

Inquiry	Parliamentary Joint Committee on Corporations and Financial Services, Oversight of the Australian Securities and Investments Commission, the Takeovers Panel and the Corporations Legislation No. 1 of the 46th Parliament
Agency	Australian Securities and Investments Commission
Question No.	016
Reference	Spoken, 18 June 2021, Hansard page reference 46
Committee member	Senator Scarr

Question

Senator SCARR: You've held very senior positions in relation to these matters. I'm going to put a rising intonation on the end of this, so it's a question. The document says:

There is also a risk that financial errors or mismanagement by Nuix, including but not limited to:

- errors in financial reporting practices or the accounting treatment of certain transactions,
- the incorrect interpretation of accounting standards or incorrect tax calculations,
- the under or over-statement of key financial metrics, or an inability to implement appropriately third party checks to identify such errors,

may result in contraventions of applicable laws or standards, financial loss or allow fraudulent activity to go unnoticed.

I must say that when I read this risk, having been involved in the preparation of prospectuses and in the drafting of key risks—bear in mind that it's key risks—that seemed to me to be a very unusual articulation of a key risk in a prospectus. Is that a fair comment, based on your experience?

Mr Longo: The risks one sees in these documents exercise the imagination. I do take your point that this particular risk raises the possibility of accounting errors. But I think the risk they're trying to identify is a risk: that the accounting treatment might be mistaken.

Senator SCARR: I'm interested. Ms Armour, do you have a view based on your experience? Is that the sort of risk that you would typically see in a modern-day prospectus?

Ms Armour: As a result of what's been said in parliament, I have no intention of commenting on--

Senator SCARR: Sorry, it was unfair of me to ask you that. Perhaps Ms Chester?

Ms Chester: Given what was in parliament, I have nothing further to add.

Senator SCARR: Okay.

Mr Longo: We do want to be helpful, though. All I would say about risk disclosure in prospectuses is that I was involved in a number of listing committee issues in another jurisdiction, and, you're right, the breadth and width of risk disclosure is often driven by legal or policy considerations that wouldn't readily occur to you. On this particular one I'd prefer to take it on notice and get the benefit of the team's view on this in context.

Senator SCARR: In one of the emails that Senator O'Neill tabled, one of the team members actually referred to it as 'slightly unusual' and then referred to the re-stated accounts, so maybe that explains it. But I would appreciate your views on that matter.

Mr Longo: I'm not suggesting it's a bad question. I think it's a very interesting question.

Senator SCARR: I come back to this concept of 'clear, concise and effective'. The key risks, I would have thought, should be risks that are not necessarily unique but particular to the investment.

Mr Longo: You touch on a very important problem. It goes back to what Commissioner Armour and I were talking about earlier with your earlier question: we've got ourselves into a situation with documents of this nature that are very long and not always as helpful to an investor as they could be. On your particular question, with this particular risk disclosure, what I'd prefer to do is take it on notice, so I have the benefit of the expertise of the corporations team, and put this particular disclosure in a better context; otherwise I'd be misleading you.

Senator SCARR: That's fine. Thank you very much.

Mr VAN MANEN: Would it be fair to say that the key risks in the prospectus should relate to the risks to the business and the operation of the business that are potentially going to affect the long-term value or otherwise of that business, which is what investors are ultimately interested in? Is that a fair observation?

Mr Longo: On principle, that must be right, yes. These documents, particularly in places like the US, are almost drafted as defence documents. We're approaching this from an investor consumer perspective. Obviously, we want investors to understand the security they might buy and to be well informed and, as Senator Scarr said, alerted to risks that are actually relevant to the business. I think they're all appropriate observations to make. On this particular risk we'll come back to you on notice. The way the system works, though, is that, if something goes wrong and the issuer is sued for misleading and deceptive conduct or for issuing a prospectus that has material omissions, the prospectus assumes quite a profound legal significance because it becomes the centre of whatever the allegations are. Well-advised issuers, sophisticated issuers, obviously will take into account all those considerations in what they actually draft. I think I might leave it at that, because I know we've taken a couple of questions on notice and we'll do our best to be more expansive in writing. You've obviously touched on a very significant topic for the Australian economy and for how we raise money, raise funds.

Answer

Part E of Regulatory Guide 228: *Effective disclosure for retail investors* gives guidance on risk disclosure.

Our view, consistent with market practice, is that issuers should disclose risks inherent in their business models. In deciding what risks to disclose, issuers should consider:

- a) any existing risk management processes;
- b) any risks raised during the due diligence process for the prospectus;
- c) the business model, in order to identify the risks inherent in that model;
- d) the risks included in any expert report; and
- e) any relevant broker reports and investor presentations.

While prospectuses will disclose a range of risks we believe it is helpful to potential investors to identify the key risks facing a business. In our view, the key risks will generally be the strategic and operational risks that directors and management focus on when they are managing a business. They are usually the type of events that:

- a) have a reasonable likelihood of occurring;
- b) are difficult to mitigate; and
- c) if they did occur, would have a very significant effect on the value of shareholders' investment.

Our letter to Aperion Law dated 4 December 2020, (**document 21.1 - FOI 011-2021**) describes our view in relation the appropriateness of the final paragraph of the risk disclosed in section 5.1.21 (page 198) of the Nuix Prospectus, titled 'Failure of internal risk controls. financial management and management of growth'. The paragraph is extracted below:

There is also a risk that financial errors or mismanagement by Nuix, including but not limited to errors in financial reporting practices or the accounting treatment of certain transactions, the incorrect interpretation of accounting standards or incorrect tax calculations, the under or over-statement of key financial metrics, or an inability to implement appropriately third party checks to identify such errors, may result in contraventions of applicable laws or standards, financial loss or allow fraudulent activity to go unnoticed. Such risks may result in damage to Nuix's reputation, future legal action or claims, restatement of previously reported financial statements (such as the restatement of FY18 and FY19 financial statements discussed in Section 4.2.2) and the potential for an adverse impact on the financial and operating performance of Nuix.

In our response to Aperion Law, we agreed that the type of risk disclosure found in the final paragraph is not common. However, we were of the view that this was not inappropriate or misleading where restatements were made to prior year accounts. This risk was not abstract and theoretical because restatements had actually been made to the historical financials. We therefore believed it was appropriate for the company to again re-emphasise through risk disclosure that restatements had been made to the historical financials and therefore was at least some possibility of further issues being identified.

ASIC's stop order powers can only be used where disclosure is misleading or deceptive or there is a material omission. In this situation, the risk that had been identified by the company was clearly disclosed.