

**THE REGULATION OF PROFIT FORECASTS
AND OTHER FORECAST INFORMATION
IN PROSPECTUSES FOR EQUITY SECURITIES**

A DISCUSSION PAPER

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JULY 1991

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1.0 INTRODUCTION

1.1 The Commission, following the publication of the report, "Profit Forecast Disclosure in New Zealand Prospectuses" (August 1990), is reviewing the provisions in the Securities Regulation 1983 (the "Regulations") relating to profit forecasts and prospective information in registered prospectuses for equity securities.

1.2 The 1990 report, which examined forecast information for initial offerings of equity securities, concluded that practices in New Zealand were unsatisfactory. Prospective information published in New Zealand appeared to be less accurate than forecasts published in other jurisdictions. The specific problems referred to in the 1990 report were:

(a) PROBLEMS WITH INACCURATE AND BIASED INFORMATION

On average, the forecasts in the sample studied were not accurate, notwithstanding that many were for financial periods ending less than one year after their publication. Deviations between forecast and actual of as much as 100% were common.

(b) PROBLEMS WITH A LONG FORECAST HORIZON

Some profit forecasts were made for periods of up to ten years. Many included forecasts for five or more financial years. The longer the forecast horizon, the less accurate the forecast tended to be and the more likely that the forecast would not be achieved.

(c) PROBLEMS WITH A MISMATCH OF FORECAST AND ACTUAL ACCOUNTING PERIODS

Some prospectuses contained forecasts for periods which did not correspond to formal reporting periods of the companies. There was no common basis of comparison between the forecasts and actual results.

(d) PROBLEMS WITH UNCLEAR POLICIES AND ASSUMPTIONS

Generally, accounting policies and forecast assumptions were not adequately disclosed. In some cases, it was unclear if the assumptions were best estimates or hypothetical assumptions. It was not possible to determine from the accounting policies as disclosed how the forecast profits were calculated.

(e) PROBLEMS WITH THE AUDIT OF THE FORECAST INFORMATION

Auditors are required under current regulations to ensure that the accounting policies and calculations are consistent with the assumptions used. They are not required to comment on the reasonableness of assumptions. This may lead to forecasts being perceived as being more reliable than they generally are.

1.3 The "Summary and Discussion of Major Findings" of the 1990 report is attached as Appendix 1.

1.4 The purpose of this Discussion Paper is:

- (1) (a) to review the existing requirements of the Securities Regulations 1983 relating to prospective information in registered prospectuses for equity securities,
 - (b) to identify limitations in the present rules,
 - (c) to consider options for improvement;
- (2) to describe the requirements in overseas jurisdictions;
- (3) to explore questions relating to:
 - (a) the use of the term "projection",
 - (b) the review of prospective information by independent experts,
 - (c) the post facto review of prospective information and the comparison of the information with actual results, and
 - (d) liability and safe harbour rules for issuers and reviewers of prospective information.

2.0 EXISTING PROVISIONS IN THE SECURITIES REGULATIONS 1983

2.1 The Regulations contain a number of clauses which require issuers of securities to disclose certain "prospective" or "forecast" information. These include:

2.2 Mandatory forecast information

- (a) Clauses 9(1) and 9(2) of the First Schedule to the Regulations on Trading Prospects;
- (b) Clauses 10(1)(c) and 10(2) of the First Schedule on Forecast Statement of Changes in Financial Position;
- (c) Clause 18 of the First Schedule on Pending Proceedings;

2.3 Optional forecast information

- (a) Clause 9(3) of the First Schedule on expected financial benefits arising from a capital project, where the capital project is specified;
- (b) Regulation 5(4) on Profit Forecasts;
- (c) Clause 42(2) of the First Schedule on the audit of profit forecasts.

2.4 Other information relating to future events

- (a) Clause 8(5) of the First Schedule on Net Tangible Asset Backing calculations;
- (b) Clause 10(4) of the First Schedule on the minimum amount that must be raised by the issue of securities;
- (c) Clause 29 of the First Schedule on Commitments and Contingent Liabilities;
- (d) Clause 41 of the First Schedule on Directors' Statement.

2.5 The provisions in sections 2.2 and 2.3 above are now discussed in detail. In discussing each item of information in these two sections, the Commission enquires whether or not it is desirable to publish the information under reference. If it is considered desirable to publish the information, should there be a legal obligation to do so under the Securities Regulations? Alternatively, is it desirable in some circumstances not to require disclosure of certain types of prospective information but to prescribe the extent of and the procedures for disclosure that must apply if an issuer chooses to publish forecast information in a registered prospectus?

2.6 The provisions referred to in section 2.4 above, while relating to future events, relate basically to information which is likely to be reasonably certain and which is not prospective information in a wider sense. A summary of the contents of these provisions is contained in Appendix 2.

3.0 MANDATORY FORECAST INFORMATION

3.1 TRADING PROSPECTS

3.1.1 Current Regulation

3.1.1.1 All prospectuses for equity securities must contain the following under clauses 9(1) and 9(2) of the First Schedule:

"9(1) A statement as to the trading prospects of the issuing group, together with any material information that may be relevant thereto.

9(2) The statement required by subclause (1) of this clause shall include a description of all special trade factors and risks that -

- (a) Are not mentioned elsewhere in the registered prospectus; and
- (b) Are not likely to be known or anticipated by the general public; and
- (c) Could materially affect the prospects of the issuing group."

3.1.2 Comment

3.1.2.1 The term "statement of trading prospects" is not defined in the Regulations.

3.1.2.2 The statement of trading prospects must contain a description of special trade factors and risks. It need not include forecast financial information.

3.1.2.3 Although the statement of trading prospects is mandatory, it is not required to be audited or otherwise reviewed by an independent person.

3.1.3 Questions

3.1.3.1 Is it desirable that a statement of trading prospects be included in a registered prospectus?

3.1.3.2 Should there be an obligation under regulations to include a statement of trading prospects in a registered prospectus?

- 3.1.3.3 Should the registered prospectus forecast the effect on trading prospects of the special trade factors and risks that have been described in accordance with clause 9(2)?
- 3.1.3.4 Should the statement of trading prospects include financial/quantitative information?
- 3.1.3.5 If financial/quantitative information is disclosed, should it be audited?

3.2 FORECAST STATEMENT OF CHANGES IN FINANCIAL POSITION

3.2.1 Current Regulation

- 3.2.1.1 Clauses 10(1)(c) and 10(2) of the First Schedule requires:

"10(1) In the case of the first offer to the public of equity securities of the issuer, - ...

- (c) A forecast statement of changes in financial position of the issuing group which the directors of the issuer expect to occur in the year commencing on the specified date.

10(2) The forecast statement required by subclause (1)(c) of this clause -

- (a) Shall show the likely receipt and proposed use of the proceeds of the offer of securities; and
- (b) Shall state the principal assumptions on which it is based."

3.2.2 Comment

- 3.2.2.1 Clause 10(1)(c) requires the disclosure of a forecast Statement of Changes in Financial Position. A Statement of Changes in Financial Position shows the net effect of a company's activities between two points in time (eg., between two balance dates). It shows the net changes in fund and asset balances of the company for a particular period or year.
- 3.2.2.2 Clause 10(2)(a) requires the issuer to show in the forecast Statement of Changes in Financial Position the likely receipt and proposed use of the proceeds of the offer. However, this information may not be readily evident in a conventional Statement of Changes in Financial Position. Changes in the financial position of an issuer may result from trading or other activities during the period and not just from the receipt and application of the proceeds of the offer.
- 3.2.2.3 Clause 10(2)(b) requires the issuer to state the principal assumptions on which the forecast Statement is based. The term "principal assumptions" is not defined.
- 3.2.2.4 Regulations do not require the forecast Statement of Changes in Financial Position to be subject to any form of audit even though it is necessary to forecast trading profits to enable the Statement to be drawn up.

3.2.2.5 With effect from 1 July 1988, the Government, on the recommendation of the Commission, amended the Regulations by repealing the requirement for a Statement of Changes in Financial Position in clause 36 of the First Schedule (and clauses 29 and 33 of the Second and Third Schedules respectively) and substituting a requirement for a Statement of Cash Flows. The Government did not make corresponding amendments to clause 10(1)(c) because of the Commission's intention to review the rules of law about prospective information. It is now appropriate to review this matter and consider whether a forecast Statement of Changes in Financial Position in clause 10(1)(c) should be replaced by a forecast Statement of Cash Flows.

3.2.2.6 The purpose of a Statement of Cash Flows, and of a forecast Statement, is to provide information about the operating, financing and investing activities of an entity and the effects of those activities on cash resources. The Statement emphasises the liquidity of an entity, enabling a user of the Statement to assess the entity's ability to meet its obligations and its financing requirements. Unlike information contained in a Statement of Changes in Financial Position, information contained in a Statement of Cash Flows is not readily derived from the Profit and Loss Statement or the Balance Sheet of the entity. A forecast Statement of Cash Flows will enable the user to assess the potential cash flows to the entity in respect of their amount, timing and related uncertainty. Such information cannot be determined from a forecast Statement of Changes in Financial Position.

3.2.2.7 As with a forecast Statement of Changes in Financial Position, it will be necessary to forecast the entity's trading profits and financial position in preparing a forecast Statement of Cash Flows. However, the forecast trading results so derived would not constitute a profit forecast under clause 42(2) and the information would not be subject to any form of audit under that section.

3.2.2.8 Clause 10(2)(a) requires the forecast Statement of Changes in Financial Position prescribed by clause 10(1)(c) to show the likely receipt and proposed use of the proceeds of the offer. If the Statement in clause 10(1)(c) is replaced by a forecast Statement of Cash Flows, the information required under clause 10(2)(a) may not be readily disclosed in the forecast Statement of Cash Flows. The requirements of clause 10(2)(a) in this regard could be met if the forecast Statement of Cash Flows were modified to incorporate this information or if the information were contained in a note to the Statement.

3.2.2.9 The provisions of clause 10 are applicable only to initial flotations by issuers.

3.2.3 Questions

3.2.3.1 Is it desirable to publish a forecast Statement of Cash Flows in a registered prospectus? Is it also desirable to publish the forecast Balance Sheet and Profit and Loss Statement prepared for the purpose of drawing up the forecast Statement of Cash Flows?

- 3.2.3.2 Should there be an obligation under regulations to publish a forecast Statement of Cash Flows in a registered prospectus? For this purpose, should the requirement for a forecast Statement of Changes in Financial Position be revoked?
- 3.2.3.3 Should the provisions apply to all issuers of equity securities or just to initial flotations?
- 3.2.3.4 Should the information disclosed in accordance with clauses 10(1)(c) and 10(2) be audited?

3.3 PENDING PROCEEDINGS

3.3.1 Current Regulation

- 3.3.1.1 Clause 18 of the First Schedule to the Regulations requires:

"A brief description of any legal proceedings or arbitrations that are pending at the specified date and that may have a material adverse effect on the issuing group."

3.3.2 Comment

- 3.3.2.1 The clause does not require quantification of the material effect whether positive or negative even though guidance on this matter is available in accounting standard SSAP-15 "Accounting for Contingencies" (NZSA, 1982). The Regulations also do not require disclosure of information about proceedings that may have positive effects on the issuing group.

3.3.2.2 The Regulations do not require the information to be audited.

3.3.3 Questions

3.3.3.1 Should all material effects of pending proceedings, whether positive or negative, be quantified (where possible) and disclosed?

3.3.3.2 Should this information be audited?

4.0 OPTIONAL FORECAST INFORMATION

4.1 EXPECTED FINANCIAL BENEFITS

4.1.1 Current Regulation

4.1.1.1 Clause 9(3) requires:

"9(3) Where the purpose of the offer of securities is expressed to be to provide finance for a particular capital project, -

(a) A brief description of the project; and

(b) An indication of the expected financial benefits of the project."

4.1.2 Comment

4.1.2.1 The Regulations do not require the issuer to express the purpose of the offer of securities (except for issuers making the first offer of equity securities to the public under clause 10(2)(a)). It is unclear why the Regulations require disclosure of "expected financial benefits" only when the proceeds of the issue are to be used for a particular capital project.

4.1.2.2 While disclosure is mandatory where the purpose of the offer is expressed for a particular capital project, the information need not be audited.

4.1.3 Questions

4.1.3.1 Is it desirable that issuers state the purpose for which proceeds of the issue are to be applied?

4.1.3.2 Should regulations require the disclosure of the purpose for which proceeds of the issue are to be applied?

4.1.3.3 Should financial forecasts be required of issuers that raise funds for purposes other than to provide finance for a particular capital project, for example, working capital needs?

4.1.3.4 Should information required under clause 9(3) be audited?

4.2 PROFIT FORECASTS

4.2.1 Current Regulation

4.2.1.1 Regulation 5(4) requires:

"Where a profit forecast is included in a registered prospectus, the registered prospectus shall contain a statement of the principal assumptions on which the forecast is based."

4.2.2 Comment

4.2.2.1 The Regulations do not specify whether a profit forecast may contain only the forecast profit figure or whether it should contain a Profit and Loss Statement.

4.2.2.2 "Principal assumptions" are also not defined.

4.2.3 Question

4.2.3.1 Is it desirable that regulations give further guidance on:

(a) what is a profit forecast; and

(b) what constitute principal assumptions?

4.3 AUDIT OF PROFIT FORECASTS

4.3.1 Current Regulation

4.3.1.1 Clause 42(2) of the First Schedule requires:

"Where the registered prospectus contains a profit forecast, the auditor's report shall contain a statement in the following form:

"In our opinion the forecasts, so far as the accounting policies and calculations are concerned, have been properly compiled on the footing of the assumptions made or adopted by the issuer set out at pp... of this prospectus and are presented on a basis consistent with the accounting policies normally adopted by the company (group)."

4.3.2 Comment

4.3.2.1 Clause 42(2) requires the auditor to report that profit forecasts have been correctly calculated and are presented on a basis consistent with the accounting policies normally adopted by the issuer. It does not require the auditor to report that the assumptions are reasonable.

4.3.2.2 Auditing Guideline AG-20 "The Examination of Prospective Financial Information" (NZSA, 1990) provides for auditors to ensure that assumptions on which prospective financial information is based are not unreasonable. However, auditors need not report on this matter. This seems anomalous.

4.3.3 Question

4.3.3.1 Should auditors evaluate and report on the reasonableness of assumptions underlying prospective financial information? In this regard, should the New Zealand Society of Accountants amend Auditing Guideline AG-20 to provide that auditors report on the reasonableness of the assumptions?

5.0 REQUIREMENTS IN OVERSEAS JURISDICTIONS

5.1 Appendix 3 is a review of provisions relating to profit forecasts in the following jurisdictions:

- (a) Ontario (Canada);
- (b) United States; and
- (c) Australia.

6.0 OTHER QUESTIONS ARISING

6.1 In sections 3 and 4, we listed a number of specific questions for consideration. In this section 6, we discuss a number of wider policy issues, namely:

- (a) the use of the term "projection";
- (b) the review of prospective information by independent experts;

- (c) the post facto review of prospective information and the comparison of the information with actual results; and
- (d) liability and safe harbour rules for issuers and reviewers of prospective information.

6.2 The use of the term "projection"

6.2.1 Comment

6.2.1.1 Regulations do not specify what constitutes a "forecast".

6.2.1.2 Although the terms forecast, projection, prospective information and forward-looking information are often used interchangeably, it is suggested that such terms have real, albeit subtle, differences in the minds of both preparers and users of the information. If these terms are used interchangeably, there is a danger that items of prospective information disclosed in a registered prospectus may be inconsistent and the reader may be misled.

6.2.1.3 Auditing Guideline AG-20 distinguishes between a forecast and a projection as follows:

"Some prospective financial information is prepared on the basis of assumptions as to future events which governing bodies or directors expect to take place and the actions they expect to take as of the date the information is prepared (**best-estimate assumptions**). This type of prospective financial information is commonly referred to as a **forecast**." (paragraph 9, emphasis added)

"Other prospective financial information may be prepared on the basis of hypothetical assumptions about future events and the actions which are not necessarily expected to take place, such as when some entities are in the start-up phase or are considering a major change in nature of operations. Such information illustrates the possible consequences as of the date the information is prepared if the events and actions were to occur, and is commonly referred to as a projection or a "what-if" scenario." (paragraph 10, emphasis added)

6.2.1.4 The Canadian Institute of Certified Accountants (CICA) also differentiates between a forecast and a projection. It explains the difference as follows:

"A forecast is based on reasonable and supportable assumptions that management believes reflect the most probable set of economic conditions and planned courses of action. To be reasonable, these assumptions need to be consistent with the plans of the entity. Assumptions are consistent with the plans of the entity if they reflect the expected economic effects of anticipated strategies, programs, and actions, including those being planned in response to expected future economic conditions. To be supportable, assumptions need to be based on past performance of the entity itself, the performance of other entities engaged in similar activities, feasibility studies, marketing studies or any other sources that provide objective corroboration of the assumptions used...

A projection is based on reasonable assumptions that include one or more hypotheses. Once hypotheses have been formulated, assumptions would be developed to reflect the most probable set of economic conditions and planned courses of action should the hypotheses prove true. Hypotheses are assumptions that assume a set of economic conditions or courses of action that are not necessarily the most probable in management's judgement, but are consistent with the purpose of the projection, as in response to the question "What would happen if...?". To be reasonable, hypotheses need to be consistent with the purpose of the projection and represent plausible circumstances. Hypotheses need not be supportable. For example, a projection might be used by an entity in its start up phase when certain key assumptions cannot be supported." (sections 4250.11 and 4250.13, CICA Handbook)

- 6.2.1.5 Under certain circumstances, it may be more appropriate for issuers to present projections based on hypothetical assumptions than forecasts based on best-estimate assumptions, for example, new issuers without the necessary operating history on which to base their forecasts or issuers wishing to disclose longer-range prospective information which is subject to greater uncertainty.
- 6.2.1.6 Distinguishing between a forecast and a projection may highlight the greater uncertainty of the projection.
- 6.2.1.7 In Ontario, businesses with less than 24 months relevant operating history are permitted to issue projections rather than forecasts (OSC Policy 5.8, Part III, paragraph 2).
- 6.2.2 **Questions**
- 6.2.2.1 Is it desirable for regulations to distinguish between forecasts and projections?
- 6.2.2.2 Is it desirable to specify the circumstances in which issuers should present projections rather than forecasts?

6.3 The review of prospective information by independent experts

6.3.1 Comment

6.3.1.1 The Regulations require profit forecasts, when disclosed, to be audited. The Regulations do not require other prospective information, whether mandatory or optional, to be audited or reviewed by any other expert.

6.3.1.2 Reviews by experts other than auditors are useful where auditors lack the necessary skill(s) to evaluate the assumptions on which the prospective information has been based.

6.3.1.3 Prospective information that has been subject to an audit or review by experts is likely to be more reliable, particularly if the reasonableness of the assumptions has been reviewed.

6.3.1.4 Reports by auditors are required to be attached to published prospective information in Ontario (OSC Policy No.5.8, part VI). The audit report must not contain any reservation of opinion and must comply with the standards of the CICA Auditing Guidelines, "Examination of a Financial Forecast or Projection Included in a Prospectus or Other Public Offering Document" (CICA, 1989). This requires the auditor to state that "...the assumptions developed by management are suitably supported...and provide a reasonable basis for the forecast" (paragraph 40).

6.3.1.5 In the United States, audits/reviews are optional. The outside reviewer of the information in the United States may be a non-accountant (Regulation S-K, subpart 229.10(b)(1)). The Regulation does not specify what the reviewer must do.

6.3.2 **Questions**

6.3.2.1 If prospective information is audited, and the auditor states that he or she relied on the opinion of an expert, should the expert also provide a written review?

6.3.2.2 What should the obligations of the auditor/expert be and to which elements of the prospective information should the obligations of the auditor/expert extend?

6.4 **The post facto review of prospective information and the comparison of the information with actual results**

6.4.1 **Comment**

6.4.1.1 There are no regulations in New Zealand which require issuers to review or update prospective information previously disclosed in registered prospectuses where significant changes have occurred which affect the assumptions on which the information is based. However, sections 34(b) and 37A(1)(d) of the Securities Act 1978 prohibit the distribution of false and misleading information in a registered prospectus.

- 6.4.1.2 Regulations also do not require issuers to compare published prospective information with actual results achieved, in interim or annual reports.
- 6.4.1.3 If issuers are required to "account" for prospective information through reviews, updates and comparisons with actual results, they may be inclined to exercise more care in drawing up the information.
- 6.4.1.4 The Ontario Securities Commission in Canada provides for some form of "post facto review" of forecast information ("Future-Oriented Financial Information" or "FOFI"), to be published in interim and annual reports:

"FOFI shall be reviewed each time the issuer is required to file historical financial statements with the Commission...to identify significant changes resulting from events that have occurred since it was issued. During the period covered by FOFI, disclosure shall be made of the fact that no significant changes are required to it. Alternatively, if an updated FOFI is provided, it shall be accompanied by explanations of significant changes, disclosure of the date of the original FOFI and the date of the update...

FOFI as initially reported or updated when applicable, shall be compared with annual audited actual results and the reasons for significant differences, if any, shall be disclosed. FOFI issued for an interim period shall be compared with actual interim results and reasons for significant differences, if any, shall be disclosed." (OSC Policy No.5.8, Section V)

6.4.2 Questions

6.4.2.1 Should there be an obligation under regulations for issuers to review and update prospective information previously published in registered prospectuses?

6.4.2.2 Are there circumstances in which issuers should be required to disclose revised forecasts, give reasons for significant changes and reconcile previous forecasts with any revised forecasts?

6.4.2.3 Is it desirable for the issuer to compare prospective information with actual results in subsequent annual or interim financial reports, with reconciliations and explanations for major variances between forecasts and actual results? Should there be an obligation under regulations to do so?

6.5 Liability and safe harbour rules for issuers and reviewers of prospective information**6.5.1 Comment**

6.5.1.1 Safe harbour rules in relation to prospective information refer to rules of law which protect issuers and/or third party reviewers of prospective information (auditors and independent experts) from liability when results deviate from forecasts.

6.5.1.2 Of the three countries surveyed in section 5 above, only the United States has general safe harbour rules. These protect issuers (including their agents and third party reviewers) from liability where results deviate from forecast information, unless it is shown that the information was disclosed without a reasonable basis or was disclosed other than in good faith (Securities Act of 1933, subpart 230.175). In the United States, the onus of proof that the information is not reasonably based or is not disclosed in good faith rests with the plaintiff (Securities Act of 1933 Release No.6084).

6.5.1.3 In New Zealand, the Securities Act 1978 contains several provisions which impose liability on directors and experts for untrue statements appearing in a registered prospectus or advertisement for a security. The Act also provides for certain limitations to that liability, or "safe harbours". These provisions are discussed below.

(i) Directors

6.5.1.4 Section 56(1) imposes civil liability on directors of a company:

"56(1) [Liability] Subject to the provisions of this section, the following persons shall be liable to pay compensation to all persons who subscribe for any securities on the faith of an advertisement or registered prospectus which contains any untrue statement for the loss or damage they may have sustained by reason of such untrue statement, that is to say: ...

(c) In the case of a registered prospectus, every person who has signed the prospectus as a director of the issuer or on whose behalf the prospectus has been so signed, ..."

6.5.1.5 A statement is deemed by section 55(a) to be untrue if:

"(i) It is misleading in the form and context in which it is included; or

(ii) It is misleading by reason of the omission of a particular which is material to the statement in the form and context in which it is included;"

6.5.1.6 A director of a company may be liable under section 56(1) if prospective information contained in a prospectus issued by his or her company is misleading in the form and context of that prospectus.

6.5.1.7 Section 58(1) imposes criminal liability on directors of a company:

"58(1) [Advertisements] Where an advertisement that includes any untrue statement is distributed-

(a) The issuer of the securities referred to in the advertisement, if an individual; or

(b) If the issuer of the securities is a body, every director thereof at the time the advertisement is distributed -

commits an offence."

6.5.1.8 It should be noted that these provisions do not apply explicitly to prospective financial information.

6.5.1.9 Section 59 imposes criminal liability on the "principal officers" of a company (including directors) for, amongst other things, distributing a prospectus in contravention of the Securities Act 1978. Failure to comply with the various requirements of the Regulations regarding prospective information would amount to a breach of this section.

(ii) Experts

6.5.1.10 Section 57(1) imposes civil liability on experts in certain circumstances:

"[Untrue statements] Subject to the provisions of this section, every person who gives consent to the distribution of an advertisement or registered prospectus required of him by section 38A or section 40 of this Act, or by regulations made under this Act, which contains an untrue statement purporting to be made by him as an expert, shall be liable to pay compensation to all persons who subscribe for any securities on the faith of the advertisement or registered prospectus for the loss or damage they may have sustained by reason of such untrue statement."

6.5.1.11 The term "expert" is defined in section 2 of the Act:

""Expert" means any person who holds himself out to be of a profession or calling that gives authority to a statement made by him; and includes an accountant, engineer, valuer, quantity surveyor, and geologist; but does not include a person acting in his capacity as an auditor or as a director or officer of a body" (second set of emphasis added).

6.5.1.12 Therefore, auditors are not subject to civil liability under section 57(1).

(iii) Limitation of liability - "safe harbours"

6.5.1.13 The provisions set out above imposing liability on directors and experts for untrue statements appearing in registered prospectuses also contain express limitations of the extent of that liability. Some of these limitations are analogous to the United States safe harbour rules.

5.5.1.14 Section 56(3) provides that a director will not be subject to civil liability under section 56(1) if he or she can prove any one of a number of matters. The ground that is relevant to this discussion is that:

"(c) As regards every untrue statement not purporting to be made on the authority of an expert or of a public official document or statement, he had reasonable grounds to believe and did, up to the time of the subscription for the securities, believe that the statement was true ..."

6.5.1.15 Section 57(2) provides that an expert will not be liable under section 57(1) if he or she can prove one of a number of matters including that:

"(c) He was competent to make the statement and that he had reasonable grounds to believe and did, up to the time of the subscription for the securities, believe that the statement was true."

6.5.1.16 If a director has committed a criminal offence under section 58(1), he or she will not be liable if:

"... he proves, either that the statement was immaterial or that he had reasonable grounds to believe, and did, up to the time of the distribution of the advertisement or registered prospectus, believe that the statement was true." (section 58(3))

6.5.1.17 The civil liability of experts and directors for mis-statements appearing in a prospectus is not confined to the grounds set out in sections 56 and 57 of the Securities Act 1978. For example, experts (including auditors) and directors may be liable for negligence in respect of such mis-statements. However, section 63(1) gives the court the power to grant relief to experts, directors and other persons from actions in connection with (amongst other things) the distribution of a prospectus:

"63(1) [Relief from liability] If in any proceedings against any person for negligence, default, breach of duty, or breach of trust in connection with - ...

(b) The distribution of a registered prospectus or advertisement; ...

it appears to the Court hearing the case that the person is or may be liable in respect of the negligence, default, breach of duty, or breach of trust, but that he has acted honestly and reasonably, and that having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default, breach of duty, or breach of trust, the Court may relieve him either wholly or partly from his liability, on such terms as the Court may think fit."

6.5.1.18 A difference between the provisions of the Securities Act 1978 in respect of statements and the American safe harbour rules in respect of prospective information is the onus of proof. In The United States, the onus is on the plaintiff to show that the prospective information is disclosed without a reasonable basis or is disclosed other than in good faith, whereas, in the Securities Act 1978, the onus is on the defendant to show that there were reasonable grounds to believe that the information disclosed was true.

6.5.1.19 In the United States, commentators of the safe harbour rules believed that the burden of proof should be on the plaintiff because:

- (a) this will reduce frivolous litigation being brought against issuers/reviewers;
- (b) the purpose of having safe harbour rules to encourage disclosure of prospective information would be negated if the burden of proof was on the issuers/reviewers; and
- (c) plaintiffs have relatively extensive powers to obtain discovery of documents in the event that court proceedings have been commenced (Securities Act of 1933 Release No.6084).

6.5.1.20 In the United States, the "reviewer" includes the auditor who reports on the prospective information. In New Zealand, the definition of "expert" in the Securities Act 1978 excludes the auditor.

6.5.2 Questions

6.5.2.1 Should New Zealand law impose explicit liability on issuers and others in respect of prospective information? Should this liability be civil liability, criminal liability or both?

6.5.2.2 If the law imposes liability in respect of prospective information, should auditors be amongst those who may be subject to that liability?

- 6.5.2.3 Should the law contain safe harbour rules to protect issuers, directors, auditors and other experts from civil and/or criminal liability where actual results deviate from the prospective information as previously disclosed in a registered prospectus?
- 6.5.2.4 What form should such safe harbour rules take? Should the onus of proof that liability arises lie with the plaintiff or with the defendant?

7.0 CONCLUSION

- 7.1 This Discussion Paper has identified and listed a number of questions arising from the review of the existing law on the disclosure of forecast information in registered prospectuses for equity securities. The Commission welcomes the opinions of those who prepare or use prospectuses registered under the Securities Act 1978.
- 7.2 The foregoing discussion covers prospective information in registered prospectuses for equity securities only. However, it is envisaged that the general policies formulated from public exposure of this paper may provide a useful base for reviewing the law on prospective information in registered prospectuses for debt and participatory securities.
- 7.3 A list of all the questions raised in this Discussion Paper for comment is contained in Appendix 4.

1. SUMMARY AND DISCUSSION OF MAJOR FINDINGS

(Extract from

"PROFIT FORECAST DISCLOSURE IN NEW ZEALAND PROSPECTUSES")

This study examined the disclosure of profit forecasts in N.Z. prospectuses for initial public offerings of equity securities issued by companies which subsequently listed on the N.Z. Stock Exchange. Using a comprehensive sample of 82 prospectuses (141 forecasts) published from 1 September 1983 through to late 1987, the accuracy and bias of profit forecasts, level of detail of profit forecast information, and the extent to which management explained deviations between forecast and actual profit in annual reports, were examined. The major findings are:

1.1. Forecast Accuracy and Bias

1.1.1. About 14% of N.Z. forecasts had forecast deviations (i.e. differences between forecast profit and actual profit) of less than $\pm 10\%$, while more than 35% of these forecasts had forecast deviations of greater than $\pm 100\%$. The average deviation was just under $\pm 70\%$. Therefore, on average, N.Z. forecasts were not very accurate. A comparison with the findings from a recent Australian study shows that N.Z. forecasts were less accurate than Australian forecasts.

1.1.2. The percentage of forecasts not achieved was just under 50% (that is, about as expected if there is an equal probability of a forecast being exceeded or not achieved). However, a relatively large proportion of actual results fell below forecast profits by more than 100%.

1.1.3. While the significant changes in the economic environment in N.Z. in recent years may have contributed to the large proportion of highly inaccurate and optimistic forecasts, it is doubtful that these alone can explain away the large forecast errors. Many forecasts which turned out to be inaccurate were for financial periods ending less than one year after their publication dates. Economic conditions were unlikely to have changed so dramatically over such short time periods. More likely, the forecasts were based on inappropriate assumptions.

1.1.4. Not surprisingly, the longer the time between the date of the prospectus and the end of the financial period being forecast (forecast horizon), the less accurate the forecast tended to be. In addition, the longer the forecast horizon, the more optimistic the forecast tended to be (that is, the more likely the forecast would not be achieved). However, these relationships, while statistically significant, were not as strong as one might have expected. Forecast horizon is but one factor which is likely to be related to forecast accuracy and bias.

1.1.5. Forecasts for manufacturing companies were the most accurate. However, differences in forecast accuracy across industry groups were not statistically significant. Forecasts by investment, financial services, property and manufacturing companies were pessimistic (that is, tended to be exceeded by actual profits), while those for tourism and leisure, retail and distribution and farming, fishing and horticulture companies tended to be optimistic (under-achieved). One possible explanation for the pessimistic forecasts for some

industry groups could be a greater ability to "manage" actual results (for example, through the structuring of transactions or the accounting treatment of transactions and events) to ensure that forecast profits are achieved or exceeded. However, again, differences in forecast bias across industry groups were not significant.

1.1.6. Forecasts published in 1984 were the most accurate while those published in 1983 were the most pessimistic. Although forecasts published in 1985, 1986 and 1987 appeared to be less accurate and more optimistic than forecasts published in 1983 and 1984, these differences in accuracy and bias were not statistically significant.

1.2. Level of Detail of Forecast Information

1.2.1. Just under half the prospectuses which included profit forecasts disclosed information on revenue and net profit before and after tax. About a quarter of the prospectuses went beyond this level of disclosure to include some information on the breakdown of expenses.

1.2.2. Larger companies (in terms of shareholders' funds immediately on completion of issue of ordinary shares) tended to disclose less detail with their forecasts. However, this finding of a relationship between company size and level of detail was only marginally significant.

1.2.3. There were significant differences in level of detail of forecast information across different industries, with farming, fishing and horticulture companies on average disclosing significantly more detail with their profit forecasts.

1.3. Explanation for Forecast Deviation in Annual Report

1.3.1. About 47% of the relevant annual reports (that is, the annual reports covering financial periods being forecast) did not contain any reference to the original forecasts. About 32% of these annual reports referred to the forecasts but did not explain the deviations, while the remaining 21% referred to and explained forecast deviations.

1.3.2. There was a significant relationship between the provision of explanations for a forecast deviation and whether the forecast was achieved. Where a forecast was not achieved, management tended to either not refer to the forecast at all, or if they did, went on to explain why the forecast was not achieved. However, the greater tendency was to make no reference to the forecast at all. That is, management was generally unwilling to disclose bad news.

1.4. Other Observations

1.4.1. Twenty-one prospectuses which included forecasts were excluded from the study because the forecasts were for twelve-month periods beginning from the date of the

prospectus. These periods did not correspond to formal reporting periods. They were not instances of balance date changes after the publication of the prospectus, but were cases where management would have been fully aware that there would not be reporting periods corresponding to the forecasts.

1.4.2. There was considerable variation in the disclosure of assumptions and accounting policies. Although variation per se is not unexpected because of differences in operating environments faced by different companies, some disclosures were extremely vague.

1.4.3. It was sometimes unclear as to whether the assumptions reflect future events expected to take place and the actions management expects to take (best-estimate assumptions), or future events and management actions which are not necessarily expected to take place (hypothetical assumptions). Further, there is currently no requirement for the auditor to comment on the reasonableness of the assumptions underlying a forecast.

1.4.4. The Regulations do not require disclosure of accounting policies adopted in the preparation of profit forecasts (according to this author's interpretation), and although some disclosure of accounting policies was normally made, in many cases they were insufficient for determining how a forecast profit figure was calculated.

1.4.5. The maximum number of financial years covered by profit forecasts was 10, and a number of prospectuses included profit forecasts for 5 or more financial years. The uncertainty associated with forecasts for such distant periods must be extremely high, and these forecasts are likely to be highly speculative.

APPENDIX 2

OTHER INFORMATION RELATING TO FUTURE EVENTS

1. SUMMARY OF FINANCIAL STATEMENTS

Clause 8 of the First Schedule sets out the information required to be disclosed in the financial statements that are contained in a registered prospectus. Besides historical information, clause 8(5) requires:

"The financial statement required by subclause (1) of this clause shall also show the net tangible asset backing per unit of the securities being offered at the date of the latest balance sheet set out in the registered prospectus calculated in accordance with each of the following assumptions:

- (a) All the securities had been allotted, and the subscriptions received, before that date:

- (b) All the securities had been allotted, and the subscriptions received, before that date and all outstanding securities that are convertible into securities of the class being offered had been converted before that date (where there are variable rates of conversion having effect at different times, at the next available rate of conversion)."

2. MINIMUM AMOUNT TO BE RAISED BY THE ISSUE

Clause 10(4) of the First Schedule requires:

"For the purposes of section 37(2) [in relation to first allotment of securities to the public] of the Act, the minimum amount that, in the opinion of the directors, must be raised by the issue of the securities in order to provide the sums (or, if any part thereof is to be defrayed in any other manner, the balance of the sums) required to be provided in respect of each of the following matters:

- (a) The purchase price of any property purchased or to be purchased which is to be defrayed in whole or in part out of the proceeds of the offer:
- (b) Any preliminary expenses payable by the issuer, and any commission so payable to any person in consideration of his agreeing to subscribe for, or of this (sic) procuring or agreeing to procure subscriptions for, any of the securities:
- (c) Working capital:
- (d) The repayment of any money borrowed by the issuer in respect of any of the foregoing matters."

3. COMMITMENTS AND CONTINGENT LIABILITIES

Clause 29 of the First Schedule to the Regulations requires:

"Each balance sheet required by clause 23 of this Schedule, or notes to the balance sheet which are set out in the registered prospectus, shall state the following matters:

- (a) Particulars (including the estimated amount thereof and the period of commitment) of any material commitments for capital expenditure (other than those included as liabilities in the balance sheet):

- (b) Particulars (including the estimated amount thereof and the period of commitment) of any material commitments in respect of leases and hire purchase agreements (other than those included as liabilities in the balance sheet):

- (c) A brief description of any material contingent liabilities, and the estimated amount thereof."

Comment

The information is required to be audited under the Regulations, being part of the audited financial statements.

4. DIRECTOR'S STATEMENT

Clause 41 of the First Schedule requires:

"A statement by the directors of the issuer as to whether, after due enquiry by them in relation to the period between the date of the latest balance sheet set out in the registered prospectus and the specified date there have, in their opinion, arisen any circumstances that materially adversely affect -

- (a) The trading or profitability of the issuing group; or

- (b) The value of its assets; or

- (c) The ability of the issuing group to pay its liabilities due within the next 12 months."

[Regulation 4(2)(f) of the Securities Act 1978 in relation to Short Form Prospectus has the same provision.]

APPENDIX 3

THE REGULATION OF FORECAST INFORMATION IN PROSPECTUSES FOR EQUITY SECURITIES IN ONTARIO, THE UNITED STATES AND AUSTRALIA**1.0 ONTARIO (CANADA)**

1.1 The inclusion of profit forecasts in prospectuses is optional in Ontario. We understand that this is the case in all jurisdictions in Canada.

1.2 The Ontario Securities Commission ("OSC") has issued a policy guideline entitled "Future Oriented Financial Information", which prescribes detailed requirements relating to the use of future oriented financial information ("FOFI"). The main features of the OSC's policy are:

- (a) The period covered by FOFI should not extend beyond the point in time for which such information can be reasonably estimated (unless unusual circumstances exist), the maximum period generally being 24 months;
- (b) FOFI must be prepared in accordance with standards set by the Canadian Institute of Chartered Accountants ("CICA");
- (c) In some circumstances, it is necessary for a company to obtain prior clearance from the OSC for a prospectus containing FOFI;

- (d) The effective date of the underlying assumptions on which FOFI is based must be no more than 120 days before the registration of the prospectus;
- (e) Where a projection is being made (as opposed to a forecast) it is necessary for the issuer to include a cautionary note in bold face in the lead paragraph of the projection stating that the projection is based on hypotheses and that there is a significant risk that actual results will vary, perhaps materially, from the results projected;
- (f) FOFI must be reviewed and updated each time the issuer files its historical financial statements. Significant changes resulting from events that have occurred since it was issued must be identified. If no changes have occurred, disclosure must be made of the fact that no changes are required to be made to the information. If FOFI is updated, it must be accompanied by explanations of significant changes, disclosure of the date of the original FOFI and the date of the update;
- (g) Issuers are required to compare actual performance (annual or interim) with previous forecasts or projections, disclosing reasons, if any, for significant differences;

(h) FOFI included in a prospectus must be accompanied by an auditor's report which does not contain any reservation of opinion. The standards for such an audit are contained in the CICA auditing guideline, "Examination of a Financial Forecast or Projection Included in a Prospectus or Other Public Offering Document".

1.3 The CICA describes the objective of presenting FOFI in financial statements as:

"Provid[ing] external users with information that assists them in evaluations any entity's financial prospects."
(section 4250.02 of the CICA Handbook)

1.4 The CICA standards on FOFI are reasonably detailed. FOFIs are classified as forecasts and projections. A forecast is defined as:

"... future-oriented financial information prepared using assumptions all of which reflect the entity's planned courses of action for the period covered given management's judgement as to the most probable set of economic conditions" (section 4250.04 of the CICA Handbook);

while a projection is defined as:

"... future-oriented financial information prepared using assumptions that reflect the entity's planned course of action for the period covered given management's judgement as to the most probable set of economic conditions, together with one or more hypotheses that are assumptions which are consistent with the purpose of the information but are not necessarily the most probable in management's judgement." (section 4250.05 of the CICA Handbook)

1.5 The main requirements of the CICA standards (without repeating those which appear in the OSC policy guideline) are:

- (a) FOFI should be prepared using assumptions appropriate in the circumstances;
- (b) FOFI should be prepared in accordance with the accounting policies expected to be used in presenting historical financial statements for the future period;
- (c) FOFI should be presented in the format of historical financial statements and include at least an income statement;
- (d) FOFI should include a cautionary note to the effect that actual results for the period covered will vary from the information presented and that the variations may be material;
- (e) As projections are likely to be more uncertain than forecasts, FOFI should be clearly labelled as either a forecast or a projection;
- (f) Significant assumptions underlying FOFI should be disclosed, while hypotheses should be separately disclosed. The CICA states:

"Future-oriented financial information is based on many assumptions about future conditions and events and the likelihood is that those conditions and events will not occur exactly as predicted. The quality of future-oriented financial information is largely dependent on the appropriateness of the assumptions. Disclosure of significant assumptions is therefore essential if the future-oriented financial information is to assist users in evaluating an entity's financial prospects." (section 4250.35 of the CICA Handbook)

- (g) When the FOFI incorporate a change in accounting policy, the change should be described and its effect disclosed.

2.0 UNITED STATES

- 2.1 The first step in the process of making an offer of equity securities to the public in the United States is to file a registration statement with the Securities and Exchange Commission ("the SEC"). A registration statement will generally include a draft prospectus and must contain all of the information required by the SEC under the Securities Act of 1933.
- 2.2 Until 1976, the SEC generally did not permit projections to be included in registration statements on the basis that the inclusion of such information could be misleading or amount to an untrue statement in breach of section 11(a) of the Securities Act of 1933. Section 11(a) imposes civil liability on a number of persons connected with the issuer, including its directors, for untrue statements made in a registration statement (although a number of defences are available to those persons).

2.3 In 1976, the SEC relaxed its policy to permit the inclusion of projections in registration statements and other SEC filings. However, concerns remained that projections which were subsequently proven inaccurate could expose an issuer's management to liability under section 11(a). To address those concerns, the SEC finalised "safe harbour" rules in 1979 to establish beyond doubt that projections and forward looking data would not automatically be in breach of the federal securities codes if it was subsequently proven to be inaccurate. These rules were expanded in 1982.

2.4 The safe harbour rules are contained in Rule 175 under the Securities Act of 1933 and Rule 3b-6 under the Securities Exchange Act of 1934 (adopted by Securities Act Release 6084, 17 SEC Dkt. 1084(1979)). The safe harbour applies to the following kinds of information:

- (a) projections of certain financial items including revenues, income, earnings (loss) per share, capital expenditures and dividends;
- (b) management plans and objectives;
- (c) discussion of future economic performance in management's discussion and analysis of the summary of earnings;
- (d) the assumptions underlying or relating to those statements.

2.5 The safe harbour provides protection from liability unless the information included in the projection was prepared without a reasonable basis or was disclosed other than in good faith.

2.6 The SEC's current policy on the inclusion of projections in registration statements and other SEC filings is contained in Regulation S-K (subpart 229.10(b) of 17 CFR, Chapter II):

"The Commission encourages the use in documents specified in Rule 175 under the Securities Act and Rule 3b-6 under the Exchange Act of management's projections of future economic performance that have a reasonable basis and are presented in an appropriate format."

2.7 Regulation S-K sets out a number of detailed guidelines regarding the content of projections contained in registration statements and other SEC filings:

- (a) Any assessment of a company's future performance must be made in good faith and on a reasonable basis.
- (b) A favourable outside review of management's projections may indicate that there is a reasonable basis for those projections, although it will not be conclusive proof of "reasonableness". If such a report is included with projections contained in a registration statement, the qualifications of the reviewer, the extent of the review and the relationship between the company and the reviewer must be disclosed (subpart 229.10(b)(1)).
- (c) Projections should be disclosed in a manner which facilitates investor understanding of the basis for and limitations of the projections. The SEC states that:

- (i) it encourages management to disclose the assumptions which, in management's opinion, are most significant to the projections or which are the key factors upon which the financial results of the enterprise depend;
 - (ii) management should consider whether the disclosure of the accuracy of previous projections would provide investors with important insights into the limitations of projections;
 - (iii) companies that have filed information with the SEC have a responsibility to make full disclosure of both favourable and unfavourable material facts regarding their financial position. This may require the amendment of past projections that no longer have a reasonable basis (subpart 229.10(b)(3)).
- (d) Forecast information need not be limited to projections of revenues, net income per share and earnings per share. However, in selecting the financial items to be projected, management must ensure that the information chosen does not present a misleading picture (subpart 229.10(b)(2)).
- (e) The period covered by the projection must be set in view of the particular circumstances of the issuer's business (subpart 229.10(b)(2)).

- (f) In some circumstances, the inclusion of a number of different projections based on varying assumptions may be more meaningful than a single projection (subpart 229.10(b)(2)).

3.0 AUSTRALIA

- 3.1 The preparation of prospectuses for equity securities in Australia is governed by the Corporations Act 1989 (which came into force on 1 January 1991).
- 3.2 The general rule established by the Corporations Act is that a prospectus must contain all information which investors and their professional advisers would reasonably require to enable them to make an informed assessment of the corporations's financial position and of the rights attaching to the securities (section 1022). The Act contains very few detailed requirements on prospectus content. The Act does not contain any specific requirements regarding the inclusion of forecast information in prospectuses.
- 3.3 The Australian Securities Commission ("the ASC") has not issued any guidelines on the inclusion of forecast information in prospectuses. However, the ASC's predecessor, the National Companies and Securities Commission ("the NCSC"), included relatively detailed policy guidelines on forecast information in its Prospectus Procedures Handbook.

3.4 The NCSC's guidelines, although defunct, are worth considering in the context of this paper. Under those guidelines (contained in section 5.007 of the Prospectus Procedures Handbook), forecasts contained in prospectuses were required to:

- (a) Be clearly distinguished as forecasts;
- (b) Disclose the methods of calculation used;
- (c) Disclose the assumptions relied upon;
- (d) Note the degree of sensitivity of critical assumptions;
- (e) Be for a period not exceeding 2 years, unless the issuer is satisfied that it is reasonable that the forecast extends for a longer period.

3.5 Forecasts were also required to include:

- (a) An independent expert's report commenting with reasons on the matters stated in the forecast, including an assessment of the appropriateness of the assumptions relied upon;
- (b) The name of the person (or group of persons) who were responsible for the preparation of the forecast.

[The provisions in respect of prospective financial information in the above three jurisdictions are summarised in Table 1.]

TABLE 1 COMPARISON OF THE REGULATION OF FORECAST INFORMATION IN RESPECT OF EQUITY SECURITIES IN ONTARIO (CANADA), AUSTRALIA* AND THE UNITED STATES

	ONTARIO (CANADA)	AUSTRALIA (NCSC)	UNITED STATES
DISCLOSURE	Optional	Optional	Optional
RULE APPLIES TO	Prospectuses, preliminary prospectuses, rights offering circulars and other documents filed with OSC	Prospectuses	Documents filed with SEC and annual reports
TERMINOLOGY USED	Future-oriented financial information (FOFI); Distinguishes forecasts from projections	Forecast, projection, estimate	Forward-looking statements, projections
PERIOD (FORECAST HORIZON)	Period not to exceed point in time for which such information can reasonably be estimated (usually a maximum of 24 months)	Usually maximum of two years, unless it is reasonable that the forecast extend for a longer period	Management to select period most appropriate in circumstances
ASSUMPTIONS	CICA guidelines require the disclosure of the principal assumptions and the separate disclosure and identification of hypotheses. The effective date of underlying assumptions should not precede by more than 120 days the date of the filing of the document containing FOFI	Assumptions must be adequately described and their sensitivity disclosed	SEC encourages the disclosure of assumptions which, in management's opinion, are most significant to the projections
AUDIT	FOFI in prospectuses must be accompanied by audit report which should not contain any reservation of opinion; OSC refers to CICA Audit Guidelines	Prospectus must contain an independent expert's report commenting, with reasons, on projections, including the appropriateness of assumptions made	Audit of projections is not required. The SEC permits outside review of management's projections; outside reviewer (expert) need not be an auditor/accountant
REVIEWS /UPDATES	FOFI to be reviewed each time issuer is required to file historical (annual/interim) statements: *identifying any significant changes, if there is no change, to disclose that there is no change; *if it is updated, to provide explanation, dates of original and updated FOFI; FOFI to be compared with annual audited actual results, disclosing reasons for significant changes	No requirements for reviews/updates	Not dealt with specifically (Companies that file information with the SEC have a responsibility to fully disclose both favorable and unfavourable material facts regarding their financial position. The SEC states that this may require disclosure that prior projections no longer have a reasonable basis)

* The Australian provisions are those from section 5.007 of the "Prospectus Procedures Handbook" (issued by the NCSC), now superseded by the provisions of the Corporations Act 1989.

LIST OF QUESTIONS IDENTIFIED FOR COMMENT

The following is a list of the questions which have been identified in the Discussion Paper for comment. The reference numbers refer to the sections/subsections in which the questions are listed in this Discussion Paper.

EXISTING PROVISIONS IN THE SECURITIES REGULATIONS 1983**3.0 MANDATORY FORECAST INFORMATION****3.1 Trading Prospects**

- 3.1.3.1 Is it desirable that a statement of trading prospects be included in a registered prospectus?
- 3.1.3.2 Should there be an obligation under regulations to include a statement of trading prospects in a registered prospectus?
- 3.1.3.3 Should the registered prospectus forecast the effect on trading prospects of the special trade factors and risks that have been described in accordance with clause 9(2)?
- 3.1.3.4 Should the statement of trading prospects include financial/quantitative information?
- 3.1.3.5 If financial/quantitative information is disclosed, should it be audited?

3.2 Forecast Statement of Changes in Financial Position

3.2.3.1 Is it desirable to publish a forecast Statement of Cash Flows in a registered prospectus? Is it also desirable to publish the forecast Balance Sheet and Profit and Loss Statement prepared for the purpose of drawing up the forecast Statement of Cash Flows?

3.2.3.2 Should there be an obligation under regulations to publish a forecast Statement of Cash Flows in a registered prospectus? For this purpose, should the requirement for a forecast Statement of Changes in Financial Position be revoked?

3.2.3.3 Should the provisions apply to all issuers of equity securities or just to initial flotations?

3.2.3.4 Should the information disclosed in accordance with clauses 10(1)(c) and 10(2) be audited?

3.3 Pending Proceedings

3.3.3.1 Should all material effects of pending proceedings, whether positive or negative, be quantified (where possible) and disclosed?

3.3.3.2 Should this information be audited?

4.0 OPTIONAL FORECAST INFORMATION

4.1 Expected Financial Benefits

4.1.3.1 Is it desirable that issuers state the purpose for which proceeds of the issue are to be applied?

4.1.3.2 Should regulations require the disclosure of the purpose for which proceeds of the issue are to be applied?

4.1.3.3 Should financial forecasts be required of issuers that raise funds for purposes other than to provide finance for a particular capital project, for example, working capital needs?

4.1.3.4 Should information required under clause 9(3) be audited?

4.2 Profit Forecasts

4.2.3.1 Is it desirable that regulations give further guidance on:

(a) what is a profit forecast; and

(b) what constitute principal assumptions?

4.3 Audit of Profit Forecasts

4.3.3.1 Should auditors evaluate and report on the reasonableness of assumptions underlying prospective financial information? In this regard, should the New Zealand Society of Accountants amend Auditing Guideline AG-20 to provide that auditors report on the reasonableness of the assumptions?

6.0 OTHER QUESTIONS ARISING

6.2 The use of the term "Projection"

6.2.2.1 Is it desirable for regulations to distinguish between forecasts and projections?

6.2.2.2 Is it desirable to specify the circumstances in which issuers should present projections rather than forecasts?

6.3 The review of prospective information by independent experts

6.3.2.1 If prospective information is audited, and the auditor states that he or she relied on the opinion of an expert, should the expert also provide a written review?

6.3.2.2 What should the obligations of the auditor/expert be and to which elements of the prospective information should the obligations of the auditor/expert extend?

6.4 The post facto review of prospective information and the comparison of the information with actual results

6.4.2.1 Should there be an obligation under regulations for issuers to review and update prospective information previously published in registered prospectuses?

6.4.2.2 Are there circumstances in which issuers should be required to disclose revised forecasts, give reasons for significant changes and reconcile previous forecasts with any revised forecasts?

6.4.2.3 Is it desirable for the issuer to compare prospective information with actual results in subsequent annual or interim financial reports, with reconciliations and explanations for major variances between forecasts and actual results? Should there be an obligation under regulations to do so?

6.5 Liability and safe harbour rules for issuers and reviewers of prospective information

6.5.2.1 Should the New Zealand law impose explicit liability on issuers and others in respect of prospective information? Should this liability be civil liability, criminal liability or both?

- 6.5.2.2 If the law imposes liability in respect of prospective information, should auditors be amongst those who may be subject to that liability?
- 6.5.2.3 Should the law contain safe harbour rules to protect issuers, directors, auditors and other experts from civil and/or criminal liability where actual results deviate from the prospective information as previously disclosed in a registered prospectus?
- 6.5.2.4 What form should such safe harbour rules take? Should the onus of proof for establishing that liability arises lie with the plaintiff or the defendant?