such should represent a key objective for market regulation. The responsibility for administering the continuous disclosure regime lies at the feet of both the ASX and the Australian Securities and Investments Commission, with ASIC handling higher and middle level enforcement mechanisms including legal action and infringement notices. The ASX's role as a market operator listed on its own exchange includes monitoring trading activity and potential continuous disclosure breaches, engaging in communication with companies suspected of breaching the requirements, and informing ASIC of problematic cases warranting further investigation.⁴ This paper is focussed on this lower level of enforcement as it forms the frontline for enforcement of the regime, evidenced by the frequency of activity compared with middle and higher level sanctions. Most research around the regime has focussed on middle and higher level sanctions while comparatively little has been written concerning other lower end enforcement activity. This is regrettable as it is arguably where the majority of the work involved in attempting to generate and maintain market integrity is being done, and where improvements might be made to the regime to make it more effective on a day-to-day basis.

Price queries and aware letters are important frontline elements in the enforcement of the continuous disclosure obligation. This is because they demonstrate that material price and volume changes are pursued by the ASX to obtain further evidence of non-compliance, which if serious enough will warrant being forwarded on to ASIC for higher level enforcement action. Indeed the process itself is productive of the release material information by companies in some cases. The analysis of company responses to these price queries can therefore yield valuable insights into the operation of the regime at a practical level and whether any recommendations might be made to improve disclosure practices in the market.

3. Data and methodology

Section 792A of the *Corporations Act 2001* (Cth) requires the ASX as a licensed market operator to 'monitor and enforce compliance with its Listing Rules'.⁵ ASX Compliance uses human and computerised monitoring methods to detect potentially suspect disclosure behaviour, usually evidenced by price or volume movements.⁶ In such circumstances ASX Compliance will contact the relevant member of staff appointed to deal with such issues at the organisation, who will be asked by the ASX whether they are aware of information which might explain recent trading in the company's securities, whether protected by the exemptions or not.⁷

² 3.1A Listing Rule 3.1 does not apply to particular information while all of the following are satisfied.

3.1A.1 A reasonable person would not expect the information to be disclosed.

3.1A.2 The information is confidential and ASX has not formed the view that the information has ceased to be confidential.

3.1A.3 One or more of the following applies.

- It would be a breach of a law to disclose the information
- The information concerns an incomplete proposal or negotiation
- The information comprises matters of supposition or is insufficiently definite to warrant disclosure
- The information is generated for the internal management purposes of the entity
- The information is a trade secret

³ Companies and Securities Advisory Committee, *Report on An Enhanced Statutory Disclosure System* (1991) 6–7. <[http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+1991/\\$file/An_Enhanced_Statutory_Disclosure_System,_September_1991.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+1991/$file/An_Enhanced_Statutory_Disclosure_System,_September_1991.pdf)>.

⁴ 'ASX Issues Please Explain ... to Itself', *Sydney Morning Herald* (Sydney), 28 September 2010, at <http://www.smh.com.au/business/markets/asx-issues-please-explain-to-itself-20100928-15uj6.html>.

⁵ Section 792A(c)(ii).

⁶ Australian Securities Exchange, *ASX Listing Rules: Guidance Note 8*, at [8.1]. See <<http://www.asx.com.au/documents/rules/guidance-note-8-clean-copy.pdf>>.

⁷ Australian Securities Exchange, *ASX Listing Rules: Guidance Note 8*, at [8.2]:

Depending on the answers received, ASX will decide whether to issue a price or volume query in order to determine whether the entity is in compliance with its continuous disclosure obligations.⁸ Queries pose four standard questions centered around whether the company is aware of any information concerning it which has not been announced, or whether it has another explanation which might explain recent trading activity in the company's securities.⁹

Additional questions are also asked in certain circumstances, which are more specifically oriented to the company concerned, and which are the focus of this paper. While the price of volume movement triggering the ASXs concerns may lead to a conclusion of inadequate disclosure performance, a presumption of innocence must attend the digestion of corporate responses as many (and unknown) factors might have caused the change queried.

This paper examines price queries issued by the ASX for the period January 2009 to December 2010. The Australian Company Announcements database hosted by the Securities Industry Research Centre of Asia-Pacific (SIRCA) was the primary source of data for this analysis. Of a total of 1209 price queries for the period, 343 asked one or more further questions in addition to the four standard questions noted above. These questions focused on profit projections and/or the potential for material abnormal items to be included in a company's financial accounts for a particular period.

Of the 45 queries which asked only one additional question, the most common was whether the company was expecting to report any material abnormal or extraordinary profit (or loss) for the period (28), with the remainder (17) asking in a similar vein regarding results, whether the company expected to see a change in operating results which would vary from the previous financial year or alternatively a change in earnings guidance by more than 15%.

While the broader aims of the 298 queries which asked more than one additional question were similar, they were expressed in different ways, some referring to 'earnings before interest, depreciation and amortisation' (EBITDA), others to 'net profit, operating loss/profit or results' depending on the company's business and prior performance. The second additional question asked was whether the company had any reason to think it might record any material abnormal or extraordinary items or material abnormal or extraordinary profit for the period referred to.

4. Analysis

Responses advising of no material change

247 responses to non-standard price queries answered that they were not aware of any reason to expect a change in either operating results or abnormal or extraordinary items when compared to the previous corresponding period or previous guidance issued by the company. The majority answered in the negative simply with a 'no', with the remainder confirming previous statements made, often stating that current expectations within the organisation remained within a guidance range previously provided.¹⁰ Others provided detail relating to previously announced information which made the company's trajectory and possible results clear to investors without necessarily stating a range within which results would fall. Such responses are generally unproblematic as far as compliance with the regime is concerned as investors had already apparently been informed of either a relevant range or material factors which could come to impact results.

Given that the crystal ball on the boardroom table is susceptible to the vagaries of business and economic conditions with the result that a sidewind might come to impact upon forecasts, some companies placed a caveat on their

When asked this question, that person is expected to answer it frankly and honestly and, if there is any such information, to tell ASX of the general nature of the information, even if he or she considers the information to be confidential and not something that otherwise requires formal disclosure to ASX under Listing Rule 3.1A. A failure to do so will deny ASX the opportunity to assist the entity with its disclosure obligations when that could be of benefit to the entity and to the market. Refusing to answer the question will also constitute a breach of Listing Rules 18.7 and/or 18.8 entitling ASX to suspend trading in the entity's securities under listing rule 17.3.1, while answering it dishonestly may constitute a criminal offence under section 1309.

⁸ Australian Securities Exchange, *ASX Listing Rules: Guidance Note 8*, at [8.2].

⁹ Note that these are the standard questions asked during the period under investigation, and that ASX has made some amendments to the questions it now asks, see Australian Securities Exchange, *ASX Listing Rules: Guidance Note 8*, at [8.3].

¹⁰ SSM Limited price query response dated 14 September, 2010.

responses stating that while they did not expect to be outside of previous guidance or the previous corresponding period that other factors might come to impact those expectations:

The Company does not expect that its operating results before abnormal items and income tax will vary by more than 15% as compared to the previous corresponding period. However, fluctuations in the AUD:USD exchange rate and the potential generation of performance fees from funds managed by the Group may have an impact on the Company's actual operating result.¹¹

Changes in accounting policies employed by respondents as a result of regulatory changes also figured as caveats on such responses¹², as did the potential effects of hedging facilities used by the company.¹³ The timing of the issuance of the query also played a role in tempering a company's claims not to expect any material variations, with some stating no change was expected but that a clearer picture would emerge once accounts for a particular sub-period had been finalised.¹⁴ Such responses have been treated as unproblematic as such sidewinds are not factors over which management have any real control (except in some instances as to timing of the adoption of new accounting and other policies) and so their underlying projection or expectation that the company would not report any material change should ordinarily fairly be accepted.

Despite not expecting to see a change in results of a material magnitude, one company was quite specific in its response:

It is expected that the first half result pre tax will be approximately 8% over the December 09 comparative period. Profit after tax is expected to be between \$6.7 million and \$7 million for the full year, up from \$5.5 million in 2010 (an increase of between 21.8% and 27.3%). The effective tax rate for 2011 is expected to return to 30% up from 26% in 2010 following the benefit received from the Federal Government Investment tax allowance which was finalised in December 2009.¹⁵

It is understandable that not all companies can provide this sort of detailed guidance within a few days of receiving an ASX query, though the clearer the guidance in a "no" answer the better prepared investors can be.

Certain organisations reported operational results from month to month, in effect regularly disclosing the organisation's progress:

Based on the announcements made to market on a monthly basis in relation to funds under management and performance of the investment funds there is a likelihood that operating results will vary from the December 2008 period. The extent of this variation is unknown due to it being largely dependent on future movements in funds under management and performance of the investment funds. Funds under management and performance continue to be disclosed on a monthly basis to ASX.¹⁶

While it is important for certain organisations to continue updating the market in piecemeal fashion regarding operations and their impact on period to period results, should the cumulative effect of a group of these announcements, which may not be material in themselves, tip the scales and send the company into territory where a material change is likely on the cards, it makes sense to summarise these changes and explain their import as a group on the accounts likely to be lodged.¹⁷ If they are not and only become released by virtue of a price query there is likely no need for alarm as all relevant information had effectively been released to the market for all to see up to that point in time. Nevertheless, it would be better practice for companies with cumulative changes to advise once they have piqued the relevant threshold to spell out the organisation's circumstances clearly.

The reference to previous announcements generally as indicators of the company's forthcoming results was frequent, and included actual releases through the ASX platform¹⁸ as well as references to disclosures about future

¹¹ HFA Limited price query response dated 23 November, 2010.

¹² There is no reason to think that there may be a change in the operating loss before abnormal items and income tax so that financial year ending 30 June 2009 would vary from the previous corresponding period by more than 15% other than those amounts arising from changes to accounting policies that the Company has instituted for the current financial year.

¹³ OGC Limited price query response dated 23 January, 2009.

¹⁴ RIO Limited price query response dated 15 May, 2009. See also CPB Limited price query response dated 3 February, 2009, ERA Limited price query response dated 26 May, 2009 and HST Limited price query response dated 30 April, 2010.

¹⁵ SIV Limited price query response dated 2 November, 2010.

¹⁶ KAM Limited price query response dated 10 November, 2009.

¹⁷ See VTG Limited price query response dated 12 October, 2009 and RHG Limited price query response dated 7 May, 2009.

¹⁸ SPN Limited price query response dated 13 February, 2009.

periods through previously released financial reports¹⁹ which indicated that results would vary by a material amount²⁰ as well as discussion mooted at the preceding annual general meeting, whereby the information became public.²¹ Again, such responses which were ostensibly consistent with previous announcements or actual guidance indicating a material change were treated as unproblematic as they were ostensibly in compliance with the requirements of the regime.

Some companies did not offer guidance for the particular period ASX requested in a query, for example, a company which provided full year but not half year guidance. One such response referred to its full year guidance and analyst consensus with it, before providing a figure with which the market might compare to the previous corresponding period:

We have not provided specific guidance on a half-year basis. The analyst projections indicate that they are forecasting profit for full year 2009 within the range of the guidance we have given. Consistent with this full year guidance, the first half operating profit before abnormal items and income tax will be in the order of 50% above last year.²²

Given this disclosed nothing new and was consistent with previous guidance provided by the company such responses were classed as providing answers consistent with previous guidance and *prima facie* unproblematic.²³ This *prima facie* fair reference to analyst forecasts to paint a picture for the market is in stark contrast to responses which tried to gild the lily or feather their descriptions with interaction with broker estimates:

On 13 February the Company noted that the then current range of market expectations for underlying profit to shareholders was concentrated in the range of \$39 million to \$45 million and that the Company was comfortable with that range subject to the customary qualifications concerning seasonal conditions, mark to market and MIS sales. It is relevant to note that the range of market expectations for underlying profit to shareholders is now understood to fall between \$19 million to \$41 million with most projections falling within the range of \$26 million to \$40 million. The Company remains comfortable with these earnings expectations and is unaware of reasons other than the qualifications previously noted why this position should change.²⁴

Quantifying this attempt at a response as far as the 10-15% range is concerned admits of a material change, but the company's feathering of its response makes it almost indecipherable upon first glance. Indeed it represents a failure as far as submitting a clear précis of the company's position in response to the ASXs questions in the absence of any previous guidance which might have assisted analysts at arriving to their valuations, which should have been referred to if in existence.

Responses advising of a material change

Any responses to a non-standard price query which did not provide a clear "no" answer placing it in the group discussed above were set aside for further analysis. Forty-four of these responses answered "yes" or explained a material change without referring to previous announcements, or otherwise rendered previous guidance irrelevant.

Of those which clearly notified of a change, many provided some exegesis of its genesis, and then attempted to downplay the importance of the changes:

Yes, the Company expects to report a significant reduction in its net loss for the half year to 31 December 2008 compared to the corresponding half year to 31 December 2007, predominantly due to a reduction in operating costs associated with reduced expenditure in order to preserve cash. The Company is not able to accurately quantify the improved loss position until the December result is finalised. However, as previously announced to the market, the main issue confronting the Company at this time is cash liquidity and the need to obtain additional funding in order

¹⁹ IDT Limited price query response dated 1 April, 2010.

²⁰ CFU Limited price query response dated 18 March, 2009.

²¹ MCP Limited price query response dated 8 February, 2009. See also ILF Limited price query response dated 12 January, 2010.

²² SKE Limited price query response dated 6 February, 2009.

²³ However see Australian Securities Exchange, Australian Securities Exchange, *ASX Listing Rules: Guidance Note 8* at [7.2-7.4] regarding analyst consensus forecasts.

²⁴ FCL Limited price query response dated 7 April, 2009.

to continue operations. As such, it is considered that the cash position is more relevant at present than a reduction in net losses.²⁵

Offering the caveat that numbers were still subject to audit and review²⁶, many responses answering “yes” were keen to explain that this would occur because of ‘non-operational’ issues including non-cash items²⁷ and write-offs²⁸, foreign exchange and depreciation and amortisation²⁹, unexpected non-recurring items³⁰ and impacts upon the company’s assets.³¹

This meant in effect that the reasons for the changes included issues not relevant to the prior period, making comparisons with them of limited use. Companies on the reverse side of that phenomenon, where such changes occurred in previous periods and were not likely to happen in the current period leading to a material difference in potential results also explained that such periods were not comparable³², yet often did not provide an exact number, simply saying that results would vary by more than 15%.

Some accordingly did a good job of explaining the context within which a change of results should be interpreted, albeit only in response to a query and not of their own volition, detailing the reasons for past performance and explaining why this was not the best base to offer a comparison with current performance:

Yes. UXC had a poor first half in the previous corresponding period, and this has been analysed and explained in the financial reports. UXC had a strong second half of financial year 2009, and reported operating results before abnormal items and income tax that were nearly three times as much as the first half. It is expected that operating results for the half year ending 31 December 2009 will be significantly improved from the previous corresponding period and more similar to long term trends reported by UXC.³³

Others explained that while management thought it possible that results might vary from the previous corresponding period by more than 15% that ‘the Company believes that the operating loss compared with the corresponding period is not material to share trading at this stage of the Company’s development’³⁴, or that ‘due to the Company’s activities as an exploration company the amount of any variation is unlikely to be material’.³⁵

This was an interesting feature of many smaller companies’ responses to non-standard price queries. The resulting question is whether companies in their nascent phases, and when operating results are thought to be immaterial to investors, should be absolved from providing up to date projections on performance? The prudent answer is likely a friendly “no”. While investors in such ventures would likely have taken the company’s potential for producing such surprises into account given their type and therefore should not come as any shock, this does not figure as a reason for failing to give due regard to reporting standards given the 10-15% threshold. Indeed, the company should still make a habit of conveying such information to the market so as to regulate expectations and not allow misapprehensions to come to exist, say where investors might misinterpret a change in trend as being due to new organic growth – although practically the chance of such misapprehensions arising and their being pursued by the regulator is unlikely, given the fact the regulator appears to have more significant priorities to deal with. Giving the market a clear grasp of the entity’s current situation in the current period vis a vis previous and future projections, and an understanding of why performance is likely to be materially different, is important in maintaining investor faith in the market and should be encouraged as a matter of habit.³⁶

Better responses also explained why they were unable at that time to give any further detailed information on the magnitude of the variation.³⁷ They also quantified the expected magnitude of the variation in an absolute figure or a

²⁵ VCR Limited price query response dated 2 January, 2009.

²⁶ NRT Limited price query response dated 22 January, 2010.

²⁷ HDF Limited price query response dated 17 February, 2009.

²⁸ MEO Limited price query response dated 27 April, 2009.

²⁹ TPI Limited price query response dated 16 February, 2009.

³⁰ AOE Limited price query response dated 13 October, 2009.

³¹ KAR Limited price query response dated 4 May, 2009.

³² CXS Limited price query response dated 5 October, 2010. See also MDL Limited price query response dated 25 September, 2009 and OIL Limited price query response dated 28 September, 2009.

³³ UXC Limited price query response dated 22 September, 2009.

³⁴ ACR Limited price query response dated 12 May, 2009.

³⁵ BOW Limited price query response dated 10 June, 2009.

³⁶ AVX Limited price query response dated 14 October, 2009. See also ALT Limited price query response dated 5 November, 2009 and NLG Limited price query response dated 10 August, 2009.

³⁷ PRR Limited price query response dated 24 September, 2009.

range in similar terms³⁸ and included the comparative figure for the previous corresponding period in their response before describing the individual factors which were expected to affect performance.³⁹

One response, though having previously advised its earnings would be more than 15% below the previous corresponding period, added in response to a price query two months later that 'it is expected that it will be approximately 40% below the previous corresponding period'.⁴⁰ Such responses were also categorised as advising of a change for the new information released in response to the price query. Another example of such information being brought to light by a non-standard price query is evident in the following response, where the company ostensibly had the information ready to hand yet had not thought it necessary to inform the market:

At this time, the Group expects that there will be a change in its operating results before abnormal items (defined as asset revaluations, impairments, mark to market and settlement of derivatives, foreign exchange impact and restructuring costs) and income tax so that the figure for the financial year to 30 June 2010 would vary from the previous corresponding period by more than 15%. The figure is currently expected to be 25-35% lower.

It should be noted, however, that in its release of 12 November 2009, the Group advised that it expected that operating results for the financial year ending 30 June 2010 would be approximately 45% lower than for the financial year ended 30 June 2009. For the purposes of responding to this price query and in the time available, the Group has conducted a limited review of financial information and expectations for the balance of the current financial year and, as noted in the paragraph above, currently expects its operating results to be 25-35% below the prior year. The expected favourable variance to the 12 November 2009 announcement is primarily due to actual and projected interest rates in the US being lower than previously forecast.⁴¹

Companies in these situations, whether the variation moves either in a positive or negative direction need to realise that continuous disclosure requires just that, so long as the information is material, regardless of the type of change. Just because the company had already noted its results would be 45% lower and had informed the market according to the 10-15% rule, this does not stop it from being required to continue to update the market of an material changes to that figure, likewise the other direction. Given investors would have priced in the previous advice of a 45% drop, information that the drop would not be as bad as anticipated of the magnitude mentioned (from 45% to 25-35% lower) could be expected to be material.

Responses stating that it was 'possible'⁴² that results 'may'⁴³ or 'could'⁴⁴ vary by material amount were also counted as affirmative answers. If unsure, the company would do well to make the contingent factors which might cause any such variation clear in their responses. Only a handful of responses outlined contingencies which might push results over the advisable threshold of 10-15%, and effectively communicated to the market the state of knowledge of the company and the matters potentially affecting its performance.⁴⁵ While there was no real clarity around whether this would happen or not from the company's actual response, this is the best that could be hoped for in the circumstances and is to be commended.

Despite the fact only a small number of companies divulged a material change in results in response to a non-standard query (44 of 12xx queries), the question which must be asked is, if this is such a serious obligation, why none of the companies which did so appear to have been pursued for their failure to disclose, especially in the case where some companies failed to provide any reason for a potential material variation?⁴⁶ Such information is obviously at some point going to be protected by the internal management information exception but once it has the requisite 'reasonable degree of certainty' that such a difference will come to exist it must be disclosed. The ASX has stated that

³⁸ ILF Limited price query response dated 13 August, 2009. See also MSB Limited price query response dated 11 January, 2010.

³⁹ IAT Limited price query response dated 28 July, 2009. See also BSR Limited price query response dated 17 August, 2009.

⁴⁰ PPX Limited price query response dated 12 February, 2009.

⁴¹ CNP Limited price query response dated 27 April, 2010. See also CRZ Limited price query response dated 20 October, 2010.

⁴² NGE Limited price query response dated 25 February, 2010.

⁴³ ACR Limited price query response dated 12 May, 2009.

⁴⁴ BOW Limited price query response dated 10 June, 2009. See also ANN Limited price query response dated 9 October, 2009.

⁴⁵ GOA Limited price query response dated 18 October, 2010. See also DGR Limited price query response dated 6 October, 2009.

⁴⁶ RSN Limited price query response dated 24 September, 2009. See also HRL Limited price query response dated 28 September, 2009.

the matters ASX refers to ASIC usually involve a very material difference in earnings compared to the relevant base used to measure market expectations... and where the announcement of the entity's results triggers a material change in the market price of its securities.⁴⁷

Whether this means these apparent breaches were not on the serious end of the spectrum when the company's circumstances and potential investor losses are taken into account will not ever be known, given the fact the market is not privy to matters referred upwards by ASX to ASIC unless any further action is taken and complied with. Given that it seems each company was able to gather and analyse relevant information in order to respond to the ASXs concerns, one must wonder whether the companies in question had appropriate accountability and reporting systems to alert disclosure relevant staff before any continuous disclosure worthy of the ASXs attention arose.

Responses relating to abnormal or extraordinary items

The second question usually asked of companies in receipt of a non-standard query with more than one additional question was whether the company had any reason to think it might record any material abnormal or extraordinary items or material abnormal or extraordinary profit for the period referred to.

A number of responses answered in the affirmative to such recognition of abnormal items for a particular period in circumstances where it seemed this was the first time the market was being made aware of the change.⁴⁸ As with the main sample, a number of companies had previously mooted the potential recording of material abnormal or extraordinary items or had announced phenomena which would lead to same⁴⁹ and made this apparent in their responses.⁵⁰ These were of no real concern, compared to instances where this was not the case. Companies noted a fall in the value of the company's investments⁵¹, writedowns in the value of inventory⁵², the recognition of tax losses from previous periods to reduce tax payable the current period⁵³, restructuring⁵⁴ and further restructuring costs⁵⁵ as causes for the likely recognition of such items.

While the prodding and prompting of the release of this information is valuable, the question must be asked again, as to why the company had not advised the market earlier in the piece. This is especially in the context of the trading activity which may have occasioned the query. While the exceptions relating to incomplete information and internal management information may have protected against disclosure, there is nowhere near enough public information to make a concrete judgment as to whether the information met these exceptions or failed on the reasonable person test, and whether company was actually in breach of the requirements of the regime in these instances (with the exception of Nufarm Limited). Nor does the market have any sense of whether such disclosure behaviour was taken further up the enforcement hierarchy for ASIC attention.

The question must be asked as to when companies become aware of such information: is it only in response to the query that the relevant investigations were performed or were they known earlier?⁵⁶ The answer to this question reincarnates the discussion first broached in relation to negotiations-in-progress above. Two companies expressed the idea that material abnormal items of the kind expected to affect results were simply within the nature of the company's business, and the market was expected to know these as '[t]he existence and nature of these abnormal items are consistent with those disclosed in prior periods'.⁵⁷ While this might be the case, it is still useful for investors and therefore and good practice for such organisations to provide up to date accounts of how such changes are expected to flow through to results and whether they will have a material effect.⁵⁸ Respondents also used the

⁴⁷ Australian Securities Exchange, *ASX Listing Rules: Guidance Note 8*, at [7.3.5].

⁴⁸ Given the lack of reference to any previous announcements in the response.

⁴⁹ NEU Limited price query response dated 20 January, 2009.

⁵⁰ AWB Limited price query response dated 18 September, 2009. See also FXJ Limited price query response dated 4 February, 2009.

⁵¹ TPI Limited price query response dated 16 February, 2009.

⁵² NUF Limited price query response dated 27 August, 2009.

⁵³ ANN Limited price query response dated 5 February, 2009.

⁵⁴ CRG Limited price query response dated 11 February, 2009.

⁵⁵ AIO Limited price query response dated 4 March, 2009.

⁵⁶ CXH Limited price query response dated 10 February, 2009.

⁵⁷ CNP Limited price query response dated 14 August, 2009. See also CER Limited price query response of the same date and 27 April, 2010.

⁵⁸ AEZ Limited price query response dated 28 September, 2009.

opportunity to note potentially new impairment charges which might be incurred⁵⁹ and which were under review⁶⁰ or being tested⁶¹ and could not yet be quantified.

Accounts not yet finalised

31 responses in the sample offered neither a confirmation nor a denial regarding the primary question asked of them, nor a reference to previous guidance as regards material variations, stating simply that accounts were not finalised and that they were unable to say whether there would be a change of the magnitude requiring disclosure.

This kind of response was also offered for the abnormal material items question, with Pacifica Limited for example stating that it was 'currently finalising its business plan for 2009-2011 which will determine whether or not an impairment loss will be booked (amount, if any, cannot be quantified at this stage)'.⁶² One response stated that the company was in the process of preparing its accounts and that there might be a need to 'announce an impairment to the carrying values of its assets. While the review is not yet finalised, by way of preliminary guidance, Pacific Brands Limited estimates that the potential impairment would be of the order of \$200 million'.⁶³ A contextualisation of such a review of the values of tangible and intangible assets would have been preferable and better disclosure practice.

While some responses mentioned above stated they expected no change but that a clearer picture would emerge after a certain period or compilation of results, others stated that they were simply unable to offer a clear answer to the questions asked at that point in time due to a lack of certainty around performance.⁶⁴ Some responses offered detail as to why⁶⁵, and explained that several factors generated uncertainty around the company's results and that a number of transactions which might affect final results were in progress.⁶⁶ Seasonality in business models was also cited as a reason in such responses.⁶⁷ Commodity price fluctuations also precluded the provision of clear guidance for companies highly exposed to movements in say one commodity price:

The Company released its First Quarter results on 30 April 2009. In that release, the Company confirmed its full year production guidance for the year ending 31 December 2009 of 280,000 - 300,000 ounces of gold; at a forecast cash cost of US\$365 - \$405 per ounce. Notwithstanding this guidance, movements in gold prices and foreign exchange rates can materially impact on the Company's financial results in any given period. Accordingly, it is difficult to provide earnings guidance for the financial half year ending 30 June 2009 with a degree of certainty prior to the completion of such period.⁶⁸

Accounting rules also caused some companies uncertainty⁶⁹, as did the company's own budgeting and modelling, with one company stating that:

Management is undertaking a review of year to date financials and assessing the reasonableness of the assumptions that underlie the Company's budget for the current financial year. This work is expected to be completed in the next two weeks. Should this result in an assessment by the directors that the Company's profit will vary from the previous corresponding period by more than 15%, the Company will immediately make an announcement to ASX.⁷⁰

It is not immediately clear why this should be considered an acceptable response, given the circumstances surrounding the infringement notice issued to Nufarm. Nor is the following:

⁵⁹ PBG Limited price query response dated 23 February, 2009.

⁶⁰ PPX Limited price query response dated 12 February, 2009.

⁶¹ BBP Limited price query response dated 27 August, 2009.

⁶² PBB Limited price query response dated 12 January, 2009. See also BBP Limited price query response dated 27 August, 2009.

⁶³ PBG Limited price query response dated 23 February, 2009.

⁶⁴ CXC Limited price query response dated 28 April, 2009. See also MCC Limited price query response dated 2 June, 2009.

⁶⁵ CPR Limited price query response dated 13 October, 2009.

⁶⁶ ISF Limited price query response dated 3 December, 2009.

⁶⁷ NUF Limited price query response dated 24 July, 2009. See also ANN Limited price query response dated 9 October, 2009 and ANZ Limited price query response dated 6 February, 2009.

⁶⁸ OGC Limited price query response dated 25 May, 2009.

⁶⁹ MIG Limited price query response dated 5 February, 2009.

⁷⁰ PBP Limited price query response dated 10 November, 2010.

As the accounts for the period ended 31 December 2008 have not yet been finalised, the Company is not in a position to confirm definitively whether or not there may be a change in the operating profit before abnormal items and income tax from the previous corresponding period by more than 15%.⁷¹

It might not be particularly easy for some businesses to put together reliable forecasts immediately upon an ASX query, with some stating that they would not be able to determine a definitive answer to the questions posed by ASX until audit and Board review.⁷² While these responses make sense from a quality over quantity perspective, should investors expect 'definitive' answers to such questions? It may be the case that while investors are used to having information otherwise regularly cast in their direction, that their expectations may need to be tempered as such information is not necessarily easy to generate depending on the company's circumstances.

On the other hand, given the rules require organisations to keep enough of a tab on their operations such that it can inform the market if it becomes aware of a material change in projected results, ignorance will be no excuse, and companies will need to institute internal reporting systems which allow management to assess the organisation's position at any given time and respond to any ASX query or in the absence of one simply inform the market when it becomes aware of a change requiring disclosure. There would need to be a corresponding tolerance for error amongst market participants, although keeping one's finger on the pulse appears more important than ever in rapidly transforming markets and investors should be privy to any information which could affect their decision to buy, sell or hold the relevant securities. Indeed, this goes to the heart of the purpose of the regime. Smaller companies should not find this difficult except for a general lack of resources and the fact their projections and comparisons from year to year and further projections may not be clear as preferred; larger ones will have had the time to understand their disclosure obligations and institute appropriate mechanisms for the reporting of material changes, though problems arise when companies either grow too rapidly and do not have the internal systems to keep up with disclosure obligations, or if the company's operations are spread across multiple geographic locations where it is difficult to obtain up to the minute information and assimilate it into the rest of the organisation's numeric readings to provide a clear picture of its operational status.

So while it is understandable for this many responses to have had no effective answer at the time for the range of reasons noted above, companies will need to consider how they might continuously adapt reporting and analysis systems to enable quick readings on the company's performance to the date of the query in order to provide a reliable estimate to the market. The reason for this is simple: Nufarm Limited. Despite exhibiting similar difficulties in getting across its accounts, the leeway given by ASIC once all relevant facts were established for coming to a view as to the company's financial position was not wide, and resulted in significant negative publicity for the company as well as the levelling of fines and entry into an enforceable undertaking. If it is not possible to obtain a complete picture at the time, the company should explain why, and give the most up to date review of its position at that time, with a promise to update the market in due course as soon as the indeterminate results reveal themselves. This is 'continuous' disclosure in its true sense and should not be shied away from. Management undoubtedly make cost benefit calls on such disclosure behaviour, in ignorance of the advice of French J (as he then was) in *Chemeq* relating to playing 'calculated risk games'⁷³, although it is unlikely the commercial mindset will ever shy away from such thought. Accordingly, any company which has a suspicion, or even a lack of definite knowledge about forthcoming results, should second guess any decision to refrain from disclosure.

While explaining it was not in possession of finalised accounts for the period requested by ASX and was not able to confirm definitively whether there was a material change from the previous corresponding period, one company stated:

Due to the timing of the letter from the ASX and as the accounts for the period ended 31 December 2008 have not yet been finalised, the Group is not in a position to confirm definitively whether or not there may be a change in the operating loss before abnormal items and income tax for the period ended 31 December 2008 from the previous corresponding period by more than 15%. However, based on management accounts prepared for the 5 month period ended on 30 November 2008 when compared with the corresponding calendar period in 2007, there is a material favourable variance in the operating position of the Group. This variance is primarily due to unrealised (i.e non-cash) net foreign currency and derivative gains resulting from significant period on period movements in foreign exchange rates. Based on the Group's hedge accounting policies and accounting treatment of intra-group loans, foreign currency and derivative gains and losses are recorded in the income statement.

⁷¹ FXL Limited price query response dated 7 January, 2009.

⁷² AMC Limited price query response dated 10 July, 2009.

⁷³ See discussion at 3.2 above.

If the net unrealised (i.e. non-cash) foreign currency exchange and derivative gains are ignored, then the underlying operating result for the 5 month period ended on 30 November 2008 is an 18% improvement on the corresponding calendar period in 2007.⁷⁴

Providing such a response instead of the ubiquitous ‘accounts are not yet finalised and there is no definitive answer for the period referred to’, the company above disclosed where it was at that time, which is ostensibly what the regime requires and is to be commended. The only question is why the company did not advise of this earlier and had to wait for a query to do so if the potential change had the character of materiality?

5. Conclusion

The issuing of queries signals consistent regulatory oversight of the market, which creates the impression that investors are not alone in circumstances involving irregular trading activity. In view of the reality and frequency of irregular trading activity through the period exciting the ASXs attention, and its potential to unsettle investors involved with the securities in question or in the market more generally, it is important that companies provide accurate and timely responses to any queries issued to them. In their absence, investors may come to question their faith in the market and therefore revise their assessments of its integrity downwards, which is negative for companies involved as well as the market itself.

While many varied reasons might explain the price movements the subject of the four standard questions in a price query, any additional questions asked are by their nature more specific and can (and should) be answered with more detail and accuracy. The fact that the generation and disclosure of such information is wholly within the control of the company should give managers extra cause for preparedness in circumstances indicating irregular trading behaviour, and where a price query might follow demanding an update. Should organisations wait until they receive a query to disclose such information, the inference that informed or insider trading may have occurred will be open to investors. In spite of the likely lack of any direct evidence to ground such inferences, the effect of any such assessment is to damage perceptions of the integrity of the market.

The majority of the responses to non-standard price queries admit of no wrongdoing by the companies concerned. Several instances analysed above however do, at the very least, suggest areas for improvement. While information quality is always a concern, there is a more important lesson to learn from these latter more problematic instances of disclosure behaviour in the period analysed: accountability systems, through which disclosure relevant staff might keep a ‘finger on the pulse’, need to be in place and working effectively in order to warn managers of potentially material issues which might become disclosure issues, and so that if any information does escape the organisation’s confidence that managers can use such systems to respond to any ASX queries with speed and accuracy so that the market is kept up to date as required by the listing rule. Of course there are limits to the reach of any such systems and so investors must appreciate that there is only so much management is reasonably able to control for and disclose depending on the circumstances. Should organisations employ such systems however it is likely that their explanations will resemble best practice noted above and therefore garner more faith than the responses of companies which appear to have no real idea where their organisation is placed or headed.

⁷⁴ VIR Limited price query response dated 2 January, 2009.