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Australian Securities & Investments Commission

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Draft Policy Statement 170 Prospective financial information

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[PS 170]

Prospective financial information

Chapter 6D — Fundraising; Chapter 7 — Securities

Part 7.9 — Fundraising — Financial products

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What this policy statement is about

[PS 170.1] This policy statement gives guidance on ASIC's current approach to the use of prospective financial information, including financial forecasts and projections, in disclosure documents and Product Disclosure Statements (PDS). It also applies to conduct under s995 of the *Corporations Act 2001* (Corporations Act). This policy statement replaces Practice Note 67 *Financial forecasts in prospectuses* [PN 67].

[PS 170.2] This policy statement discusses:

A when prospective financial information can or should be disclosed;

see [PS 170.4] – [PS 170.11]

B what are reasonable grounds for prospective financial information;

see [PS 170.12] – [PS 170.37]

C other requirements for prospective financial information; and

see [PS 170.38] – [PS 170.64]

- D** what information should be disclosed by a product issuer in the absence of prospective financial information.

see [PS 170.65] – [PS 170.71]

[PS 170.3] For further guidance on the use of prospective financial information and other material in PDS, see Policy Statement 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* [PS 168].

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A When should prospective financial information be disclosed?

Our policy

Issuer to assess whether information is required

[PS 170.4] An issuer must assess on a case-by-case basis if prospective financial information needs to be disclosed in a disclosure document or PDS. However, when there are no reasonable grounds for disclosing the prospective financial information, we think that it should not be disclosed.

Information must have reasonable grounds

[PS 170.5] A disclosure document or PDS should not include prospective financial information that does not have reasonable grounds even if it has been used to estimate future performance for internal planning purposes. Prospective financial information without reasonable grounds is not material to investors, nor would an investor reasonably require it or reasonably expect to find it in a disclosure document or PDS. The disclosure obligations in the Act do not mandate or allow disclosure of information that is misleading.

Underlying principles

[PS 170.6] We believe a decision whether or not to include prospective financial information in a disclosure document or PDS requires balancing the information value of what is disclosed against the likelihood that the information is misleading. The two elements are interrelated. So the less reliable information is, the less relevant it becomes to investors, and the less likely it should be included in the disclosure document or PDS.

[PS 170.7] We think that prospective financial information based on hypothetical assumptions is likely to be misleading and provide little information value to investors.

Explanations

[PS 170.8] Section 710 of the Corporations Act requires a prospectus to contain all information that would enable investors and

their professional advisers to make an informed assessment of the issuer's prospects.

[PS 170.9] Section 714 (Profile Statements) and s715 (Offer Information Statements) allow the inclusion of information provided it is not misleading or deceptive.

[PS 170.10] Section 1013D (inserted by the FSR Act) states in part:

a Product Disclosure Statement must include the following statements, and such of the following information as a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product:

(b) information about any significant benefits to which a holder of the product will or may become entitled, the circumstances in which and times at which those benefits will or may be provided, and the way in which those benefits will or may be provided.

[PS 170.11] We believe the general test of whether an earnings forecast must be disclosed is whether it is:

- (a) relevant to its audience; and
- (b) reliable — there must be a reasonable basis for it: see *GIO Australia Holdings Ltd v AMP Insurance Investment Holdings Pty Ltd* (1998) 29 ACSR 584.

Information is not material to investors if it is speculative or based on mere matters of opinion or judgment: see *AAPT v Cable & Wireless Optus Ltd* (1999) 32 ACSR 63.

While these cases relate to takeovers we consider that they state principles that apply equally to disclosure made in a disclosure document or PDS.

B What are reasonable grounds for prospective financial information?

Our policy

The misleading and deceptive prohibition

[PS 170.12] Prospective financial information (like any forward looking statement) must have reasonable grounds or it will be misleading under s728(2) or s769C of the Corporations Act. We believe what are “reasonable grounds” should be determined objectively in light of all of the circumstances of the statement so that reasonable persons would view the grounds that the maker has for making the statement as reasonable.

Indicative factors that may suggest reasonable grounds

[PS 170.13] The following is a non-exhaustive list of factors that may indicate reasonable grounds for prospective financial information:

- (a) forward sales contracts, leases or other contracts that lock in future expenses and revenue of a product/service and the quantum of supply;
- (b) an independent industry expert’s report which:
 - (i) is included in the document containing the prospective financial information;
 - (ii) sets out the assumptions underlying that information; and
 - (iii) makes a positive statement that both the prospective financial information and its assumptions are reasonable;
- (c) an independent accountant’s report prepared in accordance with professional standards and included in the disclosure document or PDS. The independent accountant’s report should:
 - (i) be based on an investigation of the reasonableness of the assumptions giving rise to the prospective financial information;
 - (ii) state that there is no reason to believe that the assumptions do not provide reasonable grounds for the preparation of the information;

(iii) state there is no reason to believe that the information itself is unreasonable; and

(iv) clearly identify any hypothetical assumptions and state that they have no significant impact upon the projected outcome; or

(d) short-term estimates (not exceeding 2 years) relating to an existing business and based on events management reasonably expects to take place or actions management reasonably expects to occur.

[PS 170.14] For sales contracts or leases that have a renewal option at the end of the initial term, prospective financial information should only extend to the end of the initial term unless there are reasonable grounds to believe that the option will be exercised.

These factors are not conclusive

[PS 170.15] There may be other methods of establishing reasonable grounds and, importantly, the factors listed in [PS 170.13] may not be sufficient to establish reasonable grounds in some cases. Each case must be considered in light of its own particular facts and the requirements of the Corporations Act.

Underlying principles

[PS 170.16] For forward-looking statements in disclosure documents, s728(2) provides:

“A person is taken to make a misleading statement about a future matter (including the doing of, or refusing to do, an act) if they do not have reasonable grounds for making the statement. This subsection does not limit the meaning of a reference to a misleading statement or a statement that is misleading in a material particular.”

PDS will be subject to an equivalent provision after FSR commences: see s769C.

[PS 170.17] A statement along the lines of “this is the best estimate of the directors” may not be sufficient to demonstrate that the reasonable grounds for prospective financial information required by s728(2) exist. The Explanatory Memorandum to the CLERP Bill at 8.13 explained that s728(2) of the Corporations Act was designed to:

...” encourage the inclusion of material of potential use to investors without exposing issuers to liability for legitimate forecasting. [Subsection 728(2)] also ensures that forecasts are made where

there is a reasonable basis for them and not made on the basis of genuine but unreasonable beliefs of issuers.”

Explanations

Reasons for our policy review

[PS 170.18] Studies and research have shown that the release of prospective financial information by management has a significant effect on share prices. This implies that buy/sell decisions are influenced by prospective financial information.

[PS 170.19] Consistent with this, the long-term rate of return of a financial product has been shown in studies to be the dominant criteria for investors in selecting a managed investment scheme. This finding reflects recent overseas research that indicates that for other investment products, the rate of return was seen as a determining factor in making a purchasing decision.

[PS 170.20] We are concerned at the degree of unreliability of some prospective financial information and the grounds on which it has been prepared. For example, recent statistics we compiled showed that a substantial number of companies that listed during the year 2000 failed to meet their prospectus forecasts after just one year. This reflects earlier research carried out by a major accounting firm in 1996 and various overseas studies.

[PS 170.21] Still further research identifies that longer time horizons reduce the accuracy of prospective financial information.

[PS 170.22] Finally, internal ASIC reviews have consistently identified problems with prospective financial information as a leading cause of ASIC issuing stop orders since the mid-1990s. In light of these reasons, ASIC has issued this further guidance.

Indicative factors that may suggest reasonable grounds

[PS 170.23] ASIC generally considers that prospective financial information for a period of more than 2 years may require independent or objectively verifiable sources of information to establish that it has reasonable grounds. However, for an existing business preparing prospective financial information up to 2 years, ASIC will generally not require independent verification if there otherwise appears to be reasonable grounds to make the statement. Directors should satisfy themselves and state why they believe the information is objectively

reasonable. ASIC may still take action on a forecast up to 2 years if it believes there are no reasonable grounds to make it.

Forward sales contracts or leases

[PS 170.24] The mere existence of an option in a lease or contract does not create reasonable grounds for assuming it will be exercised. Some further basis is needed. An example is where an independent industry expert provides reasonable assurance that even after a lease finishes the property can be re-leased for the relevant amount given certain assumptions about economic circumstances, local vacancy rates etc, and the expert states that all those assumptions are reasonable.

Independent industry experts' reports

[PS 170.25] Reasonable grounds for prospective financial information may exist where an independent industry expert states that the information and its underlying assumptions are reasonable and the expert does not disclaim liability for the statement. An expert could even adopt management's assumptions if that expert states that those assumptions are reasonable. However, we will not generally regard an expert's report that accepts management's assumptions without testing whether they are reasonable as meeting the test in s728(2) or s769C. In preparing an expert's report, the independent expert should have regard to Practice Note 43 *Valuation reports and profit forecasts* [PN 43]. For the requirements to establish an expert's independence, see Practice Note 42 *Independence of experts' reports* [PN 42].

Negative assurance reports

[PS 170.26] Reports prepared by an independent accountant in accordance with the relevant audit standards and this policy may establish reasonable grounds for prospective financial information. We note that the AuASB are reviewing their standards on prospective financial information and we will continue to liaise with them and, if necessary, reconsider our policy in light of their decisions. In the interim, the Appendix to this policy statement provides guidance about the preparation of an independent accountant's report for use in a disclosure document or PDS. The Appendix should be read with the entire policy statement.

These factors are not conclusive

[PS 170.27] Forward contracts or leases, independent industry experts' reports and negative assurance reports by accountants *may* indicate that reasonable grounds exist for prospective financial information, but they are not necessarily conclusive. What constitutes "reasonable grounds" must be judged according to the facts and circumstances of each case.

[PS 170.28] ASIC intends to monitor experts' reports that seek to provide reasonable grounds for prospective financial information, to ensure the reports themselves are reasonable and have not been prepared or presented in a misleading manner.

[PS 170.29] In particular, where an issuing body includes prospective financial information in a disclosure document or PDS, ASIC will closely examine supporting documents to determine whether there are reasonable grounds for including the prospective financial information if:

- (a) the body is in the start up phase;
- (b) the body will substantially change its operations following the fund raising; or
- (c) the body's present activities constitute research and development of products and the development is not significantly advanced to warrant a reasonable expectation that the products will be commercialised.

Advertising

[PS 170.30] We believe the general principles in this policy also apply to advertising because of the interaction of s765(1) and 995(2) which state respectively that:

s765(1) When a person makes a representation with respect to any future matter (including the doing of, or the refusing to do, any act) and the person does not have reasonable grounds for making the representation, the representation is taken to be misleading.

s995(2) A person shall not, in or in connection with:

- (a) *any dealing in securities; or*
- (b) *without limiting the generality of paragraph (a):*
 - (i) *the allotment or issue of securities;*
 - (ii) *a notice published in relation to securities;*

- (iii) *the making of, or the making of an evaluation of, or of a recommendation in relation to, offers under a takeover bid;*
- (iv) *the carrying on of any negotiations, the making of any arrangements or the doing of any other act preparatory to or in any other way related to any matter referred to in subparagraph (i), (ii) or (iii);*

engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

[PS 170.31] It follows that if there is advertising of prospective financial information that does not have reasonable grounds, the advertisement will be misleading. It should be clear from any advertisement that financial forecasts are not guaranteed to occur. For more on presenting prospective financial information and related assumptions and risks, see Section C of this policy statement.

[PS 170.32] After the FSR Act commences, equivalent provisions will apply to PDS: see s769C and s1041H.

Forward-looking statements and contingencies

[PS 170.33] We do not believe that s728(2) and equivalent provisions necessarily prevent statements about on what may happen as a result of a contingency that is unlikely to occur. The test is whether a reasonable class of consumers would regard the statement as having a predictive faculty: see *ASC v McLeod* (2000) 18 ACLC 424. Because of the marketing role of prospective financial information and the use by investors of prospective financial information in making purchasing decisions, it is difficult to argue that prospective financial information will not have a predictive faculty.

[PS 170.34] Deciding whether a reasonable class of consumers would believe that disclosure in a disclosure document or PDS has a predictive nature requires consideration of:

- (a) the overall impression created by the disclosure document or PDS; and
- (b) the wider circumstances and context in which the disclosure is made.

A reasonable class of consumers may include the astute and the gullible, the intelligent and the not so intelligent, and the well educated and poorly educated: see *Fraser v NRMA Holdings Ltd* (1995) 13 ACLC 132.

[PS 170.35] Statements about risks that may occur in the future and the consequences of the risks occurring will not be forward-looking statements unless they have a predictive character. Even if a specific risk has a low probability of occurring, disclosure of it should be made if it would have a material effect on an investment, were it to occur.

Implied assumptions

[PS 170.36] Issuers of prospective financial information need to ensure that assumptions, including implied assumptions, are based on reasonable grounds. For example, a document might say that “on the basis of today’s price and the yield confirmed by the expert, we expect for every share you hold, you will earn \$100 per year by year 14.” Future market conditions have not been disclosed here, so an implied assumption has been made of no change in market conditions over the period of the prospective financial information. This may have an increasingly material impact on the figures, the further into the future the prediction extends.

[PS 170.37] If there were no reasonable grounds for that assumption the statement would be misleading.

C Other requirements for prospective financial information

Our policy

Informed assessment

[PS 170.38] As well as prospective financial information based on reasonable grounds, investors should also be given enough information to enable them to assess whether the prospective financial information is relevant and reliable (ie to form their own view about how reasonable the grounds are for making the statement).

We consider prospective financial information in a disclosure document or PDS should be accompanied by:

- (a) full details of the assumptions (including the quantum of any assumption) used to prepare the prospective financial information;
- (b) the time period covered by the prospective financial information;
- (c) the risks that the prospective financial information will not be achieved; and
- (d) an explanation of how the prospective financial information was calculated and the reasons for any departures from accounting standards or industry standards that investors might expect would be followed.

“Headlined” rates of return and other potentially misleading conduct

[PS 170.39] Section 728(2) is not an exhaustive statement of when prospective financial information is misleading. The presentation and terminology used in prospective financial information should also be considered.

[PS 170.40] When prospective financial information is used in a disclosure document or PDS, we consider that:

- (a) its underlying assumptions and limits must be displayed in a prominent way (when compared to the statement); and
- (b) where a range has been given, a more favourable figure or fact in the range should not be given undue prominence.

[PS 170.41] The term “forecasts” has a particular accounting meaning. The use of that or other technical terms should not be misleading to investors.

Underlying principles

[PS 170.42] We consider that additional information must be provided with prospective financial information to enable investors and their advisers to make an informed assessment about the product under s710, 714, 715 or 1013D. Information can be misleading if it is presented in isolation from the assumptions and a description of the methodologies used to develop the information: see *Wesfi Ltd v Blend Investments Pty Ltd* (1999) 31 ACSR 69, *Cultus Petroleum NL v OMV Australia Pty Ltd* (1999) 32 ACSR 1.

[PS 170.43] Investors must be able to assess:

- (a) the validity of the assumptions on which the prospective financial information is based;
- (b) the likelihood of the assumptions actually occurring; and
- (c) the effect on the forecast if the assumptions vary.

Explanations

Informed assessment

Assumptions

[PS 170.44] A disclosure document or PDS must specifically disclose any assumptions used in compiling prospective financial information that materially affect the forecast outcome. Among other things, assumptions about expenditures and revenues should be disclosed.

[PS 170.45] We expect a disclosure document or PDS to disclose material assumptions about:

- (a) specific future economic conditions; and
- (b) particular circumstances affecting a company or financial product and the industries relevant to that company or financial product.

[PS 170.46] An assessment of the impact of these assumptions on prospective financial information should also be included. However, a disclosure document or PDS does not have to:

- (a) state general assumptions, such as the absence of war or natural disasters, unless the forecast takes these events into account; or
- (b) disclose assumptions that would not materially affect the forecast.

[PS 170.47] Including a sensitivity analysis will often be the best way of showing how significant the key assumptions are to prospective financial information. A sensitivity analysis should show the impact of change on significant assumptions to highlight the importance of those assumptions in calculating the prospective financial information. The range canvassed in the sensitivity analysis should be realistic.

[PS 170.48] It is not sufficient to state the general nature of an assumption. The quantum of the assumption must also be set out. For example, it may not be sufficient to state that prospective financial information is based on an anticipated recovery in equity markets, without setting out the amount of the required recovery: see *GIO Australia Holdings Ltd v AMP Insurance Investment Holdings Pty Ltd* (1998) 29 ACSR 584.

Disclosing confidential information

[PS 170.49] We consider that the commercial benefits of keeping certain information confidential is relevant in assessing what is reasonable for investors to require or expect for the purposes of s710 and s1013F(1). However, these commercial benefits do not justify withholding information that may deter investors from acquiring the securities if that information were generally known. Careful disclosure may often satisfy the requirements of the Act without revealing confidential information.

Period of forecast

[PS 170.50] A disclosure document or PDS must clearly state what period the prospective financial information relates to. We consider that the period of the information is an assumption that forms part of the information that must be disclosed.

[PS 170.51] It may be appropriate to explain why a particular period was selected. Persons making a forecast over periods affected by cyclical or seasonal factors or income support guarantees that will expire after the forecast period, must ensure that readers are not misled about how representative the period is likely to be. If there are specific considerations that affect a chosen period, those matters should be disclosed.

[PS 170.52] In our view, prospective financial information should be based on the financial years of the issuer. This means that:

- (a) investors can compare results with previous year financial results; and
- (b) periods are not selected to create a misleading impression.

[PS 170.53] Subject to our comments in [PS 170.50], if a reliable forecast can only be reasonably made for part of a financial year, it can be made for that part only.

Risks to prospective financial information

[PS 170.54] Any disclosure document or PDS that contains prospective financial information must indicate what factors may lead to a significant difference between the forecast and the actual results.

Use of ranges

[PS 170.55] Presenting prospective financial information as a range may reduce the risk that investors will place undue weight on it, as may occur with a single point estimate. For example, a profit of \$10–14 million may be forecast in the next financial year. However, giving a range is only appropriate for significant totals, such as net profits or net assets. Ranges may be confusing or misleading if they are used for every item that appears in a profit and loss statement or balance sheet.

[PS 170.56] A range must be small enough to give meaningful information about an issuer's prospects. A disclosure document or PDS should state what variables will have a significant effect on the outcome within the range. It may be misleading to include a range when the maker expects the results to be at the lower end of the range. If a forecast range is given, the link between the assumptions and the upper and lower ends of the range should be clear. It may be appropriate to express prospective financial information as a statement that a result of at least a specific amount is likely.

[PS 170.57] When quoting a range, undue prominence should not be given to the more favourable figure or fact in the range.

Methodology

[PS 170.58] Investors must be able to assess the reliability of prospective financial information. To do this, they should be able to assess whether the key assumptions are likely to occur. Therefore, a disclosure document or PDS must disclose the material details about

the enquiries and research undertaken and the process followed in preparing the information.

Accounting and industry standards

[PS 170.59] A disclosure document or PDS may show prospective financial information in the format of financial statements required by the Corporations Act, such as a profit and loss statement or a balance sheet. Therefore, some investors may expect that information is prepared in accordance with accounting or industry standards. Our view is that, as a general principle, the following should be disclosed in a disclosure document or PDS:

- (a) the reasons for any departure from current accounting or industry standards that apply;
- (b) the reason a particular accounting or industry standard is applied in a particular way when there is some discretion involved; and
- (c) the reason a particular accounting or disclosure treatment is adopted when current practices differ among relevant professionals.

[PS 170.60] The issuer should also disclose the effects of any chosen accounting treatment on the prospective financial information. The effects should be disclosed in enough detail for investors to properly assess the information. Reasons for preparing prospective financial information in a particular way will not need to be given if it would not be material to investors. We are not concerned with trivial or unimportant differences in accounting treatment in a prospectus. See also Practice Note 64 *Accounting and disclosure issues for property trust prospectuses* [PN 64].

[PS 170.61] Similarly, if an expert adopts a particular methodology in preference to others when preparing prospective financial information, it should be explained. Experts should refer to [PN 43] for more detailed guidance.

“Headlined” rates of return and other potentially misleading conduct

[PS 170.62] If significant information about prospective financial information is presented in a way that investors are likely to overlook, a disclosure document or PDS may be misleading see: *Fraser v NRMA Holdings Ltd* (1995) 13 ACLC 132, *Pancontinental Mining Ltd v Goldfields Ltd* (1995) 16 ACSR 463. Therefore, a disclosure document or PDS must present the information needed to assess the reliability of prospective financial information in a way that clearly

connects both types of information. This normally means that the information about assumptions, and other matters underlying prospective financial information, should be in the same part of the disclosure document or PDS as the prospective financial information itself.

[PS 170.63] ASIC considers that prospective financial information and associated material should be disclosed:

- (a) with its assumptions and limits prominently displayed immediately after the forecast, or in a way that ensures that a reader is made aware of the existence, nature and quantum of the assumptions and limits at the time they read it;
- (b) with the assumptions and limits displayed in a way which is not less prominent than the forecast; and
- (c) so that prominence is not given to a more favourable figure or fact in the forecast range if a range is cited.

[PS 170.64] The use of terms like “forecasts” may imply that their contents are calculated in accordance with auditing standards. An explanation of audit standard terminology can be found in AUS 804. Issuers should ensure that the use of any technical terms are adequately explained in a PDS or disclosure document and are not misleading. In particular, care should be taken to ensure that the use of terminology is consistent throughout a disclosure document or PDS to avoid investor confusion.

D What to disclose in the absence of prospective financial information

Our policy

Issuer to determine whether information is required

[PS 170.65] Even if prospective financial information is not included in a disclosure document or PDS (because there are no reasonable grounds to make it) there must still be adequate disclosure about the prospects of the scheme or company.

[PS 170.66] If prospective financial information has not been included in a disclosure document or PDS because there are no reasonable grounds for it, issuers should consider inserting a statement to that effect.

Explanations

[PS 170.67] Section 710 of the Corporations Act requires disclosure about the issuer's prospects. Section 1013D(1)(b) of the Corporations Act (inserted by the FSR Act) requires disclosure about significant benefits of a product and the way in which the benefits will or may be provided.

[PS 170.68] Even where there are no reasonable grounds to set out prospective financial information, disclosure is still required on the matters mentioned above.

[PS 170.69] What is sufficient to meet these disclosure requirements must be judged in the context of each case. However, some examples of information include:

- (a) historical information about the product such as yield or price (making sure that investors will not think it is a guarantee of future performance);
- (b) risks (eg historically what impacts on the key areas of yield and price, experience of the directors);
- (c) anticipated acquisitions;
- (d) product development and market share;
- (e) the kinds of matters discussed in Practice Note 70 *Prospectuses for cash box and investment companies* [PN 70].

Past performance

[PS 170.70] If events have occurred that make historical information unreliable, then those factors should be specifically identified. Past performance disclosure is also discussed in [PS 168].

Cash burn

[PS 170.71] In the case of start-up ventures and where there are reasonable grounds for establishing future costs, we would also expect some disclosure of:

- (a) the likely rate of expenditure for the venture;
- (b) if and when further funds will be required to continue business operations; and
- (c) how those funds might be raised.

Key terms

[PS 170.72]

In this policy statement, a reference to:

“AuASB” means the Auditing and Assurance Standards Board

“ASIC” means the Australian Securities and Investments Commission

“Corporations Act” means the *Corporations Act 2001* and includes regulations made for the purpose of the Act

“CLERP Bill” means the *Corporate Law Economic Reform Program Bill 1999*

“disclosure document” has the meaning set out in s9 of the Corporations Act

“FSR Act” means the *Financial Services Reform Act 2001*

“PDS” means a Product Disclosure Statement that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Part 7.9 Div 2 of the Corporations Act (as amended by the FSR Act)

“PS 136” (for example) means ASIC Policy Statement 136

“s728” (for example) means section 728 of the Corporations Act.

Related information

[PS 170.73]

Headnotes

Prospective financial information, forecasts, misleading and deceptive conduct.

Policy statements and practice notes

Policy Statement 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* [PS 168]

Practice Note 42 *Independence of experts' reports* [PN 42].

Practice Note 43 *Valuation reports and profit forecasts* [PN 43].

Practice Note 64 *Accounting and disclosure issues for property trust prospectuses* [PN 64].

Practice Note 70 *Prospectuses for cash box and investment companies* [PN 70].

Legislation

Sections 710, 714, 715, 728, 765, and 995 of the Corporations Act.

Sections 769C, 1013D and s1041H of the Corporations Act inserted by FSR.

Cases

GIO Australia Holdings Ltd v AMP Insurance Investment Holdings Pty Ltd (1998) 29 ACSR 584

AAPT v Cable & Wireless Optus Ltd (1999) 32 ACSR 63

ASC v McLeod (2000) 18 ACLC 424

Wesfi Ltd v Blend Investments Pty Ltd (1999) 31 ACSR 69

Cultus Petroleum NL v OMV Australia Pty Ltd (1999) 32 ACSR 1

Fraser v NRMA Holdings Ltd (1995) 13 ACLC 132

Pancontinental Mining Ltd v Goldfields Ltd (1995) 16 ACSR 463

Media and information releases

[IR 01/5] ASIC provides guidance for preparers and reviewers of prospective financial information included in disclosure documents, 7 February 2001

[MR 01/112] Further intervention by ASIC on fundraising disclosure, 30 March 2001

APPENDIX – Interim guidance for the preparation of independent accountant’s reports

Note: this appendix will be reviewed once the AuASB has provided further guidance in this area.

1 Disclosure of assumptions

Where forecasts or projections are included in a disclosure document, ASIC expects the assumptions to be clearly stated (see [PS 170.38]).

In order to make an informed assessment as to an issuer's prospects, we consider that investors require disclosure as to which assumptions are best estimate assumptions and which assumptions are hypothetical within the meaning of the audit standard AUS 804.

We believe it is not sufficient for a disclosure document to contain a statement that the assumptions are a mix of hypothetical assumptions and best-estimate assumptions, without clearly identifying which assumptions are best-estimate assumptions and which are hypothetical.

2 Engagements to report upon prospective financial information

Usually an expert, who is engaged to report upon prospective financial information contained in a disclosure document or PDS, will conduct a review rather than an audit of the information.

Either a review or an audit engagement is an appropriate means of providing assurance to readers of prospective financial information. We will closely examine other forms of engagements (for example agreed upon procedures engagements) to ensure that they provide reasonable grounds for the prospective financial information.

3 Review of prospective financial information

ASIC expects experts who review and report on prospective financial information contained in a disclosure document or PDS to disclose in their report the scope of their engagement and the extent and nature of their enquiries. In practice, this can be achieved by the expert stating that the review has been carried out in accordance with Australian Auditing Standards applicable to review engagements.

In all cases where an expert states that the review has been carried out in accordance with Australian Auditing Standards, the key

requirements of AUS 804: *The Audit of Prospective Financial Information*, should be complied with. In those cases where a review (rather than an audit) of prospective financial information is undertaken, AUS 804 should be applied with such adaptations as are necessary for review engagements under AUS 902: *Review of Financial Reports*. AUS 902 states that although AUS are mostly written in the context of audits, they are to be applied and adapted as necessary to review engagements (AUS 902.05).

Accordingly we expect that:

- In a typical engagement, the independent accountant should provide a negative assurance as to the reasonableness of the company's best-estimate assumptions (see AUS 804.31(d) and 804.10).
- The expert need not provide any negative assurance in his or her report in relation to the hypothetical assumptions. But the expert should undertake sufficient work to be satisfied that the hypothetical assumptions are not clearly unrealistic (see AUS 804.24). The expert's working papers should document the extent of procedures conducted to satisfy this requirement.
- The expert should ensure that a reader of the report clearly understands which assumptions are the subject of the negative assurance (the best-estimate assumptions) and which are not (the hypothetical assumptions). Accordingly the expert should check the disclosure document or PDS to see that it clearly specifies which of the assumptions are best-estimate and which are hypothetical. If it does not include this information, we would expect the expert to issue a qualified report.

Where hypothetical assumptions are used the report should state whether or not those assumptions will have a significant impact upon the prospective financial information presented. The larger the impact of hypothetical assumptions on a projected outcome, the more likely it is the projection will not be based on reasonable grounds.

4 Pro forma financial statements

Point of Sale Disclosure may include pro forma financial statements prepared on the basis of underlying pro forma transactions. These statements will generally have been prepared by management or an accountant under a compilation engagement. The pro forma transactions will, in most instances, reflect future events and management actions that are considered highly probable upon the

successful completion of the fund raising, such as anticipated acquisitions of assets.

In relation to pro forma transactions we expect:

- There should be clear disclosure of the nature and financial impact of the pro forma transactions that have been adopted in the pro forma financial statements.
- Where an expert is appointed to review the pro forma financial statements that have been prepared by management, the expert should at least provide a negative assurance as to whether:
 - (a) the pro forma financial statements have been properly prepared on the basis of the pro forma transactions; and
 - (b) the pro forma transactions form reasonable grounds for the preparation of the pro forma financial statements.

Where an audit is conducted, the expert would express the conclusion on the pro forma financial statements in the form of an audit opinion rather than negative assurance.

- Where the pro forma financial statements have been prepared as part of the expert's report, the expert must disclose the extent of his or her responsibility for the preparation of the financial information.