



ASIC

Australian Securities & Investments Commission

REPORT 484

Due diligence practices in initial public offerings

July 2016

About this report

This report outlines the key findings from reviews we conducted to examine the due diligence practices of issuers of securities under an initial public offering (IPO). This report is for issuers considering an IPO; its purpose is to help issuers, and their directors and advisers, conduct effective due diligence.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

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Executive summary

Key points

We have reviewed the due diligence practices conducted for a limited number of prospectuses of initial public offerings (IPOs). We have undertaken this work because good due diligence is vital to ensuring a prospectus contains all material information for investors and is free from error.

Our due diligence review work complements our other work regulating offers of securities, which includes reviewing prospectuses, considering relief applications and conducting investigations when we have concerns.

This report describes the context in which due diligence is conducted in the Australian market, the due diligence reviews we undertook and our key findings. We also make some recommendations for good practice due diligence in light of these findings.

Legal context and market practice for due diligence processes

- 1 Due diligence is a process adopted by issuers to determine whether they have properly prepared a prospectus offering securities to retail investors. The process is designed to ensure the prospectus contains accurate information and has not omitted any material information. In order to promote confident and informed consumers and fair and efficient markets, we seek to ensure that issuers prepare prospectuses of good quality.
- 2 Issuers of securities and their directors are responsible and liable for the information contained in the prospectus. It is important for these parties to engage in a robust and thorough due diligence process supported by their advisers to satisfy themselves that this information is not defective.
- 3 Section A of this report describes the legal context in which due diligence is undertaken for a prospectus and the market practice that has emerged in light of this legal context. Due diligence is not a process prescribed in the *Corporations Act 2001* (Corporations Act); rather, it has emerged as a market practice to ensure that the prospectus is accurate and complete and to mitigate the risk of any future liability from a poor-quality prospectus.
- 4 The key elements of current market practice for due diligence include:
 - (a) a due diligence committee that oversees and documents the due diligence process and identifies issues for investigation and disclosure in the prospectus;
 - (b) directors, management and various advisers to the issuer undertaking particular tasks to ensure the prospectus is properly prepared; and
 - (c) the due diligence committee undertaking verification of the prospectus to ensure it does not contain any false or misleading statements.

ASIC's review of due diligence processes

- 5 Section B describes the systematic reviews we have recently conducted of the due diligence practices of 12 IPOs. As part of our regular work, we sometimes seek verification of disclosures made in prospectuses. However, the purpose of the reviews was to observe the due diligence practices being adopted in the IPO market more generally and also to ascertain the quality of advice being provided to issuers.
- 6 In relation to the 12 IPOs, we reviewed various due diligence materials, including the minutes of the due diligence committee, material supporting the preparation and review of the prospectus, expert reports, and verification materials. In our review we also spoke to the officers of the issuers, and the issuers' legal, corporate and financial advisers, to obtain a thorough understanding of the due diligence process that was implemented. This report summarises the findings of these 12 reviews, which included small, mid-sized and large offers and a sample of offers from emerging market issuers.
- 7 Our due diligence review work complements other regulatory work we undertake regarding offers of securities. This includes processing relief applications, reviewing prospectuses, taking investigative action (if concerns are identified) and undertaking thematic reviews in relation to particular issues. The breadth of our role allows us to monitor the practices of the various parties involved in the IPO process, including lead managers, underwriters, brokers, and financial and legal advisers.
- 8 This work is important because the IPO market has been particularly active. As at 30 June 2016, there have been 42 IPOs this year, which raised between \$2.2 million and \$919 million (raising an average amount of \$75 million). In 2015 there were 155 IPOs, raising a total of \$13.5 billion. The sectors that are expected to be active participants in the IPO markets this year are the technology and financial services sectors.¹ In particular, the technology, media and telecommunications sector in Australia provided for 27 IPO listings on ASX in 2015, representing 37% of all listings.²

Key findings

- 9 The key findings of our review of IPO due diligence processes are summarised in Table 1 and are described in greater length in Section B. Our concerns generally relate to the quality of due diligence conducted by small to mid-sized issuers.

¹ EYGM Limited, [EY Global IPO trends: 2016 1Q](#) (PDF 1.37 MB), report, 11 March 2016, p. 8.

² Deloitte Touche Tohmatsu Limited, [Open for growth: Deloitte 2016 IPO report](#), 24 February 2016, p. 6.

Table 1: Key findings of our review of IPO due diligence processes

Key finding	Description
Poor due diligence often leads to defective disclosure	In general, the issuers that demonstrated poor due diligence practices produced prospectuses with defective disclosure, such as misleading and deceptive statements with no reasonable basis. These prospectuses also omitted material information that would have been included had the issuer conducted all reasonable investigations.
Variation in due diligence processes adopted	Each of the issuers was able to demonstrate that they had adopted some form of due diligence process. However, there was considerable variation in the due diligence processes that were adopted, which was reflected in their documentation. Generally, the small to mid-sized issuers, including emerging market issuers, adopted fewer due diligence processes (e.g. convening a due diligence committee but nothing more) and demonstrated less effort in and consideration of the process.
'Form over substance' approach to due diligence	Even in instances where a number of due diligence processes had been adopted and followed, we observed that a number of issuers adopted a 'box ticking' approach to the due diligence rather than focusing on the disclosure in the prospectus.
Superficial involvement by the board of directors	Even though the directors of an issuer have direct liability under the Corporations Act and in some cases were actively involved in the business, we observed instances where certain directors had little involvement in the preparation of the prospectus before signing off on the document. Particularly for emerging market issuers, we also observed that in certain instances prospectuses and other important documents were not translated for directors who cannot read English.
Poor oversight of due diligence conducted by foreign advisers	There are additional challenges for emerging market issuers. We observed instances of poor oversight by the Australian legal advisers of due diligence inquiries conducted by foreign advisers. Additional procedures may be required to ensure that all material matters have been considered and that foreign directors are provided with translated copies of important documents.
Inconsistent quality of contribution in the due diligence process	Each of the issuers demonstrated that the investigating accountants had sufficient financial due diligence procedures and generally provided a high standard of reporting. In contrast, we found that the legal advisers demonstrated a less consistent standard in terms of conducting legal due diligence.
Costs of conducting due diligence	While it may appear cost effective to engage a less costly adviser with a checklist approach to conducting due diligence, we found that a well-advised issuer conducting the necessary due diligence processes will be better placed to mitigate the risk of any added delays (and related costs), future liability and reputational damage from a poor-quality prospectus.

Good practice recommendations for effective due diligence

10 The findings of our review reinforce our view that it is essential for an issuer to have a good due diligence process in place to provide effective disclosure in a prospectus and to ensure that the prospectus does not contain misleading or deceptive information. Our good practice recommendations on effective due diligence are summarised in Table 2 and set out fully in Section C.

Table 2: Recommendations for effective due diligence

Elements of a robust due diligence process	<p>Issuers should adopt a due diligence process that promotes:</p> <ul style="list-style-type: none"> • oversight of the due diligence process; • investigations into the information in the prospectus; • record keeping of the key or significant issues; • verification of all material statements; and • continuation of the due diligence process after the lodgement of the prospectus and throughout the offer period to capture material developments.
A ‘substance over form’ approach	<p>Issuers and their advisers should conduct a thorough and investigative due diligence process to ensure that the prospectus not only complies with the law but also promotes informed decision making by investors and their advisers.</p> <p>Documentation should demonstrate that this approach has been taken.</p>
Director involvement in the due diligence process	<p>Directors are responsible for the contents of the prospectus. To ensure that the contents of the prospectus are complete and do not contain any material misstatements, directors must make sure that a robust due diligence process has been undertaken.</p>
Engaging appropriate professional and expert advisers	<p>An effective due diligence process should identify the material matters that will require an expert opinion and ensure that the appropriate advisers are engaged. Each adviser should be engaged on the basis that they are competent and bring their own unique set of skills, knowledge and experience to a field of expertise relevant to the preparation of the prospectus.</p>
Additional recommendations for emerging market issuers	<p>Due to the heightened challenges associated with emerging market issuers, Australian advisers should focus on effective oversight of the due diligence work carried out by foreign legal and other advisers. Australian advisers should make sure that they understand the political and cultural environment in which the issuer operates, local business practices affecting the issuer, local laws affecting the issuer and the issuer’s local expert advisers.</p>

Further work

- 11 The systematic review of IPO due diligence we have undertaken has assisted ASIC with our ongoing work regulating the IPO market. We will continue to conduct reviews to examine the due diligence practices being adopted by issuers in IPOs.
- 12 We are also planning to carry out more review work in the 2016–17 financial year, focusing on different aspects of the public company fundraising processes, to promote good market practices for fundraising.

A Legal context and market practice for due diligence processes

Key points

It is important to understand the legal context in which issuers conduct due diligence. Due diligence has emerged as a market practice designed to ensure issuers can rely on certain defences to liability for a defective prospectus, as well as to provide assurance that the disclosure in the prospectus is accurate and complete.

The due diligence process generally consists of a due diligence committee overseeing the preparation of a prospectus, the conduct of particular inquiries and the verification of the final version of the prospectus.

What is due diligence and why is it conducted?

- 13 Due diligence is a process adopted by issuers to determine whether they have properly prepared their prospectus—that is, that everything in the prospectus is accurate and nothing material has been omitted.
- 14 There is no legal requirement to conduct a due diligence process when preparing a prospectus. However, conducting a due diligence process has emerged as a market practice for issuers seeking to mitigate the risk of future liability from a poor-quality prospectus, and to ensure that the prospectus includes all information necessary to make an informed investment decision and is not misleading.
- 15 We regularly review prospectuses to ensure their compliance with Ch 6D of the Corporations Act. We may also make further inquiries to assess how a prospectus is prepared, which involves asking the issuer to demonstrate their due diligence and verification processes. We have observed that where a prospectus is defective, it is often the case that the issuer cannot demonstrate appropriate due diligence and verification processes.

Legal framework for due diligence

- 16 IPO prospectuses are prepared in accordance with the general disclosure requirements of s710 of the Corporations Act. Under s710, a prospectus for a body's securities must contain all the information that investors and their professional advisers would reasonably require to make an informed assessment of:
 - (a) the rights and liabilities attaching to the securities offered; and
 - (b) the assets and liabilities, financial position and performance, profits and losses, and prospects of the body that is to issue the securities.

- 17 The prospectus must contain this information only to the extent to which it is reasonable for investors and their professional advisers to expect to find the information in the prospectus, and only if a person whose knowledge is relevant actually knows the information, or in the circumstances ought reasonably to have obtained the information by making inquiries. If there are any materially adverse developments during the course of the offer, an issuer must publish supplementary disclosure to update existing and potential applicants under the offer.
- 18 In addition to the general disclosure requirement, the Corporations Act requires the prospectus to include specific information:
- (a) the terms and conditions of the offer (s711(1));
 - (b) the interests and fees of certain people involved in the offer (s711(2) and 711(4));
 - (c) information relating to the application for quotation of securities (s711(5));
 - (d) the date of the prospectus and its expiry date (s716(1) and 716(6));
 - (e) that a copy of the prospectus has been lodged with ASIC and that ASIC takes no responsibility for the content of the prospectus (s711(7)); and
 - (f) that the people quoted have consented to their statements being included in the prospectus (s716(2)).

Prospectus liability

- 19 Certain persons are liable to an investor who suffers loss or damage if an offer is made under a defective prospectus: see s729. These people include the issuer, directors of the issuer, the underwriter to the offer, and each party that has consented to statements in the prospectus.
- 20 A prospectus is defective if it contains statements that are misleading or deceptive, or there is an omission of information in the prospectus that must be included. A prospectus can also be defective if a new circumstance arises after lodgement that the issuer would have been required to disclose if the circumstance had arisen before the prospectus was lodged, and a supplementary or replacement prospectus has not been lodged.
- 21 In addition, the company, its directors or a person responsible for statements in the prospectus may be liable at common law (i.e. they may be subject to civil legal action brought by the investor) for a fraudulent or negligent misrepresentation in the prospectus.

Defences

- 22 The Corporations Act contains two key defences to prospectus liability:
- (a) the due diligence defence (s731), where the person proves they have made all reasonable inquiries and had reasonable grounds to believe

that the statement was not misleading or deceptive or there was no omission; and

- (b) the reasonable reliance defence (s733), where the person proves that they placed reasonable reliance on information given to them by another person (other than their own director, employee or agent).

Case law

- 23 There is currently little case law in Australia that provides authority on the operation of the defences under s731 and 733 for liability arising from defective disclosure in a prospectus. Gyles J in *Reiffel v ACN 075 839 226 Ltd* (2003) 45 ACSR 67 refers to the US authority in *Escott v Barchris Construction Corp* 283 F Supp 643 (1968), which at paragraph 32 notes that in order to rely on the due diligence defence, it must be established that:

he had, after reasonable investigation, reasonable ground to believe and did believe, ... that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading;

- 24 However, there are currently no Australian authorities that establish the standards of reasonableness for the inquiries underpinning s731 and 733. Guidance on this standard may be inferred from cases under the *Trade Practices Act 1974*, such as *Universal Telecasters (Qld) v Guthrie* (1978) 18 ALR 531. This case provides, at page 534, that to establish that reasonable precautions and all due diligence inquiries were made under s85 of the *Trade Practices Act 1974*, the issuer would need to demonstrate:

that it had laid down a proper system to provide against contravention of the Act and that it had provided adequate supervision to ensure the system was properly carried out.

Industry guidance

- 25 There is currently no published industry guidance for conducting legal due diligence, except for the now defunct *Due diligence guide* published by the Securities Institute of Australia in 1991.
- 26 There is limited discussion on the law and its practical implications in Australian academic legal texts. The focus in many of the academic publications is on the legal implications of conducting due diligence and its role in accessing the defences of s731 and 733.³ Having adequate due diligence processes in line with best practice may allow the parties to the prospectus to rely on the above defences, as it may help demonstrate that all

³ For example, RP Austin & AJ Black, *Austin & Black's annotations to the Corporations Act*, LexisNexis Australia, Chatswood, NSW, paragraph 6D.731.

reasonable inquiries were made in the circumstances.⁴ However, having a due diligence process alone will not be sufficient to rely on these provisions.⁵

- 27 The Auditing and Assurance Standards Board (AUASB) and the Accounting Professional and Ethical Standards Board (APESB) provide industry guidance on financial due diligence for auditors and professional services providers.
- 28 The AUASB issued [Standard on Assurance Engagement ASAE 3420 Assurance engagements to report on the compilation of pro forma historical financial information included in a prospectus or other document](#) (PDF 672 KB) and [Standard on Assurance Engagement ASAE 3450 Assurance engagements involving corporate fundraising and/or prospective financial information](#) (PDF 936 KB), which apply to engagements commencing on or after 1 July 2013.
- 29 The APESB issued [Accounting Professional and Ethical Standard APES 350 Participation by members in public practice in due diligence committees in connection with a public document](#) (PDF 421 KB), which took effect on 1 February 2010 and was revised in March 2011.
- 30 Further information regarding industry guidance is contained in the appendix. We have also included in the appendix a Canadian guidance note that, while describing practices in a different jurisdiction, may be of some interest to issuers and their advisers.

Insights from research into investor behaviour

- 31 We are considering conducting research into retail investor decision making in the IPO context.
- 32 A consumer research study on IPO investment decision making was conducted in New Zealand in 2014. The research was conducted via an online survey of 303 retail participants who had either invested or seriously considered but did not invest in an IPO in the past 12 months. A key finding of this research was that investors most commonly cited the offer document (54%), the company's website (45%), and newspapers and magazines (34%) as the source of information they used to find out more about the IPOs they had invested in.⁶

⁴ R Austin & I Ramsay, *Ford, Austin & Ramsay's principles of Corporations Law*, LexisNexis Australia, Chatswood, NSW, paragraph 22.440.3.

⁵ F Assaf, et al, *Australian corporation law—Principles and practice*, LexisNexis Australia, Chatswood, NSW, paragraph 7.10.0290.

⁶ Colmar Brunton, [Investor experience of IPOs](#), report commissioned by New Zealand Stock Exchange and Financial Markets Authority, February 2014.

Market practice for due diligence

- 33 The general approach taken to an adequate due diligence process includes:
- (a) devising a due diligence plan or system;
 - (b) establishing a due diligence committee to coordinate and supervise the due diligence process;
 - (c) arranging for the committee to meet regularly to ensure that the due diligence process is being implemented;
 - (d) the committee delegating tasks to the relevant parties to make particular inquiries, including administering questionnaires to appropriate parties;
 - (e) having a verification process for the disclosures of material statements of fact or opinion in the disclosure document; and
 - (f) a final due diligence report to the board of directors that outlines the procedures followed, the inquiries undertaken and a conclusion.
- 34 The market practice when preparing a prospectus is to establish a due diligence committee to oversee and coordinate the IPO due diligence process. The committee is generally established by delegation of the issuer's board of directors and should report periodically to the board of directors on the conduct of the due diligence process.
- 35 The members of the due diligence committee are usually directors (typically one executive and one non-executive director), legal advisers, investigating accountants, underwriters and lead managers. Members are generally expected to actively participate in the due diligence inquiries and deliberations, and apply an independent and inquiring mind to the prospectus and due diligence process.
- 36 The due diligence committee is generally responsible for the following:
- (a) coordinating and reviewing the information gathering process from management and experts with a view that, by the end of the due diligence process, a complete and thorough understanding of all relevant facts will be obtained and resolved before finalisation of the prospectus;
 - (b) determining the scope of the due diligence inquiries and agreeing on qualitative and quantitative materiality thresholds;
 - (c) identifying issues for investigation and disclosure in the prospectus;
 - (d) ensuring all potentially material issues identified during the course of the due diligence process are either appropriately disclosed in the prospectus or resolved as not material;
 - (e) ensuring there is adequate supervision at all stages of the due diligence process, including a system of continuing inquiry and monitoring after the prospectus has been lodged with ASIC;

- (f) supervising the drafting of the prospectus and its verification;
- (g) providing a final report to the board of directors that outlines the inquiries undertaken and enables all the directors to form the view that the disclosure in the final prospectus is complete and free from material misstatement; and
- (h) documenting the due diligence process to provide evidence of the inquiries made and the basis on which opinions have been formed (including the retention of those materials).

Roles of various members of the due diligence committee

- 37 It is market practice for the due diligence committee to delegate particular tasks or areas of inquiry to certain members of the committee. These members will be responsible for investigating and reporting on identified issues back to the committee.
- 38 The role of each member of the committee is set out in Table 3.

Table 3: Roles of the members of the due diligence committee

Committee member	Role
Directors	Directors will have oversight of the due diligence process so they can satisfy themselves that the prospectus meets the requirements of the Corporations Act. Generally the due diligence committee will include both an executive director and an independent director.
Management	Management's role is to provide key commercial and financial information to the due diligence committee, including responses to management questionnaires and interviews.
Australian legal adviser	Due diligence is usually driven by the Australian legal advisers. As a result, they will carry out the due diligence inquiries, prepare a legal due diligence report, and provide the board of directors with a legal opinion on the due diligence process and the prospectus.
Investigating accountant	The investigating accountant's role is to carry out due diligence inquiries into certain financial and accounting matters and provide: <ul style="list-style-type: none"> • an investigating accountant's report for inclusion in the prospectus; • a due diligence sign-off to the due diligence committee prepared in accordance with APES 350; • materiality guidelines providing recommendations on the level of quantitative materiality the due diligence committee should apply to the due diligence process; and • separate financial reports to the board of the directors and the due diligence committee on the historical financial information, the pro-forma historical financial information and the forecasts.

Committee member	Role
Tax adviser	The tax adviser will carry out due diligence for taxation matters, including by providing a taxation due diligence report, a tax report for inclusion in the prospectus and a tax opinion on the offer for the directors.
Underwriter or lead manager	As corporate advisers and lead managers of the offer, the underwriters or lead managers and their advisers will help coordinate the preparation of the prospectus and participate as a member of the due diligence committee in its deliberations on the contents of the prospectus. They will also provide the issuer with assistance on the marketing of the offer.

Verification process

- 39 The purpose of the verification process is to ensure that the prospectus does not contain any false, misleading or deceptive statements or statements that are likely to be false, misleading or deceptive. This means that all statements in the prospectus are to be verified using relevant external documents or statements. Generally, all statements are verified using independent and objective evidence and, where possible, by cross-referencing source documents. Where this is not possible, such as statements of opinion, then the statement should be recorded as such and the prospectus should disclose whose opinion is being quoted and the basis on which it is expressed. To conclude the verification process, each party contributing to the prospectus generally will formally acknowledge responsibility for the statements attributable to them in the form of a verification sign-off.
- 40 The market practice for an IPO is to document the verification process. It is common practice for legal advisers to collect and retain all supporting evidence as part of the verification process. Once the verification process is complete and all the evidence has been retained, law firms with better practices:
- (a) review the verification materials and check that there is a source document for each statement, unless it is a statement of opinion or has been verified by the board of directors; and
 - (b) undertake an audit of a random selection of verified material statements to confirm whether the responses refer to independent objective evidence or reliable source documents.

B Our review of due diligence practices

Key points

We have conducted a review of due diligence practices. This section sets out the purpose and methodology of the review and the key findings.

We found that:

- poor due diligence often results in defective disclosure;
- there is significant variation in the due diligence processes issuers adopted;
- small to mid-sized issuers sometimes take a ‘form over substance’ approach to due diligence;
- directors of small to mid-sized issuers sometimes have a superficial level of involvement in the due diligence process;
- there was poor oversight of due diligence inquiries conducted by foreign advisers of small to mid-sized issuers;
- there was an inconsistent quality of contribution by participants in the due diligence process; and
- a low-cost due diligence process may often lead to delays, further work and ultimately be more costly. However, even if an issuer conducts an expensive and extensive due diligence process, the quality of the due diligence conducted cannot be guaranteed if the directors do not thoroughly engage with the process.

Our role regarding IPO prospectuses

- 41 Our due diligence review work complements other regulatory work we undertake regarding offers of securities. We have general administration of the Corporations Act, including the fundraising provisions in Ch 6D. The breadth of our role allows us to monitor the practices of the various parties involved in the IPO process, including lead managers, underwriters, brokers, and financial and legal advisers. Table 4 summarises the activities that underpin our work in this area.

Table 4: Our approach to the administration of Ch 6D

Type of activity	What we do
Reviewing disclosure documents and fundraising activity	We regularly review disclosure documents that are lodged with ASIC to ensure compliance with Ch 6D. ASIC has the power to extend the exposure period applying to a disclosure document, to provide ASIC and market participants with additional time to scrutinise disclosure documents before they are used for fundraising.

Type of activity	What we do
Preventing fundraising activity without appropriate disclosure	<p>Where a disclosure document lodged by an entity does not comply with the law, ASIC has the power to issue interim or final orders to prevent fundraising from taking place under the defective disclosure document. This power also extends to certain advertisements and publications associated with the offer of securities that are defective and do not comply with the law.</p> <p>Where an entity has not complied with some or all of its disclosure obligations in the past, ASIC has the power to make certain determinations to exclude that entity from relying on specified statutory disclosure exemptions (e.g. s713, which permits an entity to use a transaction-specific prospectus).</p>
Providing relief from the law	<p>ASIC has the power to provide exemptions from all or specified provisions of Ch 6D or declare that Ch 6D applies as if specified provisions were modified, varied or omitted: s741.</p> <p>In determining applications for relief, we attempt to achieve two broad objectives: consistency and definite principles. We generally only grant relief in new policy applications where we consider that there is a net regulatory benefit, or any regulatory detriment is minimal and is outweighed by the commercial benefit: see Regulatory Guide 51 <i>Applications for relief</i> (RG 51) at RG 51.57–RG 51.62.</p>
Enforcing the law	<p>Our review of disclosure documents and other fundraising activities play a role in identifying contraventions of the Corporations Act. In appropriate cases, we may take enforcement action to protect investors and promote the confident and informed participation of investors and financial consumers in the financial system more generally.</p>
Thematic reviews of particular issues	<p>We conduct thematic reviews in relation to particular issues that are identified in the fundraising process. We may publish our findings or recommendations from these thematic reviews in an external report.</p>
42	<p>Regulatory Guide 254 <i>Offering securities under a disclosure document</i> (RG 254) provides further guidance on our regulatory processes for fundraising.</p>

Purpose and methodology of our review

- 43 Between November 2014 and January 2016, we conducted systematic reviews of the due diligence practices for 12 IPOs. This involved adopting a consistent methodology for reviews, ensuring that we collected information about the due diligence process rather than focusing solely on whether prospectus disclosure was inadequate. The purpose of the reviews was to observe the due diligence practices being adopted in the IPO market, and to ascertain the quality of advice being provided to issuers. By looking at 12 due diligence processes, we were able to understand variations in market practice, as well as identify disclosure concerns about issuers' prospectuses.
- 44 Ten of the reviews were conducted on small to mid-sized issuers (including emerging market issuers), who were largely selected following concerns

being raised during our review of the prospectus lodged by the issuer. Two of the reviews were conducted on large issuers, who were selected on the assumption that their offers would have involved a high standard of due diligence.

- 45 The reviews were conducted within six months of lodgement of the prospectus, with a majority of the reviews being conducted a month after lodgement of the prospectus. The reviews targeted issuers from a variety of industries, including educational or vocational training, financial services and investment, healthcare, agriculture, telecommunications, and mineral exploration and development. Of the 12 reviews, eight were conducted in New South Wales and two each in Victoria and Western Australia. We did not conduct any reviews in Queensland due to the quiet local IPO market during this period.
- 46 The review process involved an on-site review of due diligence materials, which we generally obtained under ASIC's compulsory information gathering powers, and requests for assistance from licensed brokers and managers. These materials included the minutes of the due diligence committee, the prospectus, expert reports and verification materials. In the course of our reviews, we also spoke to officers of the issuer, and the issuer's legal, corporate (including lead managers and brokers) and financial advisers, in order to obtain a thorough understanding of the due diligence process that was adopted.
- 47 In our reviews, we looked for:
- (a) evidence of inquiries being made, and who made them;
 - (b) the basis on which opinions were formed; and
 - (c) reasonable grounds for belief in the completeness and accuracy of all statements in a prospectus.
- 48 The key documentation we asked for included any of the following:
- (a) a due diligence planning memorandum that set out the process;
 - (b) legal advice on the content requirements of the prospectus and liability for the prospectus under Australian law;
 - (c) management questionnaires or presentations that involve management providing information to the appointed advisers about the issuer's business, strategies and exposure;
 - (d) reports on investigations by legal, financial or industry advisers;
 - (e) a key or significant issues list;
 - (f) management sign-offs;
 - (g) verification reports, including certificates and source documents, which detail the source or support for all the statements in the prospectus;

- (h) agendas and minutes of due diligence committee meetings (including documents tabled at those meetings);
- (i) a final due diligence report;
- (j) expert reports for inclusion in the prospectus;
- (k) no new circumstances sign-offs; and
- (l) an evolution of draft prospectuses.

Key findings of our review

- 49 We have a number of key findings from our systematic review of the quality of IPO due diligence of a range of issuers. Our concerns regarding the quality of IPO due diligence generally relate to small to mid-sized issuers.

Poor due diligence and defective disclosure

- 50 Our observations reinforced our view that a poor due diligence process will generally result in defective disclosure in a prospectus. In the reviews where we encountered poor or no implemented due diligence procedures, we found additional disclosure concerns about the prospectus, sometimes about significant issues. In the absence of an adequate due diligence process, it is difficult for an issuer to satisfy itself that all reasonable inquiries have been made to ensure that a prospectus does not contain any misleading and deceptive statements and that there are no material omissions.

Variation in due diligence processes adopted

- 51 In our sample of due diligence reviews, the quality of the IPO due diligence conducted varied depending on the issuer and the advisers. In general, we found that there is a wide variation in terms of the quality of due diligence conducted by small to mid-sized issuers; however, the two large offers we reviewed demonstrated a thorough and considered approach. Where we had significant concerns about the disclosure in the prospectus, our reviews revealed that the level of IPO due diligence investigation conducted by the issuer was of a poor quality.
- 52 In a number of our reviews we found poor documentary evidence of the due diligence processes conducted by the issuer, indicating little due diligence was conducted. This was prevalent in our reviews of small to mid-sized issuers. We often found that reasonable inquiries were lacking and that there was a low level of care and effort in the verifications of the statements made in the prospectus. In many instances, the lack of documentation suggested that there was no reasonable basis for certain statements in the prospectus.

53 The amount and degree of due diligence records kept varied, depending on the sophistication of the issuer's business and circumstances of the IPO. Nonetheless, the records should reflect a thorough and investigative due diligence process that puts emphasis on substantial matters for inquiry in the particular business of the issuer. In one review, while we found extensive and voluminous documentation of the due diligence process, we found little evidence that a thorough and investigative due diligence process had taken place.

'Form over substance' approach to due diligence

54 Despite many of the issuers having adopted some form of due diligence process, our reviews found that even a detailed due diligence process can lead to defective disclosure. The implemented due diligence procedures may underpin the process of making inquiries, but they do not necessarily ensure that all of the reasonable inquiries are made by the parties involved. We observed many small to mid-sized issuers adopting some form of a due diligence process with the aim to mitigate liability.

55 Effective due diligence should go beyond mere checklists and have a focus on actual investigation of issues. However, this objective will only be achieved if all members of the due diligence committee bring an inquiring mind to all aspects of the investigation and the disclosure. Advisers should perform due diligence with a healthy amount of scepticism regarding management's claims, to ensure there is a basis for all statements in the prospectus.

56 In certain small to mid-sized issuers there was an emphasis on a 'form over substance' approach and a lack of rigour and independent-mindedness by those involved. Examples of a 'form over substance' approach to due diligence include:

- (a) failure of the due diligence process to discover critical issues;
- (b) failure by advisers and non-executive directors to follow up on missing records and information that appears to contradict management's claims or the disclosure in the prospectus;
- (c) verifying a significant number of material statements as 'statements of belief' rather than relying on independent and objective evidence available;
- (d) using templates that have not been adequately updated;
- (e) discussions of due diligence placing too much emphasis on completing the process and not considering any material matters, such as the issuer's investments, commercial arrangements or underwriting arrangements;

- (f) due diligence committee minutes containing no evidence of robust deliberations of any issues for inclusion and exclusion in the prospectus;
- (g) minimal evidence of the issuer's executive management having made significant input into the prospectus, particularly regarding the issuer's business;
- (h) directors limiting their involvement in the preparation of the prospectus to only providing a few comments on the final draft, if at all;
- (i) legal due diligence reports referring to material foreign contracts that could not be verified or did not exist; and
- (j) failing to have a due diligence process that continues on after the lodgement of the prospectus, to cater for new circumstances that may arise and to address concerns raised by ASIC after reviewing the prospectus.

Superficial involvement by board of directors

- 57 Given their direct liability under the Corporations Act and involvement in the business, directors are expected to participate in the preparation of the prospectus at some stage. Although directors may rely on others to provide advice and to overcome language barriers, this does not negate their responsibilities under the Corporations Act.
- 58 Directors are responsible for making sure that a robust due diligence process has been undertaken. We observed that in a good practice due diligence, the directors engage in the due diligence process by:
- (a) critically reviewing the issuer's internal reporting systems, continuous disclosure policies and procedures, and corporate governance policies;
 - (b) engaging appropriate expert advisers;
 - (c) having a robust dialogue with management and the expert advisers involved in the due diligence;
 - (d) making sure there is an effective system of inquiry and adequate supervision at all stages of the due diligence process and during the preparation of the prospectus, so that it is properly carried out;
 - (e) participating in the verification process;
 - (f) applying an independent mind to the IPO due diligence process; and
 - (g) applying their own skills, knowledge and experience in questioning and assessing the completeness, accuracy and reliability of all statements (including all forward-looking statements) in the prospectus.
- 59 We observed that the involvement of directors of small to mid-sized issuers is even more critical in the due diligence process. These directors are often more involved with and have a close understanding of the issuer's business.

However, we found that the directors of these issuers often did not engage and failed to provide adequate oversight of the due diligence process.

60 In our review sample of issuers, all the emerging market issuers were based in China; therefore, the directors of those companies were proficient in either English or Mandarin or, in some instances, both. We found that all the directors were involved in authorising the lodgement of the prospectus with ASIC but not all of them were necessarily involved in the preparation of the prospectus. In our reviews, we observed that, for emerging market issuers:

- (a) there was often no evidence of prospectuses and directors' questionnaires having been translated into Chinese for non-English speaking directors, even when the issue was mentioned in one of the board minutes;
- (b) only one issuer produced board minutes in both Chinese and English;
- (c) there were instances where Chinese material contracts and agreements were not translated into English, and board minutes being recorded in English only, which raises questions about how the non-Chinese proficient directors are able to ultimately ensure that the information contained in the prospectus is accurate and free from material misstatement in circumstances where the due diligence committee has not commissioned any due diligence reports; and
- (d) the involvement of the Australian directors, apparently appointed to satisfy the director residency requirements for an Australian public company, was superficial regarding the preparation of the prospectus.

61 This issue also applies to local small to mid-sized issuers, where many of the directors played a very limited role in the preparation of the prospectus. In a number of instances, we observed a lack of participation by directors in the due diligence committee. We also observed that there was a lack of any substantive discussion associated with the due diligence in the minutes of the board.

Poor oversight of due diligence conducted by foreign advisers

62 Given the nature of emerging market issuers, it is not uncommon for these issuers to appoint both foreign and local legal advisers to undertake due diligence inquiries. In our due diligence reviews, we identified some problems in the oversight by Australian legal advisers and the due diligence committee of the work done by foreign advisers. These problems included an inadequate understanding by the due diligence committee and inadequate description in the prospectus of how foreign laws apply to the issuer, including regarding the issuer's effective control and management of the business. There were also problems with the committee's assessment of whether the foreign legal adviser is qualified to give its report or opinion.

- 63 We also saw failures by the Australian legal advisers to understand the political and cultural environment in which the issuer operates, local business practices affecting the issuer, local laws affecting the issuer, and the issuer's local expert advisers.
- 64 We have noted that, in certain IPOs, Australian legal advisers have relied on foreign reports from advisers of unknown quality without taking any steps to verify or test the report. In this situation, we would expect the Australian legal advisers to turn an inquiring mind to the information provided and conduct further investigations if necessary.
- 65 [Report 368](#) *Emerging market issuers* (REP 368) sets out key observations from an earlier review of emerging market issuers and the challenges independent third parties may face in verifying information or opinions about the entity's operations and performance provided by experts or professionals in an overseas jurisdiction.

Inconsistent quality of contribution in the due diligence process

- 66 We observed that, for each of the reviewed issuers, the investigating accountants demonstrated sufficient financial due diligence procedures and generally provided a high standard of reporting. This generally involves a robust process of inquiry into the financial information of the issuer, including testing the assumptions underlying forecasts and the reasonableness of any pro-forma adjustments made to the statutory figures. The findings of the investigating accountant may have a broader impact than solely on the financial information and may require the issuer to reconsider the disclosure about its prospects or performance.
- 67 In contrast, we found that the legal advisers demonstrated a less consistent standard in terms of conducting legal due diligence. We recognise that the legal advisers generally manage and drive the entire process for the issuer. We suspect the breadth of their responsibilities, compared with the resources deployed to meet these responsibilities, may mean some aspects of the due diligence are sometimes not as thorough as others.

Costs of conducting due diligence

- 68 The due diligence process involves engaging various advisers and conducting various inquiries with the different parties involved with the IPO, and we recognise that the process can be time consuming and costly. We have observed that the extent and scope of the due diligence process would usually be reflected in the costs incurred by the issuer.
- 69 We recognise that small to mid-sized issuers will generally have smaller budgets when proceeding with an IPO. While issuers should be mindful of

costs, an issuer should be careful not to allow costs to dictate the parameters of the due diligence inquiries to be made. We observed that cost-cutting during due diligence can lead to significant problems with the prospectus, which may result in an ASIC stop order and the consequential reputational damage to the issuer and the IPO. The issuer will also incur additional costs correcting defective disclosure. Furthermore, the issuer of a prospectus and those who consented to be quoted are liable for any defective disclosure in the prospectus.

- 70 We note that even if an issuer conducts an expensive and extensive due diligence process, its quality cannot be guaranteed if the directors do not thoroughly engage with the process. Particularly in the case of small to mid-sized issuers, the directors will often have an intimate understanding of the issuer's business. The issuer may be more efficient in identifying material matters and addressing any disclosure concerns by using the knowledge and experience of the directors.

Outcomes of our due diligence reviews

- 71 As a result of our due diligence reviews, issuers either lodged a replacement prospectus that addressed all our disclosure concerns, reduced the offer price or withdrew their offer.
- 72 Of the 12 issuers, 10 provided improved disclosure in the form of a replacement prospectus, with one of those issuers also reducing their offer price. Additionally, one subsequently withdrew their offer and another offer was subject to a final stop order. Despite many issuers having adopted due diligence processes, in all but one instance our due diligence reviews resulted in the issuers making corrective disclosure by way of a replacement prospectus or amendments to the terms of the offer.
- 73 In a number of instances issuers were required to make changes to the disclosure in the prospectus because potentially material issues (which were identified during the course of the due diligence process) were either not appropriately disclosed in the prospectus or were incorrectly resolved as 'not material' by the due diligence committee.
- 74 We may, as part of our business-as-usual work, also intervene in an issuer's fundraising by obtaining an amendment of the prospectus, an extension of the exposure period and a stop order. For instance, in 2015, as a result of our review of prospectuses and offer documents lodged with ASIC, we:
- (a) raised disclosure concerns with 31% of the documents lodged—changes were made to over 79% of the documents where concerns were raised;
 - (b) extended the exposure period 80 times; and
 - (c) issued 61 interim stop orders.

C Recommendations and further work

Key points

This section outlines the key recommendations arising from our IPO due diligence reviews, including:

- adoption of due diligence processes with certain key elements;
- adoption of a ‘substance over form’ approach to implementation of processes;
- increased director involvement; and
- Australian advisers providing effective oversight of due diligence work carried out by foreign legal advisers of emerging market issuers.

We also intend to conduct further focused reviews on due diligence practices as we continue to monitor the IPO market.

Purpose of our recommendations

- 75 The due diligence process in preparing for an IPO is essential to ensuring that issuers are providing investors with an accurate description of the offer.
- 76 We recognise that there is an absence of published guidance on formulating a due diligence process and adhering to a good practice standard of IPO due diligence. Our examination of a wide range of due diligence practices in the market has allowed us to form a suggested approach to IPO due diligence.
- 77 Advisers and underwriters, as gatekeepers, play an important role in protecting investors, fostering fair and efficient capital markets, and creating and maintaining confidence in capital markets. We note that the due diligence process is often driven by the legal advisers, and particular importance should be placed on their role in the process.
- 78 To ensure that prospectuses contain effective disclosure and do not contain misleading and deceptive statements, we suggest that issuers follow the approach set out in this section.

Our recommendations

Elements of a robust due diligence process

- 79 Issuers should adopt a due diligence process that contains the following elements:
- (a) *Oversight*—which involves:

- (i) the issuer establishing a due diligence committee to oversee and coordinate the due diligence process;
 - (ii) the committee escalating material matters to the board of directors;
 - (iii) the committee providing a final report on the due diligence process and a conclusion on the completeness and accuracy of the prospectus; and
 - (iv) the committee setting materiality guidance—that is, a threshold for investigations.
- (b) *Investigations*—which includes, but is not limited to:
- (i) management interviews;
 - (ii) director questionnaires; and
 - (iii) specific investigations conducted by accounting, legal, tax and industry experts, as necessary.
- (c) *Record keeping*—which involves keeping a key or significant issues list that records all the issues and their resolution.
- (d) *Verification*—which involves verifying all material statements in the prospectus.
- (e) *Continuation*—the due diligence process should not end at the lodgement of the prospectus, but should continue throughout the offer period and involve:
- (i) regular meetings of the due diligence committee;
 - (ii) ensuring that any new material matters that arise are addressed by the committee and the board of directors; and
 - (iii) considering whether supplementary disclosure is required to correct any defects in the prospectus.

A ‘substance over form’ approach

- 80 We encourage issuers and their advisers to conduct a thorough and investigative due diligence process to ensure that the prospectus not only complies with the law but also promotes informed decision making by investors and their advisers.
- 81 We encourage issuers and their advisers to approach the due diligence process with rigour and independent mindedness, and exercise professional judgement to determine the appropriate level of due diligence.
- 82 The documentation of the due diligence process and the verification process should also demonstrate that the issuer and its advisers conducted a reasonable due diligence investigation. For example, due diligence committee meeting minutes might demonstrate that there was a robust discussion of material issues rather than merely acknowledging them.

83 All statements in the prospectus should be verified using an appropriate level of evidence, which will depend on the materiality of the statement and what evidence is available. Generally, all statements should be verified using independent and objective evidence and, where possible, by cross-referencing source documents. Statements of opinion or belief should be recorded as such and the prospectus should disclose whose opinion or belief is being quoted and the basis on which it is expressed.

Director involvement in the due diligence process

84 Directors are responsible for the contents of the prospectus. To ensure that the contents of the prospectus are complete and do not contain any material misstatement, directors must make sure that a robust due diligence process has been undertaken. This means directors should engage in the due diligence process by:

- (a) providing effective oversight to ensure that the due diligence process is implemented and followed;
- (b) applying an independent mind to the IPO due diligence process;
- (c) applying their own skills, knowledge and experience in questioning and assessing the completeness, accuracy and reliability of all statements (including all forward-looking statements) in the prospectus;
- (d) having a robust dialogue with management and expert advisers involved in the due diligence;
- (e) participating in the verification process; and
- (f) making sure that all issues identified during the course of the due diligence process that may constitute ‘red flags’ are followed up and appropriately resolved.

85 The due diligence process should be fashioned to harness the knowledge of the directors, potentially reducing the cost and length of the process.

Engaging appropriate professional and expert advisers

86 Professional and expert advisers—such as managers, legal advisers, tax advisers, underwriters and lead managers—are each responsible for various aspects of the due diligence process. Each adviser should be engaged on the basis that they are competent and bring their own unique set of skills, knowledge and experience to a field of expertise relevant to the preparation of the prospectus.

87 An expert adviser can bring an independent and inquiring mind to the issues that may arise in the IPO due diligence process. This may reduce the risk of producing a deficient prospectus and reduce the liability of the issuer by demonstrating its reasonable reliance on the opinion of the expert. It is

therefore important for the expert advisers to obtain a thorough understanding of the issuer's business.

88 There are certain facets of an IPO due diligence process that clearly require the assistance of an expert adviser—for example, an investigating accountant to review of the issuer's financial information. Other areas may be less clear—for example, whether a legal opinion is required to confirm the validity of an issuer's assets. An effective due diligence process should identify the material matters that will require an expert opinion and ensure that the appropriate advisers are engaged.

89 The due diligence process can be lengthy and complex depending on the nature of the issuer's business. Engaging appropriate professional and expert advisers can help ensure that the process is as efficient and cost effective as possible.

Additional recommendations for emerging market issuers

90 Due to the heightened challenges associated with emerging market issuers, Australian advisers should provide effective oversight and apply sufficient scepticism of the due diligence work carried out by foreign legal and other advisers. To provide effective supervision, Australian advisers should make sure that they understand the political and cultural environment in which the issuer operates, local business practices affecting the issuer, local laws affecting the issuer and the issuer's local expert advisers.

91 The Australian legal advisers should ensure that:

- (a) the foreign advisers meet the materiality threshold agreed under the due diligence plan and properly carry out the due diligence inquiries;
- (b) the foreign legal advisers have sighted signed, original documents;
- (c) the foreign legal advisers have made independent inquiries, provided evidence of those inquiries and independently verified the information provided by the issuer to an appropriate level of independent and objective evidence;
- (d) the foreign legal report does not make assumptions about issues that are important for disclosure (e.g. assume that the issuer has legal title over certain material assets without independent verification);
- (e) the foreign legal report provides details about the types of documents reviewed, including a summary of all the key material terms of those agreements or contracts; and
- (f) the foreign legal report clearly sets out the basis on which its opinion has been formed on whether the agreements or contracts are valid and enforceable under the relevant foreign laws and regulations.

- 92 For emerging market issuers, language and cultural barriers must be addressed to ensure that all directors are able to effectively participate in the IPO due diligence process and provide informed consent to the lodgement of the prospectus.

Further due diligence work by ASIC

- 93 The systematic review of due diligence practices of IPO issuers has allowed ASIC to assess market practices. This review has assisted our ongoing work in monitoring the IPO market, including our prospectus reviews.
- 94 In addition to our review of disclosure in prospectuses, we intend to continue our focus on the due diligence process and the verification process in the preparation of public disclosure documents. While we often conduct due diligence reviews when we encounter disclosure concerns in a particular prospectus, we intend to conduct wider ranging systematic reviews of due diligence with the aim of improving market practice.
- 95 We recognise that there is often a direct correlation between the quality of due diligence conducted by an issuer and the quality of the disclosure in the issuer's prospectus. We consider that focused work in this area will promote improved practices in IPO fundraisings. Our reviews have also produced positive outcomes, resulting in issuers making corrective disclosure, changing offer terms or withdrawing the offer.
- 96 We have also observed that the due diligence processes are usually driven by the legal advisers of an issuer. If we observe practices that suggest certain legal advisers may have deficient due diligence processes, we will consider targeted reviews of offers prepared with the support of these legal advisers. This is consistent with our risk-based approach to reviewing disclosures more generally. Better due diligence processes give us more comfort that disclosures in a prospectus are accurate and complete.
- 97 We are also planning to carry out more review work during the 2016–17 financial year, focusing on different aspects of public company fundraising processes to promote good market practices for fundraising.

Appendix: Industry guidance

Securities Institute of Australia

- 98 The Securities Institute of Australia published the *Due diligence guide* shortly after the commencement of the *Corporations Law 1991*, which is a due diligence checklist of items for investigation. However, this checklist is no longer used because of the risk of omitting matters of material concern. Current due diligence practices adopt a more risk-based approach, with an emphasis on substantive matters for inquiry about the issuers' business and the desired outcome of the due diligence process.

Auditing standards

- 99 The AUASB issued ASAE 3420 and ASAE 3450, which apply to engagements commencing on or after 1 July 2013.
- 100 ASAE 3420 applies to assurance engagements on pro-forma historical financial information that has been compiled for inclusion in either a public document (such as a prospectus) or non-public document. Its requirements and guidance help auditors determine when to accept such engagements, the appropriate level of assurance they should provide, how the engagement should be performed, and the content of the final assurance report.
- 101 ASAE 3450 applies to assurance engagements on historical, prospective (including a pro-forma forecast), or pro-forma financial information that has been prepared for inclusion in a public or non-public document, or assurance on prospective financial information (including a pro-forma forecast and a projection) that has been prepared for any other purpose. Like ASAE 3420, it provides requirements and guidance on the key issues relating to these types of engagement.

Accounting professional and ethical standards

- 102 The APESB issued APES 350, which took effect on 1 February 2010 and was revised in March 2011.
- 103 APES 350 sets out the mandatory requirements and guidance for accountants when participating in and/or reporting to a due diligence committee as a:
- (a) committee member;
 - (b) committee observer; or
 - (c) reporting person in connection with a public document.

104 Generally, APES 350 requires accountants to observe and comply with their public interest obligations when performing professional services associated with the due diligence process of an issuer. The standard also reminds accountants of their professional obligations, established in accordance with [Accounting Professional and Ethical Standard APES 110 Code of ethics for professional accountants](#) (PDF 864 KB).

Investment Industry Regulatory Organisation of Canada

105 In December 2014, the Investment Industry Regulatory Organisation of Canada (IIROC) released a guidance note describing common practices and suggestions in respect of underwriting due diligence: [IIROC Notice 14-0299 Rules Notice—Guidance Note—Guidance respecting underwriting due diligence](#) (PDF 220 KB).

106 The purpose of the IIROC Notice 14-0299 is to promote more consistent and enhanced underwriting due diligence standards, to help underwriters more effectively perform their role and to ensure the protection of the investing public.

107 IIROC Notice 14-0299 recommends that underwriters and individuals performing due diligence investigations on their behalf take an approach to due diligence that goes beyond the avoidance of liability and mitigation of risk to underwriters. Underwriters, together with other gatekeepers, play a role in protecting investors, fostering fair and efficient capital markets, and creating and maintaining confidence in capital markets.

108 IIROC Notice 14-0299 notes due diligence must not put ‘form over substance’ and underwriters are expected to exercise professional judgement to determine the appropriate level of due diligence in each set of circumstances.

109 IIROC Notice 14-0299 sets out the following relevant list of common practices and suggestions:

- (a) each underwriter is expected to have written policies and procedures in place for all aspects of the underwriting process and to have effective oversight of these activities. These policies and procedures should reflect that what constitutes reasonable due diligence, and this will depend on the context of each underwriting;
- (b) the underwriter should have a due diligence process that reflects the context of the offering and the level of due diligence that will be reasonable in the circumstances;
- (c) due diligence ‘questions and answers’ sessions should be held at appropriate points during the offering process and are an opportunity

for all syndicate members to ask detailed questions of the issuer's management, auditors and counsel;

- (d) the underwriter should perform business due diligence sufficient to ensure that the underwriter understands the business of the issuer and the key internal and external factors affecting the issuer's business. Underwriters should use their professional judgement when determining which material fact will be verified independently depending on the circumstances of the transaction;
- (e) the extent to which an underwriter should rely on an expert's opinion depends on the context and the qualifications, expertise, experience, independence and reputation of the expert; and
- (f) underwriters should document the due diligence process to demonstrate compliance with their policies and procedures and other applicable legal requirements.

Key terms

Term	Meaning in this document
APES 350 (for example)	A standard published by the APESB (in this example numbered 350)
APESB	Accounting Professional and Ethical Standards Board
ASAE 3420 (for example)	A standard published by the AUASB (in this example numbered 3420)
ASIC	Australian Securities and Investments Commission
AUASB	Auditing and Assurance Standards Board
Ch 6D (for example)	A chapter of the Corporations Act (in this example numbered 6D), unless otherwise specified
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
due diligence committee	A delegation established by the issuer's board of directors to oversee and coordinate the due diligence process, which generally involves certain directors of the issuer and its key advisers
due diligence process	A process adopted by issuers to determine whether they have properly prepared their prospectus—that is, that everything in the prospectus is accurate and nothing material has been omitted
emerging market	A jurisdiction in Eastern Europe, Asia and the Pacific (excluding Singapore, Hong Kong, Japan and New Zealand), Africa, South America or the Middle East
emerging market issuer	<p>A listed entity, or entity seeking to list, that has:</p> <ul style="list-style-type: none"> • material assets located in, or a revenue stream derived from operations in, an emerging market; or • subsidiaries incorporated in and/or listed in an emerging market. <p>In addition, emerging market issuers may have directors or senior management based offshore in an emerging market, or engage an auditor from an emerging market</p>
IPO	Initial public offering
IIROC	Investment Industry Regulatory Organisation of Canada
IIROC Notice 14-0299 (for example)	An IIROC guidance note (in this example numbered 14-0299)
REP 368	An ASIC report (in this example numbered 368)
RG 51 (for example)	An ASIC regulatory guide (in this example numbered 51)

Term	Meaning in this document
s710 (for example)	A section of the Corporations Act (in this example numbered 710), unless otherwise specified

Related information

Headnotes

directors, due diligence, due diligence committee, due diligence process, emerging market, emerging market issuers, initial public offering, investigating accountant, IPO, issuers, legal advisers, prospectus, public disclosure document, verification

Regulatory guides

[RG 51](#) *Applications for relief*

[RG 254](#) *Offering securities under a disclosure document*

Legislation

Corporations Act, Ch 6D, s710, 711(1), 711(2), 711(4), 711(5), 711(7), 716(1), 716(2), 716(6), 731, 733, 741

Trade Practices Act 1974, s85

Cases

Escott v Barchris Construction Corp 283 F Supp 643 (1968)

Reiffel v ACN 075 839 226 Ltd (2003) 45 ACSR 67

Universal Telecasters (Qld) v Guthrie (1978) 18 ALR 531

Consultation papers and reports

[REP 368](#) *Emerging market issuers*

Standards

[APES 110](#) *Code of ethics for professional accountants* (PDF 864 KB)

[APES 350](#) *Participation by members in public practice in due diligence committees in connection with a public document* (PDF 421 KB)

[ASAE 3420](#) *Assurance engagements to report on the compilation of pro forma historical financial information included in a prospectus or other document* (PDF 672 KB)

[ASAE 3450](#) *Assurance engagements involving corporate fundraising and/or prospective financial information* (PDF 936 KB)

Other documents

F Assaf, et al, *Australian corporation law—Principles and practice*

R Austin & I Ramsay, *Ford, Austin & Ramsay's principles of Corporations Law*

RP Austin & AJ Black, *Austin & Black's annotations to the Corporations Act*

Colmar Brunton, [*Investor experience of IPOs*](#)

Deloitte Touche Tohmatsu Limited, [*Open for growth: Deloitte 2016 IPO report*](#)

EYGM Limited, [*EY Global IPO trends: 2016 1Q*](#) (PDF 1.37 MB)

[IIROC Notice 14-0299](#) *Rules Notice—Guidance Note—Guidance respecting underwriting due diligence* (PDF 220 KB)