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Form 3A/B  
Rule 6.2



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### AMENDED STATEMENT OF CLAIM

#### COURT DETAILS

Court	Supreme Court of NSW
Division	Equity
List	Commercial
Registry	Supreme Court Sydney
Case number	2017/00294069

#### FILING DETAILS

Filed for	Plaintiff[s]
Legal representative	Ian Dallen
Legal representative reference	
Telephone	[REDACTED]

#### ATTACHMENT DETAILS

In accordance with Part 3 of the UCPR, this coversheet confirms that both the Amended Statement of Claim (e-Services), along with any other documents listed below, were filed by the Court.

Amended Statement of Claim (Second Further Amended Statement of Claim - For Filing.pdf)

[attach.]

Form 3A (version 7)

UCPR 6.2

**SECOND FURTHER AMENDED JOINT STATEMENT OF CLAIM**

Filed pursuant to leave granted by orders made by Justice Ball on 24 April 20 December  
2019

**COURT DETAILS**

Court	Supreme Court of New South Wales
Division	Equity
List	Class Action Panel
Registry	Sydney
Case numbers	2017/294069 & 2018/52431

**TITLE OF PROCEEDINGS**

**Proceeding 2017/294069**

First plaintiff	<b>Haliburton Charles David Findlay</b>
Second plaintiff	<b>Marian Jennifer Denny Findlay</b>
First defendant	<b>DSHE Holdings Limited ACN 166 237 841 (receivers and managers appointed) (in liquidation)</b>
Number of defendants	457 (See the Schedule for full list of defendants)

**Proceeding 2018/52431**

First plaintiff	<b>Epaminondas Mastoris</b>
Second plaintiff	<b>Lena Mastoris</b>
First defendant	<b>DSHE Holdings Limited ACN 166 237 841 (receivers and managers appointed) (in liquidation)</b>
Number of defendants	457 (See the Schedule for full list of defendants)

**TYPE OF CLAIM**

Representative Proceeding under Part 10 of the *Civil Procedure Act 1995* (NSW); contraventions of the *Corporations Act 2001* (Cth).

## RELIEF CLAIMED

- 1 An order that the defendants pay to the plaintiffs and Group Members:
  - (a) Compensation pursuant to ss 1041I and 1325 of the *Corporations Act* 2001 (Cth);
  - (b) Compensation pursuant to s 236 of the Australian Consumer Law and/or s 12GF of the *Australian Securities and Investments Commission Act* 2001 (Cth);
  - (c) An award of damages for Group Members pursuant to s 177(1) of the *Civil Procedure Act* 2005 (NSW);
  - (d) Interest;
  - (e) Costs and interest on costs.
- 2 Such other order or orders that the Court considers appropriate.

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## NARRATIVE SUMMARY OF THE CLAIM

- 1 This statement of claim is filed on behalf of the plaintiffs in proceedings 2017/294069 (**the Findlay proceedings**) and 2018/52431 (**the Mastoris proceedings**) (collectively, the **plaintiffs**). The plaintiffs and the group members whom they represent (collectively, the **Group Members**) each suffered losses through their acquisition of shares in DSHE Holdings Limited ACN 166 237 841 (receivers and managers appointed) (in liquidation) (**DSH**).
- 2 The defendants in these proceedings are DSH and two of its directors during 2015, Mr Nicholas Abboud (**Mr Abboud**) and Mr Michael Thomas Potts (**Mr Potts**).
- 3 DSH traded as Dick Smith, the well-known Australian 'high-street' and online electronics retailer. On 4 January 2016 DSH was placed into voluntary administration by its directors and on 25 July 2016 it was placed into liquidation.
- 4 DSH was a public company which listed on the ASX in December 2013. Prior to the listing Dick Smith was owned by Woolworths and in late 2012 it was acquired by Anchorage Capital Partners Pty Ltd (**Anchorage**), a private equity company.
- 5 Anchorage controlled Dick Smith for a period of just over one year and then in November 2013 made a public offering of shares following the publication of a Prospectus. The Prospectus made various representations to the effect that new management of Dick Smith installed by Anchorage after it acquired Dick Smith had transformed Dick Smith into a successful and profitable business (see paragraph 73 below). In support of those representations, the

Prospectus provided historical “pro-forma” financial accounts for the Dick Smith business for the financial year ended 30 June 2013 (FY13) and for the first quarter of the 2014 financial year (1Q14) and a reconciliation between the FY13 statutory and pro-forma accounts (see sections B.1.3 to B.1.6 below). DSH represented through the Prospectus that those results demonstrated substantial improvements in Dick Smith’s gross margins, balance sheet and forecast profits for financial year ended 29 June 2014 (FY14) (the “Transformation Representations” – see section B.1.7 below and the “Growth and Profit Representations” – see section B.1.8). Those representations were a significant marketing feature of the Prospectus which were likely to and did induce investors and potential investors to invest in DSH.

- 6 The Prospectus was misleading because it stated that the pro-forma financial results for FY13 and 1Q14 were prepared in accordance with Australian Accounting Standards (see paragraph 62 below) when they were not. Those financial results were not prepared consistently with Australian Accounting Standards and especially AASB 102: Inventory, which required DSH to reduce the value of inventory it owned by raising provisions against the recorded value of that inventory to ensure that it was recorded at the lower of cost and realisable value. A materially greater level of inventory provision was required than was reflected in the FY13 and 1Q14 results included in the Prospectus. This, together with other accounting practices that were inconsistent with Australian Accounting Standards (see sections C.4, C.5 and C.6), had the consequence of materially overstating the value of inventory reported in DSH’s balance sheet, overstating the reported rate and amount of gross profit and net profit and overstating reported shareholders’ equity. Together the results had the effect of artificially inflating the share price of DSH following DSH’s listing on the ASX.
- 7 Had DSH prepared its financial accounts included in the Prospectus consistently with the Australian Accounting Standards, its pro-forma accounts for FY13 and 1Q14 and its forecast results for FY14 would have been no better than the results and forecasts for those periods recorded in Annexure A to this pleading. In those circumstances, two consequences would have followed. First, there would have been no basis for DSH to represent in the Prospectus that there had been a transformation in its business as demonstrated by the pro-forma financial results included in the Prospectus. Secondly, the financial results for FY13 and 1Q14 would not have supported the marketing of DSH to potential investors in the initial public offering (IPO) at \$2.20 per share and the IPO would not have proceeded in December 2013 or at an offer price of \$2.20. Consequently, none of the plaintiffs or group members in the Mastoris or Findlay proceedings would have acquired shares in DSH. Therefore, none of the plaintiffs or group members in either proceedings would have suffered any loss or damage through the acquisition of DSH shares.



- 8 The Prospectus, whose contents are pleaded in section B.1 below, was issued for the purposes of Chapter 6D of the *Corporations Act 2001 (Cth)* (CA) and was a disclosure document within the meaning of the CA. Publication of the Prospectus conveying the representations that it did was misleading and deceptive for the reasons summarised above and pleaded at section D.1.1 below and contravened ss 728 and 1041E of the CA.
- 9 The IPO was successful because of the misrepresentations in the Prospectus and Dick Smith listed on the Australian Stock Exchange on 4 December 2013 at a price of \$2.20 per share.
- 10 Throughout the entire period of its listing on the ASX, DSH's approach to valuing and provisioning for its inventory remained inconsistent with the requirements of the Australian Accounting Standards. As was the case with the financial accounts presented in the Prospectus, contrary to AASB 102 at each end of financial year reporting date post the IPO, DSH failed to report the value of inventory at the lower of cost and net realisable value; and properly provision against, or write down, the value of its inventory. As a result, at each end of financial year reporting date a significant and material under-provision was recorded against inventory, DSH overstated its total equity, net assets and reported profits and did not fairly present DSH's financial performance. See section C.2.
- 11 From at least May 2014 and throughout 2015 the management of DSH pursued a policy of maximising rebates given to DSH by vendors and suppliers (see section C.3.1). These included 'Over and Above Rebates' (which were purportedly rebates relating to promotional support of products supplied to DSH for sale) and 'Volume Rebates' (which were purportedly rebates for DSH agreeing to purchase and sell large volumes of the suppliers' products). DSH also developed a practice of directing or requesting suppliers to cancel previous invoices that had been issued without rebates and then reissue them at a higher price with rebates applied against the increased cost of the goods ("Switched Invoice Rebates"). See sections C.3.2, C.3.3 and C.3.4.
- 12 Furthermore, DSH did not have in place a system for the reliable planning, tracking and recording of rebates accrued and received from vendors and suppliers. See section C.3.10 below.
- 13 Throughout the same period, DSH's accounting for the rebates described in the preceding paragraph was not consistent with Australian Accounting Standards. Those practices, together with DSH's accounting practices for inventory, had the effect of inflating DSH's gross margins and profits and reported equity as recorded in its financial statements for the 2014 and 2015 years beyond what they would have been had DSH prepared its accounts consistently with

Australian Accounting Standards. It also meant that the financial statements did not give a true and fair view of the financial position and performance of DSH and the DSH Group. Those accounting practices for rebates, pleaded in sections C.3.2 to C.3.8 below and as further particularised in the two accounting reports prepared by the plaintiffs' expert, Michael Potter (dated 24 September 2018 (**First Potter Report**) and 16 October 2018 (**Second Potter Report**)) included:

- (a) booking certain rebates in DSH's financial statements in 2015 directly as an increase in profit (as a reduction in marketing expenses or a reduction in Cost of Sales), prior to both the sale of the product and the receipt of the marketing support or in circumstances where no rebate actually existed;
  - (b) booking certain rebates in DSH's financial statements in 2014 and 2015 as a reduction in Cost of Sales when the rebates were not attributable to such cost; and
  - (c) booking certain rebates in DSH's financial statements in 2014 and 2015 as accounts receivables when it was not probable or it was at least uncertain that the rebate would be earned, paid and where the value of the rebate could not reliably be measured.
- 14 DSH's rebate maximisation practice and accounting practices for rebates had the effect of providing an additional means by which DSH was able to record purported profit in FY14 and the financial year ended 28 June 2015 (**FY15**) that DSH would not otherwise have been able to record as earned in those years – if it had complied with Australian Accounting Standards.
- 15 During this period, DSH's objective to maximise rebates obtainable from suppliers was a significant driver of purchasing decisions within DSH. Purchasing decisions were made by DSH on the basis of the rebates that could be obtained from suppliers and not solely on the basis of anticipating the goods that DSH's customers actually wanted. This led throughout FY15 and until DSH went into administration in 2016 to an increase in inventory which became increasingly aged and obsolete and therefore difficult to sell. It also had the effect of increasing DSH's recorded profit without adequate regard to the potential effect of the purchases on existing or future levels of provision required against inventory. See paragraph 154 below.
- 16 As pleaded in section C.2, the rebates practices exacerbated DSH's existing inventory provisioning problems.
- 17 In November 2015, DSH was required to write off the value of its stock by approximately \$60 million (see paragraph 142 below).

- 18 Had DSH prepared its financial accounts for FY14 and FY15 in accordance with Australian Accounting Standards, its results would have been no better than the results presented in Annexure B to this pleading.
- 19 DSH, Mr Abboud and Mr Potts represented that DSH's financial accounts published after DSH's listing on the ASX were prepared in accordance with the Australian Accounting Standards and gave a true and fair view of the financial position and performance of DSH and its controlled entities (**the DSH Group**). The representations were made in respect of DSH's published financial statements for FY14 and FY15. Each of those financial statements was accompanied by a directors' declaration that, in each director's opinion, the statements were in accordance with the CA — including as to compliance with accounting standards and gave a true and fair view of the financial position and performance of DSH and the DSH Group. See section B.2 below.
- 20 By the directors' declarations, Mr Abboud and Mr Potts also made implied representations — including that their opinions expressed in the declarations had a reasonable basis, were the product of the exercise of reasonable care and skill and a matter to which each had turned his mind after informing himself as to the financial affairs of the company. For the reasons pleaded in sections D.4 and D.5 below, that was not the case and as a consequence the implied representations arising from Mr Abboud's and Mr Potts' directors' declarations were misleading or deceptive in contravention of ss 1041H and/or 1041E of the CA and/or s 12DA of the *Australian Securities and Investments Commission Act 2001 (Cth)* (**ASIC Act**) and/or s 18 of the Australian Consumer Law.
- 21 Further, DSH represented, through the publication of the directors' declarations, that Mr Abboud and Mr Potts held the opinions pleaded in the preceding paragraph and that those opinions had a reasonable basis, were the product of reasonable care and skill and were a matter to which each had turned his mind after informing himself as to the financial affairs of the company which their opinions were based upon. This constituted misleading or deceptive conduct by DSH in contravention of ss 1041H and/or 1041E of the CA and/or s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law, as pleaded in sections D.1 and D.2 below.
- 22 By reason of DSH's accounting practices pleaded in Part C below, the publication by DSH of each of its financial statements for FY14 and FY15 was misleading or deceptive conduct in contravention of ss 1041E and/or 1041H of the CA and/or s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law. Contrary to the representations made by DSH and its directors, the accounts were not prepared in accordance with Australian Accounting Standards and did not give a true and fair view of the financial position and performance of DSH and the

DSH Group (because they artificially inflated DSH's reported profit and overstated the total equity and net assets of DSH). Each of DSH, Mr Abboud and Mr Potts contravened ss 1041H and/or 1041E of the CA and/or s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law in causing the accounts to be published. See section D.1, D.2, D.4 and D.5 below.

23 ASX announcements and results briefings made by DSH, and authorised by Mr Abboud and Mr Potts around the time its financial statements were published for DSH's financial statements for FY14 and FY15, were also misleading or deceptive, and their publication also contravened ss 1041H and/or 1041E of the CA and/or s 12DA of the ASIC Act or s 18 of the Australian Consumer Law. The relevant ASX announcements and results briefings were:

- (a) an announcement to the ASX on 19 August 2014 in relation to the FY14 Financial Statements together with a presentation titled 'FY 2014 Results Briefing';
- (b) an announcement to the ASX on 18 August 2015 in relation to the FY15 Financial Statements together with a presentation titled 'FY2015 Results Briefing'.

24 Further, for the reasons pleaded in section D.3 below, DSH's publication of its FY14 financial report and FY15 financial report together with the associated ASX announcements and results briefings published by DSH resulted in a contravention by DSH of its continuous disclosure obligations because those reports and announcements omitted material information which was not generally available to investors and could reasonably be expected to have had a material effect on the price or value of shares in DSH.

24A Deloitte was retained by Dick Smith Sub-holdings Pty Limited (**DSSH**) and later DSH to audit the financial statements of DSSH for FY13, and DSH for FY14 and FY15. David White (**Mr White**) was the lead audit partner for each of Deloitte's audits. In conducting its audits, rebates and inventory issues were identified as matters of key and high focus for Deloitte.

24B In carrying out its audits, and in giving its audit opinions, Deloitte made representations that it had conducted its audits in accordance with applicable auditing standards. Deloitte also represented that it had obtained sufficient and appropriate evidence to carry out its audits and that, in its opinion, the financial statements of DSSH for FY13, and DSH for FY14 and FY15 were in accordance with the CA, including giving a true and fair view of DSSH's and DSH's financial position and performance respectively, and complied with the Australian Accounting Standards and the *Corporations Regulations 2001*. Deloitte further represented that these representations were the product of Deloitte conducting its audits in accordance with Deloitte's auditing obligations, including the Australian Auditing Standards, that they were the product of Deloitte having exercised reasonable care and skill in performing the audits, and that there were

reasonable grounds for making the representations. The representations were made by Deloitte and by Mr White.

- 24C For the reasons pleaded in Part C the accounting treatment, practices and decisions made by DSSH concerning the provisioning of inventory and DSH concerning both rebates and the provisioning of inventory meant that its accounts were not prepared in accordance with the Australian Accounting Standards. They led to the financial statements of DSSH for FY13 and DSH for FY14 and FY15 not giving a true and fair view of DSH's financial position and performance. Deloitte's failure to identify these matters and its representations to the contrary, was the result of Deloitte:
- (a) failing to conduct its audits in accordance with applicable auditing standards;
  - (b) failing to exercise reasonable care and skill; and
  - (c) failing to have reasonable grounds for its opinions.
- 24D The representations Deloitte made summarised in paragraph 24B above and pleaded in Section F.5 below were therefore misleading or deceptive in contravention of s 1041H of the CA and/or s 18 of the Australian Consumer Law and/or s 12DA of the ASIC Act. Further, to the extent that Deloitte's representations were representations that its audit services were of a particular standard or quality, within the meaning of s 29(1)(b) of the Australian Consumer Law and/or within the meaning of s 12DB(1)(a) of the ASIC Act, those representations were therefore false or misleading, in contravention of those provisions.
- 24E Further, by issuing and publishing each of Deloitte's Audit Reports, Mr White made statements or disseminated information, namely the representations summarised in paragraph 24B above and pleaded in Section F.5 below, which were false in a material particular or materially misleading, which were likely to induce the plaintiffs and Group Members to acquire shares in DSH or, in the alternative, which were likely to have the effect of increasing, maintaining or stabilising the price for trading in DSH shares on the ASX. Mr White ought reasonably to have known that the representations were false in a material particular or materially misleading at the each of Deloitte's Audit Reports were issued, for the reasons pleaded in Section F.7 below. As the lead audit partner, Mr White authorised the issuance of Deloitte's Audit Reports for the FY13, FY14 and FY15 years and thereby contravened s 1041E of the CA.
- 24F If and to the extent that Mr Abboud and Mr Potts relied on Deloitte's representations in seeking approval by the board of DSH for the publication of the financial statements for FY14 and FY15,

they would not have done so had Deloitte and Mr White not made the representations as alleged. The plaintiffs' case as to causation against Deloitte is pleaded in Section F.8 below.

- 25 The plaintiffs in the Mastoris proceedings purchased shares in DSH at different times in the period between the listing of DSH and the end of 2015. The plaintiffs in the Findlay proceedings purchased shares in DSH in 2015 and lost their investment when DSH went into administration in January 2016. These are representative proceedings in which the plaintiffs seek to recover compensation on their own behalf and on behalf of other shareholders who purchased DSH shares between December 2013 and when DSH went into administration in January 2016.

### **Structure of the pleading**

- 26 The pleading is in seven major parts:

- (a) Part A – Parties and Background
- (b) Part B – The Representations
- (c) Part C – Required Accounting Adjustments
- (d) Part D – Contraventions
- (e) Part E – Causation, Loss and Damage
- (ea) Part F - Claim against Deloitte
- (f) Part G – Common Questions.

- 27 Part A – Parties and Background addresses the following topics:

- (a) in section A.1 (paragraphs 33 – 37), Part 10 of the *Civil Procedure Act 1995* (NSW);
- (b) in section A.2 (paragraphs 38 – 45), the parties to the proceedings; and
- (c) in section A.3 (paragraphs 46 – 56), the background of the Dick Smith business and the DSH IPO.

- 28 Part B – The Representations addresses the following topics:

- (a) in section B.1 (paragraphs 57 – 84), the representations made by DSH in the Prospectus;  
and

- (b) in section B.2 (paragraphs 85 – 110), the representations made by DSH after its listing, including financial statements, declarations and announcements.

29 Part C – Required Accounting Adjustments addresses the following topics:

- (a) in section C.1 (paragraphs 111 – 134), DSH's accounting obligations;
- (b) in section C.2 (paragraphs 135 – 151), DSH's inventory practices the necessary accounting adjustments required to properly account for DSH's inventory provisioning;
- (c) in section C.3 (paragraphs 152 – 189), DSH's rebate practices and the necessary accounting adjustments required to properly account for various types of rebates received by DSH;
- (d) in sections C.4 (paragraphs 193 – 201), C.5 (paragraphs 202 – 207), C.6 (paragraphs 208 – 210), C.7 (paragraphs 211 – 213), C.8 (paragraphs 214 – 217) and C.9 (paragraphs 219 – 222), various other financial adjustments that affected DSSH's and DSH's financial statements either (or both) before and after the Prospectus; and
- (e) in section C.10 (paragraphs 223 – 226), the effect on the accounting of DSSH's and DSH's of making the accounting adjustments required in order to comply with the Australian Accounting Standards.

30 Part D – Contraventions addresses the following topics:

- (a) in section D.1 (paragraphs 227 – 250), DSH's misleading or deceptive conduct;
- (b) in section D.2 (paragraphs 251 – 273), DSH's contraventions of s 1041E of the CA;
- (c) in section D.3 (paragraphs 274 – 284), DSH's continuous disclosure contraventions;
- (d) in section D.4 (paragraphs 285 – 320), Mr Abboud's contraventions; and
- (e) in section D.5 (paragraphs 321 – 356), Mr Potts' contraventions.

31 Part E (paragraphs 357 – 366) details the plaintiffs' and Group Members' causation, loss and damage.

31A Part F – Claim against Deloitte addresses the following topics:

- (a) in section F.1 (paragraphs 376 - 386), background to the claim against Deloitte;

- (b) in sections F.2 and G.3 (paragraphs 387 - 409), Deloitte's auditing obligations;
- (c) in section F.4 (paragraph 410), the definition of Reasonable Auditor;
- (d) in section F.5 (paragraphs 411 - 426), representations Deloitte made in its audits that give rise to the breaches alleged;
- (e) in section F.6 (paragraphs 427 - 466), Deloitte's conduct in carrying out the audits of the financial statements of DSSH for FY13, and DSH for FY14 and FY15;
- (f) in section F.7 (paragraphs 467 - 502), Deloitte's contravening conduct;
- (g) in section F.8 (paragraphs 503 - 515), the plaintiffs' and Group Members' causation, loss and damage by reason of Deloitte's contravening conduct.

32 Part G (paragraphs 516 – 528) details the common questions of fact or law arising in these proceedings.



## **A. PARTIES AND BACKGROUND**

### **A.1. PART 10 OF THE CIVIL PROCEDURE ACT 1995 (NSW)**

33 The Findlays and Mastorises bring each of their respective proceedings on their own behalf and on behalf of represented persons pursuant to Part 10 of the *Civil Procedure Act 1995* (NSW).

34 The group members in the Findlay proceedings (**Findlay Group Members**) are persons who:

- (a) during the period commencing on 16 February 2015 and concluding on 3 January 2016 acquired an interest in ordinary shares in DSH (**DSH Shares**);
- (b) as at 14 February 2018 had not signed a funding agreement with ICP Capital Pty Ltd and Investor Claim Partner Pty Ltd; and
- (c) were not:
  - (i) a related party (as defined by s 228 of the CA) of DSH;
  - (ii) a related body corporate (as defined by s 50 of the CA) of DSH;
  - (iii) an associated entity (as defined by s 50AAA of the CA) of DSH;
  - (iv) a director, officer, or close associate (as defined in s 9 of the CA) of DSH; or
  - (v) a judge or the Chief Justice of the Supreme Court of New South Wales or a Justice or the Chief Justice of the High Court of Australia;
- (d) suffered loss or damage by, or which resulted from, the conduct of DSH and/or Mr Abboud and/or Mr Potts and/or Deloitte pleaded below.

35 As at the date of the commencement of the Findlay proceedings the Findlay Group Members comprised seven or more persons.

36 The group members in the Mastoris proceedings (**Mastoris Group Members**) are persons who:

- (a) acquired an interest in fully paid DSH Shares:
  - (i) during the period from 14 November 2013 to 15 February 2015 inclusive (**First Acquisition Period**); or

- (ii) during the period from 16 February 2015 to 3 January 2016 inclusive (**Second Acquisition Period**), provided that they had as at 14 February 2018 signed a funding agreement with ICP Capital Pty Ltd and Investor Claim Partner Pty Ltd; and
- (b) were not during the First Acquisition Period or the Second Acquisition Period (together, the **Relevant Period**), and were not as at 14 February 2018, any of the following:
  - (i) a related party (as defined by s 228 of the CA) of DSH;
  - (ii) a related body corporate (as defined by s 50 of the CA) of DSH;
  - (iii) an associated entity (as defined by s 50AAA of the CA) of DSH;
  - (iv) a director, officer, or close associate (as defined in s 9 of the CA) of DSH; or
  - (v) a judge or the Chief Justice of the Supreme Court of New South Wales or a Justice or the Chief Justice of the High Court of Australia; and
- (c) are not:
  - (i) Haliburton Charles David Findlay or Marian Jennifer Denny Findlay (the plaintiffs in the Findlay proceedings); or
  - (ii) any person who as at 14 February 2018 was only a client of Bannister Law or who only had signed a Litigation Funding Agreement with Vannin Capital, in respect of claims against DSH; and
- (d) have suffered loss or damage by reason of the conduct of DSH and/or Mr Abboud and/or Mr Potts pleaded below.

37 As at the date of the commencement of the Mastoris proceedings the Mastoris Group Members comprised seven or more persons.

## **A.2. THE PARTIES**

### **A.2.1. The plaintiffs in the Findlay proceedings**

38 The Findlays purchased and sold interests in their joint names in DSH Shares during 2015 as follows:

- (a) 20 February 2015 – purchased 7,500 shares;

- (b) 28 August 2015 – sold 3,500 shares;
- (c) 28 September 2015 – purchased 2,000 shares;
- (d) 5 October 2015 – purchased 2,000 shares; and
- (e) 28 October 2015 – purchased 2,000 shares.

#### **A.2.2. The plaintiffs in the Mastoris proceedings**

39 The Mastorises purchased and sold interests in DSH Shares during the Relevant Period on the ASX as follows:

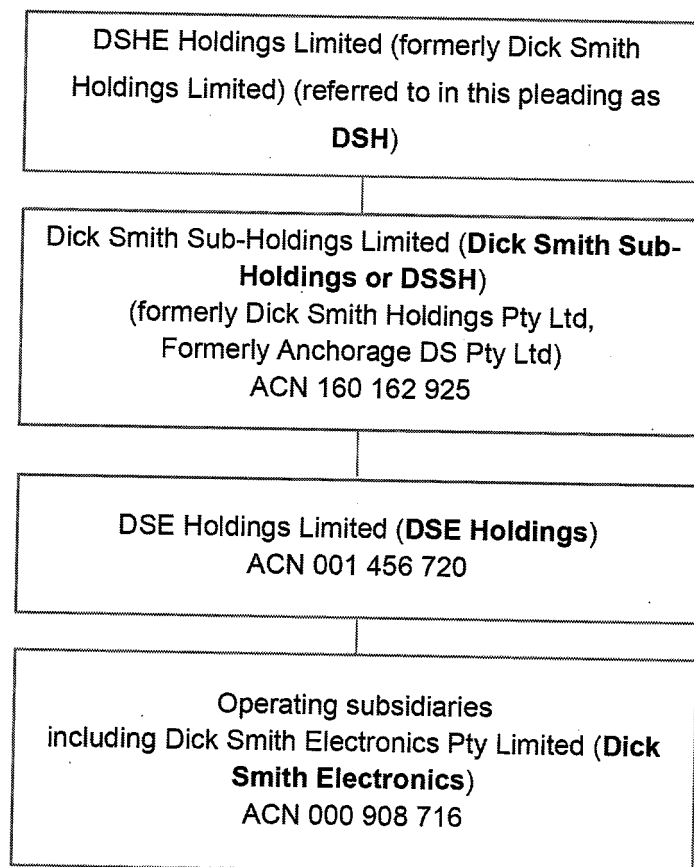
- (a) 17 December 2013 – jointly purchased 950 shares;
- (b) 28 October 2015 – jointly purchased 600 shares;
- (c) 29 October 2015 – jointly sold 1,550 shares; and
- (d) 29 October 2015 – Lena Mastoris only purchased 2,000 shares.

#### **A.2.3. The first defendant in both proceedings: DSH**

40 At all material times DSH:

- (a) was and is a company registered pursuant to the CA and is capable of being sued; and
- (b) was:
  - (i) the consolidated reporting entity for the DSH Group;
  - (ii) a person for the purposes of ss 728, 729(1), 1041E and 1041H of the CA; and
- (c) was on and from 4 December 2013:
  - (i) a corporation listed on a financial market operated by ASX Limited (**ASX**);
  - (ii) had on issue 236,511,364 ordinary shares which were:
    - (A) listed and traded on the ASX under the code “DSH”;
    - (B) “ED Securities” within the meaning of s 111AE of the CA;
    - (C) “quoted ED Securities” within the meaning of s 111AM of the CA;

- (iii) a "listed disclosing entity" within the meaning of s 111AL(1) of the CA;
  - (iv) subject to and bound by the Listing Rules of the ASX (**ASX Listing Rules**); and
  - (v) obliged by ss 111AP(1) and/or 674(1) of the CA and/or ASX Listing Rule 3.1 to, once it became aware of any information concerning DSH that a reasonable person would expect to have a material effect on the price or value of DSH Shares, tell the ASX that information immediately (unless ASX Listing Rule 3.1A applied);
- (d) carried on business itself and through the DSH Group as a retailer of consumer electronics, entertainment, computer products and related accessories; and
- (e) was the parent company of the DSH Group comprising itself and its trading subsidiaries, which DSH controlled, as follows:



## Particulars

*Page 134 of a prospectus issued and lodged with ASIC by Dick Smith Holdings dated 21 November 2013.*

- 41 On 4 January 2016, DSH was placed into voluntary administration by resolution of its directors.
- 42 On 25 July 2016, Joseph Hayes and Jason Preston of McGrath Nicol were appointed as the liquidators of DSH.
- 43 Prior to entering into liquidation, DSH traded from approximately 332 stores located mostly in Australia and via its on-line website.

### **A.2.4. The second defendant in both proceedings: Mr Abboud**

44 The second defendant, Mr Abboud:

- (a) was the Managing Director and Chief Executive Officer of DSH from on or around 25 October 2013 to 4 January 2016;
- (b) was a director of DSH from on or around 25 October 2013 to 4 January 2016;
- (c) was, as Chief Executive Officer, a person who at all times between 25 October 2013 and 4 January 2016:
  - (i) made, or participated in making, decisions that affected the whole or a substantial part, of the business of DSH and the DSH Group;
  - (ii) had the capacity to affect significantly DSH and the DSH Group's financial standing;  
and
- (d) is and was at all material times a person for the purposes of ss 728, 729, 1041E and 1041H of the CA.

### **A.2.5. The third defendant in both proceedings: Mr Potts**

45 The third defendant, Mr Potts:

- (a) was the Finance Director and Chief Financial Officer of DSH from on or around 25 October 2013 to 4 January 2016;
- (b) was a director of DSH from on or around 12 August 2014 to 4 January 2016;

- (c) was, as the Finance Director and Chief Financial Officer, a person who at all times between 25 October 2013 and 4 January 2016:
  - (i) made, or participated in making, decisions that affected the whole or a substantial part, of the business of DSH and the DSH Group;
  - (ii) had the capacity to affect significantly DSH and the DSH Group's financial standing;
- (d) was the Company Secretary of DSH from on or around 25 October 2013 to 12 August 2014; and
- (e) is and was at all material times a person for the purposes of ss 728, 729, 1041E and 1041H of the CA.

#### **A.2.6. The fourth to 457<sup>th</sup> defendants**

45A At all material times, the fourth to 457<sup>th</sup> defendants trading as Deloitte Touche Tohmatsu (**Deloitte**):

- (a) were and are natural persons able to sue and be sued;
- (b) were an Australian partnership and a member firm of the network of independent member firms affiliated with Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee;
- (c) conducted business within Australia as accountants and auditors under the partnership names "Deloitte Touche Tohmatsu" and "Deloitte";
- (d) were the suppliers of services, including audit, tax and advisory services, for a fee;
- (e) held themselves out to be, inter alia, specialist auditors and accountants, who had professional expertise and competence in the provision of auditing and accounting services;
- (f) included among its partners and employees practising in Australia persons who were registered company auditors, including Mr White, each of whom was a person for the purposes of:
  - (i) sections 1041E and 1041H of the CA;
  - (ii) sections 12DA and 12DB of the ASIC Act; and

(iii) sections 18 and 29 of the Australian Consumer Law; and

(g) were the auditors of DSH and its controlled entities.

45B Mr White was the lead auditor for each of the audits for FY13, FY14 and FY15 and signed the Audit Reports for each of these years on behalf of himself and on behalf of Deloitte.

### A.3. BACKGROUND

46 The business ultimately conducted by DSH was founded in 1968 by Richard "Dick" Smith AO.

47 In the period from about 1981 to 1983, Woolworths Ltd acquired the Dick Smith business.

48 By about 2012, Woolworths conducted the Dick Smith business in DSE Holdings, and its subsidiaries.

49 During 2012, Woolworths undertook a sale campaign in relation to the Dick Smith business.

50 On 26 September 2012, Dick Smith Sub-Holdings (formerly named Dick Smith Holdings Pty Ltd and Anchorage DS Pty Ltd), entered into a share sale agreement with Woolworths pursuant to which Dick Smith Sub-Holdings acquired all of the issued shares in DSE Holdings (**Acquisition**).

51 Upon Acquisition, Dick Smith Sub-Holdings was 98% owned by Anchorage Capital Partners Pty Ltd and 2% by LMA Investments Pty Ltd.

52 On 25 October 2013, DSH was incorporated as an Australian Public Company with the intention of raising capital through an IPO of its shares (**DSH IPO**).

53 On 14 November 2013, DSH lodged with ASIC and issued a prospectus dated 14 November 2013 (**First Prospectus**).

54 On 21 November 2013, DSH lodged with ASIC and issued a replacement prospectus dated 21 November 2013 (the **Replacement Prospectus**).

55 In this pleading, a reference to the **Prospectus** is a reference to both the First Prospectus and the Replacement Prospectus and where references to page numbers or sections of the Prospectus are given they refer to page numbers and sections of the Replacement Prospectus and the corresponding pages and sections of the First Prospectus.

56 On 4 December 2013, DSH:

- (a) acquired all of the issued shares in Dick Smith Sub-Holdings;
- (b) became the holding company of the DSH Group and thereafter conducted the Dick Smith business; and
- (c) was admitted to the official list of the ASX and commenced trading with a listing price of \$2.20 per share.



## **B. THE REPRESENTATIONS**

### **B.1. THE PROSPECTUS REPRESENTATIONS**

#### **B.1.1. The Legal Status of the Prospectus**

57 The Prospectus was:

- (a) issued for the purposes of Chapter 6D of the CA;
- (b) a disclosure document within the meaning of the CA;
- (c) issued in relation to the offer of DSH Shares for the purposes of s 709(1) of the CA;
- (d) subject to the requirements of s 710(1) of the CA, such that it was required to contain all the information that investors and their professional advisers would reasonably require to make an informed assessment of, inter alia, the assets and liabilities, financial position and performance, profits and losses and prospects of DSH;
- (e) lodged with ASX in connection with an application for admission to the official list and quotation of DSH Shares on the ASX, together with an Appendix 1A (**ASX Listing Application and Agreement**) and "Information Form and Checklist" (**Pre-Quotation Disclosure**) as required by ASX Listing Rule 1.7, which:
  - (i) confirmed that all information that a reasonable person would expect to have a material effect on the price or value of DSH Shares was included in or provided with the Pre-Quotation Disclosure (as required by Item 40 of the Information Form and Checklist); and
  - (ii) by deed poll warranted that the information and documents required by the Appendix 1A, including the information and documents referred to in the Information Form and Checklist "*are (or will be) true and correct*" (as required by cl 4 of Appendix 1A); and
- (f) was (together with the other documents comprising the Pre-Quotation Disclosure), from a time no later than the time when DSH was admitted to the official list of the ASX, publicly available to the market of potential investors in DSH Shares.

58 The content of the Prospectus was approved by the board of DSH on or about 13 November 2013.

### Particulars

*The Prospectus states that “the issue of this Prospectus has been authorized by each Director. Each Director has consented to the lodgement of this Prospectus and the issue of this prospectus and has not withdrawn that consent”, para 10.15.*

*The Prospectus contains a “Chairman’s Letter” stating that the offer made in the Prospectus was made on behalf of all directors, including Abboud.*

*Minutes of a meeting of the board of directors of DSH held on or about 13 November 2013.*

- 59 The issue of the Prospectus was authorised by DSH and each of its directors.

### Particulars

*The particulars to the paragraph above are repeated.*

- 60 Prior to the authorisation of the issue of the Prospectus, DSH and its directors undertook a process of verifying the statements contained in the Prospectus. The verification process was recorded via a Verification Matrix (The Project Yellow – Allocation table and Verification notes for Prospectus (the **Verification Matrix**)) which recorded the person who had responsibility for the verification of each statement in the Prospectus and the basis for that verification.

### Particulars

*Boxed-up Prospectus DSE.00339260.*

*Verification Matrix DSE.000235957.*

#### **B.1.2. Financial Information Basis Representation**

- 61 The Prospectus contained a summary of historical and forecast financial information of DSH being:

- (a) pro forma historical financial information, comprising:
  - (i) pro forma historical consolidated income statements for the financial year ended 26 June 2011 (FY11), the financial year ended 24 June 2012 (FY12), FY13 and 1Q14, together with a reconciliation to the FY13 statutory consolidated income statement; and

- (ii) pro forma consolidated balance sheet as at 30 June 2013 together with a reconciliation to the statutory historical consolidated balance sheet as at 30 June 2013,

(the **Pro Forma Historical Information**); and

- (b) forecast financial information, comprising:

- (i) pro forma forecast consolidated income statement for FY14, together with a reconciliation to the FY14 statutory forecast consolidated income statement; and
- (ii) pro forma forecast consolidated cash flow statement,

(the **Forecast Financial Information**).

62 DSH represented that the information described in the preceeding paragraph:

- (a) had been prepared in accordance with the recognition and measurement principles described in Australian Accounting Standards (including Australian Accounting Interpretations) and the summarised accounting policies of DSH set out in Section 11 of the Prospectus (where "Australian Accounting Standards" was defined in the Glossary in Section 12 of the Prospectus); and
- (b) that the statutory forecast income statement had been prepared on a basis consistent with how DSH's statutory financial statements would be prepared for future financial periods,

(the **Financial Information Basis Representation**).

#### **Particulars**

*Prospectus Section 5.2, page 52; Section 5.3, page 53; Section 5.3.2, page 54; Section 12, page 152; inside front cover.*

63 The Financial Information Basis Representation was verified by Mr Potts as set out in the Verification Matrix.

#### **Particulars**

*Boxed-up Prospectus and Verification Matrix, as excerpted in Annexure C, FI46, FI47, FI96.*

### B.1.3. FY13 Performance Representations

64 The Prospectus stated that:

- (a) the historical financial information for the 3 years ending 30 June 2013 included in the Prospectus was derived from:
  - (i) DSSH's Financial Report for the 10 months period ending 30 June 2013; and
  - (ii) the unaudited accounting records of DSSH for the period from 28 June 2010 to 26 November 2012; and
- (b) the Pro Forma Historical Information based upon it was prepared in accordance with the Financial Information Basis Representation.

#### Particulars

*Prospectus, page 53; Section 5.2, page 52; Section 5.3, page 53; Section 5.3.2, page 54; Section 12, page 152; inside front cover.*

65 The Prospectus included the following statements for FY13:

- (a) pro forma sales of \$1,280.4 million;
- (b) pro forma gross profit of \$303.6 million;
- (c) pro forma gross margin of 23.7%;
- (d) pro forma Cost of Doing Business (**CODB**) margin of 21.9%;
- (e) pro forma EBITDA of \$23.4 million;
- (f) EBITDA margin of 1.8%;
- (g) pro forma EBIT of \$10.9 million;
- (h) EBIT margin of 0.9%;
- (i) pro forma profit before tax of \$9.5 million;
- (j) pro forma NPAT of \$6.7 million;
- (k) capital expenditure of \$5.4 million; and

- (l) the Financial Information Basis Representation,  
(each and collectively, the **FY13 Performance Representations**).

**Particulars**

*Prospectus, pages 12, 55 and 57; Section 5.2, page 52; Section 5.3, page 53; Section 5.3.2, page 54; Section 12, page 152; inside front cover.*

- 66 The FY13 Performance Representations were verified by Mr Potts as set out in the Verification Matrix.

**Particulars**

*Boxed-up Prospectus and Verification Matrix, as excerpted in Annexure C, IO359, IO365, IO371, IO377, IO383, FI46, FI47, FI96, FI124, FI170.*

**B.1.4. FY13 Balance Sheet Representations**

- 67 The Prospectus included the following statements and representations concerning the assets of Dick Smith Sub-Holdings as at 30 June 2013:

- (a) Statutory:
- (i) Receivables – \$10.4 million;
  - (ii) Inventories – \$168.5 million;
  - (iii) Deferred Tax Assets – \$42.9 million; and
  - (iv) Retained Profits – \$140.2 million;
- (b) Inventories were stated at *“lower of cost and net realisable value. Costs include the purchase price of goods as well as transport, handling and other costs directly attributable to the acquisition of inventories less any applicable rebates and settlement discounts. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale.”*

(collectively, the **FY13 Balance Sheet Representations**).

### Particulars

*Prospectus, page 60; Section 5.2, page 52; Section 5.3, page 53; Section 5.3.2, page 54; Section 12, page 152; inside front cover; page 149.*

- 68 The FY13 Balance Sheet Representations were verified by Mr Potts as set out in the Verification Matrix.

### Particulars

*Boxed-up Prospectus and Verification Matrix, as excerpted in Annexure C, FI46, FI47, FI96, FI220, XA18.*

#### B.1.5. Obsolete Stock Representation

- 69 The Prospectus stated that management had driven a significant transformation of the Dick Smith Business after Woolworths' divestment and had "*Significantly reduced Dick Smith's level of obsolete stock*" (the **Obsolete Stock Representation**).

### Particulars

*Prospectus, page 47.*

- 70 The Obsolete Stock Representation was verified by Mr Merola as set out in the Verification Matrix.

### Particulars

*Boxed-up Prospectus and Verification Matrix as excerpted in Annexure C, CO689.*

#### B.1.6. 1Q14 Representations

- 71 The Prospectus included the following statements and representations as to Dick Smith Sub-Holdings' 1Q14 results:
- (a) the 1Q14 results represented the first period of financial performance that was not materially impacted by the strategic decisions and operational execution of the previous management team;
  - (b) historical pro forma results for 1Q14 demonstrated a significantly improved financial performance;

(c) Dick Smith Sub-Holdings' 1Q14 pro forma results were:

- (i) Sales of \$273.3 million;
- (ii) Gross profit of \$68.4 million;
- (iii) Gross margin of 25.0%;
- (iv) CODB of \$56.7 million;
- (v) CODB margin of 20.8%;
- (vi) EBITDA of \$11.6 million;
- (vii) EBITDA margin of 4.3%;
- (viii) EBIT of \$9.0 million;
- (ix) EBIT margin of 3.3%; and
- (x) Capital expenditure of \$2.7 million,

(the 1Q14 Representations).

#### Particulars

*Prospectus, page 66; Section 5.2, page 52; Section 5.3, page 53; Section 5.3.2, page 54; Section 12, page 152; inside front cover.*

72 The 1Q14 Representations were verified by Mr Potts.

#### Particulars

*Boxed-up Prospectus and Verification Matrix, as excerpted in Annexure C, FI46, FI47, FI96, FI356, FI359, FI360.*

#### B.1.7. The Transformation Representations

73 The Prospectus included the following statements:

- (a) *"Dick Smith has undergone a significant transformation under the leadership of Managing Director and CEO, Nick Abboud. Nick and his management team have driven a comprehensive program of strategic, customer, operational and cultural initiatives which, supported by the enthusiasm and commitment of the store and store support teams, have*

*already delivered substantial improvements to financial performance, and have positioned the Company for future growth. It is expected that these programs will continue to deliver additional financial benefits in the coming years. The transformation and growth initiatives underpin Dick Smith's forecast growth to an expected pro forma EBITDA of \$71.8 million in FY2014. The Directors believe that the significant increase in the underlying profitability of Dick Smith and the sustainability of the increase have been evidenced in our strong 1Q2014 results."*

#### **Particulars**

*Prospectus, page 2.*

- (b) *"As part of the transformation program, Nick has established a platform for the future growth of the business based on four main initiatives: growing the store network, expanding our omni-channel offering, driving growth in our mobility category and expanding our private label offering."*

#### **Particulars**

*Prospectus, page 2.*

- (c) *"In the period since the Acquisition, the new management team, led by Nick Abboud, has driven a rapid transformation of Dick Smith through the implementation of a comprehensive program of strategic, customer, operational and cultural initiatives, which have already delivered substantial improvements to financial performance and have positioned the Company for ongoing future growth."*

#### **Particulars**

*Prospectus, page 6.*

- (d) *"Dick Smith's new and experienced management team, led by Nick Abboud, has driven a significant transformation of the business through a comprehensive program of strategic, customer, operational and cultural initiatives. This program has already delivered substantial improvements to financial performance, as evidenced in the 1Q2014 results. It is expected that these programs will continue to deliver additional financial benefits in the coming years. Pro forma EBITDA is forecast to grow to \$71.8 million in FY2014 from \$23.4 million in FY2013."*



### Particulars

*Prospectus, page 8.*

- (e) *"The transformation and growth initiatives underpin Dick Smith's forecast growth to an expected pro forma EBITDA of \$71.8 million in FY2014. The Directors believe that the significant increase in the underlying profitability of Dick Smith and the sustainability of the increase have been evidenced in the 1Q2014 results. It is expected that this transformation program will continue to deliver additional financial benefits in the coming years."*

### Particulars

*Prospectus, page 12.*

- (f) *"Since the Acquisition, Nick Abboud and his new senior management team have substantially transformed Dick Smith, revitalising all areas of the business and repositioning Dick Smith for ongoing future growth. By June 2013, the major transformation initiatives had been implemented and Dick Smith centred its focus on the next stage of its growth agenda. Anchorage is a turnaround-focused investor and therefore, upon successful implementation of the major transformation initiatives, began to consider alternatives to reduce its investment and create an ownership structure that would better enable Dick Smith to achieve its growth objectives".*

### Particulars

*Prospectus, page 32.*

- (g) *"At the time of the Acquisition, Dick Smith was experiencing declining profitability. Following the Acquisition, the Dick Smith management team, led by Nick Abboud, rapidly implemented a comprehensive transformation program, positioning the business for sustainable growth. The program covered all areas of the business and addressed revenues, gross profits, costs and the balance sheet, as well as customer experience and internal culture. New management talent was also added to the business to complement the existing management team, to bring additional retail and transformation expertise and to provide management the capacity to progress multiple transformation and growth initiatives in parallel. Nick Abboud and the management team, with over 200 years of cumulative retail experience, also drove an internal cultural shift towards a customer-centric focus, a bias to action and accountability for results."*

## Particulars

*Prospectus, page 33.*

- (h) *“The FY2014 pro forma forecast represents the Directors’ expectations for the first full year of Dick Smith’s financial performance under the new management team. The Directors believe that 1Q2014 is the first actual reporting period under the new management team that reflects the impact of the transformation program undertaken and is not impacted by the strategic decisions and operational execution of the previous management team and owner.”*

## Particulars

*Prospectus, page 52.*

- (i) Management of DSH had undertaken the following major initiatives as part of a transformation program and had already delivered the following benefits under the transformation program:

Initiatives	Benefits realised
<p><b>Stores and staff</b></p> <ul style="list-style-type: none"> <li>■ Rolled out new store key performance indicator (“KPI”) dashboards to all stores</li> <li>■ Implemented new staff incentive model linked to KPI dashboards</li> <li>■ Implemented new staff rostering processes and staffing policies</li> <li>■ Implemented “Serve Forward” staff training program for in-store staff focused on customer service and empathy</li> <li>■ Improved in-store markdown policies</li> <li>■ Developed strong alliances with major landlords</li> <li>■ Improved recruiting profiles and policies</li> </ul>	<ul style="list-style-type: none"> <li>■ Improved store labour efficiency and profitability</li> <li>■ Improved in-store customer experience</li> <li>■ Improved gross margins through better promotion management</li> </ul>

	<b>Initiatives</b>	<b>Benefits realised</b>
<b>Suppliers and buying</b>	<ul style="list-style-type: none"> <li>■ Developed strategic relationships with key suppliers</li> <li>■ Renegotiated a number of supplier agreements (e.g. pricing and terms)</li> <li>■ Revamped range and mix of brands and products, and increased focus on mobility and private label</li> <li>■ Developed new pricing and promotional practices in collaboration with suppliers</li> <li>■ Opened new Hong Kong sourcing office and re-tendering of sourcing costs</li> <li>■ Improved buyer disciplines and accountability</li> <li>■ Improved collaboration between buying and operations</li> </ul>	<ul style="list-style-type: none"> <li>■ Store-in-store relationships with Apple and Samsung</li> <li>■ Mutually beneficial supplier agreements on commercially competitive terms</li> <li>■ Improved gross margins from pricing and product mix</li> <li>■ Clarity on range and price strategies</li> <li>■ Access to latest products and brands</li> </ul>

	<b>Initiatives</b>	<b>Benefits realised</b>
<b>Marketing</b>	<ul style="list-style-type: none"> <li>■ Developed new marketing program</li> <li>■ Implemented 'Dick Live Daily Deals'</li> <li>■ Renegotiated marketing supplier agreements</li> <li>■ Conducted extensive customer research and engagement</li> </ul>	<ul style="list-style-type: none"> <li>■ Substantial increase in marketing volumes, efficiency and 'share of voice', including greater frequency of catalogues and increased number of days of television commercials</li> <li>■ Improved collaboration with suppliers</li> </ul>

	Initiatives	Benefits realised
<b>Inventory management and supply chain</b>	<ul style="list-style-type: none"> <li>■ Undertook significant clearance of aged and obsolete stock</li> <li>■ Improved stock management and ordering practices</li> <li>■ Upgraded store replenishment system</li> <li>■ Streamlined and right sized distribution network</li> <li>■ Optimised freight movements including adding direct to store and direct to customer shipping</li> <li>■ Optimised staffing to reflect new inventory levels</li> </ul>	<ul style="list-style-type: none"> <li>■ Significant reduction in aged and obsolete stock</li> <li>■ Reduction in freight and inventory handling costs</li> <li>■ Reduction in 'out of stocks'</li> </ul>

	Initiatives	Benefits realised
<b>Omni-channel</b>	<ul style="list-style-type: none"> <li>■ Migrated website to new digital platform allowing greater flexibility, functionality, efficiency and customer experience</li> </ul>	<ul style="list-style-type: none"> <li>■ Improved visitation and sales through improved pricing, convenience, attachment and delivery functionality</li> </ul>

	Initiatives	Benefits realised
<b>Other</b>	<ul style="list-style-type: none"> <li>■ Renegotiated all key contracts and procurement agreements</li> <li>■ Addressed excess space issues</li> </ul>	<ul style="list-style-type: none"> <li>■ Sustained lower and more flexible cost base</li> </ul>

#### Particulars

*Prospectus, pages 33-35, Table 4.1.3.1.*

- (j) *"In Australia, these initiatives have already delivered significant improvements to Dick Smith's financial performance (detailed further in Section 5). The Directors believe that the significant increase in the underlying profitability of Dick Smith and the sustainability of the increase have been evidenced in the 1Q2014 results. In Australia, Dick Smith is*

*now positioned for growth and has already commenced implementation of its growth plan (described in more detail in Section 4.4)."*

#### **Particulars**

*Prospectus, page 35.*

(each of (a) to (j) collectively, the **Transformation Representations**).

- 74 The Transformation Representations conveyed to investors that:
- (a) the DSH business had been successfully transformed by management and the Board of DSH into a more profitable operation than it was when it was owned by Woolworths;
  - (b) the transformation was reflected in the 1Q14 financial results;
  - (c) the transformation had already delivered improvements in financial performance, as demonstrated by the 1Q14 financial results; and
  - (d) the transformation could be expected to deliver additional financial benefits in the coming years.
- 75 The Transformation Representations were verified by the directors, Mr Potts, Mr David Cooke, Ms Marcella Davis, Mr Neil Merola, Mr John Skellern and Mr Michael Dykes.

#### **Particulars**

*Boxed-up Prospectus and Verification Matrix, as excerpted in Annexure C, CL19, CL20, CL21, CL22, CL23, CL24, CL25, CL30, IO48, IO49, IO50, IO51, IO52, IO53, IO54, IO185, IO186, IO187, IO188, IO189, IO190, IO191, IO192, IO193, IO194, IO195, IO196, IO197, IO198, IO390, IO391, IO392, IO393, IO394, CO82, CO83, CO84, CO85, CO86, CO87, CO88, CO89, CO97, CO98, CO99, CO100, CO101, CO102, CO103, CO104, CO105, CO106, CO107, CO108, CO109, CO110, CO111, CO112, CO113, CO114, FI13, FI13A, CO127, CO128, CO129, CO130, CO131, CO132, CO133, CO134, CO135, CO136, CO137, CO138, CO139, CO140, CO141, CO142, CO143, CO144, CO148, CO149, CO150, CO151, CO152, CO153, CO154, CO155, CO156, CO157, CO158, CO159, CO160, CO161, CO162, CO163, CO164, CO165, CO166, CO176, CO177, CO178, CO179, CO180, CO181, CO182, CO183, CO184, CO185, CO186, CO189, CO190, CO191, CO192, CO193, CO194, CO195, CO196, CO197, CO198, CO199, CO200, CO204, CO205, CO206, CO207, CO208, CO209, CO210, CO211, CO212,*

CO220, CO221, CO222, CO223, CO224, CO226, CO227, CO228, CO229, CO230, CO231.

**B.1.8. The Growth and Forecast Representations**

76 The Prospectus included the following statements about DSH's forecast growth and profits:

- (a) sales for the six months ending 29 December 2013 (1H14) were forecast to be 52% of FY14 forecast sales of \$1,226.0 million (being \$637.52 million) and sales in the six months ending 29 June 2014 (2H14) were forecast to be 48% of FY14 forecast sales;
- (b) Pro Forma EBITDA for 1H14 was forecast to be 56% of FY14 forecast EBITDA of \$71.8 million (being \$40.2 million), and EBITDA in 2H14 was forecast to be 44% of FY14 EBITDA;
- (c) *"FY2014 pro forma forecast EBITDA takes into account expected profitability improvements from the transformation program. Management believes that the expected seasonality of FY2014 EBITDA in terms of the proportion of EBITDA earned in each half year will be more representative of Dick Smith's seasonality of earnings going forward. This reflects the impact of the transformation program, in particular, the benefits of operating cost reductions which are spread relatively evenly through the financial year";*

**Particulars**

*Prospectus, page 65.*

- (d) FY14 results were forecast, in comparison to FY13 results, to be:

	FY13		FY14		
	Pro forma		Pro forma		Statutory
	\$m	% of sales	\$m	% of sales	\$m
<b>Sales</b>	1,280.4		1,226.0		1,226.0
<b>Gross Profit</b>	303.6	23.7	307.8	25.1	307.8
<b>CODB</b>	(280.1)	21.9	(236)	19.2	(261.2)
<b>EBITDA</b>	23.4	1.8	71.8	5.9	46.6
<b>NPAT</b>	6.7		40.0		11.5

**Particulars**

*Prospectus, pages 8, 12, 55, 57, 68, 69.*

- (e) *“The transformation and growth initiatives underpin Dick Smith’s forecast growth to an expected pro forma EBITDA of \$71.8 million in FY2014. The Directors believe that the significant increase in the underlying profitability of Dick Smith and the sustainability of the increase have been evidenced in the 1Q2014 results. It is expected that this transformation program will continue to deliver additional financial benefits in the coming years.”;*

#### **Particulars**

*Prospectus, page 12.*

- (f) the major drivers of the forecast increase in pro forma EBITDA between FY13 and FY14 were stated to include:

- (i) *“Corporate/Procurement efficiencies and marketing rebates*

*A number of improvement initiatives were driven in key head office functional areas. Dick Smith management has increased the efficiency of media expenditure, substantially increasing media volumes and share of voice, and also increased marketing collaboration with suppliers. Lease agreements for corporate offices were also renegotiated, as were all major corporate supply agreements.”*

- (ii) *“Increase in gross profit*

*Pro forma gross margin is forecast to increase from 23.7% in FY2013 to 25.1% in FY2014 as a result of a wide range of pricing, supplier and range mix initiatives, as well as improvements to buying and stock management practices. Agreements with major suppliers have been renegotiated and new buying disciplines introduced to improve planning and increase accountability for stock levels and discounting. New pricing and promotion practices were developed in collaboration with suppliers, and improvements were made to in-store markdown procedures. Dick Smith’s range was revamped to focus on higher margin products and brands, and a new direct sourcing office was established in Hong Kong to enable more efficient purchasing, particularly for private label products and accessories. In addition, the roll out of new stores is forecast to contribute to an increase in gross profit in FY2014. Despite the forecast increase in gross margin in FY2014, the gross profit contribution of existing stores in dollar terms is expected to be lower than in FY2013 due to higher sales in FY2013 as a result of increased promotional and inventory clearance activity (see Section 5.4.2)”;* and

### Particulars

*Prospectus, page 59.*

- (g) that each of the forecast results were prepared in accordance with Australian Accounting Standards,

### Particulars

*Prospectus Section 5.3, pages 53-54; inside front cover.*

(each and together, the **Growth and Forecast Representations**).

- 77 The Growth and Forecast Representations were verified by Mr Potts, Mr John Skellern, Mr Neil Merola and Mr David Cooke.

### Particulars

*Boxed-up Prospectus and Verification Matrix, as excerpted in Annexure C, FI46, FI47, FI96, FI308, FI310, FI311, IO197, IO198, IO359, IO365, IO371, IO377, IO383, IO390, IO391, IO392, IO393, IO394, FI124, FI170, FI415, FI447, FI198, FI199, FI200, FI209A2, FI209A3, FI210, FI210A, FI211, FI211A, FI212, FI212A, FI213, FI214, FI215.*

- 78 The Growth and Forecast Representations were made and approved for publication on the basis of the verification pleaded in the preceding paragraph.
- 79 The Transformation Representations and the Growth and Forecast Representations were a significant and integral marketing feature of the Prospectus which were likely to be material to the decision of potential investors to invest in DSH.

#### **B.1.9. Financial Covenants Representations**

- 80 The Prospectus stated:

*“Dick Smith entered into a facility agreement with GE Commercial Corporation (Australia) Pty Ltd and GE Commercial Finance NZ (together, the “Lender”) on 26 November 2012 under which revolving facilities have been provided since that date. Dick Smith has agreed to enter into an amendment and restatement deed with the Lender to amend and restate that facility agreement on 22 October 2013. Under the amended facility agreement, the Lender will make available an aggregate amount of A\$75 million under a revolving working capital facility (“New Facility”), which will reduce to A\$65 million effective from 1 February*



2014. The New Facility has a term of three years from the date the New Facility becomes effective (which is expected to occur immediately following completion of the Offer).”

### Particulars

Prospectus, page 73.

81 The facility agreement referred to in paragraph 80 above included the following at clause 8.3:

#### *“8.3. Financial undertakings*

*Each obligor must:*

- (a) *ensure that, at all times, the leverage ratio of the reporting group (calculated on a rolling 12 months basis by reference to the previous 12 month period) is less than 2.50:1; and*
- (b) *ensure that, at all times during each period set out below, the adjusted leverage ratio of the reporting group (calculated on a rolling 12 months basis by reference to the previous 12 month period) is less than:*
  - (i) *6.00:1 from and including the amendment date to and including 31 December 2013;*
  - (ii) *5.25:1 from and including 1 January 2014 to and including 31 March 2014;*
  - (iii) *4.80:1 from and including 1 April 2014 to and including 30 June 2014;*
  - (iv) *5.00:1 for the financial year ending 30 June 2015; and*
  - (v) *4.75:1 for the financial year ending 30 June 2016; and*
- (c) *ensure that, at all times, the fixed charge coverage ratio of the reporting group (calculated on a rolling 12 months basis by reference to the previous 12 month period) is not less than 1.25:1 at all times; and*
- (d) *ensure that there will be no revolving loan drawings outstanding for a period of not less than 5 consecutive calendar days in each of its financial years (provided however that this covenant shall be satisfied if in respect of any 5 consecutive calendar days in a financial year, the company has cash in a bank account in an amount exceeding the then amount outstanding); and*

(e) *not, without the prior written consent of GE Capital enter into any new licence or operating lease (other than a lease of real property) for equipment if the aggregate of:*

(i) *all payments under that new licence or operating lease; and*

(ii) *all payments under all licences and operating leases existing immediately prior to the time of such new license or operating lease being entered into,*

*is or would be greater than A\$4,000,000 (or its equivalent in any other currency) in any 12- month period for reporting group."*

82 The Prospectus stated a summary of clause 8.3 as pleaded above.

#### **Particulars**

*Prospectus, page 74 (Table 5.14.3.1).*

83 The Prospectus stated:

(a) *"Dick Smith expects to remain in compliance with these undertakings [including the undertakings in 8.3 setout above]"; and*

(b) *"Management believes that the financial covenants are appropriate and will be complied with in FY2014 based on the FY2014 forecasts and the significantly transformed performance of Dick Smith in FY2014 relative to that of FY2013."*

**(the Financial Covenants Representations).**

#### **Particulars**

*Prospectus, page 74.*

84 The Financial Covenants Representations were verified by Mr Potts.

#### **Particulars**

*Boxed-up Prospectus and Verification Matrix, as excerpted in Annexure C, FI46, FI47, FI96, FI607, FI617, FI618.*

## **B.2. POST-PROSPECTUS REPRESENTATIONS**

### **B.2.1. August 2014 – FY14 Financial Statements**

85 On 19 August 2014, DSH published and lodged with the ASX its annual report and the consolidated financial report of DSH for FY14 (the **FY14 Financial Statements**).

86 The FY14 Financial Statements represented that:

- (a) statutory EBITDA was \$43.9 million and pro forma EBITDA was \$74.4 million; and
- (b) statutory NPAT was \$19.8 million and pro forma NPAT was \$42.1 million.

#### **Particulars**

*FY14 Financial Statements at pages 2, 3, 29 and 30.*

87 The consolidated statement of profit or loss included in the FY14 Financial Statements represented that:

- (a) DSH's Cost of Sales = (\$919,602,000);
- (b) DSH's Gross Profit = \$308,002,000;
- (c) DSH's Marketing and Sales Costs = (\$130,544,000);
- (d) DSH's Statutory NPAT = \$19,826,000.

#### **Particulars**

*FY14 Financial Statements at page 49.*

88 The consolidated statement of financial position included in the FY14 Financial Statements represented that:

- (a) Trade and other payables = \$46,688,000;
- (b) Inventories = \$253,814,000.

#### **Particulars**

*FY14 Financial Statements at page 50.*

- 89 The FY14 Financial Statements included a declaration by the directors of DSH that in their opinion, the FY14 Financial Statements were in accordance with the CA, including as to compliance with accounting standards and gave a true and fair view of the financial position and performance of DSH and the DSH Group.

**Particulars**

*FY14 Financial Statements at page 47.*

- 90 The declaration pleaded above at paragraph 89 was signed by the Chairman of the Board of DSH on behalf of himself and the other directors of DSH, including Mr Abboud and Mr Potts.
- 91 The FY14 Financial Statements included a statement that the consolidated financial statements of DSH for the financial year ended 29 June 2014 were general purpose financial statements which had been prepared in accordance with the CA, accounting standards and interpretations, and complied with other requirements of the law.

**Particulars**

*FY14 Financial Statements at pages 53-54.*

**B.2.1.1. Directors' FY14 Representations**

- 92 By making the declaration pleaded above at paragraph 89, Mr Abboud and Mr Potts represented to investors and potential investors in DSH that each was of the opinion that the FY14 Financial Statements were in accordance with the CA, including as to compliance with accounting standards, and gave a true and fair view of the financial position and performance of DSH and the DSH Group (the **Directors' FY14 Express Representation**).
- 93 Further, by making each of the representations pleaded above at paragraph 92, Mr Abboud and Mr Potts represented to investors and potential investors in DSH that the opinion held by each of them was:
- (a) held on a reasonable basis and was the product of the application of reasonable care and skill by each relevant director;
  - (b) a matter to which each relevant director had turned his mind, having informed himself as to the financial affairs of the company to the extent necessary to form an opinion as to the truth and fairness of the accounts;

- (c) formed after each relevant director had read and understood the financial statements and considered whether the financial statements were consistent with his own knowledge of DSH and DSH Group's financial position and financial performance; and
- (d) formed after each relevant director had taken a diligent and intelligent interest in the information available to him or which he might with fairness have demanded from the executives or other employees and agents of DSH and the DSH Group,
- (each and together, the **Directors' FY14 Implied Representation**).

### Particulars

*The Directors' FY14 Implied Representation was implied by reasons of:*

- *the declaration pleaded at paragraphs 89 and 90;*
- *the representation pleaded at paragraph 92;*
- *the terms of the FY14 Financial Statements; and*
- *the obligations imposed on companies and company directors in relation to the preparation of financial reports under chapter 2M of the CA and as interpreted by the courts.*

#### **B.2.1.2. DSH's FY14 Representations**

94 By making the statements pleaded above at paragraphs 89 and 91, DSH represented to investors and potential investors in DSH that:

- (a) the consolidated financial statements of DSH for the financial year ended 29 June 2014 had been prepared in accordance with the CA, accounting standards and interpretations, and complied with other requirements of the law; and
- (b) Mr Abboud and Mr Potts were of the opinion that the 2014 Financial Statements were in accordance with the CA, including as to compliance with accounting standards, and gave a true and fair view of the financial position and performance of DSH and the DSH Group,

(each and together, **DSH's FY14 Express Representation**).

95 Further, by making the representations pleaded above at paragraph 94, DSH represented to investors and potential investors in DSH that each of the directors' opinions pleaded in the preceding paragraph were opinions:

- (a) held on a reasonable basis and the product of the application of reasonable care and skill by each of the relevant directors;
- (b) which each of the relevant directors had turned his mind to, having informed himself as to the financial affairs of the company to the extent necessary to form an opinion as to the truth and fairness of the accounts;
- (c) formed after each of the relevant directors had read and understood the financial statements and considered whether the financial statements were consistent with his own knowledge of DSH and DSH Group's financial position and financial performance; and
- (d) formed after each of the relevant directors had taken a diligent and intelligent interest in the information available to him or which he might with fairness have demanded from the executives or other employees and agents of DSH and the DSH Group,

(each and together, **DSH's FY14 Implied Representation**).

#### **Particulars**

*DSH's FY14 Implied Representation was implied by reasons of:*

- *the declaration pleaded at paragraph 89 and 90;*
- *the representation pleaded at paragraph 94;*
- *the terms of the FY14 Financial Statements;*
- *the obligations imposed on companies and company directors in relation to the preparation of financial reports under chapter 2M of the CA and as interpreted by the courts.*

#### **B.2.2. FY14 ASX Announcement & Results Briefing**

96 On or about 19 August 2014, DSH, Mr Abboud and Mr Potts, caused to be made to the ASX:

- (a) an ASX Announcement dated 19 August 2014: *Dick Smith Beats FY14 Prospectus NPAT by 5.3%*;
- (b) *Dick Smith FY2014 Results Briefing*, Nick Abboud Managing Director and CEO, Michael Potts, Finance Director and CFO dated 19 August 2014; and
- (c) the Directors' Report in the FY14 Financial Statements,

(together and separately, the **FY14 ASX Announcement & Results Briefing**).

- 97 The FY14 ASX Announcement & Results Briefing made various positive statements about the financial position and performance of DSH.

### Particulars

#### *Statements by DSH:*

- *“EBITDA \$74.4m, beating Prospectus by 3.6%, despite challenging market conditions.”*
- *“NPAT \$42.1m, 5.3% above Prospectus forecast.”*
- *“The Company’s strong growth and trading focus delivered results ahead of Prospectus forecasts.”*
- *“Gross margin was consistent with the Prospectus, improving 140bp to 25.1% in the year (FY13:23.7%).”*
- *“Cost of doing business (CODB) improved 290bp to 19.0% (FY13:21.9%), which was 20bp ahead of the Prospectus.”*
- *“Dick Smith is well placed to deliver further strong profit growth in FY15.”*
- *“Pro forma gross margin of 25.1% was in-line with the Prospectus forecast...This represents a concerted focus on profitable sales growth, particularly in New Zealand, and further growth in the Company’s accessories and private brand sales.”*
- *“Pro forma EBITDA of \$74.4 million was a 3.6% improvement on the Prospectus forecast. This was primarily due to pro forma cost of doing business (CODB) being 20 basis points lower than the Prospectus forecast on cost savings achieved in the second half of the year, particularly the New Zealand Support Office restructure and further supply chain efficiencies in both countries.”*
- *“The balance sheet at year end shows the Company is in a healthy financial position with no drawn debt.”*
- *“Net assets increased by \$10.4 million to \$166.9 million.”*

- *The increase in inventory levels to \$253.8 million reflects the opening of net 54 new stores during the year and a healthier stock position. The quality and ageing of the stock has also improved significantly during the year.*
- *"The Board believes the Company is well placed to deliver further strong growth in 2015."*

*Statements by Mr Abboud:*

- *"The strength and quality of the result is testimony to the successful and significant transformation the Dick Smith business has undertaken during the past 18 months."*
- *"Our focus on continuously improving cost efficiencies in unwavering. We anticipate our CODB to sales ratio to decline with structural improvements in supply chain and the New Zealand restructure as well as reduced procurement across all facets of the business and lower support office costs."*
- *"...Dick Smith is well positioned for another year of strong performance."*

*Statements by Mr Potts and Mr Abboud:*

- *"Strong balance sheet, with no debt, reflecting strong cash generation."*
- *"Gross Margin...25% is a sustainable base."*
- *"CODB...continued focus on productivity improvements delivered 20bp Prospectus beat. Procurement savings, supply chain and corporate efficiencies delivers 290bp improvements y-y."*
- *"CODB reduction initiatives...Transformation results achieved expectations."*
- *"Inventory at sustainable levels...clean inventory with clearance stock 40% lower year on year."*
- *"All [debt] covenants met during the year."*
- *"Sustained gross margin likely, with private label benefiting from 40% product range uplift."*



### **B.2.3. August 2015 – FY15 Financial Statements**

- 98 On 17 August 2015, DSH published and lodged with the ASX its annual report and the consolidated financial statements of DSH for FY15 (the **FY15 Financial Statements**).
- 99 The FY15 Financial Statements represented that EBITDA was \$71,900,000 and \$79,800,000 “underlying”.
- 100 The consolidated statement of profit or loss included in the FY15 Financial Statements represented that DSH's:
- (a) Cost of Sales = (\$992,828,000);
  - (b) Gross Profit = \$326,842,000;
  - (c) Marketing and Sales Costs = (\$112,935,000); and
  - (d) NPAT = \$37,905,000 and \$43,400,000 “underlying”.
- 101 The consolidated statement of financial position included in the FY15 Financial Statements represented that:
- (a) Trade and other receivables = \$53,323,000; and
  - (b) Inventories = \$293,044,000.
- 102 The FY15 Financial Statements included a statement that the consolidated financial statements of DSH for the financial year ended 28 June 2015 were general purpose financial statements which had been prepared in accordance with the CA, accounting standards and interpretations, and complied with other requirements of the law.

#### **Particulars**

*Annual Report, Notes to the Consolidated Financial Statements at page 56, dated 17 August 2015.*

- 103 The FY15 Financial Statements included a declaration by the directors of DSH that in their opinion, the FY15 Financial Statements were in accordance with the CA, including as to compliance with accounting standards and gave a true and fair view of the financial position and performance of DSH and the DSH Group.

## Particulars

*Annual Report, Directors' declaration at page 50, dated 17 August 2015.*

104 The declaration pleaded above at paragraph 103 was signed by the Chairman of the Board of DSH on behalf of himself and the other directors of DSH, including Mr Abboud and Mr Potts.

### **B.2.3.1. Directors' FY15 Representations**

105 By making the declaration pleaded above at paragraph 103, Mr Abboud and Mr Potts represented to investors and potential investors in DSH that each was of the opinion that the FY15 Financial Statements were in accordance with the CA, including as to compliance with accounting standards, and gave a true and fair view of the financial position and performance of DSH and the DSH Group (the **Directors' FY15 Express Representation**).

106 Further, by making each of the representations pleaded above at paragraph 105, Mr Abboud and Mr Potts represented to investors and potential investors in DSH that the opinion held by each of them was:

- (a) held on a reasonable basis and was the product of the application of reasonable care and skill by each relevant director;
- (b) a matter to which each relevant director had turned his mind, having informed himself as to the financial affairs of the company to the extent necessary to form an opinion as to the truth and fairness of the accounts;
- (c) formed after each relevant director had read and understood the financial statements and considered whether the financial statements were consistent with his own knowledge of DSH and DSH Group's financial position and financial performance; and
- (d) formed after each relevant director had taken a diligent and intelligent interest in the information available to him or which he might with fairness have demanded from the executives or other employees and agents of DSH and the DSH Group,

(each and together, the **Directors' FY15 Implied Representation**).

## Particulars

*The Directors' FY15 Implied Representation was implied by reasons of:*

- *the declaration pleaded at paragraph 103 and 104;*

- *the representation pleaded at paragraph 105;*
- *the terms of the FY15 Financial Statements;*
- *the obligations imposed on companies and company directors in relation to the preparation of financial reports under chapter 2M of the CA and as interpreted by the courts.*

### **B.2.3.2. DSH's FY15 Representations**

107 By making the statements pleaded above at paragraphs 102 and 103, DSH represented to investors and potential investors in DSH that:

- (a) the consolidated financial statements of DSH for the financial year ended 28 June 2015 had been prepared in accordance with the CA, accounting standards and interpretations, and complied with other requirements of the law; and
- (b) Mr Abboud and Mr Potts were of the opinion that the FY15 Financial Statements were in accordance with the CA, including as to compliance with accounting standards, and gave a true and fair view of the financial position and performance of DSH and the DSH Group, (each and together, **DSH's FY15 Express Representation**).

108 Further, by making the representations pleaded above at paragraph 107, DSH represented to investors and potential investors in DSH that each of the directors' opinions pleaded in the preceding paragraph were opinions:

- (a) held on a reasonable basis and the product of the application of reasonable care and skill by each of the relevant directors;
- (b) which each of the relevant directors had turned his mind to, having informed himself as to the financial affairs of the company to the extent necessary to form an opinion as to the truth and fairness of the accounts;
- (c) formed after each of the relevant directors had read and understood the financial statements and considered whether the financial statements were consistent with his own knowledge of DSH and DSH Group's financial position and financial performance; and
- (d) formed after each of the relevant directors had taken a diligent and intelligent interest in the information available to him or which he might with fairness have demanded from the executives or other employees and agents of DSH and the DSH Group,

(each and together, DSH's FY15 Implied Representation).

#### Particulars

*DSH's FY15 Implied Representation was implied by reasons of:*

- *the declaration pleaded at paragraph 103 and 104;*
- *the representation pleaded at paragraph 107;*
- *the terms of the FY15 Financial Statements; and*
- *the obligations imposed on companies and company directors in relation to the preparation of financial reports under chapter 2M of the CA and as interpreted by the courts.*

#### **B.2.4. FY15 ASX Announcement & Results Briefing**

109 On or about 18 August 2015, DSH, Mr Abboud and Mr Potts, caused to be released to the ASX a document dated 18 August 2015 entitled *ASX Announcement FY2015 NPAT of \$43.4m reflects solid 2H 2015 performance* and a document dated 18 August 2015 entitled *Dick Smith FY2015 Results Briefing Nick Abboud Managing Director and CEO, Michael Potts Finance Director and CFO* (together, the **FY15 ASX Announcement & Results Briefing**).

110 The FY15 ASX Announcement & Results Briefing made various positive statements about the financial position and performance of DSH.

#### Particulars

*Statements by DSH:*

- **"Growth Strategy delivered solid underlying performance and a strong result in Australia".**
- **"EBITDA up 7.3% (FY2015: \$79.8 million v FY2014 \$74.4 million).**
- **"NPAT \$43.4 million, up 3.1% (FY2014: \$42.1 million)".**
- **"Gross margin for the year was 24.8% of sales".**
- *DSH "continues to drive cost efficiencies, with Cost of Doing Business (CODB) decreasing 32bp to 18.7% of sales in 2015."*

- DSH “employed a disciplined approach to promotional activity.”
- DSH’s “balance sheet remains strong.”

*Statements by Mr Abboud:*

- “We are pleased to have delivered another solid underlying profit performance in this our second year as a list company. Second half NPAT increased 6.3% reflecting improved leverage, with Earnings before Interest, Tax, Depreciations and Amortisation (EBITDA) up 7.4%.”
- “We are pleased with the Australian sales performance, which was achieved in the face of an increasingly competitive environment that saw more promotional activity than the prior year. This reaffirms that the Dick Smith’s Growth Strategy is working and reinforced our ongoing commitment to providing value and convenience to our customers.”

*Statements by Mr Potts and Mr Abboud:*

- “Financial highlights – Growth Strategy delivering.”
- “Gross profit up 6.1% & gross margin 24.8%”.
- “EBITDA up 7.3% to \$78.9m on CODB down 32bp to 18.7%”.
- “NPAT \$43.4m, up 3.1%”.
- “Growth strategy momentum accelerates and delivers results.”
- “Profit and Loss – strong 2H 2015 performance.”
- “2015 Sales Performance – driving profitable growth.”
- “CODB – benefits gained, more to be realised.”
- “Balance sheet – Positioning for sustainable growth.”
- “Clean inventory, with increase reflecting timing of buying”.
- “Higher inventory reflects conscious decision to benefit from advantageous trading terms and favourable exchange rate.”

- *"Increase in sundry receivables on improved supplier terms."*
- *"FY2016 Outlook – sustainable growth."*

## **C. REQUIRED ACCOUNTING ADJUSTMENTS**

### **C.1. DSH'S ACCOUNTING OBLIGATIONS**

111 At all material times, DSH was required by ss 286, 292 and 296 of the CA to prepare financial reports for a financial year in compliance with the accounting standards (as defined in s 9 of the CA), including:

- (a) Australian Accounting Standard *AASB 3 Business Combinations* (**AASB 3**);
- (b) Australian Accounting Standard *AASB 101 Presentation of Financial Statements* (**AASB 101**);
- (c) Australian Accounting Standard *AASB 102 Inventories* (**AASB 102**);
- (d) Australian Accounting Standard *AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors* (**AASB 108**);
- (e) Australian Accounting Standard *AASB 112 Income Taxes* (**AASB 112**);
- (f) Australian Accounting Standard *AASB 116 Property, Plant and Equipment* (**AASB 116**);
- (g) Australian Accounting Standard *AASB 118 Revenue* (**AASB 118**);
- (h) Australian Accounting Standard *AASB 132 Financial Instruments* (**AASB 132**);
- (i) Australian Accounting Standard *AASB 136 Impairment of Assets* (**AASB 136**);
- (j) Australian Accounting Standard *AASB 139 Financial Instruments: Recognition and Measurement* (**AASB 139**); and
- (k) Australian Accounting Standard *AASB 1031 Materiality* (**AASB 1031**).

112 Further, at all material times, DSH was required by ss 297 and 305 of the CA to prepare financial statements and notes for each financial year which gave a true and fair view of the financial position and performance of DSH (and, if consolidated financial statements were required for the DSH Group, a true and fair view of the financial position and performance of the DSH Group). In order to comply with that requirement DSH was required to prepare financial reports which complied with the Australian Accounting Standards Board pronouncement *Framework for the preparation and Presentation of Financial Statements* (**AASB Framework**).

113 In complying with the accounting standards, DSH was required to act in accordance with those standards as they existed from time to time, including but not limited to the accounting standards set out in paragraphs 114 to 134 below.

**C.1.1. AASB 101**

114 In complying with AASB 101, DSH was required to prepare financial statements which presented fairly the financial position, financial performance and cash flows of DSH (and if consolidated financial statements were required for the DSH Group, then of the DSH Group).

**Particulars**

*AASB 101, paragraph 15.*

115 In preparing the financial statements as described in the preceding paragraph, DSH was required to faithfully represent the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income, and expenses set out in the AASB Framework.

**Particulars**

*AASB 101, paragraph 15.*

116 In preparing the financial statements as described in the preceding two paragraphs, DSH was required to:

- (a) recognise assets only when it was probable that future economic benefits would flow to it which could be measured reliably; and

**Particulars**

*AASB 101, paragraph 15.*

*AASB Framework, paragraph 89.*

- (b) select and present financial information neutrally — meaning that financial information was not slanted, weighted, emphasised, de-emphasised, or otherwise manipulated to increase the probability it would be received favourably or unfavourably by users of that information.



**Particulars**

*AASB 101, paragraph 15.*

*AASB Framework Appendix, Chapter 3, QC12 and QC14-15.*

117 Also in complying with AASB 101, DSH was required:

- (a) to disclose in a summary of significant accounting policies the measurement basis (or bases) used in preparing its financial statements, and the other accounting policies used that were relevant to an understanding of the financial statements; and

**Particulars**

*AASB 101, paragraph 117.*

- (b) to disclose, in a summary of significant accounting policies or other notes, the judgements (apart from those involving estimations for uncertainty within the meaning of AASB 101 paragraph 125) that management made in the process of applying DSH's accounting policies and that had the most significant effect on the amounts recognised in the financial statements.

**Particulars**

*AASB 101, paragraph 122.*

118 Also in complying with AASB 101, DSH was required when preparing its financial statements to:

- (a) make an assessment of DSH's ability to continue as a going concern; and
- (b) when management was aware of material uncertainties related to events or conditions that might cast significant doubt upon DSH's ability to continue as a going concern, to disclose those uncertainties.

**Particulars**

*AASB 101, paragraph 25.*

### **C.1.2. AASB 102**

119 In complying with AASB 102, DSH was required to determine the costs of purchase of inventories by, among other things:

- (a) adding the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services;
- (b) deducting trade discounts, rebates and other similar items in determining the costs of purchase;
- (c) excluding storage costs (unless they were necessary in the production process before a further production stage) and instead recognising those costs as an expense; and
- (d) excluding administrative overheads that did not contribute to bringing inventories to their present location and condition, and instead recognising those overheads as an expense.

#### **Particulars**

*AASB 102, paragraphs 11, 15 and 16.*

120 Also in complying with AASB 102, DSH was required to recognise the carrying amount of inventories as an expense in the period in which revenue from the sale of that inventory was recognised - thereby matching the expense or any saving of expense relating to inventory to the period in which that inventory was sold and revenue for the sale was recognised.

#### **Particulars**

*AASB 102, paragraph 34.*

121 Also in complying with AASB 102, DSH was required when measuring the cost of inventories:

- (a) to only take into consideration rebates that DSH was entitled to receive as a reduction in the purchase price of inventories, and not deduct from the cost of inventories rebates that specifically and genuinely refund selling expenses;
- (b) to only deduct rebates in excess of selling expenses from the cost of inventories if the rebate represented the reimbursement of a specific, incremental, and identifiable cost incurred by DSH in selling a supplier's products; and

- (c) where there was a binding agreement that required a supplier to pay a rebate provided DSH completed a specific cumulative level of purchases or remain a customer for a specified period of time:
- (i) to recognise the rebate as a reduction of the cost of purchases provided the rebate was probable and reliably measurable; and
  - (ii) to measure the rebate based on the amount expected to be received in relation to the underlying transactions that had occurred during the reporting period and that resulted in progress by DSH toward achieving the specified requirements for receiving the rebate.

#### **Particulars**

*AASB 102, paragraph 11.*

*Australian Accounting Standards Board "Rejected Issue – Removed from the UIG Agenda, Inventory Rebates and Settlement Discounts (September 2005)".*

- 122 Also in complying with AASB 102, DSH was required to record its inventory at the lower of cost and 'net realisable value' (defined as being the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale).

#### **Particulars**

*AASB 102, paragraphs 6 and 9.*

- 123 Also in complying with AASB 102, DSH was required to:

- (a) that a write down of inventory value should be recognised as an expense against gross profit in the statement of profit or loss; and
- (b) that DSH's financial statements disclose the carrying amount of inventories carried at fair value less costs to sell.

#### **Particulars**

*AASB 102, paragraphs 34 and 36(c).*

### C.1.3. AASB 108

124 In complying with AASB 108, DSH was required — in the absence of an Australian Accounting Standard that specifically applied to a transaction, other event, or condition — to use management's judgement in developing and applying an accounting policy that resulted in financial statements that:

- (a) represented faithfully the financial position, financial performance, and cash flows of DSH (and if consolidated financial statements were required for the DSH Group, then of the DSH Group);
- (b) reflected the economic substance of the transaction, other event, or condition, and not merely the legal form;
- (c) were neutral, that is, free from bias;
- (d) were prudent; and
- (e) were complete in all material respects.

#### Particulars

*AASB 108, paragraph 10.*

125 In making the judgement described in the preceding paragraph, DSH and DSH's management were required to refer to and consider the applicability of:

- (a) first, the requirements in Australian Accounting Standards dealing with similar and related issues; and
- (b) second, the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the AASB Framework.

#### Particulars

*AASB 108, paragraph 11.*

126 In making the judgement described in the preceding two paragraphs, DSH and DSH's management were required to refer to and consider the requirement to select and present financial information neutrally—meaning that financial information was not slanted, weighted, emphasised, de-emphasised, or otherwise manipulated to increase the probability it would be received favourably or unfavourably by users of that information.

**Particulars**

*AASB 108, paragraph 11.*

**C.1.4. AASB 132 and AASB 139**

127 AASB 132 defined a financial asset as, inter alia, a contractual right to receive cash or another financial asset from another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity.

**Particulars**

*AASB 132, paragraph 11.*

128 AASB 132 defined a contractual right as, inter alia, an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid.

**Particulars**

*AASB 132, paragraph 13.*

129 In complying with AASB 139, DSH was required to assess at the end of each reporting period whether there was objective evidence that a financial asset was impaired.

**Particulars**

*AASB 139, paragraph 58.*

130 Also in complying with AASB 139, where there was objective evidence that an impairment loss on a receivable had been incurred, DSH was required to:

- (a) assess the loss as the difference between the carrying amount and the present value of estimated future cashflows; and
- (b) recognise the loss in the profit and loss.

**Particulars**

*AASB 139, paragraph 63.*

### **C.1.5. AASB Framework**

- 131 In complying with the AASB Framework, DSH was required to define an asset as a resource controlled by DSH as a result of past events and from which future economic benefits are expected to flow to DSH.

#### **Particulars**

*AASB Framework, paragraph 49(a).*

- 132 In complying with the AASB Framework, DSH was required to recognise an item (including an asset, liability or income) when:
- (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and
  - (b) the item has a cost or value that can be measured with reliability.

#### **Particulars**

*AASB Framework, paragraphs 82-91.*

- 133 In complying with the AASB Framework, DSH was required in assessing whether an item meets the definition of an asset, liability or equity, to give attention to underlying substance and economic reality and not merely its legal form.

#### **Particulars**

*AASB Framework, paragraph 51.*

- 134 In complying with the AASB Framework, DSH was required to present in its financial statements information which was relevant to users of those statements and which would:
- (a) enable users of the financial statements to make decisions regarding providing resources to DSH; and
  - (b) enable users of the financial statements to assess DSH's future net cash inflows; and
  - (c) assist users of the financial statements to estimate the value of DSH.

#### **Particulars**

*AASB Framework, paragraph 71 and Chapter 1 paragraphs OB2, OB3, OB4 and OB7.*

## C.2. INVENTORY

135 At all material times DSSH and, from at least Acquisition, DSH recorded inventories by classifying individual stock keeping units (**SKUs**) as:

- (a) 'Active';
- (b) 'End of Life' (from June 2014);
- (c) 'Quit';
- (d) 'No re-order'; and
- (e) 'Discontinued'.

### Particulars

*Dick Smith Buyers Manual, Section 4.8.*

*Deloitte Memo 5411a dated 18 September 2013 [DEL.002.1629]*

*Deloitte Memo 'Inventory obsolescence memo' dated 26 July 2014.*

*The plaintiffs rely on the particulars set out in the Expert Report of Wayne Basford dated 1 December 2017 at paragraph 128.*

*First Potter Report at paragraph 8.45.*

136 From FY14, DSH also recorded inventories with a further category known as "Non PLU".

### Particulars

*First Potter Report at paragraph 8.35.*

137 DSSH and DSH made provisions for inventory as follows:

- (a) during FY13 and FY14, DSH applied fixed percentages in relation to each category, without reference to the quality of individual stock items beyond the status they had been assigned;

### Particulars

*First Potter Report at paragraph 8.35.*

- (b) from FY15, DSH performed a detailed line by line calculation for each individual SKU which purported to take into account:
  - (i) the months' cover of SKUs in the Active and End of Life categories; and
  - (ii) the age of SKUs in the Discontinued, No re-order and Quit categories.

**Particulars**

*First Potter Report at paragraph 8.35-8.63.*

- 138 On or about 25 September 2015, DSH engaged consultants to investigate stock levels and undertake a review of inventory within DSH.

**Particulars**

*As against the first defendant the plaintiffs rely on the admissions at paragraph 69 of the Third Amended Commercial List Statement filed by DHS in proceeding 2017/81927 (Company's 3ACLS).*

*Affidavit of Michael Antony Holtzer sworn 11 November 2017.*

- 139 The consultants reported their findings to DSH on or about 27 October 2015 in a written report. The report concluded, inter alia, as follows:

- (a) DSH was carrying too much stock;
- (b) the stock mix was poor (i.e. there was too much poor or obsolete stock);
- (c) the stock mix had got progressively worse during 2015;
- (d) lower levels of remaining good stock were having to work harder to support sales; and
- (e) even amongst the good stock there was a lot of excess and slow moving inventory.

**Particulars**

*As against the first defendant the plaintiffs rely on the admissions made at paragraph 73 of the Company's 3ACLS.*

*Affidavit of Michael Antony Holtzer sworn 11 November 2017.*

*"Dick Smith Holdings Inventory Paper" prepared in October 2015.*



140 The consultants identified approximately \$190 million of problem stock.

**Particulars**

*"Dick Smith Holdings Inventory Paper", pages 3, 7, 8, 11 and 12.*

*Emails between Michael Holtzer and Mr Potts dated 26 November 2015 and attachment, "Dick Smith analysis.docx".*

*Affidavit of Michael Antony Holtzer sworn 11 November 2017, paragraph 76.*

141 The report advised that the consultants believed that the stock could be sold for approximately \$120 million, resulting in a potential impairment of approximately \$60 million.

**Particulars**

*Dick Smith Holdings Inventory Paper APO.002.001.0088 at page APO.002.001.0099.*

142 On 30 November 2015, DSH announced to the ASX that the Board had determined that "stock holdings remain above management's preferred levels" and a "non-cash impairment of \$60 million (pre-tax) is required."

**Particulars**

*ASX Announcement dated 30 November 2015.*

*Further, as against the first defendant the plaintiffs rely on the admissions at paragraph 84 of the Company's 3ACLS.*

143 Levels of poor quality, obsolete and inactive stock had significantly accumulated prior to the retainer of the consultants pleaded in paragraph 138 above.

**Particulars**

*Affidavit of Michael Anthony Holtzer sworn 11 November 2017 at paragraphs 38-39, 45-47, 49, 50, 52-53, 55, 59-60, 63-64, 66, 71 and 75-76.*

*Affidavit of Andrew John Powell affirmed 13 November 2017 at paragraphs 15-20, 26, 33, 36-45, 49-50, 52-53, 55, 60, 62-64, 67-70, 74 and 77-80.*

*Expert Report of Holly Felder Etlin dated 1 December 2017 at paragraphs 9 and 100-108 and exhibits 4-5 and 7-10.*

- 144 At all material times, when recording and making provisions for inventory, DSSH and DSH:
- (a) did not consider or adequately consider whether inventory was saleable in the future at a value at or above cost;
  - (b) did not consider or adequately consider whether it held excess inventory which was unlikely to be realised at or above its cost;
  - (c) did not analyse or adequately analyse or otherwise consider the number of weeks cover (or months cover, as the case was) it held for each SKU, and did not make an assessment or an adequate assessment of whether that amount of stock was likely to be saleable at or above its cost, given the nature of the product and the months' cover;
  - (d) did not calculate net realisable value when provisioning Active or End of Life inventory because it applied a lookback method, rather than considering the likely realisable value based on future sales;
  - (e) did not take into account or adequately take into account future price reductions required to dispose of excess inventory categorised as Active or End of Life;
  - (f) did not maintain an inventory system which enabled it to produce a report which accurately stated the age of inventory for each SKU or the number of weeks' or months' cover for each SKU;
  - (g) recorded ageing of inventory based on the last date each SKU was purchased, with all items in that SKU being recorded as being aged from that date; and
  - (h) did not consider or adequately take into account whether SKUs were appropriately categorised.

#### **Particulars**

*First Potter Report, paragraphs 8.6-8.13, 8.22, 8.27-8.30, 8.46-8.47, 8.54, 8.57-8.60 and 8.81.*

*Further, and with respect to (a) to (e) and FY15, the plaintiffs also rely on the particulars set out in the Expert Report of Wayne Basford dated 1 December 2017 at paragraphs 15-26 and 130-157.*

*Further, and with respect to (f) and (g), see Deloitte, Project Yellow Review at page 48.*

Further, and with respect to (h), see Mills Affidavit dated 30 November 2017 at paragraphs 229-230.

145 By recording and making provisions for inventory as pleaded above, the provisioning for inventory did not comply with AASB 102 because it did not:

- (a) take into consideration whether inventory was saleable in the future at or above its cost;
- (b) take into consideration the impact of holding levels of excess inventory; and
- (c) record inventory at the lower of the inventory cost or its net realisable value.

146 DSSH and DSH failed to provide for inventory and thereby overstated the carrying value of inventory in at least the following amounts in the following financial periods:

Period	Underprovision (cumulative)
FY13	\$22.9 million
1Q14	\$28.5 million
FY14	\$30.0 million
FY15	\$36.3 million

**Particulars**

*First Potter Report at Chapter 8, especially at paragraph 8.96.*

147 In overstating the carrying value of 'Inventories' as pleaded above, and/or understating the provision against 'Inventories', the financial statements reported by DSSH and DSH in respect of FY13, 1Q14, FY14 and FY15:

- (a) overstated the total equity and net assets of DSH;
- (b) facilitated DSH reporting a higher value of 'Inventories' and consequently higher total equity in the consolidated statement of financial position than DSH would have reported had it complied with AASB 102;
- (c) did not present fairly DSH's and the DSH Group's financial performance;
- (d) did not represent faithfully the effect of its inventory levels according to the definitions set out in the AASB Framework because the selection and presentation of the financial information relating to the inventory was not neutral in the sense required by the AASB Framework; and

(e) was not prepared in accordance with Australian Accounting Standards.

148 In failing to write down the carrying value of 'Inventories' as an expense against gross profit (as referred to in paragraph 123 above), the financial statements reported by DSSH and DSH in respect of FY13, 1Q14, FY14 and FY15:

(a) overstated the reported gross profit, EBITDA and net profit reported in the consolidated statement of profit or loss;

(b) reported gross profit, EBITDA and net profit of an amount higher than it should have reported had it complied with AASB 102;

(c) did not present fairly DSH's and the DSH Group's financial performance;

(d) did not disclose the carrying amount of inventories carried at fair value less costs to sell;

(e) did not faithfully represent the effect of its carrying value of inventory levels according to the definitions set out in the AASB Framework because the selection and presentation of the financial information relating to the carrying value of the inventory was not neutral in the sense required by the AASB Framework; and

(f) were not prepared in accordance with Australian Accounting Standards.

149 By reason of the matters pleaded in paragraphs 135 to 148 above, the Pro Forma Historical Information in relation to FY13 and 1Q14 did not comply with Australian Accounting Standards and did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

150 By reason of the matters pleaded in paragraphs 135 to 148 above, the FY14 Financial Statements did not comply with Australian Accounting Standards and did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

151 By reason of the matters pleaded in paragraphs 135 to 148 above, the FY15 Financial Statements did not comply with Australian Accounting Standards and did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

### C.3. REBATES

#### C.3.1. The Rebate Maximization Practice and Its Consequences

152 From about May 2014, DSH embarked upon a policy or practice of maximising its ability to record rebates of a kind which, under the accounting classification and methodology adopted by DSH, facilitated the reporting of increased profit and gross profit margin by recording, in the current period profit and loss account:

- (a) a reduction of marketing and promotions expense; and/or
- (b) a lowering the cost of goods sold,

whether or not the inventory to which the rebates related had been sold in that period (the **Rebate Maximisation Practice**).

#### Particulars

*Affidavit of Christopher David Borg sworn 4 December 2017 at paragraphs 34-38, 47, 61-63 and 89-96.*

*Affidavit of Carl John Bonham affirmed 8 March 2018 at paragraphs 10-17.*

*Affidavit of Michael Antony Holtzer sworn 11 November 2017 at paragraph 24.*

*Section 439A Report at page 48.*

*As against the first defendant the plaintiffs rely on the admissions made at paragraphs 30 and 38 of the Company's 3ACLS.*

*Finace and Audit Committee (FAC) Minutes and papers from meeting on 12 August 2014.*

*Evidence of Mr Abboud: transcript dated 6 October 2016 at pages 493-500.*

*Evidence of Ms Lorna Raine (Ms Raine): transcript dated 5 September 2016 at page 39.*

*Evidence of Mr William Paul Renton Wavish (Mr Wavish): transcript dated 6 September 2016 at page 126.*

153 The Rebate Maximisation Practice manifested itself through the following conduct by DSH management in relation to buying practices and rebates:

- (a) the purchase of some products by DSH from some suppliers, or the establishment of a system of buying some products from some suppliers, who offered greater rebates on those products in circumstances where those products were either in excess of DSH's requirements or customer demand, or contrary to prudent inventory management practice, and were (or due to the accumulation of such inventory would become) more difficult to sell without discounting;
- (b) requests by DSH to suppliers to issue or to re-issue invoices whereby, instead of the invoice quoting the price otherwise applicable in respect of the inventory purchased, the invoice inflated the price of the inventory by an amount equal to the rebate requested and also allowed a rebate or subsidy, such that the net cash amount payable after the allowance for rebates or subsidies remained the same;
- (c) requests by DSH to suppliers that those invoices which included an allowance for rebates or subsidies were to describe them, either within the invoice or separately, as relating to advertising, marketing or promotional subsidies, rebates or allowances; and
- (d) DSH purchasing some stock based on decisions which focused upon and prioritised the maximisation of rebates, rather than catering for current or likely future customer demand and rather than focusing upon whether the stock so purchased would be saleable at an appropriate margin within an appropriate time.

#### **Particulars**

*The plaintiffs rely on the particulars set out in the Expert Report of Holly Felder Etlin dated 1 December 2017 at paragraphs 100-108.*

*First Potter Report at paragraphs 7.105-7.143 and 8.1-8.31.*

*Affidavit of Christopher David Borg sworn 4 December 2017 at paragraphs 34-38, 47, 61-63, 80 and 89-96.*

*Affidavit of Carl John Bonham affirmed 8 March 2018 at paragraphs 10-20 and 28-30.*

*Affidavit of Michael Antony Holtzer sworn 11 November 2017 at paragraphs 10-12 and 24.*

*Section 439A Report at page 48.*

*As against the first defendant the plaintiffs rely on the admissions made at paragraphs 30-36 of the Company's 3ACLS.*

*FAC Minutes and papers from meetings on 12 August 2014 and 24 November 2015.*

*Evidence of Mr Abboud: transcript dated 6 October 2016 pages 493-500.*

*Evidence of Ms Raine: transcript dated 5 September 2016 at pages 39-40.*

*Evidence of Mr Wavish: transcript dated 6 September 2016 at page 126.*

154 The Rebate Maximisation Practice:

- (a) from about June 2014, provided an additional means by which DSH was able to record profit in FY14 that DSH would not otherwise have been able to record as earned in FY14;
- (b) provided an additional source of profit in FY15 that DSH would not otherwise have been able to record as earned in FY15;
- (c) contributed to DSH buying some stock during FY15 and FY16 which was purchased without sufficient regard to customer demand and inventory months' cover;
- (d) contributed in FY15 to an increase in the carrying value of inventory and to an increase in accumulating aged and lower-demand stock; and
- (e) inflated DSH's recorded profit without adequate regard to the potential effect of the purchases on existing or future levels of provision required against inventory,

(the **Rebate Maximisation Consequences**).

**Particulars**

*The plaintiffs rely on the particulars set out in the Expert Report of Holly Felder Etlin dated 1 December 2017 at paragraphs 100-108 and Exhibits 4-5 and 7-10.*

*First Potter Report at chapter 7 and especially paragraphs 7.6-7.14, 7.109-7.129 7.195-7.196, 7.199-7.200, 7.202.2 and 8.1-8.31, and at Appendix 33.*

*Affidavit of Christopher David Borg sworn 4 December 2017 at paragraphs 34-38, 47, 61-63, 80 and 89-96.*

*Affidavit of Carl John Bonham affirmed 8 March 2018 at paragraphs 10-17.*

*Affidavit of Michael Antony Holtzer sworn 11 November 2017 at paragraphs 10-12, 52 and 66.*

*Affidavit of Andrew John Powell affirmed 13 November 2017 at paragraphs 36-39, 44-46, 49, 60, 62 and 68.*

*Section 439A Report at page 48.*

*As against the first defendant the plaintiffs rely on the admissions made at paragraph 35-36 of the Company's 3ACLS.*

*FAC Minutes and papers from meetings on 12 August 2014 and 24 November 2015.*

*Evidence of Mr Abboud: transcript dated 4 October 2016 at pages 493-500.*

*Evidence of Ms Raine: transcript dated 5 September 2016 at page 39.*

*Evidence of Mr Wavish: transcript dated 6 September 2016 at page 126.*

### **C.3.2. Accounting Treatment of Switched Invoice Rebates**

155 During the 2015 financial year, DSH requested suppliers to issue or to re-issue invoices whereby, instead of the invoice quoting the price otherwise applicable in respect of the inventory purchased, the invoice inflated the price of the inventory by an amount equal to the rebate requested and also allowed a rebate or subsidy, such that the net cash amount payable after the allowance for rebates or subsidies remained the same (**Switched Invoice Rebates**).

#### **Particulars**

*As against the first defendant, the plaintiffs rely on the admissions made at paragraph 37 of the Company's 3ACLS.*

*First Potter Report at paragraphs 7.105-7.129 and Appendix 16.*

156 In the FY15 Financial Statements, DSH recorded the Switched Invoice Rebates received during the relevant accounting period for those statements as either:

- (a) reductions in 'Marketing and sales costs' in the FY15 Financial Statements; and/or
- (b) reductions in 'Cost of Sales'.

#### **Particulars**

*In respect of the FY15 Financial Statements, and as against the first defendant the plaintiffs rely on the admissions made at paragraphs 38-39 of the Company's 3ACLS.*



*First Potter Report at paragraphs 7.105, 7.111 and 7.209.*

157 Further, DSH recorded some Switched Invoice Rebates in the FY15 Financial Statements as:

- (a) reductions in 'Marketing Costs' immediately upon being negotiated with suppliers, notwithstanding that DSH did not incur marketing and sales promotion costs in connection with the goods the subject of the rebate in the period covered by that financial statement; and/or
- (b) reductions in 'Cost of Sales' immediately upon being negotiated with suppliers, notwithstanding that DSH did not sell the goods the subject of the rebate in the period covered by that financial statement.

#### **Particulars**

*In respect of the FY15 Financial Statements and as against the first defendant the plaintiffs rely on the admissions made at paragraph 38-39 of the Company's 3ACLS.*

*First Potter Report at paragraphs 7.105-7.143.*

158 The recording of the Switched Invoice Rebates in this way:

- (a) had the effect of reducing the 'Marketing Costs' and 'Cost of Sales' reported in the statements of profit or loss – thereby also increasing the reported EBITDA and net profit;
- (b) had the effect of creating a risk that the value of 'Inventories' reported in the statements of financial position might be inflated and not saleable at or above 'cost', thus overstating the total equity of DSH;
- (c) occurred in circumstances where the purported economic benefits of the Switched Invoice Rebates were illusory because no rebate actually existed; and
- (d) did not record or reflect the economic substance of the transaction.

#### **Particulars**

*In respect of the period after at least July 2014, and as against the first defendant, the plaintiffs rely on the admissions made at paragraph 40 of the Company's 3ACLS.*

*First Potter Report at paragraphs 7.105-7.143.*

159 The accounting treatment of the Switched Invoice Rebates pleaded above did not comply with AASB 101 because:

- (a) it did not present fairly DSH and the DSH Group's financial performance;
- (b) it did not represent faithfully the effect of the Switched Invoice Rebates according to the definitions set out in the AASB Framework because the selection and presentation of the financial information relating to those rebates was not neutral in the sense required by the AASB Framework and/or did not reflect the economic substance of the transaction nor was it a genuine reporting of the transaction; and/or
- (c) there was no disclosure in the FY15 Financial Statements of the matters pleaded above in paragraphs 155 to 158 — such matters being significant accounting policies relevant to understanding the financial statements.

160 The accounting treatment of the Switched Invoice Rebates pleaded above also did not comply with AASB 102 because, and insofar as, reductions in 'Cost of Sales' for inventory:

- (a) were not matched to the period in which that inventory was sold;
- (b) were not genuinely attributable to such costs; and/or
- (c) were not recorded as a reduction in the purchase price of inventories.

161 The accounting treatment of the Switched Invoice Rebates pleaded above also did not comply with AASB 108 because, insofar as an Australian Accounting Standard did not specifically apply to the Switched Invoice Rebates, an accounting policy was not developed and applied which resulted in financial statements that:

- (a) reflected the economic substance of the Switched Invoice Rebates and not merely their legal form; and
- (b) were:
  - (i) neutral;
  - (ii) prudent; and
  - (iii) complete in all material respects.

162 By reason of the matters pleaded in paragraphs 155 to 161, the FY15 Financial Statements did not comply with Australian Accounting Standards and did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

#### **Particulars**

*In respect of the FY15 Financial Statements, and as against the first defendant, the plaintiffs rely on the admissions made at paragraphs 52 and 67 of the Company's 3ACLS.*

*First Potter Report at paragraph 7.130.*

#### **C.3.3. Accounting treatment of Volume Rebates**

163 From at least May 2014 and continuing throughout 2015, DSH entered into agreements with suppliers to receive discounts and rebates from those suppliers in exchange for agreeing to purchase and sell large volumes of the suppliers' products (**Volume Rebates**).

164 In each of the FY14 Financial Statements and FY15 Financial Statements, DSH incorrectly recorded some of the Volume Rebates agreed during the relevant accounting period as O&A Rebates, such that they were recorded as:

- (a) reductions in 'Marketing Costs' in the FY14 Financial Statements and 'Marketing and sales costs' in the FY15 Financial Statements; and/or
- (b) reductions in 'Cost of Sales',

regardless of whether the inventory to which the rebates related had been sold in that financial period.

#### **Particulars**

*In respect of the period after at least July 2014, and as against the first defendant, the plaintiffs rely on the admissions made at paragraph 38-39 of the Company's 3ACLS.*

*First Potter Report at paragraphs 7.93-7.104.*

165 The recording of the Volume Rebates in this way had the effect of:

- (a) reducing the 'Cost of Sales' reported in the statements of profit or loss – thereby also increasing the reported EBITDA and net profit;

- (b) overstating the value of 'Inventories' reported in the statements of financial position, thus overstating the total equity of DSH;

**Particulars**

*In respect of the FY15 Financial Statements, and as against the first defendant, the plaintiffs rely on the admissions at paragraph 40 of the Company's 3ACLS.*

*First Potter Report at paragraphs 7.102-7.103.*

- (c) profits being reported before the inventory to which the profit related had been sold;
- (d) enabling DSH to inflate its profits for the period by artificially bringing forward profits from future periods.

**Particulars**

*First Potter Report at paragraphs 7.102-7.103.*

166 The accounting treatment of the Volume Rebates pleaded above did not comply with AASB 101 because:

- (a) it did not present fairly DSH's and the DSH Group's financial performance;
- (b) it did not represent faithfully the effect of the Volume Rebates according to the definitions set out in the AASB Framework because the selection and presentation of the financial information relating to those rebates was not neutral in the sense required by the AASB Framework and/or did not reflect the economic substance of the transaction nor was it a genuine reporting of the transaction; and/or
- (c) there was no disclosure in the FY14 Financial Statements and FY15 Financial Statements of the matters pleaded above in paragraphs 163 to 165 — such matters being significant accounting policies relevant to understanding the financial statements.

**Particulars**

*First Potter Report at paragraph 3.5.3 and Chapter 6.*

167 Further, the accounting treatment of the Volume Rebates pleaded above did not comply with AASB 102 because and insofar as:

- (a) it recognised some Volume Rebates as accounts receivable, despite it not being probable or despite it being at least uncertain, that the rebate would be earned, paid, and would flow to DSH so it could be measured reliably;
- (b) reductions in 'Cost of Sales' for inventory were not matched to the period in which that inventory was sold; and
- (c) the Volume Rebates were:
  - (i) recognised when they were not probable and reliably measurable; and/or
  - (ii) not measured based on the amount expected to be received in relation to the underlying transactions that had occurred during the reporting period and that resulted in progress by DSH toward achieving the specified requirements for receiving the rebate.

168 The accounting treatment of Volume Rebates pleaded above also did not comply with AASB 108 because insofar as an Australian Accounting Standard did not specifically apply to the Volume Rebates, an accounting policy was not developed and applied which resulted in financial statements that:

- (a) reflected the economic substance of the Volume Rebates and not merely their legal form; and
- (b) were:
  - (i) neutral;
  - (ii) prudent; and
  - (iii) complete in all material respects.

169 By reason of the matters pleaded in paragraphs 163 to 168, each of the FY14 Financial Statements and FY15 Financial Statements did not comply with Australian Accounting Standards and did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

#### **Particulars**

*First Potter Report at paragraphs 3.39-3.42, 3.53, 3.54, 7.96, 7.101, 7.103 and 7.209.*

*In respect of the FY15 Financial Statements, and as against the first defendant, the plaintiffs further rely on the admissions at paragraphs 52 and 67 of the Company's 3ACLS.*

#### **C.3.4. Accounting treatment of O&A Rebates**

170 From at least May 2014 and continuing throughout 2015, DSH obtained other rebates, ad hoc and individually negotiated, from suppliers and service providers – being neither Switched Invoice Rebates nor Volume Rebates and referred to in this Statement of Claim as 'Over and Above' rebates (**O&A Rebates**).

171 The O&A Rebates consisted of a number of different categories, including:

- (a) rebates from suppliers outside the standard agreements between suppliers and DSH;
- (b) rebates from suppliers of DSH's own brand goods and some other branded goods;
- (c) rebates relating to promotional support of products supplied to DSH for sale; and
- (d) rebates (by way of cash payment or credit) in consideration for the extension of contracts with service providers.

172 In each of the FY14 Financial Statements and FY15 Financial Statements, DSH recorded the O&A Rebates received during the relevant accounting period for those statements as either:

- (a) reductions in 'Marketing Costs'; and/or
- (b) reductions in 'Cost of Sales'.

#### **C.3.5. Transfers from Cost of Doing Business to the Cost of Goods Sold**

173 In FY14, DSH made journal entries which had the effect of transferring income from CODB to the Cost of Goods Sold without proper justification.

##### **Particulars**

*In FY14, DSH made a gross profit transfer of \$22.1m from "Costs of Doing Business" to "Cost of Goods Sold": First Potter Report at paragraphs 7.44-7.68.*

174 In FY15, DSH made journal entries which had the effect of transferring income from CODB to the Cost of Goods Sold without proper justification.

### Particulars

*In FY15, DSH made a gross profit transfer of \$63.5m from "Costs of Doing Business" to "Cost of Goods Sold": First Potter Report at paragraphs 7.44-7.68.*

*As against the first defendant, the plaintiffs rely on the admissions made at paragraph 38-39 of the Company's 3ACLS.*

- 175 The effects of the transfers pleaded in paragraphs 173 and 174 were to overstate DSH's reported gross profit and gross profit margin and to understate DSH's "Cost of Goods Sold" expense.

### Particulars

*First Potter Report at paragraphs 7.44-7.68.*

#### **C.3.6. Recording income prior to the sale of relevant stock or the incurring of the relevant marketing expense**

- 176 Further, DSH recorded some O&A Rebates in each of the FY14 Financial Statements and FY15 Financial Statements as:
- (a) reductions in 'Marketing Costs' immediately upon being negotiated with suppliers, notwithstanding that DSH did not incur marketing and sales promotions costs directly related to the goods the subject of the rebate in the period covered by that financial statement; and/or
  - (b) reductions in 'Cost of Sales' immediately upon being negotiated with suppliers, notwithstanding that DSH did not sell the goods the subject of the rebate in the period covered by that financial statement.

### Particulars

*First Potter Report at paragraphs 7.69-7.92.*

#### **C.3.7. Double counting rebate income and "pulling forward" rebate income**

- 177 Further, in the FY14 Financial Statements, DSH double counted O&A Rebates by:
- (a) "pulling forward" O&A Rebates in the amount of \$4.1 million originally forecast for June 2014 into May 2014, so that the entire amount of the June 2014 rebate was accounted for in May 2014;

- (b) counting the O&A Rebate of \$4.1 million again in June 2014, so that DSH effectively “double counted” the amount of the O&A Rebate in both May and June 2014.

#### **Particulars**

*First Potter Report at paragraphs 7.69-7.92.*

178 Further, DSH incorrectly recorded the amount of \$3.155 million as an O&A Rebate in its FY14 Financial Statements, despite:

- (a) that income in fact being referable to suppliers attending at, or sponsoring a specific event (being the ‘Exchange’ conference held on 29 and 30 July 2014), and not income in the nature of a rebate or a refund of genuine marketing expenses incurred;
- (b) the conference did not take place until late July 2014 (being during FY15, rather than FY14); and
- (c) evidence of certain suppliers indicated that their decision to attend the conference was contingent on DSH providing marketing support during the period subsequent to July 2014 (being during FY15, rather than during FY14).

#### **Particulars**

*Second Potter Report at paragraphs 3.16-3.20.*

179 Further, in FY14, DSH incorrectly recorded rebates for certain Toshiba products at 5% rather than 3%, such that it over recorded rebates in the amount of \$169,611, the effect of which was to incorrectly:

- (a) increase DSH’s reported FY14 NPAT by \$118,727; and
- (b) increase DSH’s reported FY14 net assets by \$118,727.

#### **Particulars**

*Second Potter Report at Chapter 10.*

### **C.3.8. Recording rebates when recovery was not probable**

180 Further, DSH recorded some O&A Rebates as accounts receivable, despite it not being probable that the future economic benefits would flow to DSH or that the receivable had a cost or value that could be measured reliably.



### Particulars

*First Potter Report at paragraphs 7.144-7.194.*

181 The recording of the O&A Rebates in this way had the effect of:

- (a) reducing the 'Marketing Costs' and 'Cost of Sales' reported in the statements of profit or loss – thereby also increasing the reported EBITDA and net profit;
- (b) overstating the value of 'Inventories' reported in the statements of financial position, thus overstating the total equity of DSH;

### Particulars

*In respect of the FY15 Financial Statements, and as against the first defendant, the plaintiffs rely on the admissions made at paragraph 40 of the Company's 3ACLS.*

*First Potter Report at paragraphs 3.47-3.54 and 7.209.*

- (c) profit being recorded before the inventory to which the profit related had been sold; and
- (d) DSH reporting increased profits for the period by incorrectly recognising profits from future periods relating to unsold inventory.

### Particulars

*First Potter Report at paragraphs 3.47-3.54 and 7.209.*

### C.3.9. O&A Rebates and Accounting Standards

182 The accounting treatment of the O&A Rebates pleaded in paragraphs 170 to 181 above did not comply with AASB 101 because:

- (a) it did not present fairly DSH's and the DSH Group's financial performance;
- (b) it recognised some O&A rebates as accounts receivable, despite it not being probable that the rebate would be earned, paid, and would flow to DSH so it could be measured reliably;
- (c) it did not represent faithfully the effect of the O&A Rebates according to the definitions set out in the AASB Framework because the selection and presentation of the financial

information relating to those rebates was not neutral in the sense required by the AASB Framework and/or did not reflect the economic substance of the transaction nor was it a genuine reporting of the transaction; and/or

- (d) there was no disclosure in the FY14 Financial Statements and FY15 Financial Statements of the matters pleaded above in paragraphs 170 to 181 — such matters being significant accounting policies relevant to understanding the financial statements.

#### **Particulars**

*First Potter Report at paragraph 3.53 and Chapter 6.*

*Second Potter Report, Chapter 3,*

183 The accounting treatment of the O&A Rebates pleaded above also did not comply with AASB 102 because and insofar as reductions in 'Cost of Sales' of inventory:

- (a) were not matched to the period in which that inventory was sold;
- (b) were not genuinely attributable to such costs;
- (c) included rebates that purported to refund selling expenses;
- (d) included excess rebates of purported selling expenses that were not the reimbursement of a specific, incremental, and identifiable cost incurred by DSH in selling a supplier's products;
- (e) were recognised when they were not probable and reliably measurable; and/or
- (f) were not measured based on the amount expected to be received in relation to the underlying transactions that had occurred during the reporting period and that resulted in progress by DSH toward achieving the specified requirements for receiving the rebate.

#### **Particulars**

*Section 439A Report at pages 43-44 and 48.*

*First Potter Report at paragraphs 3.28-3.36 and 3.34-3.50 and Chapter 6.*

184 The accounting treatment of the O&A Rebates pleaded above also did not comply with AASB 108 because insofar as an Australian Accounting Standard did not specifically apply to the O&A

Rebates, an accounting policy was not developed and applied which resulted in financial statements that:

- (a) reflected the economic substance of the O&A Rebates and not merely their legal form; and
- (b) were:
  - (i) neutral;
  - (ii) prudent; and
  - (iii) complete in all material respects.

185 The accounting treatment of the O&A rebates pleaded in paragraph 178 above did not comply with AASB 118 because:

- (a) the revenue associated with rendering the service in respect of which the rebate allegedly accrued (the Exchange conference) was not recognised at the stage of completion of the transaction at the end of the reporting period; and
- (b) the revenue from the event should have only been recognised once the event took place (and not beforehand).

### **Particulars**

*Second Potter Report at Chapter 3.*

186 The accounting treatment of the O&A Rebates pleaded in paragraph 180 above did not comply with AASB 132 and AASB 139 because:

- (a) rebate items were recorded in "trade and other receivables" which did not meet the definition of a financial asset, in that:
  - (i) they were not a contractual right to receive cash or a financial asset; and
  - (ii) they were not the subject of an agreement that had clear economic consequences and that the parties had little discretion to avoid;
- (b) an assessment had been undertaken in or about June 2015 as to the recoverability of the O&A Rebates and they were labelled "At risk";

- (c) the O&A Rebates should have been assessed as impaired and a determination made that it was not probable that any future economic benefit of the O&A Rebates would flow to DSH; and
- (d) the value of the O&A Rebates was not written off in the FY15 Financial Statements.

#### **Particulars**

*First Potter Report at paragraphs 7.144-7.181.*

187 By reason of the matters pleaded in the preceding paragraphs 170 to 186, each of the FY14 Financial Statements and FY15 Financial Statements did not comply with Australian Accounting Standards and did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

#### **Particulars**

*In respect of the FY15 Financial Statements, and as against the first defendant, the plaintiffs rely on the admissions made at paragraph 52 and 67 of the Company's 3ACLS.*

*First Potter Report at paragraphs 3.53-3.57 and Chapter 7; Second Potter Report at Chapter 11.*

#### **C.3.10. Lack of system to reliably track and record rebates**

188 Further, from at least the time the Rebate Maximisation Practice developed, DSH did not have a system in place for the reliable planning, tracking, and recording of rebates accrued and received from vendors and suppliers.

#### **Particulars**

*From about or around April 2014, for the purpose of monitoring compliance with O&A rebates targets, regular meetings of Merchandise Managers and Category Buyers were convened by John Skellern (DSH's Director of Commercial, Property, Procurement, and Supply Chain) during which O&A targets and amounts agreed with suppliers were recorded and maintained on a whiteboard in Mr Skellern's office.*

*At those meetings, John Skellern would ask buyers to state a number as the O&A rebate they were obtaining, and if he did not like the number the buyer responded with then he was prone to yell, snort, or swear at the buyer, bang his fist on the table, and ask the buyer to state a number higher than they had originally stated.*

*The whiteboard on which O&A targets and amounts agreed with suppliers were recorded was disturbed by people leaning on it, or by the whiteboard marker slipping, changing the numbers on it.*

*The numbers on the whiteboard in Mr Skellern's office were recorded without Mr Skellern obtaining any form of record or proof that they were accurate, and without any discussion of the terms on which the rebate was agreed to be paid.*

*Mr Skellern told DSH's Financial Controller, Nigel Mills, to stay away from the O&A accrual process.*

*DSH's management's (including Messrs Abboud and Potts) response to discrepancies and gaps that developed between recorded and actual rebates was to seek to reconcile the differences over time by obtaining more rebates in the future.*

*Affidavit of Michael Antony Holtzer sworn 11 November 2017 at paragraphs 7-32.*

*Affidavit of Nigel Rodney Mills sworn 30 November 2017 at paragraphs 118, 119, 130-149, 153, 154, 163-172, 175, 181, 183, 203-207, 217, 275, 298 and 299.*

*Affidavit of Christopher David Borg sworn 4 December 2017 at paragraphs 54-60.*

*Affidavit of Darren John Freeman affirmed 27 November 2017 at paragraphs 34-81.*

*Affidavit of Carl John Bonham affirmed 8 March 2018 at paragraphs 8-20.*

189 The effect of the matters pleaded in the preceding paragraph was that, from at least the time the Rebate Maximisation Practice developed, DSH did not have a system in place which would enable it to reliably determine and record:

- (a) its profits from rebates;
- (b) the economic effect of rebate arrangements on the company's financial position;
- (c) whether a contractual arrangement had been entered into with a supplier with respect to a particular rebate arrangement; and/or
- (d) the contractual terms of a rebate arrangement where a contractual agreement to receive a rebate existed.

190 By reason of the matters pleaded in paragraphs 188 to 189 above, DSH could not comply with AASB 132 and 139 in the preparation of its FY14 Financial Statements and FY15 Financial Statements because it had insufficient reliable information on which to assess and determine:

- (a) whether individual rebate items met the definition of a financial asset, in that:
  - (i) they were a contractual right to receive cash or a financial asset; and
  - (ii) they were the subject of an agreement that had clear economic consequences and that the parties had little discretion to avoid;
- (b) whether it was probable that any future economic benefit from a rebate item would flow to DSH;
- (c) whether, at the end of each reporting period, there was objective evidence that a rebate item was impaired; and
- (d) the value of an impairment loss on any rebate item.

#### **Particulars**

*AASB 132, paragraph 11, 13.*

*AASB 139, paragraph 58, 63.*

191 By reason of the matters pleaded in paragraphs 188 to 189 above, DSH could not comply with AASB 102 in the preparation of its FY14 Financial Statements and FY15 Financial Statements because it had insufficient reliable information on which to assess and determine whether:

- (a) rebate items recognised as a reduction in the 'Cost of Sales' of inventory were matched to the period in which that inventory was sold;
- (b) rebate items recognised as a reduction in the 'Cost of Sales' of inventory excluded rebates that specifically and genuinely refunded selling expenses;
- (c) rebate items recognised as a reduction in the 'Cost of Sales' of inventory were reimbursements of a specific, incremental, and identifiable cost incurred by DSH in selling a supplier's products; and/or
- (d) where there was a binding agreement that required a supplier to pay a rebate provided DSH completed a specific cumulative level of purchases or remained a customer for a specified period of time:

- (i) the rebate income was probable and reliably measurable; and
- (ii) the rebate was measured based on the amount expected to be received in relation to the underlying transactions that had occurred during the reporting period and that resulted in progress by DSH toward achieving the specified requirements for receiving the rebate.

#### **Particulars**

*AASB 102, paragraph 10-11.*

*Australian Accounting Standards Board "Rejected Issue – Removed from the UIG Agenda, Inventory Rebates and Settlement Discounts (September 2005).*

192 By reason of the matters pleaded in paragraphs 188 to 191 above, DSH could not comply with AASB 101 or the AASB Framework in the preparation of its FY14 Financial Statements and FY15 Financial Statements because it had insufficient reliable information on which to assess and determine:

- (a) whether rebate items were recorded in the accounts in a manner which presented fairly DSH's and the DSH Group's financial performance;
- (b) whether rebate items were recognised as accounts receivable only when it was probable that future economic benefits would flow to DSH from the rebate item which could be measured reliably;
- (c) whether rebate items were recognised in a manner which was neutral — meaning that financial information was not slanted, weighted, emphasised, de-emphasised, or otherwise manipulated to increase the probability it would be received favourably or unfavourably by users of that information;
- (d) whether rebate items were recognised in a manner which would enable users of the financial statements to make decisions regarding providing resources to DSH; and
- (e) whether rebates items were recognised in a manner which would enable users of the financial statements to assess DSH's future net cash inflows and assist users of the financial statements to estimate the value of DSH.

#### **Particulars**

*AASB 101, paragraph 15.*

*AASB Framework, paragraph 82-91.*

*AASB Framework Appendix, Chapter 3, QC12 and QC14-15.*

*AASB Framework, paragraph 71 and Chapter 1 paragraphs OB2, OB3, OB4 and OB7.*

#### **C.4. WARRANTY SIGN ON LIABILITY**

193 In March 2013, on or after the Acquisition, DSSH recognised a warranty sign-on liability of approximately \$2.1 million (**Warranty Sign On Liability**).

##### **Particulars**

*Second Potter Report at paragraph 5.5.*

*Deloitte Project Yellow Report at page 52.*

194 During FY13, DSSH wrote back the warranty liability in the amount of approximately \$0.4 million (\$359,195.13) against the Cost of Sales as follows:

(a) \$143,678.93 on 9 April 2013; and

(b) \$215,517.00 on 5 May 2013.

##### **Particulars**

*Second Potter Report at paragraphs 5.3, 5.8 and 5.9.*

195 During FY14, DSH wrote back the warranty liability in the amount of approximately \$0.6 million (\$634,580.64) against the Cost of Sales as follows:

(a) \$622,607.24 on 2 August 2013; and

(b) \$11,973.39 on 16 October 2013.

##### **Particulars**

*Second Potter Report at paragraphs 5.3, 5.13 and 5.14.*

196 During FY14, DSH wrote back the warranty liability in the amounts referred to in the preceding paragraph and a further amount of approximately \$1.1 million (\$1,089,599.24) against the Cost of Sales on 26 June 2014.



### Particulars

*Second Potter Report at paragraphs 5.3, 5.13 to 5.16.*

- 197 The effect of "writing back" these amounts against the Cost of Sales was to increase net profit by the amount of the write back.
- 198 As at March 2013, the Warranty Sign On Liability should not have been recognised or should have been recognised as having a value of \$nil.

### Particulars

*Second Potter Report at paragraphs 5.19 and 5.29.*

- 199 Further, DSSH's and DSH's financial statements were misstated by recording a liability in respect of the warranty liability and, over later periods including FY13 and FY14, writing back that liability.
- 200 Further, by recording and then progressively writing it back against the Cost of Sales, DSH's FY13 and FY14 reported NPAT were greater than would have been the case had the liability not been recorded in the first instance (and the unwinding of the liability not been recorded over the course of FY13 and FY14).
- 201 The approach described in paragraphs 193 and 200 above did not comply with:

- (a) AASB 3;

### Particulars

*The accounting treatment of the Warranty Sign On Liability did not comply with AASB 3 because it recognised the Warranty Sign On Liability as a liability with a (non-zero) value in FY13 and FY14 whereas the fair value of the Warranty Sign On Liability in FY13 and FY14 was \$nil.*

*AASB 3, paragraphs 10, 15 and 18.*

*Deloitte Project Yellow Review at page 52.*

*Second Potter Report at paragraphs 5.18-5.34.*

- (b) AASB 101; or

### Particulars

*The accounting treatment of the Warranty Sign On Liability did not comply with AASB 101 because it did not present fairly DSSH, DSH and the DSH Group's financial position and performance:*

- it recognised the Warranty Sign On Liability as a liability in FY13 and FY14, despite it having already been settled and DSH retaining no residual liability following the Acquisition;*
- it wrote back the liability over FY13 and FY14, with the effect of inflating DSH's reported NPAT in FY13 and FY14, despite the liability having no value; and*
- it did not represent faithfully the Warranty Sign On Liability according to the definitions and recognition criteria set out in the AASB Framework because there could be no "outflow of resources embodying economic benefits" resulting from the settling of the Warranty Sign On Liability.*

*AASB 101, paragraph 15.*

*AASB Framework, paragraph 91.*

*Second Potter Report at paragraphs 5.18-5.34.*

(c) the AASB Framework.

### Particulars

*AASB Framework, paragraph 91.*

## C.5. DOUBTFUL DEBTS PROVISION

202 In FY13, DSSH recognised provisions for "Other Creditors" of approximately \$2.1 million (\$2,129,217), the fair value of which was \$nil.

### Particulars

*Second Potter Report at paragraphs 6.3-6.8 and 6.19-6.26.*

203 In FY14, DSH recognised provisions for "Other Creditors" of approximately \$0.3 million (\$274,102), the fair value of which was \$nil.

### Particulars

*Second Potter Report at paragraphs 6.3-6.8 and 6.19-6.26.*

204 In FY14, DSH wrote off an amount of \$2.4 million in respect of "Other creditors" whilst simultaneously raising a provision for a doubtful debt in the same amount, the effect of which was to replace the original liability with another while resulting in no change to DSH's reported net assets.

### Particulars

*Second Potter Report at paragraphs 6.3, 6.4 and 6.11.*

205 Through a series of journal entries made between about 2 July 2014 and 11 July 2014, relating to FY14, DSH wrote off \$2.2 million of the doubtful debts provision, leaving a balance of about \$0.2 million.

### Particulars

*Second Potter Report at paragraphs 6.5 and 6.12.*

206 The effect of this accounting was that:

- (a) DSSH's liabilities were inflated by \$2.1 million for FY13, as the fair value of this liability should have been \$Nil;
- (b) DSSH's expenses were therefore overstated by \$2.1 million for FY13;
- (c) DSH's liabilities were, initially, inflated by \$0.3 million in FY14, as the fair value of this liability should have been \$Nil;
- (d) DSH's expenses were therefore, initially, overstated by \$0.3 million in FY14; and
- (e) by 'writing back' the amount of \$2.2 million in respect of the provision for doubtful debts for FY14 in respect of debts (or alleged debts) to be written off in FY14, DSH's expenses were understated by \$2.2 million in FY14.

207 By reason of the matters in paragraphs 202 to 206 above, DSH's financial statements were not prepared in accordance with the Australian Accounting Standards, namely:

- (a) AASB 3;

### Particulars

*The accounting treatment of the provisions did not comply with AASB 3 because it recognised the provisions as liabilities with a (non-zero) value in FY13 and FY14 whereas the fair value of the liabilities in FY13 and FY14 was \$nil.*

*AASB 3, paragraphs 16 and 18.*

*Second Potter Report at paragraphs 6.16-6.26.*

(b) AASB 101; and

### Particulars

*The accounting treatment of the provisions pleaded above did not comply with AASB 101 because it did not present fairly DSSH, DSH and the DSH Group's financial position and performance:*

- it recognised the provisions as liabilities in FY13 and FY14, despite their fair value being \$nil;*
- it wrote off the provisions in May 2014, rather than at the time that that adjustment was necessary, namely when the liabilities were first recognised and the provisions first raised;*
- in simultaneously raising a provision for a doubtful debt in the same amount as the provisions written off, it gave the impression that there has been no diminution in DSH's net assets, and no incurring of additional (net) expenses, which did not fairly represent the true position as the liabilities written-off had a fair value of \$nil; and*
- it did not represent faithfully the provisions according to the definitions and recognition criteria set out in the AASB Framework because there could be no "outflow of resources embodying economic benefits" resulting from the settling of the liabilities, which had a fair value of \$nil.*

*AASB 101, paragraph 15.*

*AASB Framework, paragraph 91.*

*Second Potter Report at paragraphs 6.16-6.26.*

- (c) the AASB Framework.

#### Particulars

*AASB Framework, paragraph 91.*

### C.6. DEFERRED EXPENSES

- 208 In the 1Q14 financial accounts presented in the Prospectus, DSH did not include certain expenses of approximately \$1.6 million (before tax) which had been incurred in that period.

#### Particulars

*First Potter Report at Section 9.*

*Further particulars may be provided following discovery, subpoenas and evidence.*

- 209 The effect of this accounting was that:

- (a) DSH's expenses in the 1Q14 period were understated and did not record certain expenses which were incurred during that period; and
- (b) DSH's Net Profit in the 1Q14 period was overstated by approximately \$1.6 million.

- 210 By reason of the matters in paragraphs 208 and 209 above, DSH's financial statements were not prepared in accordance with the Australian Accounting Standards, namely AASB 101.

#### Particulars

*The accounting treatment of the expenses did not comply with AASB 101 because it did not present fairly DSH and the DSH Group's financial position and performance:*

- *it did not record the expenses in the period in which they were incurred (being 1Q14), the effect of which was to inflate DSH's reported profit in 1Q14;*
- *it did not adopt 'accrual accounting', in that the expenses were not recorded as being incurred in the period to which the expenses related; and*
- *it did not represent faithfully the expenses according to the definitions and recognition criteria set out in the AASB Framework in that it did not properly match costs with revenues, which involves the simultaneous or combined*

*recognition of revenues and expenses that result directly and jointly from the same transactions or other events.*

*AASB 101, paragraphs 15 and 27-28.*

*AASB Framework, paragraphs 94-98.*

*First Potter Report at Chapter 9.*

## **C.7. CAPITALISATION OF WAGES**

211 In FY14, DSH recorded wages and salaries as an expense.

212 Also in FY14, DSH capitalised \$2.7 million of wages and salaries (previously recorded as an expense) into property, plant and equipment, comprised as follows:

- (a) \$0.7 million in 1Q14; and
- (b) \$2.7 million over FY14.

### **Particulars**

*Second Potter Report at paragraphs 8.2-8.8.*

213 This capitalisation of wages and salaries was contrary to the Australian Accounting Standards, namely:

- (a) AASB 116;

### **Particulars**

*The accounting treatment of the wages and salaries did not comply with AASB 116 because the wages and salaries were costs in the nature of overheads (relating to Finance, Supply Chain, Online, Executive, IT, Human Resources, and Planning) that should not have been capitalised as they:*

- *were not costs "directly attributable to bringing [an] asset to the location and condition necessary for it to be capable of operating in the manner intended by management"; and*
- *were costs of a type expressly prohibited from being capitalised into property, plant and equipment, being either:*

- *costs of operating a new facility;*
- *costs of introducing a new product or service (including costs of advertising and promotional activities);*
- *costs of conducting business in a new location or with a new class of customer (including costs of staff training); or*
- *administration and other general overhead costs.*

*AASB 116, paragraphs 7, 12, 16, 17, 19 and 20.*

*Second Potter Report at paragraphs 8.10-8.19.*

(b) AASB 101; and

#### **Particulars**

*The accounting treatment of the wages and salaries did not comply with AASB 101 because it did not present fairly DSH and the DSH Group's financial position and performance for the reasons set out in the preceding paragraph.*

*AASB 101, paragraph 15.*

*Second Potter Report at paragraphs 8.10-8.19.*

*In the alternative to paragraph (a) above, if it was appropriate to capitalise the wages and salaries costs (which is denied), the accounting treatment of the wages and salaries did not comply with AASB 101 because:*

- *the costs were not incremental costs that would not be incurred in subsequent years (when the relevant project finished) or costs of the type that would be allocated to a new project that would enable the cost to be capitalised;*
- *no adjustment was made to DSH's pro-forma FY14 NPAT on the basis that the wages and salaries would be incurred in future years;*
- *therefore, it did not present fairly DSH and the DSH Group's financial position and performance; and*

- *as a result, the FY14 Financial Statements did not enable existing and potential investors to assess future net cash flows or to estimate the value of the entity.*

*AASB 101, paragraph 15.*

*AASB Framework, paragraphs 72 and Chapter 1, paragraphs OB2, OB3, OB4 and OB7.*

*Second Potter Report at paragraphs 8.10-8.19.*

- (c) the AASB Framework.

#### **Particulars**

*The AASB Framework, paragraphs 71, OB2-OB4 and OB7.*

#### **C.8. ONEROUS LEASES**

- 214 In FY14, DSH released a provision of \$4.1 million (**Onerous Lease Provision**) described as "release of onerous lease provisions".
- 215 The effect of the release of the Onerous Lease Provision was to improve DSH's reported NPAT in its FY14 reported statutory results.
- 216 However, the release of the Onerous Lease Provision was one-off in nature, and therefore DSH should have:
- reduced its reported pro-forma FY14 NPAT by \$4.1 million relating to the Onerous Lease Provision; and/or
  - disclosed that \$4.1 million of the statutory FY14 NPAT of \$19.8 million (20.7%) and the reported pro-forma FY14 NPAT of \$42.1 million (9.7%) was attributable to a one-off, non-recurring item.

#### **Particulars**

*Second Potter Report at Chapter 7.*

- 217 DSH failed to take the steps in paragraph 216 above.



218 By reason of the matters in paragraphs 214 to 217 to above, DSH's financial statements were not prepared in accordance with the Australian Accounting Standards, namely:

- (a) AASB 101; and

**Particulars**

*The accounting treatment of the Onerous Lease Provision did not comply with AASB 101 because it did not present fairly DSH and the DSH Group's financial position and performance for the reasons set out in the next subparagraph.*

*AASB 101, paragraph 15.*

*Second Potter Report at paragraphs 7.7-7.16.*

- (b) the AASB Framework.

**Particulars**

*The accounting treatment of the Onerous Lease Provision did not comply with the AASB Framework because the FY14 Financial Statements:*

- *did not disclose that the reported results were materially assisted by a one-off, non-recurring item, namely the release of the Onerous Lease Provision; and*
- *as a result, the FY14 Financial Statements did not:*
  - *present information that is relevant to existing and potential investors;*
  - *enable existing and potential investors to make decisions regarding providing resources to the entity (including providing capital);*
  - *enable existing and potential investors to assess future net cash flows; and*
  - *enable existing and potential investors to estimate the value of the entity.*

*AASB Framework, paragraphs 72 and Chapter 1, paragraphs OB2, OB3, OB4 and OB7.*

*Second Potter Report at paragraphs 7.7-7.16.*

### **C.9. DEED OF RELEASE PAYMENT**

219 Pursuant to a deed of release DSH entered into with Star Track, DSH paid Star Track approximately \$1.4 million (\$1.351 million).

#### **Particulars**

*Deloitte report to the FAC for the year ended 28 June 2015 at page 7.*

220 This payment to Star Track should have been included in DSH's expenses in FY15 because that is when the expense was occurred, but instead it was deferred to the financial year ending June 2016 (**FY16**).

221 The effect of deferring the expense in this way was to improve DSH's reported FY15 NPAT, and to understate DSH's FY15 expenses by \$1.4 million (being the before tax value of the additional expense of \$1.351 million).

#### **Particulars**

*Second Potter Report at paragraph 9.10.*

222 By reason of the matters in paragraphs 219 to 221 above, DSH's financial statements were not prepared in accordance with the Australian Accounting Standards, namely:

(a) AASB 101; and

#### **Particulars**

*The accounting treatment of the deed of release payment did not comply with AASB 101 because it did not present fairly DSH and the DSH Group's financial position and performance:*

- *it did not record the expense in the period in which it was incurred (being FY15), the effect of which was to inflate DSH's reported statutory NPAT in FY15;*
- *it did not represent faithfully the deed of release payment according to the definitions and recognition criteria set out in the AASB Framework because, in failing to recognise the expense in the period in which it was*

*incurred, the FY15 Financial Statements did not faithfully represent "the effects of transactions" as the expense should have been recorded in FY15 rather than in FY16.*

*AASB 101, paragraph 15.*

*AASB Framework, paragraph 91.*

*Second Potter Report at paragraphs 9.7-9.13.*

(b) the AASB Framework.

**Particulars**

*AASB Framework, paragraph 91.*

**C.10. RESTATEMENT OF FY14 AND FY15 FINANCIAL STATEMENTS**

223 Contrary to the FY14 Financial Statements, and by reason of the matters pleaded in sections C.2, C.3, C.4, C.5, C.6, C.7 and C.8, the financial position and performance of DSH for FY14 was no better than that stated in Annexure B (as that annexure applies to FY14).

**Particulars**

*First Potter Report at Section 11 and Second Potter Report at Section 11.*

224 Contrary to the FY15 Financial Statements, and by reason of the matters pleaded in sections C.2, C.3 and C.9, the financial position and performance of DSH for FY15 was no better than that stated in Annexure B (as that annexure applies to FY15).

**Particulars**

*First Potter Report at Section 11 and Second Potter Report at Section 11.*

225 The adjustments to the FY14 Financial Statements set out in Annexure B (as that annexure applies to FY14) and referred to in paragraph 223 above were "material" under the terms of AASB 1031.

**Particulars**

*First Potter Report at Section 11 and Second Potter Report at paragraphs 11.14-11.17.*

226 The adjustments to the FY15 Financial Statements set out in Annexure B (as that annexure applies to FY15) and referred to in paragraph 224 above were "material" under the terms of AASB 1031.

**Particulars**

*First Potter Report at Section 11 and Second Potter Report at paragraphs 11.14-11.17.*

## **D. CONTRAVENTIONS**

### **D.1. DSH'S MISLEADING OR DECEPTIVE CONDUCT**

#### **D.1.1. The Prospectus**

227 Contrary to the Financial Information Basis Representation, the Pro Forma Historical Information insofar as it related to FY13 and 1Q14 and the Forecast Financial Information were not prepared in accordance with the recognition and measurement principles described in Australian Accounting Standards (including Australian Accounting Interpretations) and the summarised accounting policies of DSH set out in Section 11 of the Prospectus (where "Australian Accounting Standards" was defined in the Glossary in Section 12 of the Prospectus).

#### **Particulars**

*Paragraphs 144 to 149, 193 to 201, 202 to 207 and 208 to 210 above are repeated.*

*First Potter Report at paragraphs 3.3-3.54, Section 6 (especially paragraphs 6.4-6.117), Section 8 (especially paragraphs 8.98-8.101) and Section 9 (especially paragraphs 9.7-9.8).*

*Second Potter Report at paragraphs 2.5-2.6, Section 5 (especially paragraphs 5.26-5.33) and Section 6 (especially paragraphs 6.16-6.25).*

228 Contrary to the:

- (a) FY13 Performance Representations;
- (b) FY13 Balance Sheet Representations;
- (c) 1Q14 Representations;
- (d) the Pro Forma Historical Information insofar as it related to FY13 and 1Q14; and
- (e) Financial Information Basis Representation,

the financial position and performance of Dick Smith (as defined in Prospectus, Section 12), Dick Smith Sub-Holdings and DSH was not as stated in the Prospectus and was materially inferior to that represented.

### Particulars

*Paragraphs 144 to 149, 193 to 201, 202 to 207 and 208 to 210 above are repeated.*

*The financial position and performance of Dick Smith and DSH in respect of financial periods covered by the pleaded representations was no better than that stated in Annexure A being the FY13 and 1Q14 results for DSH, prepared consistently with Australian Accounting Standards (from the First Potter Report at Section 11 and the Second Potter Report at Section 11).*

229 Contrary to the:

- (a) Growth and Forecast Representations; and
- (b) Financial Information Basis Representation,

the forecast financial position and performance and prospects of Dick Smith and DSH was not as stated in the Prospectus.

### Particulars

*The forecast financial position and performance of Dick Smith and DSH in respect of the financial periods covered by the pleaded representations was no better than the "high" scenario stated in the Report of Michael Potter dated 29 October 2018 (**Third Potter Report**) at 8.35.*

230 The Prospectus did not disclose:

- (a) the matters pleaded at section C.2 concerning inventory and inventory management practices as they were at the time of the Prospectus (**Prospectus Inventory Information**);
- (b) the matters pleaded at section C.4 concerning the Warranty Sign On Liability as it was at the time of the Prospectus (**Prospectus Warranty Sign On Liability Information**);
- (c) the matters pleaded at section C.5 concerning the doubtful debts provisions as they were at the time of the Prospectus (**Prospectus Doubtful Debts Provision Information**); and
- (d) the matters pleaded at section C.6 concerning deferred expenses (**Deferred Expenses Information**).

231 The Prospectus did not disclose:

- (a) that the Financial Information and Dick Smith Sub-Holdings' reported and pro forma results for the period to 30 June 2013 given in the Prospectus were dependent upon:
  - (i) the non-compliance with the Financial Information Basis Representation;
  - (ii) the Prospectus Inventory Information;
  - (iii) the Prospectus Warranty Sign On Liability Information; and
  - (iv) the Prospectus Doubtful Debts Provision Information;
- (b) the effect on the reported and pro forma results for the period to 30 June 2013 of each of:
  - (i) the non-compliance with the Financial Information Basis Representation;
  - (ii) the Prospectus Inventory Information;
  - (iii) the Prospectus Warranty Sign On Liability Information; and
  - (iv) the Prospectus Doubtful Debts Provision Information.

232 By reason of that non-disclosure, each of:

- (a) the Financial Information Basis Representation (see paragraph 62 above);
- (b) the FY13 Performance Representations (see paragraph 65 above);
- (c) the FY13 Balance Sheet Representations (see paragraph 67 above);
- (d) the Obsolete Stock Representation (see paragraph 69 above);
- (e) the 1Q14 Representations (paragraph 71 above);
- (f) the Transformation Representations (see paragraph 73 above); and
- (g) the Growth and Forecast Representations (see paragraph 76 above),

were misleading or deceptive in contravention of s 728 of the CA.

233 To the extent that the representations identified in paragraph 232 above were about future matters, they were made without reasonable grounds and are deemed by ss 728(2) and 769C of the CA to have been misleading.

234 By reason of each the matters set out in paragraphs 230 to 232 above, each of the following representations were misleading or deceptive and in contravention of s 728 of the CA:

- (a) the FY13 Financial Statements and the Pro Forma Historical Information insofar as it relates to FY13 and 1Q14, because they did not give a true and fair view of the financial position and performance of Dick Smith, DSH, DSSH or the DSH Group and for the reasons pleaded in paragraphs 227 and 228 above;
- (b) the 1Q14 results for Dick Smith Sub-Holdings, because they did not give a true and fair view of the financial position and performance of DSH, DSSH or the DSH Group;
- (c) the FY13 Performance Representations, because they did not present fairly or represent faithfully the financial position, financial performance and cashflows of Dick Smith, DSSH, DSH or the DSH Group;
- (d) the Forecast Financial Information, because it did not give a true and fair view of the forecast financial position and future performance of Dick Smith, DSSH, DSH or the DSH Group; and
- (e) the 1Q14 Representations.

**Particulars**

*Paragraphs 227 and 228 above are repeated.*

235 The Financial Covenants Representations were statements about future matters within the meaning of ss 728(2) and 769C of the CA which were misleading because DSH did not have reasonable grounds to make the Financial Covenants Representations.

**Particulars**

*The Financial Covenants Representations were based, in part, upon the Pro Forma Historical Information for FY13 and 1Q14 and the Forecast Financial Information.*

*First Potter Report at paragraphs 10.40-10.59.*

*Second Potter Report at paragraphs 11.7-11.13.*

*The Financial Information, including the Forecast Financial Information, did not accord with the Financial Information Basis Representation for the reasons pleaded in paragraphs 227 to 229.*



*The Forecast Financial Information was materially misstated and flawed in the ways pleaded in paragraphs 227 to 229 and 230 to 234.*

*The Financial Covenants Representations were given Boxed-up Prospectus reference FI607 and were verified by Mr Potts without amendment, without any supporting documents referred to in the Verification Matrix with the basis of verification and description of source documents given as "Statement of belief" and nothing more.*

236 By reason of the matters pleaded in paragraphs 232 to 235, the Financial Covenants Representations were misleading and deceptive in contravention of s 728 of the CA.

237 The Transformation Representations and the Growth and Forecast Representations were misleading and deceptive in contravention of s 728 of the CA.

#### **Particulars**

*The pro forma financial performance of Dick Smith for FY13 was no better than a net loss after tax of \$8.0 million.*

*The pro forma financial performance of Dick Smith for 1Q14 was no better than a net profit after tax of \$0.3 million.*

*The gross profit margin for FY13 for Dick Smith was not 23.7% but was 21.9% and the gross profit margin for 1Q14 was not 25.0% but was 22.7%.*

*The transformation program had not:*

- *delivered substantial improvements to the financial performance of Dick Smith;*
- *resulted in a significant increase in the underlying profitability of Dick Smith;*
- *delivered a sustainable increase in underlying profitability evidenced in strong 1Q14 results;*
- *delivered substantial improvements to financial performance;*
- *delivered a significant transformation of the business evidenced in 1Q14 results;*
- *positioned the business for sustainable growth.*

*Second Potter Report at Tables 23, 25 and 26.*

*Although the major aspects and majority of initiatives of the DSH management team, led by Mr Abboud, had been implemented by the end of 1Q14, they had failed to deliver financial performance much better than break even, and a gross profit margin materially less than assumed in the Forecast Financial Information, which provided an inadequate basis upon which to found the Transformation Representations.*

*For the reasons pleaded in paragraphs 63, 66, 68, 70, 72, 75, 77 and 84, the pleaded representations in the Prospectus were made without reasonable grounds because they were made in reliance upon:*

- mere statements of belief or assertions as recorded in the Verification Matrix; and/or*
- under the false assumption that a statement about a future matter was a “statement of fact”; and/or*
- statements otherwise unsupported by any information providing any ground for the making of the statement; and*
- a process wherein statements of belief which were assigned to the board for verification were not verified by the Board but where a director, Mr Ishak, reviewed a random selection (made by him) of three statements per page of the verification version of the Prospectus and checked that the applicable corresponding source document appeared to verify the statement, following which the Due Diligence Committee approved the Prospectus: Minutes of Project Yellow Due Diligence Committee Meeting No 11.*

238 In the premises, and by reason of the matters pleaded above in paragraphs 230 to 237 above, the Prospectus offered securities under a disclosure document containing misleading or deceptive statements within the meaning of, and in contravention of, s 728 of the CA.

#### **D.1.2. FY14 Financial Statements**

239 The issuance and publication by DSH of the FY14 Financial Statements was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA because those FY14 Financial Statements:

- (a) did not disclose the Rebate Maximisation Practice, the Rebate Maximisation Consequences as they related to FY14, and the effect of that practice on DSH’s financial performance and financial position pleaded above in section C.3.1;

- (b) did not disclose the accounting treatment of the Volume Rebates and its effect pleaded above in section C.3.3;
- (c) did not disclose the accounting treatment of the O&A Rebates and its effect pleaded above in sections C.3.4, C.3.5, C.3.6, C.3.7 and C.3.8;
- (d) did not disclose each of the matters pleaded above in section C.3.10 with respect to the reliability of DSH's recorded profits and financial statements generally;
- (e) did not disclose each of the matters pleaded above in paragraphs 136 and 144 with respect to the recording and provisioning of DSH's inventory;
- (f) did not disclose the Warranty Sign On Liability matters pleaded at section C.4 above, as it was at the time of the FY14 Financial Statements;
- (g) did not disclose the doubtful debts provisions pleaded at section C.5 above, as they were at the time of the FY14 Financial Statements;
- (h) did not disclose the capitalisation of wages matters pleaded at section C.7, as they were at the time of the FY14 Financial Statements; and/or
- (i) did not disclose the onerous lease provision matters pleaded at section C.8 above, as they were at the time of the FY14 Financial Statements.

#### **Particulars**

*Sections C.2, C.3.3, C.3.4, C.3.5, C.3.6, C.3.7, C.3.8, C.4, C.5, C.7 and C.8 are repeated.*

*The amounts by which the FY14 Financial Statements:*

- *overstated inventories;*
- *understated Cost of Sales; and*
- *overstated EBITDA, net profit and total equity,*

*are summarised in the First Potter Report at Chapter 11 and the Second Potter Report at Chapter 11.*

240 The issuance and publication by DSH of the FY14 Financial Statements was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the

ASIC Act and/or s 18 of the Australian Consumer Law because the FY14 Financial Statements were not prepared in accordance with Australian Accounting Standards.

#### **Particulars**

*Paragraph 239 is repeated.*

241. The issuance and publication by DSH of the FY14 Financial Statements was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law because the FY14 Financial Statements did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

#### **Particulars**

*Paragraphs 239 to 240 are repeated.*

*The amounts by which the FY14 Financial Statements:*

- *overstated inventories;*
- *understated Cost of Sales; and*
- *overstated EBITDA, net profit and total equity.*

*are summarised in the First Potter Report at Chapter 11 and the Second Potter Report at Chapter 11.*

#### **D.1.3. DSH's FY14 Express Representation and FY14 Implied Representation**

242. DSH's FY14 Express Representation was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law because the consolidated financial statements of DSH for the financial year ended 29 June 2014 had not been prepared in accordance with the CA, nor with accounting standards and interpretations.

#### **Particulars**

*Section D.1.2 is repeated.*

243. DSH's FY14 Implied Representation was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the ASIC Act and/or s 18 of the

Australian Consumer Law because insofar as the representations pleaded at paragraph 94(b) were based on an opinion:

- (a) the opinion was not held on a reasonable basis and was not the product of the application of reasonable care and skill by either Mr Abboud or Mr Potts;
- (b) the opinion was not a matter to which either Mr Abboud or Mr Potts had turned his mind, having informed himself as to the financial affairs of the company to the extent necessary to form an opinion as to the truth and fairness of the accounts;
- (c) the opinion was not formed after either Mr Abboud or Mr Potts had read and understood the financial statements and considered whether the financial statements were consistent with his own knowledge of DSH's and the DSH Group's financial position and financial performance; or
- (d) the opinion was not formed after either Mr Abboud or Mr Potts had taken a diligent and intelligent interest in the information available to him or which he might with fairness have demanded from the executives or other employees and agents of DSH and the DSH Group.

#### **Particulars**

*The facts, matters and circumstances pleaded and particularised at paragraph 239 above were also present and occurred at the time DSH made DSH's FY14 Implied Representation.*

*Further as against all the defendants:*

- *Mr Abboud and Mr Potts had not adequately considered the appropriate accounting treatment of the inventory, including in light of AASB 101, 102 and 108 and whether the accounting treatment would give a true and fair view of DSH's financial position and performance.*
- *Given the effect of the accounting treatment as pleaded above in sections C.2 and C.3, Mr Abboud and Mr Potts had not obtained accounting advice specifically directed at whether those effects meant the accounting treatment was in accordance with AASB 101, 102 and/or 108 and/or gave a true and fair view of DSH's financial position and performance.*

- *At all material times, Mr Abboud and Mr Potts did not have sufficient information to form the opinion that the inventory was accounted for by DSH in accordance with the Australian Accounting Standards and in a way that gave a true and fair view of the financial position and performance of DSH and the DSH Group.*

#### **D.1.4. FY14 ASX Announcement & Results Briefing**

244 The issuance and publication by DSH of the FY14 ASX Announcement & Results Briefing was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H, s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law of the CA because it:

- (a) did not disclose the matters pleaded and particularised in paragraphs 239(a) to (i) above;
- (b) did not disclose the fact DSH's growth, profit, and strength were the result of the matters pleaded and particularised in paragraphs 239(a) to (i) above;
- (c) did not disclose the Rebate Maximisation Practice and the Rebate Maximisation Consequences as pleaded above in section C.3.1;
- (d) represented that an increase in sundry receivables was related to improved supplier terms, without disclosing the matters pleaded above with respect to the Volume Rebates and the O&A Rebates in sections C.3.3, C.3.4, C.3.5, C.3.6, C.3.7 and C.3.8 above;
- (e) did not disclose that the reported net profit and EBITDA were achieved by reason of the accounting practices in sections C.4, C.5, C.7 and C.9 above, which practices were not in accordance with Australian Accounting Standards; and/or
- (f) did not disclose that the FY14 Financial Statements from which the reported EBITDA and net profit were taken did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

#### **Particulars**

*The amounts by which the FY14 ASX Announcement & Results Briefing overstated the EBITDA and net profit are summarised in the First Potter Report at Chapter 11 and the Second Potter Report at Chapter 11.*

#### **D.1.5. FY15 Financial Statements**

245 The issuance and publication by DSH of the FY15 Financial Statements was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the

ASIC Act and/or s 18 of the Australian Consumer Law because those FY15 Financial Statements:

- (a) did not disclose the Rebate Maximisation Practice, the Rebate Maximisation Consequences as they related to FY15 and the effect of those practices on DSH's financial performance and financial position pleaded above in section C.3.1;
- (b) did not disclose the accounting treatment of the Switched Invoice Rebates and its effect pleaded above in section C.3.2;
- (c) did not disclose the accounting treatment of the Volume Rebates and its effect pleaded above in section C.3.3;
- (d) did not disclose the accounting treatment of the O&A Rebates and its effect pleaded above in sections C.3.4, C.3.5, C.3.6, C.3.7 and C.3.8;
- (e) did not disclose each of the matters pleaded above in section C.3.10 with respect to the reliability of DSH's recorded profits and financial statements generally;
- (f) did not disclose each of the matters pleaded above in paragraphs 136 and 144 with respect to the recording and provisioning of DSH's inventory; and/or
- (g) did not disclose the deed of release payment pleaded above in section C.9.

#### **Particulars**

*Sections C.2, C.3.2, C.3.3, C.3.4, C.3.5, C.3.6, C.3.7, C.3.8 and C.9 are repeated.*

*The amounts by which the FY15 Financial Statements:*

- *overstated and failed to make provision in respect of inventories;*
- *understated Cost of Sales; and*
- *overstated EBITDA, net profit and total equity,*

*are summarised in the First Potter Report at Chapter 11 and the Second Potter Report at Chapter 11.*

246 The issuance and publication by DSH of the FY15 Financial Statements was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the

ASIC Act and/or s 18 of the Australian Consumer Law because the FY15 Financial Statements were not prepared in accordance with Australian Accounting Standards.

#### **Particulars**

*Paragraph 245 is repeated.*

247 The issuance and publication by DSH of the FY15 Financial Statements was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law because the FY15 Financial Statements did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

#### **Particulars**

*Paragraphs 245 to 246 are repeated.*

*The amounts by which the FY15 Financial Statements:*

- *overstated and failed to make provision in respect of inventories;*
- *understated Cost of Sales; and*
- *overstated EBITDA, net profit and total equity,*

*are summarised in the First Potter Report at Chapter 11 and the Second Potter Report at Chapter 11*

#### **D.1.6. DSH's FY15 Express Representation and FY15 Implied Representation**

248 DSH's FY15 Express Representation was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law because the consolidated financial statements of DSH for the financial year ended 28 June 2015 had not been prepared in accordance with the CA, nor with accounting standards and interpretations.

#### **Particulars**

*Paragraphs 245 to 247 are repeated.*

249 DSH's FY15 Implied Representation was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the ASIC Act and/or s 18 of the



Australian Consumer Law because insofar as the representations pleaded at paragraph 107(b) were based on an opinion:

- (a) the opinion was not held on a reasonable basis and was not the product of the application of reasonable care and skill by either Mr Abboud or Mr Potts;
- (b) the opinion was not a matter to which either Mr Abboud or Mr Potts had turned his mind, having informed himself as to the financial affairs of the company to the extent necessary to form an opinion as to the truth and fairness of the accounts;
- (c) the opinion was not formed after either Mr Abboud or Mr Potts had read and understood the financial statements and considered whether the financial statements were consistent with his own knowledge of DSH's and the DSH Group's financial position and financial performance; or
- (d) the opinion was not formed after either Mr Abboud or Mr Potts had taken a diligent and intelligent interest in the information available to him or which he might with fairness have demanded from the executives or other employees and agents of DSH and the DSH Group.

#### **Particulars**

*As against the first defendant the plaintiffs rely on the admissions at paragraph 48, 52 and 63 of the Company's 3ACLS.*

*Further as against all the defendants:*

- *Mr Abboud and Mr Potts had not adequately considered the appropriate accounting treatment of the rebate practices and inventory, including in light of AASB 101, 102 and 108 and whether the accounting treatment would give a true and fair view of DSH's financial position and performance.*
- *Given the effect of the accounting treatment as pleaded above in sections C.2 and C.3, Mr Abboud and Mr Potts had not obtained accounting advice specifically directed at whether those effects meant the accounting treatment was in accordance with AASB 101, 102 and/or 108 and/or gave a true and fair view of DSH's financial position and performance.*
- *At all material times, Mr Abboud and Mr Potts did not have sufficient information to form the opinion that the inventory was accounted for by DSH in accordance*

*with the Australian Accounting Standards and in a way that gave a true and fair view of the financial position and performance of DSH and the DSH Group.*

- *At all material times, Mr Abboud and Mr Potts did not have sufficient information to form the opinion that the Switched Invoice Rebates and/or the Volume Rebates and/or the O&A Rebates were accounted for by DSH in accordance with the Australian Accounting Standards and in a way that gave a true and fair view of the financial position and performance of DSH and the DSH Group.*
- *At all material times, Mr Abboud and Mr Potts did not have sufficient information to form the opinion that there was a basis for the O&A Rebates, Volume Rebates and/or Switched Invoice Rebates to be recognised in the accounts of DSH immediately upon being negotiated with suppliers and in any event before the goods the subject of the rebate were sold or support, the subject of the rebate, was received.*
- *Members of the DSH board, including Mr Abboud and Mr Potts, received the Deloitte Report to the FAC dated 6 August 2014 that reported O&A Rebates were to be recognised within costs of sales (on the basis of management's advice that O&A Rebates were essentially a contribution to the selling cost of the inventory being cleared) and recommended management undertake an annual review to determine whether deferral of income derived from O&A Rebates was required.*
- *Mr Abboud and Mr Potts ought to have been aware that no adequate testing had been undertaken by management to determine that O&A Rebates were essentially a contribution to the selling cost of the inventory being cleared or to determine whether deferral of income derived from O&A Rebates was required. See Mr Abboud's evidence: transcript dated 6 October 2016 at page 500.*
- *Mr Abboud and Mr Potts ought to have been aware that rebates initially accounted for as a cost of doing business were subsequently, at least in part, transferred to cost of goods sold without any analysis of whether or not the goods had been sold.*
- *Mr Abboud and Mr Potts, as members or attendees at FAC meetings, ought to have known that income derived from rebates relating to stock purchases held in inventory at the year end or promotions in the following financial year should be deferred to the following year.*

- *Mr Abboud and Mr Potts were each present at or aware of the meetings convened by John Skellern, and the maintenance of the whiteboard to record O&A Rebates.*
- *Mr Abboud and Mr Potts were each aware of shortcomings in and problems with DSH's planning, tracking, and recording of rebates accrued and received from vendors and suppliers, including:*
  - *the matters set out in the particulars to paragraph 188 above as to the meetings convened by John Skellern and the recording of rebates and targets on a whiteboard in Mr Skellern's office, which meetings were sometimes attended by Mr Abboud and Mr Potts;*
  - *in the case of Mr Abboud, the existence of discrepancies between the rebates recorded on Mr Skellern's whiteboard and those entered into DSH's AS400 systems;*
  - *in the case of Mr Abboud, Mr Abboud's practice of reviewing or signing-off on purchase orders and rebates;*
  - *in the case of Mr Potts, Mr Potts' involvement in the preparation of a "position paper" on O&A Rebates for Deloitte in about May and June 2014 and the matters discussed therein;*
  - *in the case of Mr Potts, the lack of "support" from vendors confirming that O&A accruals were genuine in around August 2014;*
  - *the observations made by Deloitte as to DSH's recording of rebates in its report to the FAC for FY14 and discussion at the FAC meeting on 12 August 2014, at which meeting Mr Abboud and Mr Potts were present;*
  - *in the case of Mr Abboud, the recording of rebate targets on a whiteboard at leadership team meetings convened by Mr Abboud from about September 2014;*
  - *the "black hole" that Mr Abboud said existed around rebates recorded by buyers and what was able to be claimed by the company, and his observation about a "lack of visibility over O&A rebates" in around December 2014 (Holtzer Affidavit, paragraph 9);*

- *in the case of Mr Potts, attempts by Tomer Bar-Ami to put in place a system for the recording of rebates in about January 2015;*
  - *in the case of Mr Potts, the concerns expressed to Mr Potts by Michael Holtzer between about January and March 2015 in relation to DSH's reporting and accounting treatment of rebates as recorded in the Holtzer Affidavit;*
  - *that any "disciplines" Mr Potts tried to put in place in respect of inventory control were "overridden by Mr Abboud"; and*
  - *in the case of Mr Potts, the systems proposed by Software Paradigms International Australia Pty Ltd (SPI) in early 2015 to improve DSH's recording and tracking of rebates were put on hold in May 2015 and not implemented by DSH.*
- *Mr Abboud and Mr Potts were each aware of DSH's failure to write down inventory, its purchase of excess inventory and its method of recording and making provision for inventory as pleaded in sections C.2 and C.3.1 above. In the alternative, they ought to have been aware of those matters, by virtue of their positions as officers and directors of DSH, given their duties pursuant to sections 286, 296, 297 and 344 of the Corporations Act and by reason of their involvement in and oversight over DSH's decisions concerning its rebate and inventory practices and accounting practices in relation thereto as set out above and as detailed in the affidavits of Mr Holtzer, Mr Powell and Mr Bonham and in the evidence given by Mr Abboud and Mr Potts in their public examinations by the liquidators of DSH.*

#### **D.1.7. FY15 ASX Announcement & Results Briefing**

250 The issuance and publication by DSH of the FY15 ASX Announcement & Results Briefing was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law because it:

- (a) did not disclose the matters pleaded and particularised in paragraphs 245(a) to (g);
- (b) did not disclose the fact DSH's growth, profit, and strength were the result of the matters pleaded and particularised in paragraphs 245(a) to (g);

- (c) represented that higher inventory reflected a conscious decision to benefit from advantageous trading terms and favourable exchange rate without disclosing the Rebate Maximisation Practice, the Rebate Maximisation Consequences as they related to FY15 and the effect of those practices as pleaded above in section C.3.1;
- (d) represented that an increase in sundry receivables was related to improved supplier terms without disclosing the Switched Invoice Rebates, the Volume Rebates, and the O&A Rebates in sections C.3.2, C.3.3, C.3.4, C.3.5, C.3.6, C.3.7 and C.3.8 above;
- (e) did not disclose that the reported net profit and EBITDA were achieved by reason of the accounting practices pleaded in section C.9, which practices were not in accordance with Australian Accounting Standards; and/or
- (f) did not disclose that the FY15 Financial Statements from which the reported EBITDA and net profit were taken did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

#### **Particulars**

*The amounts by which the FY15 ASX Announcement & Results Briefing overstated the EBITDA and net profit are summarised in the First Potter Report at Chapter 11 and the Second Potter Report at Chapter 11.*

## **D.2. DSH'S CONTRAVENTION OF SECTION 1041E OF THE CA**

### **D.2.1. The Prospectus**

251 By issuing and publishing the Prospectus, DSH made statements, or disseminated information, which:

- (a) were false in a material particular or materially misleading;

#### **Particulars**

*Section D.1.1 is repeated.*

- (b) were likely to induce, directly or indirectly, the plaintiffs and Group Members to acquire shares in DSH;

### Particulars

*Investors or potential investors in DSH's securities were likely to rely upon the information contained in and the representations conveyed by the Prospectus in deciding whether to invest in DSH Shares.*

- (c) were likely to have the effect of increasing, maintaining or stabilising the price for trading in DSH Shares on ASX.

### Particulars

*The Prospectus was disclosed to the secondary market via ASX before quotation of DSH Shares commenced.*

252 When DSH issued and published the Prospectus, DSH ought reasonably to have known it was false in a material particular or materially misleading because:

- (a) the directors of DSH and Mr Potts ought to have known that the Prospectus Inventory Information and Deferred Expenses Information could materially impact upon DSH's financial statements and results in the Prospectus;
- (b) DSH was under a duty, pursuant to s 286 of the CA, to keep written financial records that correctly recorded and explained its transactions and financial position and performance, and that would enable true and fair financial statements to be prepared and audited;
- (c) each director of DSH was under a duty, pursuant to s 344 of the CA, to take all reasonable steps to comply with or secure DSH's compliance with s 286 of the CA;
- (d) the directors of DSH were under a duty, pursuant to ss 296 and 297 of the CA, to form an opinion as to whether DSH's financial statements complied with the accounting standards and gave a true and fair view of the financial position and performance of DSH before making any declaration pursuant to s 295 of the CA;
- (e) the directors of DSH were under a duty to have sufficient financial literacy so as to understand the basis upon which the financial statements were prepared, including the accounting treatment of rebates and decisions as to whether to recognise impairments to inventory;
- (f) the directors of DSH had access to accounting advice in relation to the preparation of the Prospectus, including advice in relation to:

- (i) accounting standards;
  - (ii) the requirements and application of each of those standards with respect to the accounting treatment of rebates; and
  - (iii) the impairment of inventory;
- (g) the directors of DSH and Mr Potts had access to and were aware, or ought to have been aware, of the content of the Deloitte Project Yellow Report, including as to the limitations of DSH's inventory ageing system;
- (h) in discharging their duties pleaded in the subparagraphs above, the directors of DSH ought to have been aware (after properly informing each of themselves and making proper enquiries, and applying each of their own knowledge about DSH's and the DSH Group's business, financial position, and financial performance) of the matters in (a) to (g) above, and that the Prospectus did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

253 In the premises, DSH contravened s 1041E of the CA by issuing and publishing the Prospectus.

#### **D.2.2. FY14 Financial Statements**

254 By issuing and publishing the FY14 Financial Statements, DSH made statements, or disseminated information, which:

- (a) were false in a material particular or materially misleading;

##### **Particulars**

*Section D.1.2 is repeated.*

- (b) were likely to induce, directly or indirectly the plaintiffs and Group Members to acquire shares in DSH; and

##### **Particulars**

*Investors or potential investors in DSH's securities were likely to rely upon financial statements, the corresponding directors' declaration and the representations it conveyed therein in deciding whether to invest in those securities.*

*DSH's financial statements could not be issued and published to the market through the ASX without the director's declaration.*

- (c) further, or in the alternative to paragraph (b), were likely to have the effect of increasing, maintaining or stabilising the price for trading in DSH Shares on ASX.

#### **Particulars**

*The reporting by DSH of EBITDA, net profit and total equity at levels higher than what would have been the case (had the FY14 Financial Statements been prepared in compliance with the accounting standards and gave a true and fair view of the financial position and performance of DSH) was likely to have the effect of increasing, maintaining or stabilising the value of DSH Shares from what they otherwise would have been.*

255 When DSH issued and published the FY14 Financial Statements, DSH ought reasonably to have known they were false in a material particular or materially misleading because:

- (a) the directors of DSH ought to have known about the O&A Rebates and DSH's accounting treatment of them;
- (b) the directors of DSH ought to have known that the accounting treatment of rebates could materially impact upon DSH's financial statements and results;
- (c) the directors of DSH ought to have been aware of the Rebate Maximisation Practice and the Rebate Maximisation Consequences as they related to FY14;
- (d) the directors of DSH ought to have known about the matters pleaded above in section C.2 with respect to DSH's inventory, and that such conduct could materially impact upon DSH's financial statements and results;
- (e) the directors of DSH ought to have been aware of the matters relating to DSH's inventory pleaded above in paragraphs 139 and 143;
- (f) DSH was under a duty, pursuant to s 286 of the CA, to keep written financial records that correctly recorded and explained its transactions (which included the Volume Rebates and the O&A Rebates) and financial position and performance, and that would enable true and fair financial statements to be prepared and audited;
- (g) each director of DSH was under a duty, pursuant to s 344 of the CA, to take all reasonable steps to comply with or secure DSH's compliance with s 286 of the CA;



- (h) the directors of DSH were under a duty, pursuant to ss 296 and 297 of the CA, to form an opinion as to whether DSH's financial statements complied with the accounting standards and gave a true and fair view of the financial position and performance of DSH before making any declaration pursuant to s 295 of the CA;
- (i) the directors of DSH were under a duty to understand the basis upon which the financial statements were prepared, including the accounting treatment of rebates and decisions as to whether to recognise impairments to inventory;
- (j) the directors of DSH had access to accounting advice in relation to the preparation of DSH's financial statements, including advice in relation to:
  - (i) accounting standards;
  - (ii) the requirements and application of each of those standards with respect to the accounting treatment of rebates; and
  - (iii) the impairment of inventory;
- (k) in discharging their duties pleaded in the subparagraphs above, the directors of DSH ought to have been aware (after properly informing each of themselves and making proper enquiries, and applying each of their own knowledge about DSH and the DSH Group's business, financial position and financial performance) of the matters in (a) to (e) above, and that the FY14 Financial Statements did not give a true and fair view of the financial position and performance of DSH and the DSH Group;
- (l) the directors of DSH and Mr Potts had access to and were aware, or ought to have been aware, of the content of the Deloitte Project Yellow Report, including as to the limitations of DSH's inventory ageing system;
- (m) further, the directors of DSH ought to have been aware of the effect of the accounting treatments of rebates pleaded in Part C.3 above on DSH's gross profit, EBITDA, and net profit; and
- (n) the directors of DSH ought to have been aware that the failure by DSH to write down the value of its inventory prior to publishing the FY14 Financial Statements:
  - (i) was not in accordance with Australian Accounting Standards; and
  - (ii) meant the FY14 Financial Statements did not give a true and fair view of the financial position and performance of DSH and the DSH Group;

256 In the premises, DSH contravened s 1041E of the CA by issuing and publishing the FY14 Financial Statements.

**D.2.3. DSH's FY14 Express Representation and FY14 Implied Representation**

257 By making each of DSH's FY14 Express Representation and DSH's FY14 Implied Representation, DSH made statements, or disseminated information, which:

- (a) were false in a material particular or materially misleading;

**Particulars**

*Section D.1.3 is repeated.*

- (b) were likely to induce, directly or indirectly, the plaintiffs and Group Members to acquire shares in DSH; and

**Particulars**

*The particulars at paragraph 254(b) are repeated.*

- (c) further, or in the alternative to paragraph (b), were likely to have the effect of increasing, maintaining or stabilising the price for trading in DSH Shares on ASX.

**Particulars**

*The particulars at paragraph 254(c) are repeated.*

258 When DSH made DSH's FY14 Express Representation, DSH ought reasonably to have known it was false in a material particular or materially misleading because DSH ought to have known that the consolidated financial statements of DSH for FY14 had not been prepared in accordance with the CA, nor with accounting standards and interpretations, for the reasons pleaded in paragraph 255 and sections C.2, C.3, C.4, C.5, C.7 and C.9 above.

259 When DSH made DSH's FY14 Implied Representation, DSH ought reasonably to have known it was false in a material particular, or materially misleading because, in light of the matters pleaded and particularised above in paragraph 243, the opinion pleaded at paragraph 94(b):

- (a) was not held on a reasonable basis and was not the product of the application of reasonable care and skill by either Mr Abboud or Mr Potts;

- (b) was not a matter to which either Mr Abboud or Mr Potts had turned his mind, having informed himself as to the financial affairs of the company to the extent necessary to form an opinion as to the truth and fairness of the accounts;
- (c) was not formed after either Mr Abboud or Mr Potts had read and understood the financial statements and considered whether the financial statements were consistent with his own knowledge of DSH's and the DSH Group's financial position and financial performance;  
or
- (d) was not formed after either Mr Abboud or Mr Potts had taken a diligent and intelligent interest in the information available to him or which he might with fairness have demanded from the executives or other employees and agents of DSH and the DSH Group.

**Particulars**

*The facts, matters and circumstances pleaded at paragraph 255 above were also present and occurred at the time DSH made DSH's FY14 Implied Representation.*

260 In the premises, DSH contravened s 1041E of the CA by making DSH's FY14 Express Representation and DSH's FY14 Implied Representation.

**D.2.4. FY14 ASX Announcement & Results Briefing**

261 By issuing and publishing the FY14 ASX Announcement & Results Briefing, DSH made statements, or disseminated information, which:

- (a) were false in a material particular or materially misleading;

**Particulars**

*Section D.1.4 is repeated.*

- (b) were likely to induce, directly or indirectly, the plaintiffs and Group Members to acquire shares in DSH; and

**Particulars**

*Investors or potential investors in DSH's securities were likely to rely upon DSH's ASX announcements and results briefings about its financial performance in deciding whether to invest in DSH securities.*

- (c) further, or in the alternative to paragraph (b), were likely to have the effect of increasing, maintaining or stabilising the price for trading in DSH Shares on ASX.

#### **Particulars**

*Positive statements made by DSH in the FY14 ASX Announcement & Results Briefing that were based on the FY14 Financial Statements and that did not disclose the matters pleaded in paragraph 244 were likely to have the effect of increasing, maintaining or stabilising the price of DSH Shares from what they would otherwise have been had the FY14 Financial Statements been prepared in compliance with the accounting standards and gave a true and fair view of the financial position and performance of DSH and the information pleaded at paragraph 244 been disclosed.*

- 262 When DSH issued and published the FY14 ASX Announcement & Results Briefing, DSH ought reasonably to have known it was false in a material particular or materially misleading because it reported the financial results from, or pro forma financial information based on, DSH's FY14 Financial Statements which DSH ought to have known were false in a material particular or materially misleading for the reasons pleaded in paragraph 255.
- 263 In the premises, DSH contravened s 1041E of the CA by issuing and publishing the FY14 ASX Announcement & Results Briefing.

#### **D.2.5. FY15 Financial Statements**

- 264 By issuing and publishing the FY15 Financial Statements, DSH made statements, or disseminated information, which:
- (a) were false in a material particular or materially misleading;

#### **Particulars**

*Section D.1.5 is repeated.*

- (b) were likely to induce, directly or indirectly the plaintiffs and Group Members to acquire shares in DSH; and

#### **Particulars**

*The particulars at paragraph 254(b) are repeated.*

- (c) further, or in the alternative to paragraph (b), were likely to have the effect of increasing, maintaining or stabilising the price for trading in DSH Shares on ASX.

#### **Particulars**

*The reporting by DSH of EBITDA, net profit and total equity at levels higher than what would have been the case (had the FY15 Financial Statements been prepared in compliance with the accounting standards and gave a true and fair view of the financial position and performance of DSH) was likely to have the effect of increasing, maintaining or stabilising the value of DSH Shares from what they otherwise would have been.*

*Further particulars may be provided following discovery and evidence.*

265 When DSH issued and published the FY15 Financial Statements, DSH ought reasonably to have known they were false in a material particular or materially misleading because:

- (a) the directors of DSH ought to have known about the Rebate Maximisation Practices and the Rebate Maximisation Consequences;
- (b) the directors of DSH ought to have known about the Switched Invoice Rebates and DSH's accounting treatment of them;
- (c) the directors of DSH ought to have known about the Volume Rebates and DSH's accounting treatment of them;
- (d) the directors of DSH ought to have known about the O&A Rebates and DSH's accounting treatment of them;
- (e) the directors of DSH ought to have known that the accounting treatment of rebates could materially impact upon DSH's financial statements and results;
- (f) Messrs Abboud and Potts knew or ought to have known, and the other directors of DSH ought to have known, that DSH did not have a system for the reliable planning, tracking, and recording of rebates accrued and received from vendors and suppliers;
- (g) the directors of DSH ought to have known that the effect of DSH not having a system for the reliable planning, tracking, and recording of rebates accrued and received from vendors and suppliers was as pleaded in section C.3.10 above;

- (h) the directors of DSH ought to have been aware of the matters relating to DSH's inventory pleaded above in paragraphs 139 and 143; and
- (i) the directors of DSH ought to have been aware that the failure by DSH to write down the value of its inventory prior to the publishing the FY15 Financial Statements:
  - (i) was not in accordance with Australian Accounting Standards; and
  - (ii) meant the FY15 Financial Statements did not give a true and fair view of the financial position and performance of DSH and the DSH Group.

266 In the premises, DSH contravened s 1041E of the CA by issuing and publishing the FY15 Financial Statements.

#### **D.2.6. DSH's FY15 Express Representation and FY15 Implied Representation**

267 By making each of DSH's FY15 Express Representation and DSH's FY15 Implied Representation, DSH made statements, or disseminated information, which:

- (a) were false in a material particular or materially misleading;

#### **Particulars**

*Section D.1.6 is repeated.*

- (b) were likely to induce, directly or indirectly, the plaintiffs and Group Members to acquire shares in DSH; and

#### **Particulars**

*The particulars at paragraph 254(b) are repeated.*

- (c) further, or in the alternative to paragraph (b), were likely to have the effect of increasing, maintaining or stabilising the price for trading in DSH Shares on ASX.

#### **Particulars**

*The particulars at paragraph 264(c) are repeated.*

268 When DSH made DSH's FY15 Express Representation, DSH ought reasonably to have known it was false in a material particular or materially misleading because DSH ought to have known that the consolidated financial statements of DSH for the financial year ended 28 June 2015

had not been prepared in accordance with the CA, nor with accounting standards and interpretations, for the reasons pleaded in paragraph 265 above.

269 When DSH made DSH's FY15 Implied Representation, DSH ought reasonably to have known it was false in a material particular, or materially misleading because, in light of the matters pleaded above in paragraph 265, the opinion pleaded at paragraph 107(b):

- (a) was not held on a reasonable basis and was not the product of the application of reasonable care and skill by either Mr Abboud or Mr Potts;
- (b) was not a matter to which either Mr Abboud or Mr Potts had turned his mind, having informed himself as to the financial affairs of the company to the extent necessary to form an opinion as to the truth and fairness of the accounts;
- (c) was not formed after either Mr Abboud or Mr Potts had read and understood the financial statements and considered whether the financial statements were consistent with his own knowledge of DSH's and the DSH Group's financial position and financial performance; or
- (d) was not formed after either Mr Abboud or Mr Potts had taken a diligent and intelligent interest in the information available to him or which he might with fairness have demanded from the executives or other employees and agents of DSH and the DSH Group.

#### **Particulars**

*The facts, matters and circumstances pleaded at paragraph 265 above were also present and occurred at the time DSH made DSH's FY15 Implied Representation.*

270 In the premises, DSH contravened s 1041E of the CA by making DSH's FY15 Express Representation and DSH's FY15 Implied Representation.

#### **D.2.7. FY15 ASX Announcement & Results Briefing**

271 By issuing and publishing the FY15 ASX Announcement & Results Briefing, DSH made statements, or disseminated information, which:

- (a) were false in a material particular or materially misleading;

#### **Particulars**

*Section D.1.7 is repeated.*

- (b) were likely to induce, directly or indirectly, the plaintiffs and Group Members to acquire shares in DSH; and

#### **Particulars**

*The particulars at paragraph 261(b) are repeated.*

- (c) further, or in the alternative to paragraph (b), were likely to have the effect of increasing, maintaining or stabilising the price for trading in DSH Shares on ASX.

#### **Particulars**

*Positive statements made by DSH in the FY15 ASX Announcement & Results Briefing that were based on the FY15 Financial Statements and that did not disclose the matters pleaded in paragraph 250 were likely to have the effect of increasing, maintaining or stabilising the price of DSH Shares from what they would otherwise have been had the FY15 Financial Statements been prepared in compliance with the accounting standards and gave a true and fair view of the financial position and performance of DSH and the information pleaded at paragraph 250 been disclosed.*

- 272 When DSH issued and published the FY15 ASX Announcement & Results Briefing, DSH ought reasonably to have known it was false in a material particular or materially misleading because it reported the financial results from DSH's FY15 Financial Statements which DSH ought to have known were false in a material particular or materially misleading for the reasons pleaded and particularised in paragraphs 250 and 265.
- 273 In the premises, DSH contravened s 1041E of the CA by issuing and publishing the FY15 ASX Announcement & Results Briefing.

### **D.3. DSH'S CONTINUOUS DISCLOSURE CONTRAVENTIONS**

- 274 At all material times, DSH was a listed disclosing entity subject to ASX Listing Rule 3.1 and ss 111AP and 674 of the CA.
- 275 By ASX Listing Rule 3.1, once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must tell ASX that information.



- 276 By ASX Listing Rule 19.2, an entity must comply with the listing rules as interpreted in accordance with their spirit, intention and purpose, by looking beyond form to substance and in a way that best promotes the principles on which the listing rules are based.
- 277 By ASX Listing Rule 19.3, expressions that are not specifically defined in the listing rules, but are given a particular meaning in the CA, have the same meaning in the listing rules.
- 278 By ASX Listing Rule 19.12:
- (a) an entity becomes aware of information if, and as soon as, an officer of the entity has, or ought reasonably to have, come into possession of the information in the course of performance of their duties as an officer of that entity; and
  - (b) information includes matters of supposition and other matters that are insufficiently definite to warrant disclosure to the market and matters relating to the intentions, or likely intentions, of a person.
- 279 Upon and from the commencement of its listing on the ASX, DSH ought to have disclosed that:
- (a) its Prospectus, published prior to its listing on the ASX, contained misleading statements, for the reasons pleaded in sections B.1 and D.1 above; and
  - (b) the financial position and performance of Dick Smith and DSH in respect of financial periods covered by the pleaded representations was no better than that stated in Annexure A, being the FY13 and 1Q14 results for DSSH prepared consistently with Australian Accounting Standards.
- 280 At the time of release of DSH's FY14 Financial Statements and the issuing of the FY14 ASX Announcement & Results Briefing, and thereafter, DSH ought to have disclosed:
- (a) the correct financial position and performance and the correct pro forma financial performance;
  - (b) that the level of rebates recorded in June 2014 of \$29.6 million was materially in excess of budgeted rebates for June 2014 of \$6.9 million and the level of rebates recorded in FY14 of \$98.1 million was materially in excess of budgeted rebates for FY14 of \$72.9 million;
  - (c) the declining rate of budgeted first margin gross profit (ie before accounting for rebates) from July 2012, being 17.6% in FY13, to June 2014, being 15.2% in FY14 with quarterly

first gross margins in FY14 of 17.6%, 17.0%, 15.7% and 10.7% for each of the four quarters of FY14;

- (d) the difficulty or impossibility for DSH to measure accurately the ageing and months' cover for each SKU and inventory generally due to the limitation in its inventory system and that there was no reliable data available regarding the ageing of inventory;
- (e) further, or in the alternative to paragraph (d) above, the increasing level of inventory months' cover: June 2013 being 4.7 months and June 2014 being 5.6 months;
- (f) the extent to which expenses had been capitalised in FY14;
- (g) the Rebate Maximisation Practice; and
- (h) the Rebate Maximisation Consequences, as they related to FY14.

#### **Particulars**

*First Potter Report at Chapters 8 and 11.*

*Second Potter Report at Chapters 8 and 11.*

*Third Potter Report at paragraph 9.31-9.48, 9.66-9.75 and 9.77-9.101.*

*Project Yellow Report at page 48.*

281 At the time of release of DSH's FY15 Financial Statements and the issue of the FY15 ASX Announcement & Results Briefing, and thereafter, DSH ought to have disclosed:

- (a) the correct financial position and performance and the correct pro forma financial performance;
- (b) that the level of rebates recorded in FY15 of \$126.3 million was materially in excess of budgeted rebates for FY15 of \$66.6 million;
- (c) the declining rate of budgeted first margin gross profit (i.e. before accounting for rebates) from 15.2% in FY14 to 12.9% in FY15;
- (d) the difficulty or impossibility for DSH to measure accurately the ageing and months' cover for each SKU and inventory generally due to the limitation in its inventory system and that there was no reliable data available regarding the ageing of inventory;

- (e) further, or in the alternative to paragraph (d) above, the increasing level of inventory months' cover: June 2014 being 5.6 months and June 2015 being 8.1 months;
- (f) the extent to which expenses had been capitalised in FY15;
- (g) the Rebate Maximisation Practice; and
- (h) the Rebate Maximisation Consequences.

**Particulars**

*First Potter Report at Chapters 8 and 11.*

*Second Potter Report at Chapters 8 and 11*

*Third Potter Report at paragraphs 9.49-9.75 and 9.77-9.101.*

*Project Yellow Report at page 48.*

282 At all material times, the matters pleaded above in paragraphs 279, 280 and 281 each and collectively constituted information which:

- (a) was not generally available within the meaning of s 674(2)(c)(i) of the CA;
- (b) a reasonable person would expect, if it were generally available, to have a material effect on the price or value of shares in DSH;
- (c) for the purposes of s 677 of the CA, would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of shares in DSH;
- (d) DSH had within the meaning of s 674(2) of the CA; and
- (e) ought reasonably have come into the possession of an officer of DSH in the course of the performance of his or her duties as an officer of DSH.

**Particulars**

*The plaintiffs repeat paragraphs 252, 255, 258, 259, 262, 265, 268, 269 and 272.*

283 By reason of the matters pleaded above in paragraph 282, and pursuant to ASX Listing Rule 3.1, DSH became obliged to, but failed to, inform the ASX about each of the matters pleaded above in paragraphs 279, 280 and 281 immediately upon it becoming aware of those matters.

284 By reason of the matters pleaded above in paragraphs 279 to 283, DSH contravened s 674(2) of the CA.

#### **D.4. MR ABOUD'S CONTRAVENTIONS**

285 Mr Abboud:

- (a) authorised the issue and publication of each of the FY14 Financial Statements and FY15 Financial Statements;
- (b) made each of the Directors' FY14 Express Representation, Directors' FY14 Implied Representation, Directors' FY15 Express Representation and Directors' FY15 Implied Representation;
- (c) caused each of the FY14 ASX Announcement & Results Briefing and FY15 ASX Announcement & Results Briefing to be issued and published; and
- (d) presented the results briefings forming part of the FY14 ASX Announcement & Results Briefing and FY15 ASX Announcement & Results,

286 By reason of his conduct pleaded in the preceding paragraph, Mr Abboud, on each of these occasions, engaged in conduct:

- (a) in relation to an offer of securities under a disclosure document, within the meaning of Chapter 6D of the CA;
- (b) in relation to a financial product or a financial service within the meaning of Part 7.1 of the CA;
- (c) in trade or commerce in relation to financial services within the meaning of s 12DA of the ASIC Act; and/or
- (d) in trade or commerce within the meaning of s 4 of the Australian Consumer Law.

##### **D.4.1. FY14 Financial Statements and DSH's FY14 Express Representation**

287 Mr Abboud had knowledge of the contents of the FY14 Financial Statements and DSH's FY14 Express Representation therein.

### **Particulars**

*The FY14 Financial Statements were provided to the Board of DSH prior to its meeting on 18 August 2014: Board Papers for 18 August 2014.*

*The FY14 Financial Statements were presented, discussed, and adopted by the Board of DSH on 18 August 2014: Minutes of meeting of the Board of DSH dated 18 August 2014 at page 2.*

*The Directors' Declaration that accompanied the FY14 Financial Statements was signed by the Chairman of DSH on behalf of Mr Abboud.*

- 288 Mr Abboud authorised the issue and publication of the FY14 Financial Statements and DSH's FY14 Express Representation therein.

### **Particulars**

*Minutes of meeting of the Board of DSH dated 18 August 2014.*

*The Directors' Declaration that accompanied the FY14 Financial Statements was signed by the Chairman of DSH on behalf of Mr Abboud.*

- 289 Mr Abboud's conduct pleaded in the preceding paragraph was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law, because he authorised the issue and publication of the FY14 Financial Statements and DSH's FY14 Express Representation therein which were misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law for the reasons pleaded and particularised above in sections D.1.2 and D.1.3.

- 290 Further, in authorising the issue and publication of the FY14 Financial Statements and DSH's FY14 Express Representation therein, Mr Abboud made statements, or disseminated information, which:

- (a) were false in a material particular or materially misleading;

### **Particulars**

*Sections D.1.2 and D.1.3 are repeated.*

- (b) were likely to induce, directly or indirectly, the plaintiffs and Group Members to acquire shares in DSH; and

**Particulars**

*The particulars at paragraph 254(b) are repeated.*

- (c) further, or in the alternative to paragraph (b), were likely to have the effect of increasing, maintaining or stabilising the price for trading in DSH Shares on ASX.

**Particulars**

*The particulars at paragraph 254(c) are repeated.*

291 When Mr Abboud authorised the issue and publication of the FY14 Financial Statements and DSH's FY14 Express Representation therein, he ought reasonably to have known that the statements, or dissemination of information, were false in a material particular or materially misleading for the reasons pleaded and particularised above in paragraph 255.

292 In the premises, Mr Abboud contravened s 1041E of the CA.

**D.4.2. Directors' FY14 Implied Representation**

293 Mr Abboud's making of the Directors' FY14 Implied Representation was misleading or deceptive, or likely to mislead or deceive, in contravention of s 1041H of the CA, s 12DA of the ASIC Act and/or s 18 of the Australian Consumer Law because the opinion pleaded at paragraph 92 held by him:

- (a) was not held on a reasonable basis and was not the product of the application of reasonable care and skill by Mr Abboud;
- (b) was not a matter to which Mr Abboud had turned his mind, having informed himself as to the financial affairs of the company to the extent necessary to form an opinion as to the truth and fairness of the accounts;
- (c) was not formed after Mr Abboud had read and understood the financial statements and considered whether the financial statements were consistent with his knowledge of DSH's and the DSH Group's financial position and financial performance; or