Association of Securities & Derivatives Advisers of Australia

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Mr Terence Kouts
Corporations
Australian Securities and Investments Commission
By email: policy.submissions@asic.gov.au

Response to ASIC Consultation Paper 257 – Improving disclosure of historical financial information in prospectuses: Update to RG228

The Association of Securities and Derivatives Advisers of Australia (ASDAA) appreciates the opportunity to provide these comments to ASIC in respect of ASIC Consultation Paper 257 – Improving disclosure of historical financial information in prospectuses: Update to RG228.

ASDAA is a newly formed association which represents its members from the Securities and Derivatives advisory profession. Its members are comprised of individuals who are either directors or employees of firms which hold Australian Financial Services Licences (AFSLs).

ASDAA believes that there is room for improvement and that ASIC could provide assistance generally by providing a basic template of the financial information required along with guiding principles for information to be included relating to the business description and who the directors are. By providing a template, this will have the flow on effect of reducing legal costs relating to the production of a prospectus and ultimately ensure that those prospectuses submitted to ASIC meet minimum requirements as outlined in the template.

We recognise that this is outside of the scope of this submission however we believe that ASIC should assess whether it is reasonable for a company to extend its offer to more retail clients above and over the limitations currently in place (ie. the 2/20 rule in 12 months). We believe that a minimum capital raising threshold which is a minimum amount that should be raised by a company to trigger the requirement to issue a PDS would open the market and allow companies to access more funds. The idea would be that companies seeking to raise amounts below the minimum capital raising threshold would be able to do so using a simplified methodology which does not include a detailed PDS and large legal, accounting and audit costs and still gives them the flexibility to seek investments from retail clients.

We wish to highlight the following matters that we believe require further consideration and/ or clarification:

- The requirement to have the accounts audited may be an unnecessary additional expense. If the issuer and business being acquired had no legal obligation to produce audited financial statements then they should have no obligation to include audited financial statements in the prospectus.
- Potential impediments:
  - cost of auditing financial information;
  - where the audit is conducted retrospectively, ensuring that the appropriate accounting standards are applied as these frequently change;
  - time taken to complete and audit financial information.
- How reliable is audited financial information when the financial information can't be produced according to relevant accounting standards as appropriate accounting records were not maintained?
- Where the fundraising is targeted towards resolving a going concern issue shouldn't there be a requirement to disclose in the prospectus the reasons for the going concern issue and shouldn't ASIC consider whether it is appropriate for a company to undertake a fundraising when it has an issue with going concern. This gives rise to the question – where is the benefit for potential investors.
- If a company has not been subject to the requirements of Ch 2M in the past, the issue that arises is whether or not they maintained the relevant records which will allow them to reproduce accounts that are compliant with Ch 2M.
- ASIC should deal with businesses where the subject of the fundraising has changed so substantially that any unaudited post-balance-date material event disclosure would be of similar or greater significance for investors as the disclosure in the most recent audited or reviewed financial statements on a case by case basis. If the audited data will add value without incurring unnecessary astronomical costs then we agree that audited financial information should be included. If however obtaining the audit will incur astronomically high costs which are to be paid for with funds raised under the IPO then we do not see the added value that audited data would provide over reviewed data, especially if the audit would result in material qualifications.
- ASIC should consider including guiding principles as to what it would consider to be acceptable conditions for an applicant to be permitted to depart from the two-and-a-half or three year guideline on the grounds of relevance.
- We believe that the term relevance should be defined or the underlying principles that ASIC will use to determine whether something is relevant should be included in the guidance.

Our specific comments to each of ASIC's proposals in the Consultation Paper are detailed in Annexure A of this letter.

ASDAA appreciates the opportunity to provide this Submission to ASIC on these significant proposals. We would be happy to discuss any issues arising from our submissions on this issue, or to provide any further material that may assist. Should you require any further information, please contact Brad Smoling, Director of Communications, on (07) 5532 3930 or email brad@asdaa.com.au.

Yours Sincerely

Marija Pajeska

Compliance Director

Annexure A: Response to ASIC Questions

Corporate form and historical reporting requirements

B1 proposal: ASIC proposes to clarify that, subject to the circumstances described in proposals B11–B13, an issuer should disclose audited historical financial statements for two-and-a-half or three years for both the issuer and any business it acquires. This is regardless of whether the financial statements were required by law to be produced (apart from being in the prospectus) or whether the business is in a corporate form: see draft RG 228.88.

ASIC Question		Response
B1Q1	Do you have any comments on this proposed clarification?	The requirement to have the accounts audited may be an unnecessary additional expense. If the issuer and business being acquired had no legal obligation to produce audited financial statements then they should have no obligation to include audited financial statements in the prospectus.
B1Q2	Is it unduly onerous to for an issuer to obtain audited financial information about the business being acquired?	The requirement to have the financial information about the business being acquired audited may be an unnecessary additional expense. If the business being acquired had no legal obligation to produce audited financial statements then the issuer should have no obligation to include audited financial information about the business being acquired in the prospectus.
B1Q3	Are there potential impediments to issuers providing audited rather than reviewed or unaudited historical financial information? If so, under what conditions would these arise?	Potential impediments: • cost of auditing financial information; • where the audit is conducted retrospectively, ensuring that the appropriate accounting standards are applied as these frequently change; • time taken to complete and audit financial information.
B1Q4	Do you have any feedback on the related examples in Case Studies 1 – 7 and 11 in Section C?	Refer to Annexure B

Audited financial information

B2 proposal: ASIC proposes to clarify that where an audit or review opinion (for half year financial information) included in a prospectus has a qualification or modification that indicates that the audit opinion provides limited independent assurance for investors, we are likely to treat the financial information as effectively unaudited. In the event we treat the information as unaudited, it is likely that we will view the prospectus as not complying with the s710 test: see draft RG 228.92.

ASIC Question		Response
B2Q1	Do you have any comments on this proposed clarification?	The clarification is useful but confusing as the initial intent appears to be that all financial information should be audited but then ASIC is saying that it has the power to accept unaudited financial information even though unaudited financial information would result in non-compliance with the s710 test.
B2Q2	Do you believe that risk disclosure can remedy issues related to the disclosure of financial statements that contain, for example, disclaimer opinions where the auditor could not access appropriate accounting records for material areas of the financial statements? If so, why?	What is the point of imposing a requirement to have financial information audited when the financial information can't be produced according to relevant accounting standards as appropriate accounting records were not maintained? Maybe there should be a condition that only companies that maintain appropriate accounting records for 2 and ½ years to 3 years are permitted to issue a prospectus and undertake an IPO.
B2Q3	Do you have any feedback on the related examples in Case Studies 8 – 9 in Section C?	Refer to Annexure B

B3 proposal: ASIC proposes to clarify that it will generally accept that audit reports including emphasis of matter paragraphs (e.g. 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: see draft RG 228.93.

ASIC Question		Response
B3Q1	Do you have any comments on this proposed clarification?	If there is a question as to a companies going concern should it not be in the best interest of investors for ASIC to reject the prospectus in the first instance. Where the fundraising is targeted towards resolving a going concern issue shouldn't there be a requirement to disclose in the prospectus the reasons for the going concern issue.
B3Q2	Do you have any feedback on the related examples in Case Studies 8 – 9 in Section C?	Refer to Annexure B

B4 proposal: ASIC proposes to provide guidance recognising that there may be practical audit issues where up to three years of financial statements are being audited for the first time. In these circumstances, ASIC proposes to note that it is generally acceptable for the audit or review opinion to contain opening balance qualifications and, subject to materiality, issues related to inventory inspections: see draft RG 228.94.

ASIC Question		Response
B4Q1	Do you have any comments on this proposed clarification?	If it is acceptable to contain opening balance qualifications and be, subject to materiality, issues related to inventory inspections then where is the value add of including an audit report. Such qualifications can be included in the Director's report without the need for an audit.
B4Q2	Are there audit issues other than those relating to 'opening balance' qualifications and inventory inspection procedures that may arise where financial statements for prior years are audited for the first time?	What accounting standards should the accountant and auditor apply when completing the accounts and auditing financials which are 3 years old, the current standards or those standards that applied 3 years ago?
B4Q3	Do you have any feedback on the related examples in Case Studies 8 – 9 in Section C?	Refer to Annexure B

B5 proposal: ASIC proposes to clarify that the audit or review of historical financial information included in the 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: see draft RG 228.91.

ASIC Question		Response
B5Q1	Do you have any comments on this proposed clarification?	If a company has not been subject to these standards in the past, the issue that arises is whether or not they maintained the relevant records which will allow them to reproduce accounts that are compliant with Ch 2M.
B5Q2	Do you have any feedback on the related examples in Case Studies 8 – 9 in Section C?	Refer to Annexure B

Asset acquisition and development of assets

B6 proposal: ASIC proposes to clarify that if assets acquired by an issuer are in substance the acquisition of a business, the issuer should generally disclose historical income statements: see draft RG 228.95.

ASIC Question		Response
B6Q1	Do you have any comments on this proposed clarification?	The clarification provided by ASIC is sufficient.
B6Q2	Do you have any feedback on the related examples in Case Studies 6 - 7 in Section C?	Refer to Annexure B

B7 proposal: ASIC proposes to use the guidance in Appendix B of AASB 3 to assist us in determining whether an issuer has in fact acquired or is operating a business rather than an asset or a collection of assets: see draft RG 228.96.

ASIC Question		Response
B7Q1	Do you have any comments on our proposal to use Appendix B of AASB 3	We have no comments.
B7Q2	Do you have any feedback on the related examples in Case Studies 6 - 7 in Section C?	Refer to Annexure B

Updating financial disclosure

B8 proposal: ASIC proposes to clarify its guidance on when financial information is considered current in a prospectus. RG 228.89 already states that issuers should include current financial information in their prospectus.
This extends to requiring the inclusion of half-year financial information. Where the existing business that is the subject of the fundraising has not changed substantially and has an acceptable audit history (as described in draft RG 228.91–RG 228.94), the financial information will generally be considered current if the prospectus includes the most recent:
(a) half-year audited or reviewed financial statements (where the prospectus is lodged with ASIC less than three months after year end); or
(b) full-year audited financial statements (where the prospectus is lodged with ASIC less than 75 days after half-year end).

ASIC Question		Response
B8Q1	Do you have any comments on this proposed clarification?	The clarification provided by ASIC is sufficient.
B8Q2	Do you have any feedback on the related examples in Case Studies 10 – 11 and 11 in Section C?	Refer to Annexure B

B9 proposal: In some instances the business that is the subject of the fundraising may have changed so substantially that any unaudited post-balance-date material event disclosure would be of similar or greater significance for investors as the disclosure in the most recent audited or reviewed financial statements. We propose that in such cases the audited financial information included in the prospectus should have a more current balance date: see draft RG 228.90.

ASIC Question		Response
B9Q1	Do you have any comments on this proposed clarification?	The clarification provided by ASIC is sufficient.
B9Q2	Do you agree that the issuer should provide audited rather than reviewed disclosure in the circumstances described above?	We believe that this should be dealt with on a case by case basis. If the audited data will add value without incurring unnecessary astronomical costs then we agree with the proposal. If however obtaining the audit will incur astronomically costs which are to be paid for with funds raised under the IPO then we do not see the added value that audited data would provide over reviewed data, especially if the audit would result in material qualifications.

ASIC Question		Response
B9Q3	Where an issuer has commenced operations and seeks to raise funds using a prospectus in its first year of operation, should the issuer be required to include audited rather than reviewed accounts?	We believe that if the issuer is required by law to produce audited accounts then audited accounts should be included. If the issuer is not required by law to produce audited accounts then reviewed accounts should be included.
B9Q4	Do you have any feedback on the related example in Case Study 11 in Section C	Refer to Annexure B

Inclusion of cash flow statements

B10 proposal: ASIC proposes to provide guidance that historical cash flow statements may need to be included in a prospectus where the financial history otherwise requires disclosure: see draft RG 228.87(b)(ii)

ASIC Question		Response
B8Q1	Do you have any comments on this proposed clarification?	The clarification provided by ASIC is sufficient.

Circumstance where historical financial information disclosure may not be necessary

B11 proposal: ASIC proposes to provide guidance describing the circumstances where audited financial information for the past two-and-a-half or three years would include information not relevant to an informed assessment of the issuer's financial position, performance or prospects, or which would not be reasonable for investors and their professional advisers to expect. In such circumstances, the provision of either unaudited information, audited information with a 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 the s710 test. Issuers may therefore justify departure from the two-and-a-half or three year audited guideline in two broad sets of circumstances, outlined in proposals B12–B13: see draft RG 228.97.

ASIC Question		Response
B11Q1	Do you have any comments on this proposed clarification?	ASIC should also include a paragraph to the extent that other circumstances may exist and those circumstances will be assessed on a case by case basis. ASIC should also outline what principles it will use to determine whether other circumstances where historical financial information disclosure may be required are approved.
B11Q2	Do you have any feedback on the related examples in Case Studies 2–3 and 9 in Section C?	Refer to Annexure B

B12 proposal: ASIC proposes to provide guidance that historical financial information disclosure may not be necessary where two-and-a-half or three years of audited financial information, or some part of it, is not relevant: see Table 10 in draft RG 228 and Table 1 below for some examples where this may apply.

ASIC Question		Response
B12Q1	Does the list of examples provide sufficient clarification as to the exceptional cases in which we may accept departure from the two-and-a-half or three year guideline on the grounds of relevance? If not, what are other examples or scenarios that should be included?	If ASIC intends to use the examples on the basis that they are the only situations where it will accept departure from the two-and-a-half or three year guideline on the grounds of relevance then these are not examples. If ASIC's intent is to limit the circumstances or situations under which it intends to allow applicants to utilize these circumstances then ASIC should be clear in its guidance as to its intent. ASIC should consider including guiding principles as to what it would consider to be acceptable conditions for an applicant to be permitted to depart from the two-and-a-half or three year guideline on the grounds of relevance.

ASIC Question		Response
B12Q2	Is there a need to define relevance? We would generally consider that an operating history is relevant if it relates to the same sphere of economic activity as those the issuer intends to engage in after the issuance.	We believe that the term relevance should be defined or the underlying principles that ASIC will use to determine whether something is relevant should be included in the guidance.
B12Q3	Do you have any feedback on the related examples in Case Studies 2–5 and 9 in Section C?	Refer to Annexure B

B13 proposal: ASIC proposes to clarify that historical financial information disclosure may not be necessary if it is not reasonable for investors and their advisers to expect two-and-a-half or three years of audited financial information: see Table 10 at draft RG 228 and Table 2 below for some examples where this may apply.

ASIC Question		Response
B13Q1	Does the list of examples provide sufficient clarification as to the exceptional cases where it is not reasonable to expect compliance with the two-and-a-half or three year guideline? If not, what are other examples or scenarios that should be included?	No. ASIC should consider including guiding principles as to what it would consider to be acceptable conditions for an applicant to be permitted to depart from the two-and-a-half or three year guideline on the grounds of relevance.
B13Q2	Do you have any feedback on the related examples in Case Studies 2–3 and 9 in Section C?	Refer to Annexure B

Annexure B: Feedback relating to Case Studies

Case Study	Comments
1: Acquisition using IPO funding	We understand the logic ASIC has provided as to why Company Y and Company Z are to comply with RG228 if they were standalone applicants, however once the operations of Company Y and Company Z are absorbed into Company X then certain financial data is no longer relevant, ie. operational costs incurred by Company Y and Company Z as a result of running as a standalone company. These costs are generally transitioned to Company X. The question is raised as to whether the cost of reconstructing the accounts and audited the accounts of Company Y and Company Z will outweigh any benefit achieved as such costs would most likely be paid for from funds raised which effectively takes funds away from Company X and may affect its ability to achieve its goals.
2: Multiple immaterial acquisitions using IPO funding	The income tax statements lodged with the ATO are a statutory document presenting the income and expenditure of these individuals. The cost and time required to reconstruct the accounts using different accounting principles (ie. other than accounting on a cash basis) for such individuals, who will be subject to a different costs structure when consolidated under Company X raised the question of relevance. How is it relevant to Company X or an investor to know historical financial information which is retrospectively put together and will most likely include material qualifications within an audit? Isn't it more relevant for Company X and investors to have details of key historical metrics which are quantified on the basis that the changes in operational structure will significantly change the financial position of the individual as they are no longer applying accounting principles on a cash basis and are benefiting from economies of scale as a result of consolidating operational costs within Company X.
3: Carve out acquisition using IPO funding	We understand ASIC's point but question the ethics applied in the audit industry if an auditor can vary the materiality level of an audit. There should be a standard benchmark set that should be applied by all auditors and no variance allowed thus ensuring that people confidently rely on the information provided in an auditor's report. If ASIC is implying that the materiality level applied by an auditor in relation to a business which is immaterial to Company X would be such that the auditor would not even assess or consider the immaterial business being sold, then we don't think that Company X should rely or mention the audit of Company Y at all as such audit is not relevant to the immaterial business that Company Y is selling.
4: Major acquisition in financial history, not funded by IPO	If Company X discloses a three-year financial history including Company Y as if it was acquired at the beginning of the three-year period then we believe it is important that Company X include relevant disclaimers highlighting the fact that the first 1 and ½ years of results are technically hypothetical as Company Y was not part of Company X in the first 1 and ½ years and there is assumption that the decisions made by Company Y would have been made by Company X and that the same expenses and income would have been generated.
5: Backdoor listing	We agree with ASIC's view
6: Development of assets	We agree with ASIC's view

Case Study	Comments
7: Acquisition of assets	We agree with ASIC’s view
8:Disclaimer of opinion in audit of a foreign issuer	ASIC should provide more detail in this example as to whether or not it would accept or reject the prospectus or alternatively outline what additional information the issuer would need to provide in order for ASIC to consider approving the prospectus.
9: Disclaimer of opinion in audit of a listed issuer	We agree with ASIC’s view
10: Out-of-date financial statements	We agree with ASIC’s view
11: Out-of-date financial statements – intervening circumstances	We agree with ASIC’s view as Company Y has been in operation for just over year and thus to expect the accounts to be audited would not be unreasonable.