



**ASIC**

Australian Securities & Investments Commission

CONSULTATION PAPER 69

# Disclosing pro forma financial information

July 2005

## What this draft guide is about

- 1 This draft guide sets out our proposed guidelines for the use of pro forma financial information in financial reports and other documents, such as fundraising documents, product disclosure statements, takeover documents and public announcements. The purpose of our guidelines is to promote full and clear disclosure for investors and other users of pro forma financial information.
- 2 In this draft guide, we discuss what types of pro forma financial information can be published and what additional disclosures should be made so that any such information is not misleading.
- 3 There are specific limitations on the use of pro forma financial information in financial reports under Chapter 2M of the *Corporations Act 2001* (the Act). The use of pro forma financial information in documents other than Chapter 2M financial reports is governed by general statutory obligations, such as requirements that the information not be misleading.
- 4 Our proposed guidelines do not replace the law for those other documents. Disclosure in documents other than financial reports that does not follow our guidelines will not necessarily breach the law. However, because our guidelines reflect our view of good disclosure practice, following them may minimise the potential for non-compliance in other documents.

## Your feedback is invited

We invite you to comment on our proposed guidelines and the issues for consideration in this draft guide. All submissions will be treated as public documents unless you specifically request that we treat the whole or part of your submission as confidential. Following the comment period, we aim to publish final guidelines by 30 November 2005.

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### Your comments

Comments are due by 30 September 2005 and should be sent to:

Office of Chief Accountant  
Australian Securities & Investments Commission  
GPO Box 9827  
Sydney NSW 2001  
fax: (02) 9911 2615  
email: [douglas.niven@asic.gov.au](mailto:douglas.niven@asic.gov.au)

You can also contact ASIC Infoline on 1300 300 630 for information and assistance.

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# Section 1: What is pro forma financial information?

1.1 In this draft guide, *pro forma financial information* is any financial information, financial figure, measure or ratio that:

- (a) is not specifically required to be disclosed in a financial report by the financial reporting requirements of Chapter 2M of the Act (including accounting standards); and/or
- (b) is not prepared in accordance with all relevant accounting standards.

We use the term ‘statutory financial reporting requirements’ to describe the financial reporting requirements of Chapter 2M of the Act (including accounting standards).

1.2 *Pro forma financial statements* are pro forma financial information that has been presented in a form that purports or appears to be:

- (a) a statement of financial position (balance sheet);
- (b) a statement of financial performance (profit and loss statement or income statement); or
- (c) a statement of cash flows,

but which has not been prepared in accordance with statutory financial reporting requirements.

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## Your feedback: Section 1

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**Q1.1** Are these definitions appropriate? If not, how should they be amended?

## Section 2: Pro forma disclosures in financial reports

### The purpose of a financial report

**2.1** Many companies, registered schemes and disclosing entities are required to lodge financial reports prepared in accordance with statutory financial reporting requirements. These requirements are intended to ensure consistent and comparable reporting of historical financial performance, position and cash flows of entities.

**2.2** Preparing a financial report in accordance with statutory financial reporting requirements ensures that it is informative and not misleading to the broad range of users, including current and potential members, creditors, employees and customers, and analysts. It also enables comparison of the financial position and performance of the entity between reporting periods and with other entities.

### What may be included in a financial report?

**2.3** Under s295(3), pro forma financial information (other than pro forma financial statements: see paragraphs 2.5–2.6 below) may be included in a financial report:

- (a) in the notes to the financial statements
- (b) *if* the additional information is necessary to give a true and fair view of the financial position and financial performance of the entity for the financial period.

**2.4** Because financial information prepared in accordance with statutory financial reporting requirements will normally provide a true and fair view, additional pro forma financial information under s295(3) will be necessary only in rare and exceptional circumstances. This is because:

- (a) the financial report provides a historical record of the actual financial performance of an entity for a period and its financial position at the end of that period, whereas pro forma financial information does not always present actual historical financial performance or position of the entity for the period (eg when the pro forma information excludes certain revenues or expenses, or includes adjustments for transactions that had not occurred at the time as if they had occurred);
- (b) compliance with accounting standards in itself should give a true and fair view, given the consideration and approval of these

standards by the Australian Accounting Standards Board (AASB), and the extent of consultation and due process before each standard is made; and

- (c) specific accounting standards already prescribe the methodology to account for particular transactions and balances. For example, acquisitions of assets or entities and consolidation of the results of controlled entities acquired or divested during the reporting period.

Note: See, for example, AASB 1015 'Acquisitions of Assets', AASB 1013 'Goodwill', AASB 1024 'Consolidated Accounts' and AASB 1042 'Discontinuing Operations' (for years commencing on or after 1 January 2005, AASB 116 'Property, Plant and Equipment', AASB 3 'Business Combinations', AASB 127 'Consolidated and Separate Financial Statements' and AASB 5 'Non-current Assets Held for Sale and Discontinued Operations').

## What may not be included in a financial report?

2.5 Pro forma financial statements may not be included in a financial report. In particular:

- (a) s295(1) and (2) specify the contents of a financial report and, in our view, provide an exhaustive list of what may be included. Pro forma financial statements are not specifically listed; therefore they cannot be included in a financial report;

Note: Changes to the wording of s295(2) by the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* with effect for financial years commencing on or after 1 July 2004 do not alter this view. The revised subsection specifies the presentation of financial statements that are specifically required by accounting standards and does not permit the presentation of other financial statements.

- (b) s296 specifies that a financial report must comply with accounting standards and any further requirements in the regulations. Any financial statements in a financial report must therefore fully comply with accounting standards; additional pro forma financial statements usually would not comply with these standards;

Note: Pro forma financial statements generally involve adjustments to the financial information prepared in accordance with accounting standards, and therefore result in a subjective and non-comparable outcome that cannot be supported by reference to an underlying reporting framework.

- (c) for years commencing on or before 31 December 2004, paragraph 4.5 of AASB 1018 'Statement of Financial Performance' states that 'a financial report must not contain a statement that purports to be a statement of financial performance where that statement is not in accordance with a[n Accounting] Standard'. That is, a pro forma

statement of financial performance should not be included in any part of a financial report, including the notes to the financial statements;

- (d) although accounting standards do not explicitly prohibit a pro forma statement of financial position or pro forma statement of cash flows (other than as referred to in subparagraph (c) above), specific provisions in other accounting standards prohibit treatments that may form the basis of pro forma financial statements; and

Note: For example, pro forma financial statements that include results for a subsidiary before the date that control is obtained (or exclude the results of a subsidiary before control ceases) would be contrary to accounting standards. AASB 1024 'Consolidated Accounts' (for years commencing on or after 1 January 2005, AASB 127 'Consolidated and Separate Financial Statements') requires a subsidiary to be included in consolidated financial statements only from the date on which the parent entity obtains control of the subsidiary, until the time it is no longer controlled. AASB 1042 'Discontinuing Operations' provides for a specific method of accounting for operations that are divested during the period.

- (e) pro forma financial statements may be misleading (see s1308 and paragraphs 2.7–2.9 below).

#### 2.6 Pro forma financial statements include:

- (a) information presented in the form of an additional or 'third' column on a financial statement (even if it is described as a note to the financial statements); and
- (b) information presented in the notes to the financial statements in a form that resembles financial statements.

## Disclosure should not be misleading

**2.7** Pro forma financial information included in a financial report should not be presented in a manner that is misleading to users of the report: s1308. Disclosure that could be misleading includes information that is purported to be in accordance with accounting standards when it is not.

**2.8** Pro forma financial information provided in a financial report should not be presented with greater prominence, emphasis or authority than the corresponding financial information prepared in accordance with accounting standards.

**2.9** A note to the financial statements is permitted reconciling key line items in the financial statements (e.g. profit and net assets) to figures prepared under the GAAP of another jurisdiction in which the entity is listed, provided that it is not presented in a misleading manner.

## Half-year financial reports

**2.10** Because the requirements for half-year financial reports (see s302–305) mirror the requirements for annual financial reports, our proposed guidelines apply equally to half-year financial reports.

## Concise financial reports

**2.11** Our proposed guidelines also apply to pro forma financial information in concise financial reports prepared in accordance with s314.

**2.12** Under s314(1), a company, registered scheme or disclosing entity may send a concise report to members instead of a full financial report and auditor’s report. The financial statements and specific disclosures required in a concise financial report must be derived from the financial report of the entity, and any other information included must be consistent with the financial report of the entity: see paragraph 4.1 of AASB 1039 ‘Concise Financial Reports’.

**2.13** Although AASB 1039 requires some additional disclosures to those required in a full financial report, these additional disclosure requirements should not be seen as justification for including additional pro forma financial information.

## Relief

**2.14** We may exercise our discretionary relief powers under s340 and 341 to grant relief from s295 and 303 to allow an entity to include a financial statement other than their statutory financial statements in a financial report in certain circumstances, but we envisage that this relief would be necessary only in rare and exceptional circumstances. This is because:

- (a) including such pro forma financial statements in financial reports is contrary to the intentions of the legislature and of accounting standard setters; and
- (b) s295(3)(c) and 303(3)(c) already provide for other pro forma financial information to be included in the notes to the financial statements where that is necessary to give a true and fair view.

Note: For our policy on applications for relief from the requirements of Chapter 2M of the Act, see Policy Statement 43 *Accounts and audit relief* [PS 43].

**2.15** We have granted class order relief in three specific circumstances:

- (a) to allow issuers of stapled securities to include their financial statements and the consolidated or combined financial statements of



the stapled group in adjacent columns in one financial report (see Class Order [CO 05/0642]);

- (b) to allow related registered schemes with a common responsible entity to include their financial statements in adjacent columns in a single financial report where there is a facility for investors to switch monies between the related schemes (see Class Order [CO 05/0643]); and
- (c) to allow the presentation of a pro forma statement of financial position in the notes to the financial statements to explain the financial effect of material acquisitions and disposals of entities and businesses after balance date (see Class Order [CO 05/0644]).

**2.16** For financial years commencing on or before 31 December 2004, we may also provide case-by-case relief for companies in dual listed company arrangements to present combined group financial statements: see Practice Note 71 *Financial reporting by Australian entities in dual listed company arrangements* [PN 71].

## International Financial Reporting Standards

**2.17** Our proposed guidelines do not prevent disclosure of information on the transition to the Australian equivalents of International Financial Reporting Standards as required by accounting standards AASB 1047 'Disclosing the Impacts of Adopting Australian Equivalents to International Financial Reporting Standards' and AASB 1 'First-time Adoption of Australian Equivalents to International Financial Reporting Standards'.

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### Your feedback: Section 2

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- Q2.1** Are there any specific circumstances where pro forma financial statements would need to be included in a financial report in order to provide a true and fair view of the financial position and/or financial performance of an entity for a financial period?
- Q2.2** Are there any circumstances where ASIC should consider class order relief to allow the inclusion of financial statements of different entities in columns side-by-side (other than those circumstances covered by the class order relief in paragraph 2.15)?

## Section 3: Pro forma disclosures in disclosure documents and announcements

### The purpose of pro forma disclosures

**3.1** Under the Act, disclosure documents and announcements:

- (a) must not be misleading (see paragraphs 3.5–3.6 below), and/or
- (b) must contain information that:
  - (i) is reasonably required by users;
  - (ii) is material to the relevant decision for which the document is prepared; or
  - (iii) could materially affect the price of listed securities.

**3.2** There are many instances where providing pro forma financial information in documents other than financial reports may be useful, and at times necessary, to fulfill disclosure obligations under the Act. There is also potential for pro forma financial information to be misleading, particularly if it is not prepared or presented in accordance with statutory financial reporting requirements, and there is inadequate disclosure of the basis of preparation and the corresponding statutory financial information.

**3.3** Our proposed guidelines in this section apply to disclosure of historical and forward-looking pro forma financial information in:

- (a) prospectuses;
- (b) product disclosure statements;
- (c) takeover bidders' statements, target statements, and other relevant takeover documents;
- (d) scheme of arrangement documents;
- (e) directors' reports;
- (f) related party documents; and
- (g) continuous disclosure notices and other public announcements.

In this draft guide, we refer to these documents collectively as 'disclosure documents and announcements'.

3.4 Our proposed guidelines are designed to assist entities that disclose pro forma financial information in disclosure documents and announcements to do so in a manner that:

- (a) enables users to properly assess the information; and
- (b) is less likely to be misleading.

## **Disclosure should not be misleading**

3.5 Disclosure of pro forma financial information should not be presented in a manner that is misleading. There are a number of sections of the Act that deal with misleading information including s1041E (false and misleading statements), s1041H (misleading and deceptive conduct), s728 (misstatement in, or omission from, disclosure document), s670A (misstatements in, or omissions from takeover and compulsory acquisition and buy-out documents), s1308 (false or misleading statements), and s1309 (false information).

3.6 In some circumstances, pro forma financial information disclosed may (of itself) only present limited information and be potentially misleading due to material information being omitted. For example, a company may announce that it expects to report a profit for a financial period based on a non-statutory profit measure that excludes certain costs, when in fact the statutory profit for the same period may indicate a loss. If the statutory financial information is not included in the announcement, or is included with significantly less prominence, investors may be misled as to the actual financial performance of the company.

## **Accounting standards**

3.7 The Act does not specifically require financial information in a disclosure document to comply with accounting standards. In our view (having regard to the requirements outlined in paragraph 3.1 above), users of disclosure documents and announcements can reasonably expect financial information for an entity to be prepared and presented in accordance with accounting standards because:

- (a) past and/or future financial reports of an entity may be required to comply with accounting standards;
- (b) users are accustomed to financial information prepared on the basis of accounting standards; and
- (c) use of accounting standards enables comparisons with other entities reporting on that basis.

**3.8** Where a particular accounting standard is not followed, the nature, reasons and financial effect of the departure should be prominently disclosed to ensure that the document is not misleading.

## Use of pro forma financial information

**3.9** We propose the following guidelines for use of pro forma financial information in disclosure documents and announcements:

- (a) Whenever pro forma financial information is disclosed, the corresponding information in accordance with accounting standards should also be disclosed. The corresponding information provides users with an objective benchmark against which the information may be critically assessed.

Note: See paragraph 3.10 below for some examples.

- (b) Any pro forma financial information should not be given greater prominence than any corresponding information in accordance with accounting standards.
- (c) The amount and nature of all material adjustments that have been made to the statutory financial information to derive the pro forma financial information should be disclosed, usually by way of reconciliation.
- (d) Whether or not the pro forma and statutory financial information has been audited should be disclosed.
- (e) Any financial ratios prepared on the basis of pro forma financial information should be calculated in accordance with accounting standards or generally accepted practice, and the corresponding ratios prepared on the basis of the relevant statutory financial information should also be disclosed.
- (f) All relevant material assumptions underpinning the pro forma financial information should be disclosed.
- (g) Where the pro forma financial information is provided to reflect a particular transaction such as an acquisition or sale of an entity or operation, the information must reflect the full transaction and not selected aspects.

## Examples

**3.10** The following table provides some examples of statutory financial information that might be disclosed when particular types of pro forma financial information are included in disclosure documents and announcements.

Type of pro forma financial information	Corresponding information in accordance with accounting standards to be disclosed
Any pro forma earnings figure including but not limited to: <ul style="list-style-type: none"> <li>• earnings before interest, tax, depreciation and amortisation (EBITDA);</li> <li>• earnings before interest and tax (EBIT);</li> <li>• ‘underlying earnings’;</li> <li>• ‘core earnings’;</li> <li>• ‘adjusted earnings’; and</li> <li>• ‘cash basis profit’</li> </ul>	Net profit after tax calculated in accordance with accounting standards  When prospective earnings information is disclosed, prospective net profit after tax calculated in accordance with accounting standards should also be disclosed
Revenue or sales	Revenue calculated in accordance with accounting standards
Earnings per share	Earnings per share calculated in accordance with the requirements of AASB 1028 ‘Earnings per Share’ (AASB 133 ‘Earnings per Share’)
Statement of financial position or balance sheet	A statement of financial position prepared in accordance with accounting standards. This must be used as the basis for any pro forma statement of financial position presented
Operating cash flow or cash flow from operations	Cash flow from operating activities calculated in accordance with accounting standards

## ASX requirements

**3.11** Our proposed guidelines do not prevent the disclosure of certain financial information on the basis of accounting standards as required by Appendices 4E, 4C and 5B of the Listing Rules for Australian Stock Exchange Limited (ASX).

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### Your feedback: Section 3

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**Q3.1** Are our proposed guidelines for disclosure of pro forma financial information in documents other than financial reports appropriate? If not, why not? Are they sufficient? If not, why not?

# Key terms

In this draft guide, unless a contrary intention appears, the following terms have the following meanings:

**AASB** The Australian Accounting Standards Board

**accounting standards** As defined in s9 of the Act

**Act** The *Corporations Act 2001*, including regulations made for the purposes of the Act

**ASIC** The Australian Securities and Investments Commission

**ASX** Australian Stock Exchange Limited

**disclosure documents and announcements** Prospectuses, product disclosure statements, takeover bidders statements, takeover target statements, other relevant takeover documents, scheme of arrangement documents, directors' reports, related party documents, continuous disclosure notices and other public announcements

**pro forma disclosures** Disclosure of pro forma financial information in financial reports and other documents

**pro forma financial information** Has the meaning set out in paragraph 1.1 of this draft guide

**pro forma financial statements** Has the meaning set out in paragraph 1.2 of this draft guide

**statutory financial information** Financial information that is required to be disclosed in a financial report under Chapter 2M of the Act (including accounting standards) and is prepared in accordance with all relevant accounting standards

**statutory financial reporting requirements** The financial reporting requirements of Chapter 2M of the Act (including accounting standards)

**statutory financial statements** Financial statements that are required to be disclosed in a financial report under Chapter 2M of the Act (including accounting standards) and are prepared in accordance with all relevant accounting standards.