



17 March 2020

Ms Vanessa Nevjestic
Advisor, Listings Compliance (Perth)
Australian Stock Exchange

Dear Vanessa

Skin Elements Limited (SKN) – Queries Regarding Accounts

In response to your letter of 5 March 2020, Skin Elements Limited advises as follows:

ASX refers to:

- A. SKN's half year accounts for the half year ended 31 December 2019 lodged with ASX Market announcements Platform and released on 1 March 2020 ('Half Year Accounts').
- B. ASX notes that the Independent Auditor's Report attached to the Half Year Accounts ('Auditor's Report') contains a qualified conclusion together with the Basis for qualified conclusion:

"Qualified conclusion

We have reviewed the half-year financial report of Skin Elements Limited (the Company) and its subsidiaries (the Group), which comprises the consolidated statement of financial position as at 31 December 2019, the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the half year then ended, and notes comprising a statement of accounting policies and other explanatory information, and the directors' declaration.

Based on our review, which is not an audit, with the exception of the matter described in the Basis for qualified conclusion section, we have not become aware of any matter that makes us believe that the half-year financial report of the Group is not in accordance with the Corporations Act 2001 including: (i) Giving a true and fair view of the Group's financial position as at 31 December 2019 and of its financial performance for the half-year ended on that date; and (ii) Complying with Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Regulations 2001.

Basis for qualified conclusion

Included in the consolidated statement of financial position as at 31 December 2019 is technology and formula Intangible assets of \$8,799,721 as disclosed in note 9 and note 1(d)(i). Due to sustained operating losses, the Group has undertaken an impairment assessment of its Intangible in accordance with AASB 136 Impairment of assets.

Due to the significant variability of the future cash flows of the asset, we were unable to satisfy ourselves as to the appropriateness and reliability of the forecast of future cash flows that was included in the impairment model. Therefore we were unable to obtain sufficient appropriate evidence about the carrying value of the Intangible assets as at 31 December 2019.

Natural Science by Skin Elements

Consequently we were unable to determine whether any adjustments to the carrying value of the Intangible asset in the consolidated statement of financial position are necessary for the period ended 31 December 2019.

Emphasis of matter – Material uncertainty relating to going concern

We draw attention to Note 1 (b) in the financial report which describes the events and/or conditions which give rise to the existence of a material uncertainty that may cast significant doubt about the Group's ability to continue as a going concern and therefore the Group may be unable to realise its assets and discharge its liabilities in the normal course of business. Our conclusion is not modified in respect of this matter."

C. SKN's Corporate Governance Statement for 2019 lodged on the ASX Market Announcements Platform on 28 November 2019 which provides confirmation that SKN complies with recommendation 4.2 of the ASX Corporate Governance Principles and Recommendations (Third Edition) which states:

"The board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and CFO a declaration that, in their opinion, the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively."

D. Listing Rule 12.1 which states:

12.1 The level of an entity's operations must, in ASX's opinion, be sufficient to warrant the continued quotation of the entity's securities and its continued listing.

E. Listing Rule 12.2 which states:

12.2 An entity's financial condition (including operating results) must, in ASX's opinion, be adequate to warrant the continued quotation of its securities and its continued listing.

F. Listing Rule 19.11A which states:

19.11A If a listing rule requires an entity to give ASX accounts, the following rules apply.

(a) If the entity controls an entity within the meaning of section 50AA of the Corporations Act or is the holding company of an entity, required by any law, regulation, rule or accounting standard, or if ASX requires, the accounts must be consolidated accounts.

(b) The accounts must be prepared to Australian accounting standards. If the entity is a foreign entity the accounts may be prepared to other standards agreed by ASX.

(c) If the listing rule requires audited accounts, the audit must be conducted in accordance with Australian auditing standards by a registered company auditor. If the entity is a foreign entity, the audit may be conducted in accordance with other standards agreed by ASX and may be conducted by an overseas equivalent of a registered company auditor.

(d) If the listing rule requires accounts to be reviewed, the review must be conducted in accordance with Australian auditing standards. If the entity is a foreign entity, the review may be conducted in accordance with other standards agreed by ASX. Unless the listing rule says an independent accountant may conduct the review, it must be conducted by a registered company auditor (or, if the entity is a foreign entity, an overseas equivalent of a registered company auditor).

(e) If there is a directors' declaration that relates to the accounts, the directors' declaration must be given to ASX with the accounts.

(f) If there is a directors' report that relates to the period covered by the accounts, the directors' report must be given to ASX with the accounts.

Request for Information

In light of the information contained in the Half-Year Accounts and the Auditor's Report, and the application of the Listing Rules stated above, please respond to each of the following questions:

1. Is SKN able to confirm that in the Directors' Opinion the Half Year Accounts:

(a) comply with the relevant Accounting Standards; and

(b) give a true and fair view of SKN's financial performance and position?

SKN confirms that in the directors' opinion the Half Year Accounts comply with the relevant Accounting Standards, and give a true and fair view of SKN's financial performance and position

We note that the qualification matter described in the basis for qualified conclusion was in respect of the auditor not being able to obtain sufficient appropriate audit evidence that SKN's Intangible assets recoverable amount was not lower than its carrying value as reported in the 2019HYR, rather than a qualification stating that the accounts had not complied with AASB 136.

The directors believe that the cashflow projections they used to justify the recoverable amount of these assets are reasonable and reliable forecasts and that the requirements of AASB 136 have been fully complied with.

2. Please explain the basis for and the factors considered by the Directors to satisfy themselves that future cashflows that were included in the impairment model were appropriate?

The Company's assessment of impairment is based on the best estimate of future cash flows available at the time of preparing the report. However, facts and circumstances may come to light in later periods which may change this assessment if these facts had been known at the time.

Due to sustained operating losses of the group, the Group has undertaken an impairment assessment of its Intangible assets in accordance with AASB136 *Impairment of assets*. The recoverable amount of Intangible assets is determined from a value in use model. The key assumptions for the value in use calculations are those regarding the future forecast cashflows which takes into account discount rates, growth rates and direct costs during the period and include:

- Receiving \$1 million working capital from equity through underwritten rights issue which will provide working capital to fund the Company's operations,
- Securing a \$270,000 debt production funding facility to fund scale production of the Company's products,
- Commencing scale production of the full range of the Company's skincare products under terms with contract manufacturers,
- Increase in sales through the Company's existing sales channels including \$200,000 in customer prepayments in the first two months of 2020.

As a result of the assessment, no impairment loss was recognised for the period.

3. What steps has SKN taken since the release of the Half Year Accounts to obtain an unqualified opinion with regards to its future financial statements?

The Directors are confident that the increased working capital, increased production and increased sales activities will validate the reliability of SKN's cash flow models used to support the recoverable amount of the intangible assets.

The directors anticipate that they will be able to satisfy the auditor at 30 June 2020 that the models used to determine the recoverable amount of the asset are reliable and will receive an unqualified audit opinion.

4. Does SKN consider that its level of operations is sufficient to warrant continued quotation of its securities on ASX as required under listing rule 12.1? In answering this question, please explain the basis for this conclusion. In answering this question, please comment on the nature of the SKN's current business activities.

For the reasons detailed in response 2. above SKN considers that its level of operations is sufficient to support the underlying valuation of approximately \$9 million for its intellectual property and warrant continued quotation of its securities on ASX as required under Listing Rule 12.1.

As detailed in the Half Year Report, Skin Elements did not achieve sales results compared to previous periods due to the focus on the China distribution project and the resulting delay in production of stock during the past year. With the focus now on production of its Soleo Organics and PapayaAvtivis ranges, the Company believes that it can achieve at a minimum, sales consistent with previous periods.

5. Does SKN consider that the financial condition of SKN is sufficient to warrant continued listing on ASX as required under Listing Rule 12.2? In answering this question, please also explain the basis for this conclusion.

SKN considers that the financial condition of SKN is sufficient to warrant continued listing on ASX as required under Listing Rule 12.2.

As set out in the Company's Half Year Report for 31 December 2019 the Group recorded a loss of \$1,108,530 (31 December 2018: \$1,432,081 loss), a net working capital surplus of \$133,199 (30 June 2019: surplus of \$200,028) and had net cash outflows from operating activities of \$244,387 (31 December 2018: \$1,257,759).

Management believe there are sufficient funds to meet the entity's working capital requirements based upon future cashflow projections which include:

- Receiving \$1 million working capital from equity through underwritten rights issue which will provide working capital to fund the Company's operations,
- Securing a \$270,000 debt production funding facility to fund scale production of the Company's products,
- Commencing scale production of the full range of the Company's skincare products under terms with contract manufacturers,
- Increase in sales through the Company's existing sales channels including \$200,000 in customer prepayments in the first two months of 2020.
- The group expects to continue to receive the full support of its creditors; and
- Non-call of amounts payable to related parties;

6. If the answer to questions 4 or 5 is "No", please explain what steps SKN has taken, or proposes to take, to warrant continued listing on ASX under the requirements of Listing Rules 12.1 and 12.2.

See 5 above

7. In relation to the Half Year Accounts, did the Board receive the CFO and CEO declaration, as described in section 4.2 of ASX's Corporate Governance Principles and Recommendations, that in the opinion of the CFO and CEO, the financial records of SKN have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of SKN and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively?

Yes, the Chief Financial Officer and the Executive Chairman have confirmed that the financial records of SKN have been properly maintained and that the financial statements comply with appropriate accounting standards and give a true and fair view of the financial position and performance of SKN formed on the basis of a sound system of risk management and internal control which are operating effectively.

Skin Elements Limited has a formally established Audit and Risk Committee. The purpose of the Committee is to provide assistance to the Board in fulfilling its corporate governance and oversight responsibilities, as well as advise on the modification and maintenance of the Company's financial reporting, internal control structure, risk management systems, external audit functions, and appropriate ethical standards for the management of the Company.

The Board and Committee take a proactive approach to risk management. The identification and proper management of risk within SKN is a priority for the Company.

The Committee is responsible for oversight of the processes whereby risks, and also opportunities, are identified on a timely basis and the Company's objectives and activities are aligned with the risks and opportunities identified and recommendations made to the Board.

The Company has sought to minimize business risks by focusing on the Company's core business. The Board and Committee are responsible for ensuring that the Company's risk management systems are adequate and operating effectively.

An annual review of the Company's risk profile is undertaken by the Committee and any material changes to the risk profile are noted. To assist the Committee to conduct the annual review, management and key executives are required to report on any material risks identified, how the risks are being managed, the implementation of any risk management or internal control system, and whether any breaches of the risk management policies have occurred during the preceding 12 months.

8. If the answer to Question 7 is 'no', why did the Board not receive the CEO and CFO declaration as described in section 4.2 of SKN's Corporate Governance Disclosure?

See 7 above

9. What enquiries did the Board make of management to satisfy itself that the financial records of SKN have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of SKN?

The directors make regular and direct inquiry of the management of the Group to satisfy itself that the financial records of SKN have been properly maintained and that the financial statements comply with the appropriate accounting standards and give true and fair view of the financial position and performance of SKN.

In particular in relation to the assessment of the carrying value of intangible assets the Board actively reviewed the cashflow forecasts and the underlying key assumptions supporting those forecasts. Members of the Board also directly attended meetings with and participated in negotiations with opportunities for development of the business which provided a first hand understanding of the underlying assumptions in the cashflow forecast model.

10. Commenting specifically on the qualified conclusion, does the board consider that SKN has a sound system of risk management and internal control which is operating effectively?

The directors believe that SKN has a sound system of risk management and internal control which is operating effectively.

Management has produced detailed cashflow models to support the recoverable amounts of its intangibles, the models show that the intangible assets recoverable amount is well in excess of its carrying value.

All intangibles are being actively commercialised.

11. Given the Auditor has been unable to obtain sufficient and appropriate audit evidence as to whether the SKN can continue as a going concern and SKN has cash and cash equivalents of \$36,679 and total current liabilities of \$321,826 as at 31 December 2019, on what basis do the directors consider that SKN is a going concern.

The directors have formed the opinion that SKN is a going concern for the reasons set out in response 5 above and as detailed in the half year report.

12. Please confirm that SKN is complying with the Listing Rules and, in particular, Listing Rule 3.1.

We confirm that SKN is complying with the Listing Rules and, in particular, Listing Rule 3.1. and there is no information that should be given to ASX about its financial condition under that rule that has not already been released to the market.

13. Please confirm that SKN's responses to the questions above have been authorised and approved under its published continuous disclosure policy or otherwise by its board or an officer of SKN with delegated authority from the board to respond to ASX on disclosure matters.

SKN's responses to the questions above have been authorised and approved in accordance with its published continuous disclosure policy.

Yours sincerely



Craig Piercy
Company Secretary