Integrated Reporting and Directors' Concerns about Personal Liability Exposure: Law Reform Options

Abstract

Integrated Reporting (<IR>) holds significant promise as a new reporting paradigm that is holistic, strategic, responsive, material and relevant across multiple time frames. However, its uptake in Australia is being hampered by directors' concerns about personal liability exposure, particularly for forward-looking statements that subsequently prove to be unfounded. This article seeks to illuminate the bases for these liability concerns by outlining the similarities between <IR> and the Operating and Financial Review requirements under the *Corporations Act*, and the relevant grounds for liability for misleading and deceptive disclosures, and breach of directors' duties. In light of this discussion, this article proposes four possible reform options, ranging from minor adaptations to the <IR> Framework to far-reaching reforms of the *Corporations Act.* As assurance is desirable to ensure that reliance can be placed on Integrated Reports, the development of a legal safe harbour for auditors of forward-looking information is also canvassed.

Part I: Introduction

There is growing international momentum for companies to voluntarily adopt the Integrated Reporting (<IR>) Framework, which was released in December 2013.[1] <IR> arose in response to the perceived limitations of current corporate reporting practices, including issues

[1] International Integrated Reporting Committee (IIRC), "<IR> Framework" (2013) http://www.theiirc.org/international-ir-framework/ viewed 9 October 2014; KPMG, "Operating and Financial Reviews: Application of ASIC's Regulatory Guide" (2014) http://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/Better-Business-Reporting/Documents/operating-and-financial-reviews-2014.pdf viewed 9 October 2014.

of 'clutter' resulting from growing reporting requirements, and disclosures that fail to meet investors' needs.[2] The aim of an integrated report is to drive and provide a concise, holistic account of company performance by indicating a comprehensive range of financial as well as human, intellectual, environmental and social factors that impact on a company's short, medium and long term capacity for value creation. An integrated report should provide transparency around the dynamics of the business model and associated risks and opportunities that may emerge. This should include a clear vision of the company's business model, the way that the organization's performance and sustainability is aligned with its strategy, analysis of the impacts and the interconnections of material opportunities' risk and performances, and the resulting governance model. The IIRC envisions that the integrated report may, in time, serve as 'the next phase in the evolution of corporate reporting', which incorporates but goes beyond the types of information currently reported in companies' financial statements.[3]

There is a multiplicity of potential internal and external benefits for companies as a result of engaging with <IR>,[4] which has underpinned the business community's support for the <IR> Framework in other parts of the world.[5] There is also increasing regulatory interest in <IR>.

[2] See, eg, United Kingdom Financial Reporting Council, "Cutting Clutter: Combating Clutter in Annual Reports" (2011) https://www.frc.org.uk/getattachment/8eabd1e6-d892-4be5-b261-b30cece894cc/Cutting-Clutter-Combating-clutter-in-annual-reports.aspx viewed 9 October 2014.

[3] IIRC, above n 1.

[4] Adams S, Fries J, and Simnett R, "The Journey toward Integrated Reporting" (2011) *Accountants Digest* 558; Eccles R, Cheng B, and Saltzman D (eds), "The Landscape of Integrated Reporting" (Harvard Business School, Boston (Ebook)); Integrated Reporting Committee of South Africa (IRCSA), "Framework for Integrated Reporting and the Integrated Report: Discussion Paper" (2011) http://www.sustainabilitysa.org/Portals/0/IRC%20of%20SA%20Integrated%20Reporting%20Guide%20Jan%2011.pdf viewed 9 October 2014; Dhaliwal D, Zhen L, Tsang A, & George Y, "Voluntary Non-Financial Disclosure and the Cost of Equity Capital: The Initiation of Corporate Social Responsibility Reporting" (2011) *The Accounting Review* 86(1) 59; Zhou S, "The Capital Market Benefits of Integrated Reporting" (2014) unpublished PhD thesis, School of Accounting, UNSW.

[5] For example, there are more than 100 participants in the <IR> Pilot Programme: see http://www.theiirc.org/companies-and-investors/pilot-programme-business-network/. KPMG notes that of the 51% of companies worldwide that produced corporate social responsibility reports in 2013, one in ten claimed to publish an integrated report: KPMG, "Corporate Responsibility Reporting Survey 2013" (2013) 11-2

South Africa became the first jurisdiction to mandate <IR> in 2010, following the prescriptions of the influential King III report.[6] Mandatory reporting rules in Europe,[7] and stock exchange listing rules in, inter alia, Sao Paulo, Singapore, Kuala Lumpur and Copenhagen,[8] also require companies to report on environmental, social and governance issues, reflecting elements of <IR>.

Integrated Reporting is still voluntary in Australia and, compared to their counterparts from other jurisdictions, Australian business leaders have been particularly outspoken regarding their concerns about the increased risk of directors' liability for forward-looking statements in integrated reports. These views were evidenced in responses to the Consultation Draft of the International <IR> Framework in July 2013,[9] and in the lead up to the release of the <IR> Framework in late 2013.[10] The Australian business community's strong concerns about <IR> have led to a perception of a slower uptake of the <IR> Framework in Australia.[11]

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http://www.kpmg.com/au/en/issuesandinsights/articlespublications/pages/corporate-responsibility-reporting-survey-2013.aspx viewed 9 October 2014. Further, the 571 companies of the 4046 that used the Global Reporting Index framework in 2013 self-claimed that their reports were 'integrated': Global Reporting Index (GRI), "Sustainability disclosure database" (2014) http://database.globalreporting.org/pages/about viewed 9 October 2014.

[6] King Committee, *The King Report on Governance for South Africa* (Institute of Directors in South Africa, 2009) http://www.ecgi.org/codes/documents/king3.pdf viewed 2 February 2015.

[7] European Parliament. "Texts Adopted" (2014) http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2014-0368&language=EN&ring=A7-2014-0006#BKMD-68 viewed 2 February 2015.

[8] International Integrated Reporting Council (IIRC), "April Newsletter" (2013) http://www.theiirc.org/2014/04/30/april-newsletter-2/ viewed 2 February 2015.

[9] Chartered Secretaries Australia (CSA), "Consultation Draft of the International <IR> Framework" (2013) http://www.theiirc.org/wp-content/uploads/2013/08/143_Chartered-Secretaries-Australia.pdf last viewed 9 October 2014; Business Council of Australia (BCA), "Submission to the International Integrated Reporting Council regarding the Consultation Draft of the International Integrated Reporting Framework" http://www.bca.com.au/docs/820E1D0F-2FF0-47CF-87F0-148942401B67/submission-to-the-consultation-draft-of-the-internatoinal-integrated-reporting-framework_19072013.pdf viewed 9 October 2014; Australian Institute of Company Directors (AICD), "Integrated Reporting Draft Raises Director Liability Concerns" (2013) http://www.companydirectors.com.au/Director-Resource-Centre/Publications/The-Boardroom-Report/Back-Volumes/Volume-11-2013/Volume-11-Issue-8/Integrated-reporting-draft-raises-director-liability-concerns viewed 9 October 2014.

[10] Drummond S, "Integrated Reporting Brings Legal Worries", *Australian Financial Review* (17 April 2013) http://www.afr.com/f/free/markets/capital/cfo/integrated_reporting_brings_legal_RvN24L7rPruGI4M90qe4dI viewed 9 October 2014; Drummond S and King A, "Confusion just one of the Hurdles for Integrated Reporting", *Australian Financial Review* (27 November 2013)

A key issue that has been the subject of growing concern in the Australian business community is directors' potential personal liability for forward-looking disclosures.[12] The <IR> Framework, which includes 'strategic focus and future orientation' as one of its Guiding Principles,[13] has drawn attention to the issue of directors' sign-off on forward-looking information. The types of forward-looking information contained in integrated reports are likely to be welcomed by investors as they provide information with which investors can make judgments about companies' future profitability.[14] However, one significant obstacle in Australia to engagement with, and uptake of, <IR> is directors' reluctance to sign off on integrated reports due to personal legal liability concerns. Directors are increasingly concerned about the legal environment in which they operate. Australia is witnessing the rise of shareholder class actions supported by litigation funding, making this jurisdiction a fertile ground for class action litigation.[15] A major law firm has noted that directors and other officers and professional advisors are being increasingly targeted not only by class action plaintiffs but by the defendant companies as they seek to spread liability.[16] Concerns, arising from such a high risk profile, have underpinned renewed calls for greater liability protection for directors taking responsibility for forward-looking statements from the Australian business community.[17] In this article, we canvass why directors are particularly

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http://www.afr.com/p/national/professional_services/confusion_just_one_of_the_hurdles_dzrTmyFIizut3mY2kJEYAO viewed 9 October 2014.

[11] Drummond, n 7.

[12] AICD, n 6.

[13] IIRC, n 1 at [3.3].

[14] IIRC, n 1.

[15] See further, Legg M and Mirzabegian S, "Shareholder Claims in Australia" in Charman A and Du Toit J (eds), *Shareholder Actions* (Bloomsbury Professional, 2013) Ch 14.

[16] King & Wood Mallesons, "The Review (Class Actions in Australia 2013/2014)" http://www.mallesons.com/Documents/The%20Review%20Class%20Actions%20in%20Australia%202013%202014%20%28Jul14%29_FINAL.pdf viewed 9 October 2014.

[17] See, eg, Stanhope S, "Integrated Reporting is Inevitable and will be Global", *Australian Financial Review* (29 May 2013) http://www.afr.com/p/national/professional_services/integrated_reporting_is_inevitable_V4SWCMBLCJhnaJAMyP7JKL viewed 9 October 2014; Drummond, n 7.

concerned about signing off on integrated reports in Australia, and evaluate possible solutions that may effectively ameliorate these concerns.

The issue of whether those charged with governance (TCWG) should acknowledge their responsibility for the integrated report was one of the most contentious issues in the stakeholder responses to the Consultation Draft on the development of the <IR> Framework in 2013. Respondents were approximately evenly split on this issue with proponents reasoning that such sign off would enhance the responsibility of TCWG for the integrated report, and promote the reliability, credibility and accountability of the report. By contrast, opponents of requiring a statement from TCWG argued that no statement was necessary as such responsibility was already implicit in other parts of the Framework, and would generate legal and liability impediments to the uptake of <IR> in some jurisdictions.[18] On balance, the IIRC decided that without a statement by TCWG, integrated reports may come to be perceived as 'marketing documents', which was more of a concern than slower take-up of <IR> in some jurisdictions.[19] Responses to the <IR> Consultation Draft, and reactions to the approval of the Framework and subsequently to the Framework's release, indicate that Australia is a major jurisdiction where the requirement for the sign off of TCWG is seen as hindering the uptake of <IR>.

Directors' hesitancy in Australia about signing off on integrated reports appear to be interlinked with concerns about their potential personal liability for forward-looking statements in Operating and Financial Reviews (OFRs). The focus of this article is on forward-looking information disclosures to existing shareholders in Australia, such as those

[18] International Integrated Reporting Council (IIRC), "Basis for Conclusions" http://www.theiirc.org/wp-content/uploads/2013/12/13-12-08-Basis-for-conclusions-IR.pdf viewed 9 October 2014.
[19] IIRC, n 14.

contained in OFRs and integrated reports. Regulatory requirements for forward-looking information to attract future shareholders, such as those that related to prospectuses,[20] raise different legal issues, and will not be a focus of the present discussion.

Although compliance with the <IR> Framework is voluntary in Australia, OFRs are mandated by corporations law. Under s 299A(1) *Corporations Act 2001* (Cth), annual OFRs require an assessment of an entity's financial performance, position, strategies and future prospects. The OFR requirements have received increasing attention from the Australian Securities and Investments Commission (ASIC) since 2010, when the *Corporations Amendment (Corporate Reporting Reform) Bill 2010* (Cth) extended s 299A to apply to all listed entities. In practice, however, there was considerable diversity in how these requirements were implemented. In March 2013, ASIC released a regulatory guide on enhancing companies' consistent conformity with the OFR requirements under s 299A(1).[21] In this guide, ASIC made it clear that entities should provide the relevant OFR disclosures in a 'single, self-contained section' of the annual report,[22] and clarified the circumstances in which the 'unreasonable prejudice' exemption could be relied upon.[23] For many companies, compliance with this non-binding guidance, which is desirable to prevent ASIC taking action for non-compliance, necessitated significant changes to their OFR practice.[24] Significantly, the regulatory expectation of increased OFR disclosures in the Directors' Report, with sign

[20] See, eg, the requirements in s 710(1) *Corporations Act 2001* (Cth) regarding forward-looking statements in prospectuses.
[21] Australian Securities and Investments Commission (ASIC), "Regulatory Guide 247: Effective Disclosure in an Operating and Financial Review" (March 2013) at [247.81] https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg247-published-27-March-2013.pdf/$file/rg247-published-27-March-2013.pdf viewed 9 October 2014.
[22] ASIC, n 17 at [247.81].
[23] ASIC, n 17 at [247.52], [247.65-.78].
[24] KPMG, n 1.

off by directors, has led to directors' heightened concerns that they may be personally liable for forward-looking statements if those insights subsequently turn out to be incorrect.[25]

The focus of this article is on the directors' legal liability concerns hindering the uptake of <IR> in Australia, and the possible reforms that may ameliorate these concerns. In order to illuminate these issues, the article will canvass the possible grounds for directors' liability for forward-looking statements in OFRs under Australian corporations law as these appear to be the types of liability concerns posing an obstacle to the uptake of <IR>. Although there are differences between the aims and specifications of OFRs and <IR>, ASIC's recent regulatory guidance around providing clearer explanations of companies' performance and future prospects has been heralded as a 'stepping stone' between what is currently being reported in OFRs and the requirements of Integrated Reporting.[26]

Concomitantly, there is concern among some members of the business community that additional moves to regulate <IR> may increase companies' reporting burden, and further extend the range of disclosures for which directors' are potentially liable.[27] Directors are concerned that, regardless of whether <IR> is adopted as a voluntary or mandatory measure, it does raise potential liability concerns for directors under the *Corporations Act 2001* (Cth) if a company releases statements that are subsequently found to be misleading and deceptive, or otherwise in breach of the directors' duties.[28] Some observers have claimed that these concerns about <IR> may be overblown.[29] One such observer is Professor Mervyn King, the Chairman of the IIRC, and a pivotal figure in the adoption of <IR> in South Africa, who has

[25] Stanhope, n 13.
[26] Drummond, n 7.
[27] Drummond and King, n 7.
[28] See discussion of relevant sections of the Act in Part IV below.
[29] Drummond and King, n 7.

questioned whether Australian directors' resistance to <IR> is motivated by risk-aversion out of self-interest, which is an improper motive.[30] According to King, the solution to the risk that statements may turn out to be misleading is for directors to inform the market if circumstances change.[31]

This article will outline the types of personal liability that directors may attract for erroneous forward-looking statements under the *Corporations Act 2001* (Cth) ('the Act') as context for the liability concerns in relation to <IR>. Specifically, if forward-looking statements included in OFRs and integrated reports are deemed to be 'misleading and deceptive', the company will be in breach of s 1041H of the Act, potentially exposing directors to personal liability under s 79 if they were 'involved in' the contravention. Further, following the personal liability trend in recent high profile cases such as Centro[32] and James Hardie,[33] the same conduct giving rise to breach of directors duties in these cases (breach of mandatory disclosure rules) could potentially be the basis for an alleged contravention of the duty of care and diligence in ss 180(1) and 601FD(3) of the Act .

The business judgment rule in s 180(2) of the Act, which provides a defence for breaches of s 180(1) in specified circumstances, does not currently provide a defence for directors in relation to forward-looking statements in companies' mandatory disclosures, even if they made best endeavours in relation to those statements. The legislative shortcomings in the operation of the statutory business judgment rule are discussed below. A number of prominent representatives of the Australian business community have recognised this and are advocating for law reform to provide safe harbours for directors providing forward-looking

[30] Drummond, n 7.
[31] Drummond, n 7.
[32] *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291 (Centro).
[33] *Gillfillan v Australian Securities and Investments Commission* (2012) 92 ACSR 460 (James Hardie).

information.[34] In this context, the article addresses gaps in the current law under the Act and canvasses a range of law reform options for a more effective safe harbour for directors aimed at ameliorating liability concerns with regard to forward-looking statements in <IR>.

The rest of this article proceeds as follows. In Part II, an overview of <IR> and issues inhibiting its uptake in Australia is provided. Part III further explores the linkages between <IR> and OFRs, and provides more detail on the OFR requirements in the *Corporations Act*. In Part IV, the types of liability that directors may potentially attract under this legislation are canvassed. Part V then outlines the safe harbour provisions for directors' forward-looking statements in comparable jurisdictions such as the US and the UK, before four options for reform are considered in Part VI. Part VI considers the desirability of assuring OFRs and Integrated Reports, before concluding remarks are offered in Part VII.

Part II: Integrated Reporting and its Potential Uptake in Australia

The <IR> Framework is principles-based, and provides guidance on key Fundamental Concepts, Guiding Principles and Content Elements that need to be considered in preparing an integrated report. In order to classify as an integrated report, a report should be prepared in accordance with the <IR> Framework,[35] and be a 'designated, identifiable communication'.[36]

An integrated report can take many forms, one of which is building off existing mandated communications such as management commentary,[37] the Australian equivalent of which is the OFR requirements. As long as a report prepared to meet existing compliance requirements is also prepared in accordance with the <IR> Framework, it can still be

[34] See, eg, the discussion in Part VI.D.
[35] IIRC, n 1 at [1.2].
[36] IIRC, n 1 at [1.12].
[37] IIRC, n 1 at [1.14].

considered an integrated report.[38] As discussed further in the following section, <IR> can thus potentially be seen as an enhanced form of OFR reporting, which underpins directors' concerns that their potential liability for erroneous statements in OFRs may extend to additional <IR> disclosures. An integrated report can also be prepared as a standalone report, or as a distinguishable part of another report, such as an annual report.[39] In order to claim they have produced an integrated report, an organisation must apply all the requirements identified in bold type in the <IR> Framework unless explanation is provided regarding the unavailability of reliable information or specific legal prohibitions.[40]

There are a number of benefits associated with both the process of <IR> and the final product, which is the integrated report. In terms of the process of <IR>, an important outcome is 'integrated thinking', which is 'the active consideration by a company of the relationships between its various operating and functional units and the capitals that the organization uses and affects'.[41] Companies gain internal advantages from undertaking integrated thinking. Firstly, it advances the alignment of strategic focus with both financial and non-financial performance. For many companies it is the first time that senior management has considered elements of sustainability performance, and even for many companies with a history of publishing sustainability reports, the processes for considering, evaluating and communicating financial and sustainability performance has been, and continues to be, siloed. The poor state of integration is illustrated by the finding by the Investor Responsibility Research Centre Institute[42] that while 499 of the companies in the

[38] IIRC, n 1 at [1.14].
[39] IIRC, n 1 at [1.15].
[40] IIRC, n 1 at [1.17] and [1.18].
[41] IIRC, n 1 at 9.
[42] Investor Responsibility Research Centre Institute (IRRCI), "Integrated Financial and

United States S&P 500 made at least one sustainability related disclosure, only seven integrated their financial and sustainability reporting. By taking a holistic view of these two interrelated dimensions in commercial, social and environmental contexts, it is argued that corporations have an ability to attain a more complete understanding of value drivers and how these drivers contribute to their strategic goals. As a result, there are more opportunities to enhance the value of a company without compromising its short or long term focus.

Further, with greater comprehension of how a company creates value and the social and environmental impact that its activities have, it is more likely that management will recognize the imperative of integrating sustainability opportunities and concerns into business strategies. Moreover, these strategies can be communicated to the employees to raise awareness at the operational level, which will likely facilitate a higher degree of collaboration and engagement.[43] Another potential advantage stems from the redesign of procedures for collecting and gathering data. As the relevant information processes are revamped to capture information on each of the capitals, their efficiency and effectiveness will also improve significantly which eventually leads to higher quality, more comprehensive and timely information.[44] This advantage brings about further benefits in the decision-making process and the assessment of risks and opportunities. Due to the enhanced quality of information, companies have better input on which to base their decisions. These internal benefits of <IR>, including the realization of significant cost savings from issues ranging from systems

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Sustainability Reporting in the United States" (2013) http://irrcinstitute.org/pdf/FINAL_Integrated_Financial_Sustain_Reporting_April_2013.pdf viewed 9 October 2014.

[43] Adams, Fries and Simnett, n 4.

[44] Eccles, Cheng and Saltzman, n 4.

design to energy costs savings, are commonly described in the experiences of the more than 100 international reporting entities that are currently trialling the principles of <IR>.[45]

In addition to these internal benefits, the external benefits claimed to be associated with <IR> are manifold, as corporations are enabled to demonstrate how they create value, consider sustainability matters and coordinate their financial and non-financial efficacy in short, medium and long-term perspectives. For example, a discussion paper released by the Integrated Reporting Council of South Africa[46] suggests that benefits accrue to companies that release <IR> information to external stakeholders as "the leadership's ability to demonstrate its effectiveness, coupled with the increase in transparency, could result in a lower cost of capital to the organization".[47] Consistent with Dhaliwal et al.'s finding of cost of capital benefits for companies disclosing sustainability reports, the value-relevant information provided through <IR> can also reasonably be expected to realize cost of capital reductions for integrated report preparers.[48] Recent research by Zhou shows that the improvement in the disclosure quality of integrated reports does lead to a reduction in the cost of equity capital, especially for companies with a low analyst following.[49]

Although providers of financial capital are identified as the primary users of an integrated report, <IR> also provides an opportunity for companies to satisfy information demands from other key stakeholders and demonstrate willingness to attend to their needs.[50] This point leads

[45] International Integrated Reporting Council (IIRC) "Pilot Programme Business Network" (2014) http://www.theiirc.org/companies-and-investors/pilot-programme-business-network/ viewed 9 October 2014.
[46] IRCSA, n 4.
[47] IRCSA, n 4.
[48] Dhaliwal et al, n 4.
[49] Zhou, n 4.
[50] Holder-Webb L, Cohen J, Nath L, and Wood D, "The Supply of Corporate Social Responsibility Disclosure among U.S. Firms" (2009) *Journal of Business Ethics* (February) 497; Eccles, Cheng and Saltzman, n 4; Eccles R and Krzus M, "One Report: Integrated Reporting for a Sustainable Strategy" (John Wiley & Sons, United States of America, 2010); IIRC, n 1at 8.

to a further benefit resulting from lowering reputation risk. As a member of the wider system, it is important that corporations are well-regarded and supported by other parties and the general community. Reputation risk management is therefore crucial,[51] and the integrated report gives rise to a greater extent of transparency regarding a company's impact on, and commitment to, the social, ecological and governance environments. In effect, it becomes an effective tool in shaping the public perception that a company is seriously attempting to account for their sustainability matters and commit to the delivery of positive impacts for society.

Part II.A: Aspects of the <IR> Framework that are Contributing Factors to Directors' Liability Concerns

Despite the myriad of internal and external benefits that <IR> can provide, there is evidence of resistance to integrated reporting in the Australian business community. In the remainder of this section, we outline the key provisions of the <IR> Framework that are most likely to be contributing to directors' concerns about liability risks.

One of the requirements identified in bold type in the <IR> Framework is that TCWG will include a statement that they are responsible for an integrated report. In the transition period of the first three years of a company issuing an integrated report, this can be done on a comply-or-explain basis.[52] Thus, there is an expectation that TCWG will ultimately take full responsibility for the disclosures in a company's integrated report. This perhaps partly explains the reticence of Australian companies to engage with the <IR> Framework. In 2013, only six Australian companies listed on the Global Reporting Initiative web site self-claimed

[51] Eccles, R G, Jr., Newquist S C, and Schatz R, "Reputation and its Risks" (2007) 85(2) *Harvard Business Review* 104.
[52] IIRC, n 1 at [1.20].

that they had provided an 'integrated' report. Table 1 provides a summary of the features of these 'integrated' reports. As indicated in Table 1, TCWG assumed responsibility for all six reports, suggesting that these directors were not unduly concerned with potential liability risks related to forward looking comments, perhaps reflective that this concern does not hold over all of TCWG, or that the reporting of forward looking information in these particular instances was of a form that did not raise personal liability risks. Only two of the six companies mentioned the <IR> Framework, which was at that time in draft form, and in both cases these companies were pilots aligned with the IIRC.[53] As the <IR> Framework was released at the end of 2013, it will be interesting to see whether more Australian companies explicitly link their 'integrated' reports with the <IR> Framework. One reason they may not is that, if they do so, they only have three years before TCWG are required to take responsibility for these reports. As discussed in Part IV, there are potential legal liability risks that may attach to this responsibility.

One area that directors are particularly reluctant to accept personal liability is in relation to forward-looking statements which, by their very nature, are subject to change as future events unfold in ways that were previously unexpected. Forward-looking statements can include revenue, income and other financial and economic performance projections, as well as management's strategies and targets for future operations. In relation to forward-looking information in <IR>, guiding principle 3A specifically pertains to 'Strategic focus and future orientation'. This guiding principle states that 'An integrated report should provide insight into the organization's strategy, and how it relates to the organization's ability to create value in the short, medium and long term, and to its use of and effects on the capitals'.[54] Future

[53] These companies are Stockland Corporation Ltd and National Australia Bank.
[54] IIRC, n 1 at [3.3].

information is also relevant to Content Element 4E: Strategy and Resource Allocation, which states that 'An integrated report should answer the question: Where does the organization want to go and how does it intend to get there?'[55] and Content Element 4G: Outlook, which asks companies to report as to 'What challenges and uncertainties is the organization likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?'[56] In addition, future-oriented information is addressed under Guiding Principle 3F: Reliability and Completeness, with paragraph 3.53 specifying that 'Future-oriented information is by nature more uncertain than historical information. Uncertainty is not, however, a reason in itself to exclude such information'.

Although these types of information are highly valued by shareholders and stakeholders, issues of director liability for forward-looking commentary underpin many directors' caution about <IR>. Former president of the Business Council of Australia, Graham Bradley, FAICD, summarises directors' concerns:

> [T]he push for more "future-oriented information" will be of particular concern for boards given the self-evident liability risks of forecasting in a volatile global business environment. This risk is that lengthy cautionary statements and extensive listing of key assumptions will erode the informational value of mandating more detailed future outlook statements.[57]

In addition, some directors are concerned that extended disclosures of companies' strategies, business models, and other non-mandatory information may jeopardise the competitive advantage of firms. Paragraph 3.51 of the Framework recommends a balancing process that weighs the risks of disclosing information about the 'essence' of a strategy that may indicate a competitive advantage against the need for the integrated report to achieve its primary

[55] IIRC, n 1 at [4.27].
[56] IIRC, n 1 at [4.34].
[57] AICD, n 6.

purpose of explaining to providers of financial capital how an organisation creates value over time.[58] This has clear parallels with the OFR requirement in s 299A(1) *Corporations Act* in which the annual directors' report must contain information about an entity's business strategies and prospects for future financial years unless to do so may result in unreasonable prejudice.

Part III: <IR>, OFRs and Forward-Looking Statements

The OFR disclosures required in ASIC's 2013 Regulatory Guide, RG 247, can be seen as a step towards <IR>.[59] Moreover, RG 247 disclosures may be further enhanced by using the <IR> Framework.[60] In relation to the latter point, KPMG argue that the <IR> Framework may be particularly useful in helping companies to provide 'a clear explanation of the organisation's business model, its business strategies, and its prospects',[61] as required under s 299A *Corporations Act.* That is, <IR> is not fundamentally different from what is already required under Australian law,[62] and may well serve as a means of enhancing OFR reporting. Although <IR> is not currently mandated in Australia, if companies meet their OFR requirements through adopting <IR>, directors' potential liability for misleading and deceptive disclosures in OFRs may thus also apply to these integrated reports. These similarities between <IR> and OFRs, and the potential for both the OFR and <IR> requirements to be met simultaneously in the one document, or any other way in which <IR> requirements may become mandatory disclosure requirements in Australia, may underpin some of the concerns in the Australian business community about directors' liability for erroneous forward-looking statements in both contexts.

[58] IIRC, n 1 at [3.51], [1.17].
[59] Drummond and King, n 7.
[60] KPMG, n 1.
[61] KPMG, n 1 at 43.
[62] Drummond S, "Integrating Reporting Defended" (2013) *Australian Financial Review*, 30 May, p 14.

The purpose of the OFR provisions in the *Corporations Act* is to 'help ensure that the financial report and directors' report are presented in a manner that maximises their usefulness, with a particular focus on the needs of people who are unaccustomed to reading financial reports'.[63] The putative benefits of OFR reporting include providing a central repository of relevant information, promoting consistency of disclosure between larger and smaller listed entities,[64] and clarifying the underlying drivers and reasons for an entity's performance.[65] These are also aims of <IR>, which is why some commentators have argued that the OFR provisions and related regulatory guidance may provide a suitable platform for the adoption of <IR> in Australia.[66] In determining what is reasonably required to be reported in an OFR, the company's specific circumstances, including, inter alia, its size, maturity, industry and complexity should all be taken into account.[67]

Since 2010, compliance with OFR requirements has been one of ASIC's surveillance focal points, and continues to be an area of focus for the regulator in 2014.[68] One of the reasons behind the release of RG 247 was a gap between the aims of the OFR requirements and practice. For example, potential impediments to OFRs include lengthy, 'boiler-plate' disclosures that hinder rather than promote effective communication, and companies simply reproducing content from financial statements, rather than providing narratives that are easier for non-expert investors to comprehend.[69] As foreshadowed in the Introduction, the guidance in RG 247 specified that entities should provide the relevant OFR disclosures in a 'single,

[63] ASIC, n 17 at [247.25].
[64] ASIC, n 17 at [247.8].
[65] ASIC, n 17 at [247.43].
[66] KPMG, n 1.
[67] ASIC, n 17 at [247.32].
[68] KPMG, n 1.
[69] KPMG, n 1.

self-contained section' of the annual report.[70] This is similar to the requirement in paragraph 1.12 of the <IR> Framework that 'An integrated report should be a designated, identifiable communication'. Although the guidance in RG 247 is non-binding, many companies perceive that compliance is desirable to prevent ASIC taking action for non-compliance. Thus, there is a regulatory expectation of increased OFR disclosures in the annual report, with sign off by directors, underpinning directors' concerns about potential personal liability if forward-looking statements subsequently prove to be unfounded.[71]

Forward-looking information has particular salience in the OFR requirements under s 299A(1) *Corporations Act*.[72] This section specifies that the annual directors' report must contain information that members of the entity would reasonably require to make an informed assessment of the entity's operations, financial position, and 'business strategies, and prospects for future financial years'. However, there is provision in s 299A(3) to omit information that would otherwise be included under paragraph (1)(c) regarding business strategies and prospects for future financial years if it may result in unreasonable prejudice, so long as the report acknowledges the omitted information, and that information is not otherwise publicly available.[73] Regulatory Guide 247 specifies that this discussion will typically be in the form of a 'narrative explaining the financial performance and financial outcomes the entity expects to achieve overall'.[74] Significantly, the Guide states that, 'It is important that a discussion about future prospects is balanced. It is likely to be misleading to discuss prospects for future financial years without referring to the material business risks

[70] ASIC, n 17 at [247.81].
[71] Drummond, n 56 at p 14.
[72] Related requirements can be found under s 299(1)(e) *Corporations Act*, it is specified that annual directors' reports must include, inter alia, 'likely developments in the entity's operations in *future* financial years and the expected results of those operations' (emphasis added).
[73] ASIC, n 17 at [247.52].
[74] ASIC, n 17 at [247.60].

that could adversely affect the achievement of the financial prospects described for those years'.[75] The focus on forward-looking information in both OFRs and integrated reports is a key contributing factor to directors' reticence to sign off on both types of disclosures without more substantial legal safeguards.

Part IV: Directors' and Other Officers' Liability for Forward-Looking Information

There are a number of potential grounds of liability for directors and other officers[76] under the *Corporations Act* for forward-looking statements in OFRs, and integrated reports that are serving a dual function as an OFR. These include the provisions for misleading conduct,[77] and lack of due care and diligence.[78] In addition, there is potential liability arising under the *Competition and Consumer Law 2010* (Cth), the *Australian Securities and Investments Commission Act 2001* (Cth), contract law, tort law and criminal law. In line with this paper's focus on <IR> and OFRs, the focus of the following discussion will be on potential grounds for liability under the *Corporations Act*.

Part IV.A: Misleading and Deceptive Conduct

Under s 1041H *Corporations Act*, 'conduct, in relation to a financial product or a financial service, that is misleading or deceptive or is likely to mislead or deceive' is proscribed. This provision covers both misstatements and non-disclosures,[79] and may extend to 'innocent'

[75] ASIC, n 17 at [247.61].
[76] *Corporations Act 2001* (Cth), s 9.
[77] *Corporations Act 2001* (Cth), ss 769C and 1041H.
[78] *Corporations Act 2001* (Cth), ss 180(1) and 601FD(3).
[79] Baxt R, Black A and Hanrahan P, Securities and Financial Services Law (8th ed, LexisNexis, Sydney, 2012).

disclosure failures.[80] Although failure to comply with s 1041H is not an offence, it may nonetheless give rise to civil liability for loss or damage under s 1041I.[81]

Section 1041H applies to conduct in relation to a financial product or financial service, which potentially includes conduct in relation to securities.[82] The court observed that the phrase 'in relation to' 'ought to receive a broad construction'.[83] It is arguable, therefore, that forward-looking statements in OFRs and integrated reports that have a material effect on the price or value of shares, for example, may constitute conduct in relation to a financial product. In order for conduct to be 'misleading or deceptive or likely to mislead or deceive', it must 'lead or be likely to lead' a reasonable person or class of persons 'into error'.[84]

For the purposes of Chapter 7, which includes s 1041H, s 769C *Corporations Act* specifies that if a person (in this case, the reporting entity[85]) does not have 'reasonable grounds' for making a representation about future matters,[86] which includes the doing of, or failing to do,

[80] Bednall T and Hanrahan P, "Officers' Liability for Mandatory Corporate Disclosure: Two Paths, Two Destinations?" (2013) 31 C&SLJ 474 at 484.
[81] Similar provisions are contained in s 18 ACL and s 12DA *Australian Securities and Investments Commission Act 2001* (Cth). As Baxt, Black and Hanrahan note, in practice, proceedings are typically commenced under multiple provisions: Baxt, Black and Hanrahan, n 73 at 283.
[82] *Corporations Act 2001* (Cth), Pt 7.1 Div 3 and ss 764A(1) and 761A.
[83] *Australian Securities and Investments Commission v Narain* (2008) 169 FCR 211, per Finkelstein J at [9].
[84] *Miller & Associates Insurance Broking v BMW Australia Finance* (2010) 241 CLR 357 at [15] per French CJ and Kiefel J. There are additional provisions in the *Corporations Act* that cover intentionally or recklessly including false or misleading information in public documents such as OFRs. An entity that makes or authorises the making of a statement that the entity knows is 'false or misleading in a material particular, or omits or authorises the omission of any matter or thing without which the document is to the person's knowledge misleading in a material respect, is guilty of an offence' under s 1308(2). Moreover, if an entity makes such a statement or omission 'without having taken reasonable steps to ensure that the statement was not false or misleading or to ensure that the statement did not omit any matter or thing without which the document would be misleading', it contravenes s 1308(4), and is guilty of an offence. These provisions apply to misleading information that is intentionally or recklessly included in an OFR (RG247.34) if the failure to take steps reflects criminal, rather than civil, negligence: *Gould v Companies Auditors and Liquidators Disciplinary Board* (2009) 71 ACSR 648; [2009] FCA 475 at [233]. However, these will not be a focus here as the debate about proposed reforms is premised on innocent, rather than knowingly fraudulent, misstatements.
[85] Or, as is established below, a director or other officer who is 'involved in the contravention' under s 79 *Corporations Act*.
[86] Cf other representations under s1041H, for which a statement may be held to be misleading even if there is an absence of intention on the part of the person who made the statement to mislead or deceive: *Australian*

an act, it is 'taken to be misleading'. It appears that the burden of proving lack of reasonable grounds for a representation about future matters lies with the person alleging the misrepresentation.[87] Thus, if a reasonable person making a decision about, for example, investing in securities is lead into error by a representation about future matters in an OFR or integrated report that they can prove lacked reasonable grounds, s 1041H will be contravened, triggering civil liability for any resulting loss or damage under s 1041I.

For the OFR requirements under the *Corporations Act*, the disclosure obligation is on the listed entity itself. However, the entity's directors and offices may be personally liable in some circumstances as a result of being 'involved' in the entity's contravention,[88] or through the attribution of negligence,[89] which is discussed below. Relevantly here, liability may extend to directors and other officers if they are a person 'involved in a contravention' of s 1041H via s 79 of the *Corporations Act.*[90] To establish such liability in respect of representations about future matters, Bednall and Hanrahan argue that a plaintiff must show that the person allegedly involved in the contravention had 'actual knowledge that the representation was made, and that it was misleading or that the corporation had no reasonable grounds for making it'.[91] As the director should sign off on the OFR or integrated report, proving actual knowledge of the representation should be straightforward. However, Bednall and Hanrahan argue that proving that the director had actual knowledge that the

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Securities and Investments Commission v Fortescue Metals Group Ltd (2011) 81 ACSR 563; [2011] FCAFC 19 at [102].

[87] *Clifford v Vegas Enterprises Pty Ltd* [2011] FCAFC 135 at [148].

[88] *Corporations Act 2001* (Cth), s 79.

[89] Bednall and Hanrahan, n 74.

[90] This section states that 'a person is involved in a contravention if, and only if, the person:
(a) has aided, abetted, counselled or procured the contravention; or
(b) has induced, whether by threats or promises or otherwise, the contravention; or
(c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or
(d) has conspired with others to effect the contravention'.

[91] *Quinlivan v Australian Competition and Consumer Commission* (2004) 160 FCR 1 at [15]; Bednall and Hanrahan, n 74 at 491 fn 94.

representation was misleading or that the corporation had no reasonable grounds for it constitutes a potentially high hurdle that will be difficult for a prosecutor or plaintiff to establish.[92] Perhaps because negligence is easier to establish than actual knowledge, business leaders' concerns about liability for OFRs and <IR> appears to centre on directors' potential liability for lack of due care and diligence under s 180(1) in the absence of adequate safe harbour protections.[93]

Part IV.B: Breach of Care and Diligence

Directors and other officers may also be liable for forward-looking statements that are in breach of the statutory duty of care they owe to the company under s 180(1) *Corporations Act*. Business leaders' concerns about potential liability for lack of due care and diligence in relation to forward-looking statements in integrated reports is highlighted in the following excerpt from submission of the Governance Institute of Australia (then Chartered Secretaries Australia (CSA)) to the 2013 <IR> consultation process:

> Directors are subject to statutory and common law duties which require them to act with reasonable care and diligence, in good faith in the best interests of the company and for a proper purpose. A defence may apply to decisions taken by directors in relation to breaches of care and diligence but it is not available, at least in Australia, where the process leading up to the decision is defective (such as where the decision is made on the basis of clearly inadequate information or it is not reasonable to rely on the advice of those providing the information). Providing forward-looking reporting means that the information provided could well be based on inadequate information, given that circumstances can change rapidly. This exposes directors to much higher risks of actions against them, including class actions, which are becoming increasingly prevalent and remain only lightly regulated.[94]

In this part, the potential legal bases for directors' liability on these grounds are outlined.

[92] Bednall and Hanrahan, n 74 at 494.
[93] Drummond and King, n 7; Drummond, n 56.
[94] CSA, n 6.

Under s 180(1) of the Act, a 'director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise' in their situation. Section 180(1) is a civil penalty provision under s 1317E *Corporations Act* giving rise to disqualification orders from management,[95] pecuniary penalties[96] and compensation orders.[97]

The decriminalisation of a breach of s 180(1), and the subsequent elevation of the performance expectation of the modern director in *Daniels v Anderson*[98] by rejecting the subjective test to determine breach, has resulted in vigorous enforcement of this duty by ASIC.[99] This quantum shift has a significant impact on liability concerns for directors. This is exacerbated by the enforcement approach adopted by ASIC based on derivative liability where company directors are often made liable for the company's conduct by default. Following the personal liability trend in recent high profile cases such as *Centro* and *James Hardie*,[100] the same conduct that forms the basis for the company's breach of mandatory disclosure rules could potentially be the basis for an alleged contravention by the director of ss 180(1) and 601FD(3) of the Act for failure to exercise due care and diligence.

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[95] See, for example, *Gillfillan v Australian Securities and Investments Commission* (2012) 92 ACSR 460 where the entire board of James Hardie Ltd were disqualified from management for breach of duty of care when approving misleading media release to the public.

[96] See, for example, *ASIC v Adler* (2002) 41 ACSR 72 where both Alder and Williams, directors, were ordered to pay pecuniary penalties of $400,000 and $245,000 respectively for breach of directors' duties, including duty of care.

[97] See, for example, *ASIC v Adler* (2002) 41 ACSR 72 where both Adler and Williams, directors, were ordered to pay nearly $8 million compensation to the company for breach of directors' duties, including duty of care.

[98] (1995) 37 NSWLR 438; Cf *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 which accepted a lower standard of care and diligence, measured by a subjective standard to determine breach.

[99] For fuller discussion on the evolution of the duty of care and diligence and the modern performance expectations of directors, see *ASIC v Rich* (2009) 75 ACSR 1; Baxt R, "The Duty of Care of Directors: Does it Depend on the Swing of the Pendulum?" in Ramsay I (ed), *Corporate Governance and Duties of Company Directors* (Centre for Corporate Law and Securities Regulation, University of Melbourne, 1997).

[100] For detailed analysis of *ASIC v Macdonald (No 11)* (2009) 71 ACSR 368, see Hargovan, A, "Corporate Governance Lessons from James Hardie" (2009) 33 *Melbourne University Law Review* 984. This decision was subsequently upheld by the High Court in *ASIC v Hellicar* (2012) 88 ACSR 246 and in *Shafron v ASIC* (2012) 88 ACSR 126.

Herzberg and Anderson have described the above approach as part of the 'stepping stone' approach, by which ASIC 'applies directors' duties in a novel context'.[101] They note:

> The first stepping stone involves an action against the company for contravention of the [*Corporations Act*]. The establishment of corporate fault then leads to the second stepping stone; a finding that by exposing their company to the risk of criminal prosecution, civil liability or significant reputational damage, directors contravened their statutory duty of care with the attendant civil penalty consequences.[102]

Thus, for example, if a company contravenes its obligations for OFRs and integrated reports under s 299A by including false or misleading forward-looking information, invoking liability under s 1041I, a director who caused or allowed the contravention to take place may be in breach of their statutory duty of care, with attendant civil pecuniary penalties and disqualification risks. In this way, both the company and an individual director may be liable for the same conduct.[103]

Since the introduction of the statutory business judgment rule in 2000 as a safe harbour for director liability, Australia is yet to witness successful reliance on this defence.[104] The practical utility of the statutory business judgment rule has been questioned – both prior to[105]

[101] Herzberg A and Anderson H, "Stepping Stones – From Corporate Fault to Directors' Personal Civil Liability" (2012) *Federal Law Review* 40, 181. For collection of judicial authorities adopting the stepping stone approach to director liability, see Australian Institute of Company Directors - A Proposal for Law Reform: The Honest and Reasonable Director Defence (AICD, Sydney, August 2014) at 8.
[102] Herzberg and Anderson, n 95 at 182.
[103] As Bednall and Hanrahan note, 'it does not flow automatically from a finding that an entity has contravened the *Corporations Act* that the officers must have contravened their duty of care to the company. What matters is whether, in a particular instance, each officer has taken reasonable care to protect against a foreseeable risk of harm to the company resulting from their own action (or inaction). … [W]hat can reasonably be expected of a director or other officer in a particular case depends upon the corporation's circumstances and the particular office held by, and responsibilities of, the individual officer': n 74 at 496.
[104] For a critical assessment of the business judgment rule, see *ASIC v Rich* (2009) 75 ACSR 1; Lumsden A, "The Business Judgment Defence: Insights from *ASIC v Rich*" (2010) 28 C&SLJ 164.
[105] Redmond P, 'Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule?' in I Ramsay (ed), *Corporate Governance and the Duties of Company Directors* (Centre for Corporate Law and Securities Regulation, University of Melbourne, 1997).

and after its introduction[106] – with one senior legal commentator dismissing it as mere window dressing.[107]

Significantly, protection from liability from the business judgment rule in s 180(2) of the *Corporations Act*[108] does not apply to forward-looking information as a decision as to what should be disclosed is not considered a business judgment. This is because a 'decision related to compliance with the requirements of the Act', such as fulfilling reporting requirements under s 299A, does not relate to the 'business operations' of the entity, and is thus not a business judgment as defined under s 180(3).[109] Thus, if a director or officer is found liable for breaching the statutory duty of care in relation to a misleading forward-looking statement in an OFR or integrated report, no protection against liability is provided by the business judgment rule as currently formulated.

Although directors are allowed to delegate powers[110] and to rely on others,[111] there are limits to the operation of these defences as highlighted by the *Centro* and *James Hardie*

[106] Young N, "Has Directors' Liability Gone Too Far or Not Far Enough? A Review of the Standard of Conduct Required of Directors under Sections 180-184 of the Corporations Act" (2008) 26 C&SLJ 216. Cf judgment of Austin J in *ASIC v Rich* (2009) 75 ACSR 1 where his Honour found that s 180(2) had some protective work to do.

[107] Young, n 100.

[108] The business judgment rule in s 180(2) states that: 'A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:
(a) make the judgment in good faith for a proper purpose; and
(b) do not have a material personal interest in the subject matter of the judgment; and
(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
(d) rationally believe that the judgment is in the best interests of the corporation.
The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.'

[109] *Australian Securities and Investments Commission v Fortescue Metals Group Ltd* (2011) 190 FCR 364 per Keane CJ.

[110] *Corporations Act 2001* (Cth), s 198D.

[111] *Corporations Act 2011* (Cth), s 189.

decisions.[112] In *Centro*, it was held that signing off on the company's accounts was a board function that was not delegable to management and remained the responsibility of the board itself. In *James Hardie*, it was held that the board's reliance on experts was unreasonable in the circumstances of the case. Directors seeking judicial relief for breach of duties under ss 1317S or 1318 of the Corporations Act have not fared very well despite frequent attempts to rely on these provisions for forgiveness. To date, the courts have been overwhelmingly reluctant to excuse honest but negligent conduct by directors, as illustrated by the *Centro* and *James Hardie* decisions.[113]

Part V: Safe Harbours for Forward-Looking Information in the US and UK

The current legal position in Australia in relation to directors' potential liability for forward-looking information, such as information required in integrated reports and OFRs, is out of step with the legal position in comparable jurisdictions such as the US and the UK. In the US, voluntary public disclosure of corporate projections and predictions and other forward-looking statements[114] is 'now the norm' as a result of safe harbour provisions under

[112] For fuller discussion on the operation of these defences, see Byrne M, "Do Directors Need Better Statutory Protection When Acting on the Advice of Others?" (2008) 21 *Australian Journal of Corporate Law* 238.

[113] Rare exceptions have arisen in the context of director liability for insolvent trading under s 588G of the *Corporations Act*. A director obtained partial relief from liability in *Hall v Poolman* (2007) 65 ACSR 123 and full relief from liability in *Re McLellan; Stake Man Pty Ltd v Carroll* (2009) 76 ACSR 67; see further, Hargovan A, "Directors' Liability for Insolvent Trading, Statutory Forgiveness and Law Reform" (2010) 18 *Insolvency Law Journa*l 96.

[114] The Private Securities Litigation Reform Act of 1995 (US) identifies a forward-looking statement as any of the following:

(A) A statement containing a projection of revenues, income (including some loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial terms;
(B) A statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
(C) A statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in in the results of operations included pursuant to the rules and regulations of the Commission;
(D) Any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);
(E) Any report issued by an outsider reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or
(F) A statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

legislative law reform.[115] In 1995 Congress enacted reforms that enable companies to make forward-looking statements without the risk of liability so long as they include meaningful cautionary warnings outlining the risks that could eventuate if the actual results differ from the predictions made.[116] The safe harbor was enacted as amendments that added a new section 27A to the *Securities Act of 1933* and a new section 21E to the *Securities Exchange Act of 1934* to achieve dual aims: (a) to protect against meritless private securities litigation arising from strike suits; and (b) to increase the flow of useful information into the capital markets.[117]

The relevant provisions, cast very widely to insulate the issuer of forward -looking statements, are summarised by Ripken:

> The Safe Harbor contains three alternative provisions that immunize defendants from liability for making forward-looking statements that turn out to be untrue. First, a defendant will not be liable for any forward-looking statement that is "identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement" (the "meaningful cautionary statement prong"). Second, no liability attaches to forward-looking statements that are "immaterial" (the "immateriality prong"). Third, the defendant is not liable if the plaintiff fails to prove that the forward looking statement "was made with actual knowledge **...** that the statement was false or misleading" (the "actual knowledge prong").[118]

Thus, the company has a statutory safe harbour protection against potential liability for making forward-looking statements through three separate tests.[119] Appropriately, however, the threat of enforcement action by the SEC remains as a deterrent against any attempt by the

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The term "person acting on behalf of an issuer" means any officer, director, or employee of such issuer.

[115] Olazabal A M, "False Forward-Looking Statements and the PSLRA's Safe Harbour" (2011) 86 *Indiana Law Journal* 595 at 595.

[116] Ripken SK, "Predictions, Protections, and Precautions: Conveying Cautionary Warnings in Corporate Forward-Looking Statements" (2005) No. 4 *University of Illinois Law Review* 929 at 929.

[117] For discussion of legislative history, policy considerations and judicial application, see Olazabal, n 108.

[118] Ripken, n 110 at 948 (citations omitted).

[119] For critical analysis, see *Slayton v Am.Express.Co.*, 604 F.3d 758 (2d Cir. 2010).

issuer to defraud the market. This measure is viewed as sufficient disincentive for abuse of the safe harbour as a licence by any issuer to deliberately lie to the market.

The *Companies Act 2006* (UK) provides a similar provision to the third prong of the US's safe harbor provision in relation to the directors' report, strategic report, and directors' remuneration report. Under s 463(3), a director is only liable to compensate the company for any loss suffered as a result of an untrue or misleading statement, or an omission of a mandated disclosure, if the director 'knew or was reckless as to whether the statement was untrue or misleading; or knew the omission to be dishonest concealment of a material fact'. Directors are not liable to a person other than the company resulting from the reliance on information in such a report.[120] This protection extends to future-oriented information in the strategic report. The strategic report provisions, which came into force in September 2013, place a requirement on companies to, inter alia, 'discuss the main trends and factors likely to affect the future development, performance and position of the company's business' 'to the extent necessary for an understanding of the business'.[121] There are thus clear overlaps between the aims of strategic reports in the UK, OFRs in Australia, and <IR>. In the UK, section 463 of the Act gives comfort to directors that, except in cases of dishonesty or recklessness, they cannot be sued for negligence by making forward-looking statements in strategic reports.

As discussed in the previous section, Australia does not have a comparable safe harbour protection for directors who make forward-looking statements in reports such as integrated

[120] *Companies Act 2006* (UK), s 463(4). For critical discussion, see Aiyegbayo O and Villiers C, "The Enhanced Business Review: Has it Made Corporate Governance More Effective?" (2011) 7 *Journal of Business Law* 699; Villiers C, "Narrative Reporting and Enlightened Shareholder Value under the Companies Act 2006" in Loughrey J (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crises*, Cheltenham, Edward Elgar, 2013 at 97.
[121] *Companies Act 2006* (UK), s 414C(7)(a).

reports and OFRs. The following passage from the submission of the Governance Institute of Australia (then Chartered Secretaries Australia (CSA)) to the 2013 consultation process exemplifies the business community's concerns in this regard:

> At present, an adequate 'safe harbour' from liability for directors and executives for making forward-looking statements has not been adopted in Australia, although CSA notes it has in other jurisdictions such as the UK. CSA and other parties are advocating that such a 'safe harbour' be introduced in Australia, on the basis that the uptake of integrated reporting and the call for increasingly detailed forward-looking statements in ASIC's Regulatory Guide 247 on the operating and financial review (OFR) will be hindered if this liability issue is not addressed.[122]

Against this backdrop, in the following section, four options for reform, each of which address directors' liability concerns about <IR> in less or more far-reaching ways, will be canvassed. These options are outlined in ascending order in terms of ease of operationalisation.

Part VI: Four Options for Reform

Part VI.A: An Exception to the TCWG Responsibility for <IR> Requirement in the Australian Context

One possibility is that the IIRC could be requested to make an exception in Australia to the requirement that TCWG take responsibility for integrated reports after three years. The case for applying for such an exception has been outlined in this article; namely, that the legal context in Australia, which differs from comparable jurisdictions, is inhibiting the uptake of <IR> in this country. To date, the IIRC has not outlined a clear process for how it will resolve issues such as this. If an application was made to the IIRC regarding this issue, it may catalyse the development and clarification of a process for accommodating these types of jurisdictional issues.

[122] CSA, n 6.

An alternative approach is for Australian companies to follow, but not refer to, the <IR> Framework. As outlined previously, paragraph 1.17 of the Framework specifies that an organisation must apply all the requirements identified in bold type in the <IR> Framework, including the requirement that TCWG will take responsibility for the integrated report, in order to claim they have produced an integrated report. By adopting this option, companies can reap the internal and potentially some of the external benefits of <IR>, as outlined above, but do not need to comply with the TCWG responsibility requirement of the <IR> Framework. This would allay directors' concerns about personal liability for forward-looking statements in integrated reporting, but not in relation to OFRs.

Part VI.B: Additional Guidance in RG 247

As outlined above, many directors' concerns about potential personal liability for <IR> are interrelated with their caution around personal liability for OFRs. As the OFR requirements in s 299A are reporting obligations, compliance with which is enforced by ASIC as the regulator, ASIC could be petitioned to amend its regulatory guidance in RG 247 to reassure directors required to make forward-looking statements. Just as RG 247 made explicit the requirement that entities should provide the relevant OFR disclosures in a 'single, self-contained section' of the annual report,[123] it could be amended[124] to mirror the UK position in s 463 of the 2006 Act that ASIC will only undertake compliance actions against directors for forward-looking statements in OFRs if ASIC can establish the director 'knew or was reckless as to whether the statement was untrue or misleading; or knew the omission to be dishonest

[123] ASIC, n 17 at [247.81].

[124] It is not unprecedented for ASIC's regulatory guides to be amended. For example, 'Regulatory Guide 214: Guidance on ASIC Market Integrity Rules for ASX and ASX 24 Markets' was re-issued in 2014 with minor amendments to the previous version issued in 2010: Australian Securities and Investments Commission (ASIC), "Regulatory Guide 214: Guidance on ASIC Market Integrity Rules for ASX and ASX 24 Markets" (February 2014) http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg214-published-7-February-2014.pdf/$file/rg214-published-7-February-2014.pdf viewed 9 October 2014.

concealment of a material fact'. In this way, an effective safe harbour could be provided to directors by clarifying ASIC's enforcement policy, rather than through statutory amendment, which may be more difficult to achieve in practice. This type of protection could extend to integrated reports if companies are producing OFRs that simultaneously fulfil the requirements of the <IR> Framework.

Part VI.C: Reform of Section 299A

A related option, which would necessitate statutory amendment, is for s 299A to be amended to provide a safe harbour for directors for forward-looking information. Here, the US safe harbour protections provide a possible model. That is, a new sub-section in s 299A could specify that directors will be immune from liability for forward-looking statements that turn out to be untrue if a 'meaningful cautionary statement' is provided, and/or the forward-looking statements are immaterial, and/or that ASIC as the regulator cannot prove that the forward looking statement was made with actual knowledge that the statement was false or misleading.[125] As this type of safe harbour protection would be enshrined in legislation, it would likely offer greater comfort to Australian directors engaging in OFRs and integrated reporting.

However, as a statutory amendment along these lines would require an amendment Act for the *Corporations Act* to be passed by both houses of Parliament, a strong case for legislative reform would need to be made. In light of the altered environment in which directors in Australia now operate, with securities class actions and litigation funding a permanent part of the legal landscape, any move to consider such a proposal to stem open-ended liability does not appear to be far-fetched or fanciful. Unlike the Australian position discussed earlier, the

[125] Ripken, n 111.

US approach strikes a balance – it offers the twin benefits of weeding out meritless claims but also allowing meritorious claims to proceed. Similar to the US position, ASIC can retain the residual power to take enforcement action should there be any deliberate attempt to mislead the public. In spite of the imperfections in the US model,[126] dealing with definitional issues, it provides a template on which to build upon.

Part VI.C: A Broad and Overarching Defence

The final, and most far-reaching, proposed option is to insert a broad and overarching defence for directors in the *Corporations Act* which also modifies the current business judgment rule in s 180(2) of the Act. Simply reforming the existing statutory business judgment rule would have little effect as s 180(2) is limited in scope - (1) it only applies in respect of a business judgment, narrowly defined in s 180(3) which requires an actual decision; and (2) it only applies to one aspect of directors' duties, namely, breach of the duty of care and diligence (statutory, common law and in equity).

Unsurprisingly, there have been repeated calls for law reform in this area, with the most recent call led by the Australian Institute of Company Directors (AICD) for the introduction of an overarching defence in the Corporations Act known as the 'honest and reasonable director defence'.[127] This broad based defence is designed to overcome the limits of the statutory business judgment rule by applying to all acts and omissions by a director so long as the director acted with honesty (without moral turpitude), for a proper purpose and with the

[126] See further, Norman J, "PSLRA Safe Harbor: A New Perspective On 'Important Factors'" (2012) 12 *Wake Forest Journal of Business and Intellectual Property Law* 313.
[127] Australian Institute of Company Directors (AICD), "A Proposal for Law Reform: The Honest and Reasonable Director Defence" (AICD, Sydney, August 2014) http://www.companydirectors.com.au/~/media/Resources/Director%20Resource%20Centre/Policy%20on%20director%20issues/2014/The%20Honest%20%20Reasonable%20Director%20Defence%20A%20Proposal%20for%20Reform_August%202014_F.ashx viewed 9 October 2014.

degree of care and diligence that the director rationally believes to be reasonable in all the circumstances.[128] If adopted by parliament, this defence will integrate the current objective test under s 180(1) duty of care and diligence with a new subjective test which will potentially excuse a director from liability from breach of s 180(1) based on the surrounding circumstances. So long as the director's belief as to the circumstances of the care and diligence exercised is rational, a director can be exempt from liability for omissions or compliance duties.[129]

A broader consideration of how the honest and reasonable director defence may apply to other liability provisions under the Corporations Act is beyond the scope of this article. However, viewed in the specific context of liability for forward-looking statements, the adoption of the AICD law reform proposal is likely to provide some comfort to directors. The broad nature of the proposed defence, with particular reference to the subjective component, may provide immunity for directors for making a forward-looking statement that turns out to be untrue. Based on all the surrounding circumstances of the case, the director may not be found liable for conduct later found to be unreasonable so long as he or she acted with honesty and genuinely believed that the care exercised was reasonable and that this assessment was rationale. The proposed defence, in this manner, retains but dilutes the strength of the objective standard which currently underpins ss 180(1) and 180(2) of the Act. It also overcomes the current restrictive threshold requirement in s 180(3) to access the statutory business judgment rule. The AICD law reform proposal, if accepted by parliament, should go a long way to allay the current reticence by directors to adopt Integrated Reporting.

[128] AICD, n 121.
[129] AICD, n 121.

Whilst an amendment to the *Corporations Act* along these lines may well allay Australian directors' litigation fears, such an amendment will have far-reaching consequences that extend well beyond forward-looking statements in OFRs and integrated reports that turn out to be untrue. Thus, we consider that this is likely to be the most difficult statutory amendment to have passed into law, as well as being the type of reform that would most reassure directors in relation to, inter alia, <IR> and OFRs.

An alternative proposal for a new statutory business judgment rule provides a broad based defence for directors' derivative liability for the conduct of corporations.[130] This option, proposed by Bob Austin of Minter Ellison, entails a defence that would be inserted into the interpretation statutes that operate federally and in each state and territory, meaning it would apply to all statutes, including the *Corporations Act*.[131] This proposal sets up a rebuttable presumption of no liability for business judgments, defined more broadly than the current statutory provision in s 180(3),[132] which would shift the current onus of proof on directors under s 180(2) of the Act. Thus, the Austin/Minter Ellison proposal is broader than the AICD proposal as it would apply to all statutory obligations imposed on directors, but it is also more modest than the AICD proposal as it does not seek to dilute the strength of the objective test currently contained in s 180(1) *Corporations Act*.[133] Either set of reforms, if adopted, are likely to go a long way towards allaying directors' concerns about liability for forward-looking statements in <IR>.

[130] Austin B, "Boards that Lead Need Better Protection", *Australian Financial Review* (21 March 2014) <www.afr.com>.
[131] See further, Harris J and Hargovan A, "Revisiting the Business Judgment Rule" (2014) *Governance Directions*, November 2014, 634.
[132] Under the Austin/Minter Ellison law reform proposal, business judgments are defined as 'an exercise of judgment relating to taking or not taking action in connection with any business of the corporation'. See further, Harris and Hargovan, n 125.
[133] Harris and Hargovan, n 125.

Part VII: The Desirability of Assuring OFRs and Integrated Reports

If any of the above options are introduced to limit directors' liability for forward-looking statements in OFRs and integrated reports, it is critical that mechanisms are implemented to ensure that reliance can nonetheless be placed on these forward-looking statements. One such safeguard is assurance of OFRs and integrated reports. As outlined by the IIRC, assurance is vitally important to <IR> because it is 'a fundamental mechanism for ensuring reliability and enhancing credibility'.[134] There are both practical challenges to assuring integrated reports, such as whether traditional assurance models and assurance providers will be an appropriate fit for <IR> and the cost of assurance, and technical challenges, such as the existence of suitable criteria, materiality issues, the level of assurance that is appropriate, and how to assure future-oriented information. The IIRC is currently involved in an international stakeholder consultation process concerning these types of issues.[135]

Expectations of assurance are likely to arise in the context of integrated reports that are serving a double function as OFRs. Although RG 247 specifies that an OFR prepared under s 299A of the *Corporations Act* is not required to be audited,[136] OFRs and integrated reports that are part of the directors' report fall under the rubric of 'other information' in a document that contains an audited financial report. Auditing Standard ASA 720 *Other Information in Documents Containing Audited Financial Reports* requires auditors to read the OFR and integrated report to ensure there are no material inconsistencies with the audited financial report and that the OFR and integrated report contains no material misstatements of fact. This is enforceable as section 307A of the *Corporations Act* specifies that audits of financial

[134] International Integrated Reporting Council (IIRC), "Assurance on <IR>: An Exploration of Issues" (2014) http://www.theiirc.org/wp-content/uploads/2014/07/Assurance-on-IR-an-exploration-of-issues.pdf viewed 9 October 2014.
[135] IIRC, n 128.
[136] ASIC, n 17 at [247.37].

reports must be conducted in accordance with Australian auditing standards. An offence based on an auditor's breach of s 307A is a strict liability offence.

An additional consideration is that auditors may also soon have increased responsibilities to report on 'key audit matters', which include 'significant risks identified by the auditor', as outlined in the recently approved *International Standard on Auditing (ISA) 701: Communicating Key Audit Matters in the Independent Auditor's Report*. In some circumstances, this could be conceived to extend to significant future risks described in forward-looking statements. It is expected that ISA 701 will be adopted by the Australian Auditing and Assurance Standards Board, consistent with its policy of convergence with international auditing standards, unless there are 'compelling reasons' not to do so.[137] As outlined above, once this requirement is integrated into Australia Auditing Standards, it will be enforceable through s 307A of the *Corporations Act*.

With the possibility of auditors becoming more involved in assuring OFRs and integrated reports, the issue of auditor liability needs to be considered. Similarly to the proposed broadening of the business judgment rule discussed above, some commentators have called for an "auditor judgment rule" that would provide a safe harbour for auditors who have made auditing judgments in good faith.[138] Reflecting on the US context, Peecher, Solomon and Trotman argue that 'auditors' judgments, even if made in good faith, can be second-guessed

[137] Australian Auditing and Assurance Standards Board (AUASB), "Principles of Convergence to International Standards of the International Auditing and Assurance Standards Board (IAASB) and Harmonisation with the Standards of the New Zealand Auditing and Assurance Standards Board (NZAuASB)" (2012) [3] http://www.auasb.gov.au/admin/file/content102/c3/Principles_of_convergence_and_harmonisation.pdf viewed 9 October 2014.

[138] Peecher M E, Solomon I and Trotman K T, "An Accountability Framework for Financial Statement Auditors and Related Research Questions" (2013) 38 *Accounting, Organizations and Society* 596.

as courts can rule that alternative judgments should have been reached'.[139] Accordingly, they argue for the development of an auditor judgment rule, which is modelled after the business judgment rule that applies to American corporate directors, and provides a safe harbour for auditors who 'make judgments that are within their authority and for which there is a rational basis'.[140] Alongside the types of additional legal protections for directors that we outlined above, an additional consideration is the concomitant development of these types of protections for auditors, particularly in the context of auditing forward-looking information in OFRs and integrated reports.

Part VIII: Conclusion

<IR> is an important international development for corporate reporting, and its uptake in Australia is likely to be welcomed by both shareholders and other stakeholders. Additionally, there are potentially numerous internal and external benefits for companies that adopt <IR>. However, unlike in other jurisdictions, there is particular concern amongst Australian business leaders that there are liability risks attached to adopting <IR>, which is hampering its uptake. This article has sought to illuminate the bases for these liability concerns. It has argued that there are many similarities between the OFR requirements in the *Corporations Act* and the requirements of <IR>, and that <IR> can be compared with an enhanced form of OFR reporting. From a practical perspective, this is significant as it means that many directors who are concerned about potential personal liability for forward-looking statements under corporations law are equating these fears with <IR>. Regardless of whether <IR> is adopted as a voluntary or mandatory measure, directors may be liable for misleading and deceptive statements, or breaches of directors' duties. It is highly relevant to address these

[139] Peecher, Solomon and Trotman, n 132 at 606.
[140] Peecher, Solomon and Trotman, n 131 at 605.

concerns of directors to promote the uptake of <IR> in Australia, which is likely to have benefits for companies and the wider community.

Accordingly, this article has considered four possible reform options, ranging from acute remedies to address the issue of director sign-off of integrated reports in Australia to more far-reaching proposals for reform of the statutory business judgement rule in the *Corporations Act*, the consequences of which will extend well beyond <IR>. Perhaps the least intrusive option that will protect directors legally is for Australian companies to use the <IR> Framework in their reporting, thus reaping the benefits of this approach, but without referencing the Framework, and therefore not requiring TCWG to directly accept responsibility for forward-looking statements whose future veracity cannot be guaranteed. However, the <IR> liability debate in Australia appears to be feeding into wider debates about safe harbours for directors making forward-looking statements in Australia. To fully allay directors' concerns in this regard, more far-reaching statutory reforms of sections 299A and/or the inclusion of a broad, overarching defence for directors in the *Corporations Act* may be necessary. If any of these proposed reforms are implemented to limit directors' liability for forward-looking statements in OFRs and integrated reports, it is beneficial that mechanisms, such as external assurance, are utilised to ensure that reliance can nonetheless be placed on these forward-looking statements. The concomitant development of a legal safe harbour for auditors alongside legal protections for directors in relation to forward-looking information in OFRs and integrated reports is thus a further area for consideration.

Table 1: Australian Companies on GRI that Produced a Self-Claimed 'Integrated' Report in 2013

Company	Name of Report	Reference to <IR> Framework	Responsibility of TCWG	Assurance
Stockland Corporation Ltd	2013 Annual Review	Yes; <IR> pilot company	Whole annual review signed off by Chairman, and the Managing Director and CEO	Yes, by NetBalance
Dexus	2013 Annual Review	No reference to <IR> Framework	Whole annual review signed off by Chairman	PwC provided limited assurance over selected data from Australia and NZ within the integrated online reporting suite
SIMS Metal Management	2013 Annual Report	No reference to <IR> Framework	Whole annual report signed off by Chairman	Financial statement (included in report) audited by PwC
National Australia Bank	2013 Annual Review	<IR> pilot	Whole annual review signed off by Chairman	EY provided limited assurance on Annual Review
Insurance Australia Group	2013 Sustainability Report	No reference to <IR> Framework	Whole sustainability report signed off by Chairman and Managing Director	NetBalance assured sustainability indicators to a limited level using ASA 3000
GPT Group	2013 Sustainability Report	No reference to <IR> Framework	Statement that 'The Board has ultimate responsibility for ensuring that the sustainability strategy conforms to GPT's Sustainability Policy and that there are robust management system procedures in place for managing GPT's key areas of sustainability risk and opportunity'	No