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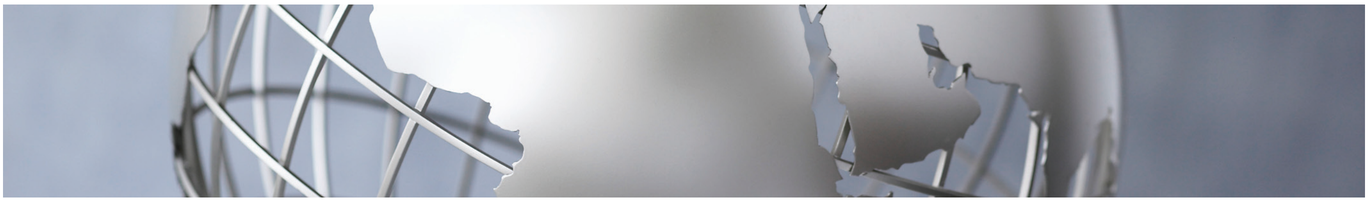

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Use of Forecasts in Disclosure Documents and Day-to-Day Financial Management

When structuring transactions, forecasts are often used to determine value and post transaction shareholdings. With ASIC's increased scrutiny on how forecasts are used, directors need to understand the regulatory environment and their responsibilities.

This paper focuses on forecasting principals and tips that apply equally to public disclosure documents and prudent day-to-day financial management, including areas such as budgeting, performance management, purchase price allocations and impairment testing.

Increasingly ASIC is focusing on the appropriate use of forecasts in Independent Expert's Reports and public disclosure documents. This can be troublesome for directors, since ASIC has the power to stop the release of public transaction documents or request additional disclosures. When this happens, delays are inevitable and additional costs unavoidable.

Why is ASIC Focusing on Forecasts in Disclosure Documents?

There are a number of reasons for ASIC's interest:

- Uncertainty in the domestic and global economic outlook
- Failure of companies to achieve previously forecast results
- Lack of disclosure on risks associated with forecasts
- Lack of sufficient due diligence on assumptions and key drivers underpinning forecasts

These factors also highlight the need for Directors and Management to focus on forecasts they prepare for day-to-day purposes.

The Risks for Directors

Directors need to beware that failure to have reasonable grounds for a public statement about forecasts can lead to legal exposure.

Directors can lessen their risk by conducting appropriate due diligence and preparing appropriate disclosures. In our experience, it is crucial that these actions are undertaken and formally documented so that a company can demonstrate to ASIC both its process and the outcomes of its forecast review.

What are ASIC's Rules?

ASIC's Regulatory Guide *170 Prospective financial information* and Regulatory Guide 111 Content of expert reports require prospective financial information to be included in disclosure documents and Independent Expert's Reports only if there is a **"reasonable"** basis (or grounds) for that information.

"Reasonable" extends to the forecast outcomes and to the specific drivers which underpin the forecasts.

ASIC provides guidance on what might be considered "reasonable" grounds:

Reasonable	Not reasonable
a) forward sales contracts, leases or other contracts that lock in future expenses and revenue of a product/service and the quantum of supply b) reliance upon an independent industry expert's report that sets out the underlying assumption and makes a positive statement that both the prospective financial information and its assumptions are reasonable c) a detailed review of the prospective financial information and underlying assumptions contained in an Independent Expert's Report prepared d) short-term estimates relating to an existing business and based on events that management reasonably expects to take place	a) prospective financial information supported only by hypothetical assumptions rather than reasonable grounds b) mere statements by issuers asserting reasonable grounds for the inclusion of information, with no verifiable reasons to support such statements c) "best estimate" style options

ASIC's rules also call for prospective financial information to be formulated using existing methods of analysis and presentation, not new systems and approaches with favourable outcomes.

It is important to note too that ASIC considers prospective financial information based on hypothetical assumptions is likely to be misleading and of little information value to users.

How does this Impact Valuations and Transactions?

Where ASIC prevents a company from using forecast results, there can be a significant impact on how the valuation of the transaction, or the capital raising, is presented to the market. Consequently, fairness conclusions and communications with potential investors may be affected as uplifts in future performance cannot be quantified.

Case Study:

Independent Expert's Report

An ASX listed company sought to acquire a private business in exchange for issuing shares representing in excess of 20% of itself, a transaction which requires an Independent Expert's Report. When assessing whether the proposed transaction would be fair and reasonable to shareholders of the listed company, ASIC prevented the Independent Expert from utilising the private business' forecasts as it deemed the underlying assumptions were not sufficiently supported by historical data.

With no access to the forecasts, the Independent Expert could only conclude that the proposed transaction was "not fair". As a result, it was very difficult for the directors to present a financially attractive transaction to shareholders.

Case Study:

Capital Raising / IPO

In a similar example, a company undertaking a capital raising was precluded from utilising forecasts in its prospectus. Instead, it had to rely on historical data which created difficulty in marketing the offer as a retail investment.

Tips for Preparing Forecasts

Where companies follow an appropriate review process, they should be able to utilise forecasts in Independent Expert's Reports and public disclosure documents.

When guiding Boards and Management teams through the forecasting process, Crowe Horwath ensures they:

a) Consider the key drivers and high level structure of the forecast model

b) Relate key drivers back to verifiable assumptions

c) Disclose sensitivities around key drivers and variables (including foreign currency impacts if relevant)

d) Determine the appropriate forecast to present to the market based on adequate consideration of risk factors and sensitivities

e) Document the process undertaken to prove transparency should ASIC decide to conduct a review

f) Comply with ASIC policy statements and regulatory guides

For Further Information

For further information, please contact your local Corporate Finance Team.

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Crowe Horwath in Australia

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