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Mr Terence Kouts
Corporations
Australian Securities and Investment Commission
GPO Box 9827
Sydney NSW 2001

26 July 2016

Dear Mr Kouts

Comments on Consultation Paper: *Improving disclosure of historical financial information in prospectuses: Update of RG 228*

Deloitte is pleased to provide ASIC with our comments on ASIC Consultation Paper 257: *Improving disclosure of historical financial information in prospectuses: Update of RG 228* (the Consultation Paper or CP 257).

As outlined in CP257, ASIC is proposing to update the guidance in Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors (RG 228)* to improve the disclosure of historical financial information in prospectuses and assist companies and their advisers to better understand their disclosure obligations.

Deloitte is supportive of ASIC's imperative to improve prospectus disclosures and ultimately the integrity and quality of future initial public offerings in Australia. We have outlined our responses to the proposal and questions raised in the Consultation Paper commencing overleaf.

We understand ASIC and ASX are working collaboratively on these regulatory changes aimed at improving the quality of the companies seeking to list on the Australian Securities Exchange which will enhance the reputation and standing of the Australian financial markets. Attached also is our submission to the ASX in respect of their consultation paper with respect to the admission requirements dated 12 May 2016.

We thank you for this opportunity to comment on this Consultation Paper. Please do not hesitate to contact us if you would like to discuss any of our comments further.

Yours sincerely

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Proposal B1

We propose 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.

Feedback B1

B1 Q1 Do you have any comments on this proposed clarification?

The existing RG 228 requires certain financial information to be included in a prospectus including an audited statement of financial position at the latest balance date and up to three years of audited income statements and other information that is material, which is derived or extracted from the financial statements, notes to the financial statements and other documents attached to the financial report.

The proposed amendments to RG 228.88 states that the prospectus “should disclose audited financial statements…” We note that accepted market practice is to include summarised or abridged versions of statements of financial position, income statements and cash flows as extracted from the financial statements rather than to include financial statements in their entirety. Reference to “financial statements” the above proposal suggests that it is ASIC’s intention for financial statements in their entirety to be included in a prospectus.

We are supportive of improving the disclosure of financial information, however, we do not believe full financial statements need to be included in a prospectus.

Additional clarity is also sought from ASIC with regard to the following:

- Whether the financial statements of the most recent financial year lodged pre-listing are required to be prepared in accordance with general purpose financial reporting (tier 1 or 2) or whether special purpose financial statements would be deemed sufficient? We believe that if special purpose financial statements were prepared this would conflict with the reporting entity concept in SAC 1 *Definition of the Reporting Entity* and the definition of public accountability in AASB 1053 *Application of Tiers of Australian Accounting Standards* .
- If special purpose financial statements are deemed sufficient, are such accounts required to comply with all recognition and measurement requirements of Australian Accounting Standards?
- Where financial statements are prepared by an Issuer in order to satisfy the prospectus disclosure requirements prior to listing, in certain circumstances comparatives have not been included in the financial statements of the earliest year due to the time and cost implications of having these audited. Clarity would be appreciated as to whether ASIC is comfortable with the first year financial statements not having comparatives (as long as the prospectus satisfies the disclosure requirement of 2.5 or 3 year audited/reviewed financial information), that is where the reference to 2.5 years or 3 years of financial statements is in fact to 3 separate sets of financial statements? The proposal above requires inclusion in the prospectus of the financial statements of any business acquired. Where this business is a subset of another entity and not a separate vehicle, what should be the basis of preparation for the financial statements of the business? Refer to B1 Q2 below.

B1 Q2 Is it unduly onerous to for an Issuer to obtain audited financial information about the business being acquired?

Where a business to be acquired is a subset of or carve out of another entity (whether a company, trust or other vehicle) it will in most cases be extremely difficult or impractical to perform the audit of the financial information and express a clean audit opinion about the business being acquired. If considering a Corporations Act entity, the Corporations Act requires an entity to keep financial records that enable true and fair financial statements to be prepared and audited however this is done for the entity as a whole. There is no requirement that business or operations streams within an entity maintain separate ledgers. Where an entity is comprised of a number of business operations, there is the likelihood that certain assets, costs and financing are shared across the entity. Any determination of an allocation to separate business would be subject to significant judgement and uncertainty.

In the circumstances of an acquirer purchasing an unaudited target business, it may be not be possible for acquirers to obtain the historical financial information sufficient for an audit to be performed. By way of example, a transaction involving assets or operations that historically have not been a standalone business or entity. Where such a limitation genuinely exists, it cannot be reasonably expected for such entities to produce audited historical information.

In such circumstances, we would also not expect an Issuer to retrospectively recognise the earnings and cash flows of the target businesses in the pro forma historical information of the Issuer on the basis that information limitations also preclude the review of such information by the Investigating Accountant.

B1 Q3 Are there potential impediments to Issuers providing audited rather than reviewed or unaudited historical financial information? If so, under what conditions would these arise?

In addition to a recent business or asset acquisition (noted in this proposal), there are a number of circumstances that will provide challenges to the audit of historical financial information, some of which are noted in examples identified by ASIC in proposals B6 and B12, and will most commonly result from complexities associated with recent business structural changes.

In our experience we have found the preparation of audited financial information to be a more time consuming process for Issuers and their auditor than the review of financial information or preparation of unaudited financial information. With reference to financial information presented in a prospectus being current (per timeframes contemplated in Proposal B8), we have concerns that the IPO preparation process timeframe (including prospectus drafting) may potentially be significantly delayed by the audit timeframe, often with no significant benefit beyond that which a limited-assurance review opinion would provide. The inclusion of reviewed financial information in a prospectus may be sufficient for investors' needs without adversely impacting the commercial imperatives of the IPO preparation process.

As noted by ASIC in Proposal B13, the historical period immediately preceding the forecasts are of the highest priority to investors and in some circumstances a limited-assurance review opinion with regard to the preceding periods may be appropriate.

The current drafting of Proposal B1 does not appear to contemplate any alternative to audited financial information. We do, however, appreciate that Issuers defaulting to reviewed financial information as common practice is not the preference of ASIC.

B1 Q4 Do you have any feedback on the related examples in Case Studies 1–7 and 11 in Section C?

We make comments on the following case studies only:

<u>Case Study 1</u>

As discussed above, in certain cases, acquirers find it is impractical as part of the sale process to obtain historical financial information from target businesses which is sufficient so as to enable an audit opinion to be expressed. Where such a limitation genuinely exists, it cannot be reasonably expected for such entities to produce audited historical information even though a reasonable basis may exist for including forecast financial information (for instance, where this is supported by run-rates or contracted earnings).

<u>Case Study 3</u>

Paragraph 61 notes "we would have reservations about accepting Company Y's financial statements…". It is our reading of the consultation paper that ASIC is expecting the financial statements of the business purchased from Y and therefore it would not be Company Y's financial statements that would be provided in any instance. Also, it appears that the proposal requires the audit opinion on the acquired business to be disclosed, or is ASIC suggesting that per current practice the prospectus will disclose in the *Basis of Preparation section of the Financial Information* that the information has been audited, including the name of the auditor where relevant.

<u>Case Study 4</u>

It appears that ASIC's view has been formed on the basis that Company Y's audited financial information formed 'a substantial portion of the consolidated audited results'. For clarity, please confirm that if Company Y had been acquired later in the historical period (less than 18 months before IPO) ASIC's view would be that Company Y has not been audited for a sufficient (i.e. majority) period of time to be included in the pro forma historical financial information.

<u>Case Study 7</u>

There are currently diverse views in determining at what point the acquisition of investment property moves from an asset acquisition to a business combination. The facts as included in this case study may not in fact represent a business which could create confusion as to ASIC's intention.

Proposal B2

We propose 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

Feedback B2

B2Q1 Do you have any comments on this proposed clarification?

CP 257 recognises that not all qualified or modified audit reports will result in ASIC regarding the financial information as unaudited, for example, emphasis of matter modifications with regard to 'going concern' in circumstances where a successful listing will enable the company to continue its operations, or opening balance qualifications or qualifications related to the inability to inspect inventory where three years of financial statements are audited for the first time, a proposal which we agree with. In our view, there may be other circumstances where modified opinions could be acceptable, such as where the basis for opinion includes a quantification of the financial impact of the misstatement. In such circumstances investors and their professional advisers should be able to determine the impact of such a modified audit opinion and the inclusion in the prospectus of pro forma financial information adjusted for such misstatements should not be seen to impact the integrity of the financial information presented in prospectuses.

We note that the discussion regarding emphasis of matter paragraphs linked to going concern issues does not reflect the latest Auditing Standard ASA 570 *Going Concern* effective for 31 December 2016 year ends which requires that in cases where adequate disclosure about the material uncertainty of an entity to continue as a going concern is made in the financial report, the auditor would express an unmodified opinion and the auditor's report will include a separate section under the heading "Material Uncertainty Related to Going Concern". This should be updated in any revised Regulatory Guide.

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?

No, we do not consider it is possible to adequately remedy such a situation such that prospective investors are not adversely impacted.

B2Q3 Do you have any feedback on the related examples in Case Studies 8–9 in Section C?

No, we do not.

Proposal B3

We propose to clarify that we 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.

Feedback B3

B3Q1 Do you have any comments on this proposed clarification?

Refer B2Q1 above.

B3Q2 Do you have any feedback on the related examples in Case Studies 8–9 in Section C?

No, we do not.

Proposal B4

We propose 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, we propose 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.

Feedback B4

B4Q1 Do you have any comments on this proposed clarification?

Refer B2Q1 above.

In addition we note that CP 257 refers to review ‘opinions’ however Audit Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity* instead refers to ‘conclusions’.

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?

Refer B2Q1 above.

B4Q3 Do you have any feedback on the related examples in Case Studies 8–9 in Section C?

No, we do not.

Proposal B5

We propose 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.

Feedback B5

B5Q1 Do you have any comments on this proposed clarification?

The Consultation Paper notes that entities should "substantially comply" with the requirements in Ch 2M and also states that ASIC is not going to mandate the use of Australian accounting and auditing standards.

B5Q2 Do you have any feedback on the related examples in Case Studies 8–9 in Section C?

No, we do not.

Proposal B6

We propose 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.

Feedback B6

B6Q1 Do you have any comments on this proposed clarification?

Please clarify that the statement "*the Issuer should generally disclose historical income statements*" is implying that the historical earnings associated with the acquired assets should be included in the pro forma historical financial information of the Issuer and / or to be disclosed separately in the prospectus? If they are required to be disclosed separately, is disclosure by reference sufficient or would they be required to be disclosed within the prospectus, potentially in an appendix of Additional / Supplementary financial information?

Inclusion in the pro forma historical financial information of the Issuer will require audit of the historical income statements of the acquired assets in accordance with Proposal B1. We believe in some cases it may be difficult to obtain audited financial information in the circumstances of an asset acquisition, separated from the legacy business(es) / corporate entity structure(s) of the acquired assets. A common example is an asset carve-out from a corporate entity structure that, although the entity itself has been historically audited, the acquired assets themselves do not have available audited financial information.

Should draft RG 228.95 also require disclosure of historical cash flows in the prospectus consistent with Proposal B10?

B6Q2 Do you have any feedback on the related examples in Case Studies 6–7 in Section C?

Refer B1Q4.

Proposal B7

We will 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.

Feedback B7

B7Q1 Do you have any comments on our proposal to use Appendix B of AASB 3?

The Consultation Paper distinguishes between an entity and a business and confirms that a business does not need to be an entity for financial information to be provided. The Consultation Paper however has not contemplated the possibility that an entity acquired/to be acquired may actually not be a business and we believe clarification should be provided as to whether three years of financial information is required in such instances.

B7Q2 Do you have any feedback on the related examples in Case Studies 6–7 in Section C?

Refer B1Q4.

Proposal B8

We propose to clarify our 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).

Feedback B8

B8Q1 Do you have any comments on this proposed clarification?

We believe this clarification will be helpful in Issuers and their advisers and the proposed guidelines are not dissimilar to current market practice in terms of assessing if financial information disclosed in a prospectus is current.

B8Q2 Do you have any feedback on the related examples in Case Studies 10–11 in Section C?

No, we do not.

Proposal B9

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.

Feedback B9

B9Q1 Do you have any comments on this proposed clarification?

We seek further clarity on the nature of post-balance date material events that ASIC is intending to address with this proposal. Example events may include:

- a pre-IPO corporate restructure or fundraising event performed by the Issuer; and
- a business or asset acquisition event.

Clarity from ASIC with regard to use of the term ‘substantially’ will assist with the practical application of this proposal. Does substantial equate to material?

We do not consider that a more current balance date audit by the Issuer would provide greater insight or understanding of Issuer to investors in all circumstances of a post balance date event. We note that it is common market practice for the pro forma statement of financial position presented in a prospectus to consider such post-balance date material events in addition to the impact of the IPO offer, which is subject to review by the Investigating Accountant.

In the circumstances of a material business or asset acquisition event the pro forma adjustments recognising the impact of the acquisition event may be subject to audit, the equivalent of an opening balance sheet audit of the acquired business or assets. We believe this requirement would be consistent with the requirements of Proposal B1.

In many circumstances, we believe that a pro forma forecast statement of financial position as at the anticipated listing date would provide greater insight to investors.

B9Q2 Do you agree that the Issuer should provide audited rather than reviewed disclosure in the circumstances described above?

Further to the queries raised in B9Q1, we do not necessarily believe that in all circumstances it will be appropriate or required for the post-balance date information to be audited rather than reviewed.

As with the examples noted in B9Q1, we would expect a business or acquisition event post-balance date to be disclosed with reference to audited historical financial information in accordance with Proposal B1, whereas circumstances involving structural changes to the financial position of the Issuer (not impacting the trading performance) may be sufficiently addressed by review procedures of the Investigating Accountant.

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?

As above we believe these requirements are onerous.

B9Q4 Do you have any feedback on the related example in Case Study 11 in Section C?

No, we do not.

Proposal B10

We propose 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).

Feedback B10

B10Q1 Do you have any comments on this proposed clarification?

We agree that some cash flow information is useful information to include in a prospectus and note that currently it is typically market practice to do so, although there has been inconsistent presentation of reconciling pro forma historical operating cash flows to statutory historical cash flows.

We believe the relevant cash flow information is that relating to operating cash flows and capital expenditure. Other cash flows we believe have less relevance as historical financing and other investing cash flows are influenced by the historical corporate structure which may change after IPO or acquisition. We note that current market practice is to typically exclude tax cash flows from the presentation of pro forma historical cash flows on the basis that taxation structures may change after IPO. Guidance from ASIC on circumstances when such cash flows should or should not be disclosed in pro forma historical cash flows would be helpful to assist prospectus consistency and comparability.

If such a proposal is included it would also be useful to clarify the format of such presentation given AASB 107 *Statement of Cash Flows* allows operating cash flows to be presented either using the direct or indirect method. We note that the most commonly used approach and one that is best understood by the market and analysts is the indirect form.

Proposal B11

We propose 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

Feedback B11

B11Q1 Do you have any comments on this proposed clarification?

We seek clarification and guidance from ASIC as to whether the examples provided in Proposals B12 and B13 are intended to be exceptional circumstances only or represent more common place reasons for disclosing less than two and a half or three years of historical financial information. Also refer to feedback provided to Proposals B12 and B13 below.

B11Q2 Do you have any feedback on the related examples in Case Studies 2–3 and 9 in Section C?

Refer B1Q4.

Proposal B12

We propose 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.

Feedback B12

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?

We are concerned that, without additional clarification, the examples provided, particularly the main business change example, may be applied to a greater extent than in exceptional cases only, as appears to be envisaged by ASIC. Does ASIC intend to provide objective guidance or set of facts that assist Issuers and their advisers as to when a *main business change* has occurred?

An example may be where an Issuer has been restructured under ownership of a financial sponsor in periods prior to an intended offer. There may be a high degree of subjectivity in this circumstance to determine if the financial sponsor has undertaken a substantial / fundamental change in the main business.

We note that it is common market practice to present the pro forma historical income statement below EBIT to reflect the proposed post-IPO capital structure and tax structure of the Issuer.

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.

Refer B12Q1.

B12Q3 Do you have any feedback on the related examples in Case Studies 2–5 and 9 in Section C?

Refer B1Q4.

Proposal B13

We propose 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.

Feedback B13

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?

Similar to feedback to B12 Q1, we are concerned that these examples may be applied by Issuers to a greater extent that the exceptional cases envisaged by ASIC, without inclusion of additional clarification of the circumstances as to when reduced financial disclosure would be permitted.

Example 4 Year-one audit appears to be quite broad in terms of guiding Issuers and their advisers on circumstances that would constitute certain information not being available and therefore removing the need to audit the oldest financial years to be presented in the prospectus.

Example 5 Materiality appears to be primarily focused on incremental business acquisitions by the Issuer during the historical period. Will ASIC provide guidance on how materiality should be defined and established by the Issuer and their advisers for the purposes of assessing if an acquisition or some part of the business is not material?

B13Q2 Do you have any feedback on the related examples in Case Studies 2–3 and 9 in Section C?

Refer B1Q4.