# Attachment to CP 257: Proposed updates to Section F of RG 228

This attachment sets out mark up of our draft amendments to Section F of Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228), which contain our proposed updated guidance on disclosure of historical financial information in prospectuses. We are proposing that the draft amendments be incorporated into RG 228 once this guidance has been finalised.

See Consultation Paper 257 *Improving disclosure of historical financial information in prospectuses: Update to RG 228* (CP 257) for our complete proposals.

# F Financial information: What is your financial position, performance and prospects?

**Key points**

Your prospectus should explain your financial position, performance and prospects: s710. Failure to do so in accordance with the guidance in this section materially increases the risk of ASIC taking regulatory action.

Information about your financial position, performance and prospects is often the most important consideration for investors.

## What to disclose if you have an operating history

### Historical financial information

RG 228.87 Except in the circumstances outlined in RG 228.97, i~~I~~f you ~~have,~~ or a business or entity you propose to acquire has~~,~~ an operating history, you should ~~generally~~ include in your prospectus:

(a) a consolidated audited statement of financial position for the most recent financial year (or audited or reviewed half-year depending on the date of your prospectus: see RG 228.89) showing the major asset, liability and equity groups and a corresponding pro-forma statement of financial position showing the effect of the offer;

(b) the following audited financial information for at least the three most recent financial years (or two-and-a-half financial years depending on the date of your prospectus: see RG 228.89):

(i) a consolidated income statement showing major revenues and expense items, and profit or loss, including EBIT and net profit after tax (NPAT);

Note: You should also consider providing pro-forma income statements for this period, especially if the company has undergone significant changes during the relevant period.

(ii) other ~~material~~ information that is material from ~~the notes to the~~ financial statements, notes to the financial statements and other documents attached to the financial report. Examples of other material information will depend on the specific circumstances and may include a cash flow statement, matters such as details of material exposures through financial instruments and contingent liabilities, and details of any related party transactions or unusual transactions; and

(iii) any modified opinion by the auditor (e.g. a going concern emphasis of matter or qualification);

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(c) all events that have had a material effect on the company since the date of the most recent financial statements; and

(d) a warning that past performance is not a guide to future performance.

Note: Companies seeking to list will also need to comply with the financial information disclosure requirements of the relevant exchange.

RG 228.88 ~~Disclosure of less than three years' (or two-and-a-half years if applicable: see RG 228.89) historical financial information is not generally~~You should disclose audited financial statements for two-and-a-half or three years regardless of whether your business or entity (or the business or entity you are acquiring) was required by law to produce audited financial reports or was in a corporate form. If there has been a significant restructure of the company in the last three years, this should be demonstrated by the use of pro-forma information or otherwise explained. ~~If you believe that the disclosure of less historical financial information is justified because of the particular circumstances of your company, you should disclose these circumstances in the prospectus.~~

RG 228.89 You should include current financial information in your prospectus. Where a company's most recent financial statement relates to a half year, your prospectus should include financial information based on those audited or reviewed half-year financial statements. Provided that the existing business that is the subject of the fundraising has not changed substantially and has an acceptable audit history, as set out in RG 228.91–RG 228.94, financial information will generally be considered current if you include in the prospectus:

(a) the most recent half-year audited or reviewed financial statements (where the prospectus is lodged with ASIC less than three months after year end); or

(b) the most recent full-year audited financial statements (where the prospectus is lodged with ASIC less than 75 days after half-year end).

RG 228.90 In some instances the business you operate that is the subject of the fundraising may have changed so substantially that any post-balance-date material event disclosure would be of similar or greater significance for investors as the disclosure in the most recent audited full-year or reviewed half-year financial statements. In such cases, you should arrange for more up-to-date financial statements to be prepared and audited, and include those in the prospectus.

### Preparation and audit of financial information

RG 228.91 The preparation and audit or review of historical financial information to be included in your prospectus should be conducted, for businesses and entities in Australia, in compliance with Ch 2M and, for businesses and entities from foreign countries, in substantial equivalence to Ch 2M.

RG 228.92 In some instances, an audit opinion—or a review opinion for half-year financial information—will have a qualification or modification that suggests that the opinion is so materially compromised that it provides little independent assurance for investors. For instance, this may be the case if the auditor's report includes a disclaimer of opinion indicating that financial records of the core business of the company were not available. In such instances, we will closely scrutinise the nature of the qualification or modification and may regard any such financial information included in a prospectus as effectively unaudited.

RG 228.93 We will generally accept that emphasis of matter paragraphs—for example, due to uncertainty about whether the company can continue as a going concern in circumstances where a successful fundraising will enable the company to continue its operations—will not result in us regarding the financial information as unaudited.

RG 228.94 In some cases, you may need to audit up to three years of financial statements for the first time, which may present audit issues. In these circumstances, it is generally acceptable for the audit or review opinion to contain opening balance qualifications and, subject to materiality, qualifications related to the inability to inspect inventory.

### Asset acquisitions

RG 228.95 Where you are acquiring assets rather than a business or entity with an operating history, you should explain the basis for the acquisition price (such as by providing property valuations or geological expert reports for mining tenements). The acquisitions should be disclosed in the pro-forma balance sheet. However, if the assets acquired by you are in substance the acquisition of a business, you should disclose historical income statements. For example, an acquisition of a business may be structured by acquiring the assets of the company to avoid any legacy liabilities. If the acquirer intends to acquire the assets and operate this business in a new entity, then historical financial disclosure is still required.

RG 228.96 We will use the guidance in Appendix B of Australian Accounting Standard AASB 3 *Business combinations* to assist us to determine whether an issuer has, in fact, acquired a business rather than just a collection of assets.

### Circumstances where historical financial information disclosure may not be required

RG 228.97 There may be some circumstances where the disclosure of historic financial information in accordance with RG 228.87(b) would include information not relevant to an informed assessment of your financial performance or prospects, or which would not be reasonable for investors and their professional advisers to expect to be disclosed. In these circumstances, the provision of either unaudited information, audited information with a

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modified audit opinion or financial information of less than two-and-a-half or three years duration may be consistent with investors receiving sufficient information for the purposes of s710. Examples of such circumstances are described in Table 10.

**Table 10: Circumstances where historical financial information disclosure may not be required**

| Circumstance | Examples |
|---|---|
| Two-and-a-half or three years of audited (or reviewed for half year) financial information of the company, or some part of it, is not relevant | **Example 1**<br>The main business undertaking you operate has changed significantly in the historical period and has no relationship to the current business activities. This could occur when the main business undertaking was divested (in the first year of the three-year history) and a new and unrelated business was subsequently acquired or commenced (in year two). In this case financial information for the first year is unlikely to be relevant.<br>**Example 2**<br>The company you operate is a vehicle for a 'backdoor listing', where the company discloses it is effectively a shell without material assets or liabilities. In such a case, only the operating history of the incoming business, rather than the shell company, would be relevant along with the opening pro-forma balance sheet.<br>Note: Companies may also need to satisfy listing rule requirements for financial statements when a listed shell company is seeking to re-comply with the listing rules. |
| It is not reasonable for investors and their advisers to expect two-and-a-half or three years of audited (or reviewed for half year) financial information | **Example 3**<br>You prepare audited consolidated financials that already incorporate an acquisition for a substantial portion of the disclosed financial history and prior financial records are of limited reliability. In this situation, it may not be reasonable (if you do not already have the information) for investors and their advisers to expect audited financial information about the acquired business before acquisition.<br>**Example 4**<br>You have provided adequate financial information about the first year of a three-year disclosed financial history, but you propose to depart from the audit requirement for the first-year information due to the difficulty in obtaining an audit opinion that follows the audit guidance in RG 228.91–RG 228.94. Where the subsequent periods are audited, the financial information in totality may still be sufficient.<br>**Example 5**<br>The financial information is difficult to access and relates to a part of the business that is not material to the business as a whole.<br>Note: See also RG 228.91–RG 228.94 for guidance on audit reports. |

RG 228.98 If you are relying on RG 228.97 because of the particular circumstances of your company, you should disclose these circumstances in the prospectus. We will monitor issuers' explanations to ensure that these exceptions are being used appropriately.

### Forecast financial disclosure

~~RG 228.90~~RG 228.99 It is common market practice for companies with an operating history to provide prospective financial information at least to the end of the current financial year (where there are reasonable grounds to do so: see RG 228.104). Often this information is accompanied by an investigating accountant's report.

~~RG 228.91~~RG 228.100 In some cases, companies may provide prospective financial information for a longer period of time (if there are reasonable grounds to do so: see RG 228.104).

## What to disclose if you have no operating history

~~RG 228.92~~RG 228.101 If you are a start-up company that does not have an operating history, you should include your most recent statement of financial position. You should also provide a pro-forma statement of financial information showing the effect of the offer.

## Pro-forma financial information

~~RG 228.93~~RG 228.102 Pro-forma financial information may be useful and is sometimes necessary to satisfy the disclosure requirements of the Corporations Act (e.g. to show the effects of a proposed transaction). If pro-forma financial information is included in your prospectus, it may be appropriate to give it more prominence than statutory financial information.

~~RG 228.94~~RG 228.103 Our more detailed guidance on the use of pro-forma financial information in prospectuses and other transaction documents that is not prepared in accordance with the accounting standards is explained in RG 230. This guidance explains how to ensure that pro-forma information is not used in a misleading way. It also contains our guidance on presenting financial information for overseas entities that is prepared under foreign generally accepted accounting principles (GAAP) and translated into Australian currency.

## Prospective financial information

~~RG 228.95~~RG 228.104 Prospective financial information can be useful for investors if it has reasonable grounds. You must have reasonable grounds for any prospective financial information and other forward-looking statements included in your prospectus—otherwise, the information will be taken to be misleading: see s728(2) and RG 170. The assumptions underlying forward-looking statements should be explained in your prospectus.

Note: While stated to apply to prospective financial information, the guidance in RG 170 is useful to the inclusion of all forward-looking statements in a prospectus.

~~RG 228.96~~RG 228.105 The use of warnings and other cautionary language will not always be sufficient to prevent particular information being misleading and importantly will not, of itself, affect the requirement for there to be reasonable grounds to state the information: see RG 170.94.

~~RG 228.97~~RG 228.106 If you cannot include detailed prospective financial information you must still provide investors with disclosure on your prospects: see RG 170.20–RG 170.22 for examples of information that may satisfy this disclosure requirement.

## Financial ratios

~~RG 228.98~~RG 228.107 Financial ratios (where appropriate) can provide retail investors with a useful snapshot of your financial position and prospects.

Note: Financial ratios cannot be meaningfully calculated for all companies. For example, ratios that require earnings information cannot be calculated for an exploration company that does not have historical or forecast earnings.

~~RG 228.99~~RG 228.108 Three common categories of financial ratios are ratios that relate to financial stability, market performance and pricing, and profitability. We encourage you to consider which ratios (if any) are appropriate to your circumstances and useful to potential investors. For example:

(a) Companies that have earnings or forecast earnings often provide market performance ratios such as P/E, earnings per share (EPS), dividend yield and dividend per share (DPS) ratios.

(b) Gearing and interest cover ratios are generally useful for retail investors and their importance is heightened when a company is in financial difficulty, there is financial volatility or there is less access to the debt capital markets.

~~RG 228.100~~RG 228.109 The financial ratios that are appropriate will depend on a number of factors. We encourage you to consider the following:

(a) the ratios that are commonly cited for your industry or sector;

(b) the ratios that brokers and analysts use for your company or companies in similar circumstances;

(c) the type of ratios that you target or use for internal management purposes;

(d) the ratios you plan to provide to investors on an ongoing basis to explain or benchmark your performance over time;

(e) any ratios included in your loan covenants (see RG 228.111); and

(f) your financial position—for example, s710 may require you to give some information about your loan covenant ratios if you have breached them or it is reasonably foreseeable that you will breach them (see RG 228.62).

Note: Only include financial ratios that will be useful and relevant for retail investors in your circumstances. A few well-chosen and explained ratios may be more useful than a long list of ratios.

~~RG 228.101~~RG 228.110 If your prospectus has financial ratios, you should explain how they are calculated and any material assumptions. When you are calculating a ratio, you will need to consider whether it is appropriate to use historical statutory, historical pro-forma or prospective financial information for that ratio. For example, a gearing ratio should generally be based on the pro-forma statement of financial position showing the effect of the offer.

~~RG 228.102~~RG 228.111 If you provide a financial stability ratio (such as gearing or interest cover) you should inform investors if it is calculated in a different way from a similar ratio under your loan covenants and why you have used a different ratio in the prospectus.

~~RG 228.103~~RG 228.112 We also encourage you to briefly explain what the ratio means. For example, retail investors may not understand that:

(a) a P/E ratio is a comparison between the company's share price and its earnings per share;

(b) an interest cover ratio gives an indication of an issuer's ability to meet its interest payments from earnings and therefore provides important information about the issuer's financial sustainability and the risks associated with the issuer's level of borrowing; and

(c) a gearing ratio indicates the extent to which an issuer is funded by debt and gives an indication of the potential risks the issuer faces in terms of its level of borrowings due, for example, to an increase in interest rates.

## Meaning of financial terms

~~RG 228.104~~RG 228.113 Prospectuses should define and explain any financial terms that are used. Disclosure of financial information should avoid accounting jargon: see Table 3. Retail investors will often not understand these terms and disclosure should cater for their needs.