



Mr T Kouts
Corporations
Australian Securities and Investments Commission
GPO Box 9827
Sydney
NSW 2001

5 July 2016

Dear Mr Kouts

ASIC Consultation Paper 257

PwC welcomes the opportunity to comment on ASIC's Consultation Paper 257 "Improving disclosure of historical financial information in prospectuses: Update to RG 228" (CP257).

We are supportive of ASIC's intention to clarify their expectations as to the quality and quantity of historical financial information that should be disclosed in a prospectus. We are also generally supportive of ASIC's detailed proposals however we have some broad comments to make in respect to CP257 as a whole and detailed feedback on the specific questions raised by ASIC. The more detailed feedback is attached as an appendix to this letter.

What distinguishes prospectus disclosure in Australia is the principles based approach that underpins it, as exemplified by the general disclosure test in s710 of the Corporations Act. The flexibility that this achieves allows the issuers of prospectuses to reflect the facts and circumstances which impact their particular company and the industry in which it operates more meaningfully than may be the case in a more prescriptive regime. This has allowed issuers with complex histories and structures and those who operate in emerging industries and markets to access non-bank finance via a listing on the ASX.

We agree that additional guidance is useful, particularly in more complex situations and in areas where issuers have fallen below the legal requirements. These are however a minority of the prospectuses that are issued and it would be potentially detrimental to the Australian IPO market if a more prescriptive approach were imposed on all issuers. Whilst the proposals in CP257 are all individually worthy of consideration, taken as a whole they potentially undermine the "principles based" approach. We believe that an amended RG228 should include specific reference to the "principle based" approach and the willingness of ASIC to consider the particular facts and circumstances that have influenced an issuer in their disclosure choices.

You have specifically requested comment on the likely compliance costs, effect on competition and any other impacts, costs and benefits of adopting these proposals. The compliance cost burden of these proposals will be greatest for those entities which have not previously had a requirement to undertake an audit of their historical financial information. Smaller entities in emerging markets or utilising new

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technologies are likely to fall in this category. The cost burden may delay innovative companies from accessing the local equity market at a time when they need funding for commercialisation and are unable to access debt finance. Alternatively it may persuade these entities to look to markets overseas either in the region (for example Singapore or Hong Kong) or further afield if those markets appear to be more amenable to entities of this type such as the AIM market in the United Kingdom. Neither of these potential outcomes would be beneficial to the Australian economy. It may also inhibit the transition to an innovation led domestic economy which many, including PricewaterhouseCoopers, believe is important if Australia is to diversify from being resources dependent.

We further note that the greatest cost and time impost of these proposals will be on any “roll up” IPOs involving multiple entities. The management time and third party costs involved in auditing three years of financial information for say between ten and twenty entities could easily exceed 6 months of time and over \$1million in audit fees. These represent “sunk costs” and until such time as the entity explores the market for its offering on the “roadshow” immediately prior to lodgement of the prospectus there is no guarantee that the IPO will proceed and hence the third party audit costs may never be recovered from the proceeds of the Offer. This could prove a considerable disincentive for any entities contemplating a “roll up” IPO, whether they are family owned businesses or Private Equity owned businesses seeking an “exit” via an IPO.

Having noted the above, such considerations largely existed for issuers of prospectuses prior to the release of CP 257. Greater clarity as to ASIC’s expectations for historical financial information removes some of the uncertainty that faced issuers, particularly those with more complex structures and histories. The proposals align with a need for potential issuers to improve their readiness for life as a listed entity before issuing a prospectus. ASIC’s challenge is to endeavour to do this without imposing so great a burden on some that it stifles innovation and reduces the number of entities able to access capital via an ASX listing.

Yours sincerely

A handwritten signature in black ink, appearing to read 'M. Haberlin', written in a cursive style.

Mark Haberlin
Partner

A handwritten signature in black ink, appearing to read 'Troy Porter', written in a cursive style.

Troy Porter
Partner



PwC Feedback on ASIC proposals

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

B1Q1 Do you have any comments on this proposed clarification?

It should be made clear throughout the revised wording in RG228 that if an entity is in a position to disclose two and a half years of historical financial information that the half year can be either audited or reviewed. Whilst this is set out in RG228 there are many references to two and a half years being audited without mention of the fact that the half year may be reviewed. This may lead to confusion amongst users of the Guide.

B1Q2 Is it unduly onerous for an issuer to obtain audited financial information about the business being acquired?

Where entities are being acquired that were previously subject to statutory reporting and audit, this requirement will not be unduly onerous.

However, where acquired entities do not meet the relevant thresholds required to produce audited statutory financial statements, or in more complex situations such as the ‘carve out’ of a division or a sales channel, the business being acquired may never have reported, nor have been audited. Thus ‘carve outs’ and “roll ups” (whereby multiple small entities that have never been subject to an audit are combined on IPO) the requirement to obtain audited financial information could be seen as unduly onerous in terms of both management time and third party audit costs.

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?

There may be potential impediments to issuers providing audited financial information in certain situations.

If the entity(ies) involved have never been required to produce audited financial statements over the past 3 years it may not be possible to access key management and accounting personnel from the entire period who were responsible for preparation of the financial statements.

Without access to these personnel or evidence it may be difficult for an auditor to gather sufficient evidence to form an unqualified opinion on the financial statements.



Also the directors of the entity may be reluctant to provide a “Directors Statement” on the financial statements or a letter of representation to the auditor or Investigating Accountant if there has been no continuity of Board and senior management over the entire 3 year period. We note that under paragraph 70 of ASAE 3450 the absence of a letter of representations is a limitation of scope which would prevent the Investigating Accountant forming an unqualified review opinion on the financial information in a prospectus.

Another challenge is that certain financial statement line items are inherently difficult to obtain sufficient appropriate audit evidence if we are engaged after the financial reporting date. For example, if an auditor has not observed a physical inventory count at the financial reporting date it is difficult to get sufficient appropriate audit evidence over inventory. There may be alternative procedures an auditor can perform, however, the further back in time the reporting date the more difficult it becomes. Without such evidence, this could result in a qualified opinion for all three years.

Another situation that could impede an audit being undertaken is where an IPO is conditional upon the acquisition of a “carved out” portion of a separate entity where both acquirer and acquiree are required to produce three years of historical audited financial information. The acquirer may not have sufficient rights over the carved out business to commission an audit or it may have difficulty accessing the complete underlying financial records of that business to allow all necessary audit evidence to be gathered prior to the IPO itself.

B1Q4 Do you have any feedback on the related examples in Case Studies 1–7 and 11 in Section C?

Case Study 1: The principle is clear however it may be necessary for a “transition period” to be built into any revision to RG 228 so that issuers can negotiate acquisition agreements such that they are in a position to commission audits of material acquisitions. Also it may be preferable to give guidance as to what criteria ASIC would look to in defining an acquisition as “material”.

Case Study 2: As noted in the body of this letter this proposal could lead to a very considerable cost and time burden on issuers. Also it is arguable that potential investors into the listed vehicle are primarily concerned with any material misstatements or omissions at the “combined level”. In undertaking audits of each individual entity in the “roll up” the materiality level used is likely to be well below that which would be used on a go forward basis for the consolidated group, which further increases the cost of undertaking a “roll up” IPO.

Case Study 3: By using the term “reservations” it is not clear from this case study what a potential issuer should do if they cannot get access to commission an audit of the business being “carved out” of the larger listed entity. If ASIC’s intention is that in these circumstances any alternative prospectus disclosure (e.g. the use of unaudited historical financial information on Y or not including any pro-forma combined X and Y financial information but instead describing Y’s business as ascertained from Y’s public disclosures and X’s due diligence) would result in a non-compliant prospectus it may be better to say so. If there are circumstances whereby ASIC will accept less than fully audited historical information on Y, for example where Y is a reporting segment of the larger Listed entity it would be useful for this to be noted.

Case Study 4: The principle is clear and the use of an 18 month period prior to IPO in the example is realistic. What is perhaps not clear is whether the principle demonstrated in the example would still



apply if the acquisition was only 12 months or even only 6 months prior to IPO? If the principle ASIC is seeking to establish is that an acquisition prior to the latest set of audited (or reviewed?) accounts will not require 3 years of audited history maybe it would be useful to set out that principle.

A short period between a pre IPO acquisition and the IPO itself also highlights a potential unintended consequence of the proposals. If an acquisition can be effected by bridging finance just prior to IPO rather than being funded directly from the proceeds of the IPO and this results in different audit requirements in respect to the results of the entity being acquired (i.e. no requirement for a full 3 years of audit) the proposals might prompt an entity to accept expensive bridging finance in order to avoid having to undertake audits.

Case Study 5: The principle is clear however the wording might need tightening up to make it clear that by providing audited financial information for the “prior 2 years” the issuer will in effect be disclosing historical financial information for Y covering a two and a half or three year period as appropriate.

Case Study 6: This example is clear – no comment.

Case Study 7: This example is clear; however refer to our feedback on proposal B7.



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 RG228.92

Feedback

B2Q1 Do you have any comments on this proposed clarification?

Given that CP 257 also sets out those modifications and qualifications which would not prevent the use of audited historical financial in a prospectus then this proposed clarification is acceptable. However refer to comments in B3 below.

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 that a risk disclosure can remedy the existence 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

B2Q3 Do you have any feedback on the related examples in Case Studies 8–9 in Section [C](#)?

Case Study 8: This example is clear – no comment.

Case Study 9: This example is clear – no comment.



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 228.93

Feedback

B3Q1 Do you have any comments on this proposed clarification?

We believe this proposal is in line with current market practice.

B3Q2 Do you have any feedback on the related examples in Case Studies 8–9 in Section [C](#)?

Case Study 8: This example is clear – no comment.

Case Study 9: This example is clear – no comment.



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

B4Q1 Do you have any comments on this proposed clarification?

The proposed clarification is a sensible recognition of the fact that opening balances and inventory qualifications are likely to arise if three years of audits are being undertaken for the first time. The reference to “subject to materiality” may require some further explanation. Is the intention to indicate that certain inventory qualifications could be so material as to mean financial statements with a qualification relating to inventory would not be acceptable as a source of historical financial information?

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?

As well as inventory there may also be other financial statement line items where it is difficult to get sufficient appropriate audit evidence after the financial reporting period. For example, existence of property, plant and equipment or accuracy of accounting estimates. The inability to obtain sufficient appropriate audit evidence over such balances may result in a qualification to audit opinions in each of the three years subject to audit.

The challenge in getting sufficient appropriate evidence over opening balances in the first period subject to audit could have a flow-on effect in the subsequent periods. For example the potential misstatement of a comparative balance may materially impact the next period and periods thereafter.

Further, if accounting standards have changed over the past three years, then management would need to consider if such changes have been appropriately reflected in the financial statements. There may be difficulty for the auditor to conclude whether accounting policies have been consistently applied across all three periods or adequately disclosed or presented in accordance with the applicable financial reporting framework.

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

Case Study 8: This example is clear – no comment.



Case Study 9: This example is clear – no comment.



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

B5Q1 Do you have any comments on this proposed clarification?

This clarification is clear for issuers with businesses and entities in Australia. Issuers with businesses and entities in foreign jurisdictions would likely benefit from more practical guidance beyond the use of the term “substantial equivalence”. Setting out acceptable non Australian GAAP and auditing regimes which ASIC would deem appropriate would be useful.

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

Case Study 8: This example is clear – no comment.

Case Study 9: This example is clear – no comment.



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

B6Q1 Do you have any comments on this proposed clarification?

The intent of the clarification is clear. This may result in a requirement for the issuer to commission an audit of the “business” acquired in the form of an “asset acquisition” which is potentially subject to practical difficulties for both the issuer and the vendor of the business. For example, if the acquisition is a “carve out” from a larger entity the issuer may not have negotiated sufficient access to the underlying records and management to be able to commission an audit. In addition, the cost structure applied to the “carve out” business prior to the date of acquisition, with potentially significant cost allocations from the larger entity, may be materially different to that applicable in a “carve out” scenario.

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

Case Study 6: This example is clear - no comment.

Case Study 7: This example is clear; however refer to our feedback on proposal B7.



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

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

Linking the determination of what constitutes a business to Appendix B of AASB 3 has some initial appeal, given it is a recognized standard which companies and their accountants and auditors have experience with. However, Accounting Standards are subject to change and in particular, AASB3 may well be revised following initiatives by international accounting bodies in the near future. If the definition of a business changes in AASB 3 ASIC may have to re-issue RG228 if a revised definition does not accord with ASIC's view of what constitutes a business.

Further, we believe Appendix B of AASB3 is difficult to interpret. We believe issuers are more likely to consistently define a business if they focus on specific matters such as:

- the establishment of a board of directors or governance body
- the recruitment of an executive team, particularly a CEO and CFO
- if applicable, the production of goods on a commercial scale
- if applicable, the sale of good or services on a commercial scale
- the obtaining of necessary licenses, patents etc. that facilitate the operation of a business
- the funding and capital structure that facilitates the operating of a business

Thus, we request ASIC set out the principles which, in its view, define a business.

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

Case Study 6: This example is clear - no comment.

Case Study 7: Whilst the example of a caravan park is clear, it leads to consideration of other property based assets with similar characteristics to a caravan park, e.g. a small shopping mall. Would this be viewed in the same way by ASIC?



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

B8Q1 Do you have any comments on this proposed clarification?

Providing guidance about the “currency” of financial information when an issuer has an acceptable audit history and is conducting “business as usual” between the latest financial statements date and prospectus lodgment date is a useful clarification. It will greatly assist issuers who have encountered delays in the proposed timing of prospectus lodgment especially when these delays threaten to go beyond 6 months after their latest audited or reviewed balance sheet.

The time frames proposed by ASIC are however, inconsistent with those used by the ASX which could lead to confusion in the market. The ASX has an “eight month rule” in respect of the need to produce half year financial statements as part of its listing application rules. Therefore for an entity with a June year end which lodged its prospectus in March of the following year, but before 75 days since 31 December had elapsed, ASIC would not require December accounts whilst ASX would.

Approaching ASX to make the requirements of both bodies in terms of accounts align would also solve a further inconsistency. Using the example of the June year end issuer set out above, for a prospectus lodged after 75 days from 31 December both the ASX and ASIC would require reviewed December half year accounts but ASIC would be satisfied with the 2 prior years audited accounts whereas ASX would require 3 years of audited accounts.

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

Case Study 10: This example is clear - no comment.

Case Study 11: This example is clear - no comment.



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

B9Q1 Do you have any comments on this proposed clarification?

Whilst the principle underlying the proposed clarification is clearly set out, the lack of guidance as to what is meant by “changed so substantially” could result in an inconsistent approach in providing more “up to date” financial information for a prospectus.

For material post balance date acquisitions or post balance date but pre IPO capital raisings many issuers have reflected these by way of an adjustment to the pro-forma balance sheet in order to reflect a more realistic net debt position for the entity to be listed.

Indeed many issuers and their advisers express concern that the pro-forma net debt position as shown in the pro-forma balance sheet may be materially different to that which will eventuate on listing. Certain prospectuses have dealt with this concern via a note disclosure. It may be preferable for ASIC’s guidance to indicate that if a material difference in net debt is anticipated on listing (which is not a result of normal trading) then the issuer should consider either :

- a pro forma adjustment to the balance sheet to reflect the main components of the material movement, or
- in cases where the nature of the underlying business has changed, preparing and utilizing more up to date financial information.

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

When listed entities report to the market other than at their financial year end there is no requirement for that information to be subject to an audit. Therefore it would be appear onerous to expect an entity which is seeking to be listed, assuming it has provided audited financial information for its 3 prior financial years (or two and a half years with at least two years audited and the half reviewed) to be held to a stricter regime. As such a requirement for the more current financial information to be reviewed would seem sufficient.

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 this issuer will not yet have provided any audited financial information it may be appropriate to require these accounts to be audited rather than reviewed. However, as mentioned in the covering letter ASIC will need to be aware of the possibility that such a requirement may deter innovative companies with emerging technologies from accessing funds from an IPO on the ASX



B9Q4 Do you have any feedback on the related example in Case Study 11 in Section [C](#)?

Case Study 11: This example is clear - no comment.



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

B10Q1 Do you have any comments on this proposed clarification?

Current market practice typically includes the disclosure of pro forma historical cash flow statements which are then reconciled to the actual historical cash flow statements. Any revision to RG 228 should provide issuers with the flexibility to adopt this approach as an alternative to the disclosure of full actual historical cash flow statements.



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

B11Q1 Do you have any comments on this proposed clarification?

As set out in our covering letter we support an approach which allows the particular facts and circumstances which impact an issuer's historical financial information to influence an assessment of what is relevant and reliable historical financial information for inclusion in a prospectus. As such we support the proposed clarification subject to our comments on the particular examples used to demonstrate the points included in our feedback in respect to proposal B12.

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

Case Study 2: Refer to our comments under Proposal B1

Case Study 3: Refer to our comments under Proposal B1

Case Study 9: This example is clear - no comment.



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

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?

The examples provided provide some clarification and we have no comments on example 1 in table 10. We do however have comments on the other examples provided as follows:

Example 2: ASIC should consider making it clear in the example that if the incoming business is the “relevant” entity whose historical financial information should be disclosed in a prospectus then ASIC would expect to see three (or two and a half) years of audited (or reviewed in the last half year) financial information.

Example 3: ASIC might consider adding guidance to the example on what is meant by a “substantial period” and also set ASIC’s preferred approach if an acquisition does not cover a “substantial period”. Would this mean, assuming an audit of the pre-acquisition period was not possible, that any historical financial information for the issuer and its acquisition for an insubstantial period would not be relevant and therefore should not be disclosed at all?

Example 4: It is not clear from the example as to what particular circumstances for the first year would lead ASIC to consider that disclosing 3 years of historical financial information, but with year one unaudited would be acceptable. As the example stands issuers who have no audited financial information for the first year of the 3 year historical period may interpret this example as meaning that any difficulty (however trivial) in undertaking an audit is sufficient reason to include unaudited financial information only for that year.

Example 5: This example would be clearer if it was edited to read “The Financial Information in relation to an acquisition or some part of the business is difficult to access and relates to a part of the business that is not material to the business as a whole”.

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.

The additional guidance in this question as to what ASIC would generally consider to be relevant should be included in any revision to RG228 rather than a formal definition.

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



Case Study 2: Refer to our comments under Proposal B1

Case Study 3: Refer to our comments under Proposal B1

Case Study 4: Refer to our comments under Proposal B1

Case Study 5: Refer to our comments under Proposal B1

Case Study 9: This example is clear - no comment.



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

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?

Refer to our feedback to proposal B12 including our comments on the examples in table 10.

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

Case Study 2: Refer to our comments under Proposal B1

Case Study 3: Refer to our comments under Proposal B1

Case Study 9: This example is clear - no comment.