



25 March 2019

Ms Penelope Reid
Advisor, Listings Compliance (Perth)
Australian Stock Exchange

Dear Penelope

Skin Elements Limited (SKN) – Queries regarding Accounts

In response to your letter of 12 March 2019, Skin Elements Limited advised as follows:

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 financial statements for the period ended 31 December 2018 (2018HYR):

- (a) Comply with the relevant Accounting Standards; and
- (b) 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 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 2018HYR, 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. 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 the Group has a net asset position of \$9,415,089, has a suite of over 40 natural skincare products developed and is pursuing significant opportunities to develop and grow its business of commercialising these products.



As set out in the Company's Interim Financial Report, Skin Elements ability to continue is based upon the Company:

- Achieving positive cashflows from securing major distribution agreements.
- Raising additional equity to contribute to the Group working capital position in the near term.

In this regard the Company announced on 25 March 2019 that it had entered into a Term Sheet with Henan Huatuo Health Management Co, Ltd (HHHM) for proposed distribution into the China Skincare market. The relevant key terms of this agreement are set out in the announcement and in summary propose (subject to terms and conditions):

- \$20 million in orders progressively over three years
- Provision of additional strategic investment of \$2.4 million.

The Company believes that this announcement is indicative of the opportunities for the Company's technologies.

3. If the answer to questions 2 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 above.

4. In relation to the Half Year Accounts, did the Board receive the CFO and CEO declaration, as described in SKN's Corporate Governance – 2 Audit and Risk Management Committee Charter ('Corporate Governance Disclosure'), 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 reporting risk management and associated compliance and controls have been assessed and the adequacy of the system of risk oversight, management and internal control.

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.

5. If the answer to Question 4 is 'no', why did the Board not receive the CFO and CEO declaration as described in SKN's Corporate Governance Disclosure?

See above

6. 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 Board of Directors makes 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.

7. 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 Board believes 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.



8. As the qualified conclusion in the Auditor's Review Report relates to the Auditor's inability to obtain sufficient appropriate audit evidence about the carrying value of SKN's intangible assets, as a result of the Auditor's inability to satisfy themselves as to the appropriateness and reliability of the forecast, please explain how the directors of SKN satisfied themselves that the carrying values are appropriate and adhere to the current Australian Accounting Standards.

The forecast cashflows prepared by management to determine the intangible asset's recoverable amount, involve SKN successfully completing negotiations with major customers overseas, particularly in the UK, USA and China.

Although the board are confident that these negotiations will lead to major sales contracts as at the date of issuing the 2018HYR there were no signed contracts in place and there had been delays to the projects as originally anticipated at the time of the June 2018 audit.

Management and directors are involved in day to day negotiations with these customers and are confident of their success however they were unable to provide the auditors with signed agreements or confirmed orders as evidence as to the commercialisation proceeding.

9. We note the Auditor's Report in SKN's Annual Report highlighted the carrying value of intangible assets as a key audit matter. The Auditor's Report identified the procedures used to address the matter in the audit. What circumstances have changed in the period subsequent such that those procedures were unable to be relied on in the review of the carrying value of intangible assets in SKN's Half Year Accounts? Please explain with reference to the Auditor's finding of insufficient audit evidence and the qualified conclusion in SKN's Half Year Accounts.

The cashflow models used to determine the intangible assets recoverable amount in June 2018, assumed the successful completion of major contracts with a major UK retail chemist chain and a major retailer in the USA . These forecasts were supported by documentation as to the promising on- going negotiations with these prospective customers. At the same time SKN had working capital and could demonstrate an ability to raise sufficient funds to commercialise these opportunities.

At the time of the review the following circumstances impacted the auditors confidence that these forecasts could be relied upon.

- (a) Both the UK and US projects had fallen behind the timetable envisaged in June
- (b) The UK project was delayed largely as a result of SKN having difficulties in sourcing the necessary packaging, and as a result having to explore alternative sourcing of appropriate packaging.
- (c) The US Project was delayed due to a request for additional market point of difference analysis information.
- (d) SKN's had reduced working capital
- (e) SKN were actively negotiating with a Chinese entity regarding a distribution agreement and strategic investment

The Directors believe that these setbacks and delays would be more than mitigated by the significant opportunity from a major Chinese customer. SKN had commenced negotiations with the Chinese customer/ investor in November 2018, however, at the time of the auditor issuing their review



report, the agreement had not been finalised and no monies had been deposited with SKN. For this reason the auditor was not able to form a view as the Company could not provide evidence of settlement.

As set out above and announced on 21 March 2019, these negotiations have, as the directors anticipated in the determination of the intangible assets recoverable amount, resulted in both a major sales order and access to funds to allow SKN to progress its go to market plan, including in the UK, USA and online sales

10. What steps does SKN intend to take to obtain an unqualified audit conclusion with regards to its future financial statements?

The Directors are confident that the arrangement with the Chinese customer / investor will validate the reliability of SKN's cash flow models used to support the recoverable amount of the intangible assets.

The models validity will be further strengthened by progressing the major opportunities with the UK and US customers.

The directors anticipate that they will be able to satisfy the auditor at 30 June 2019 that the models used to determine the recoverable amount of the asset are reliable and will receive an unqualified audit opinion.

11. 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.

12. Please confirm that SKN's responses to the questions above have been authorised and approved in accordance with 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.

We confirm that SKN's responses to the questions above have been authorised and approved by the Board of Directors under its published continuous disclosure policy.

Yours sincerely



Craig Piercy
Company Secretary

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12 March 2019

Mr Craig Piercy
Company Secretary
Skin Elements Limited
7/36 Ord Street
WEST PERTH WA 6005

By email: craig@senatural.com

Dear Mr Piercy

Skin Elements Limited ('SKN'): Queries regarding Accounts

ASX refers to:

- A. SKN's Half Year Accounts for the half year ended 31 December 2018 released on the ASX Market Announcements Platform ('MAP') on 1 March 2019 ('Half Year Accounts').
- B. ASX notes that the Independent Auditor's Report prepared by BDO Audit (WA) Pty Ltd ('Auditor') attached to the Half Year Accounts ('Auditor's Review Report') contains a qualified conclusion supported by the following basis for the qualified conclusion:

"Included in the consolidated statement of financial position as at 31 December 2018 is technology and formula Intangible assets of \$9,228,775 as disclosed in note 8 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 cashflows that was included in the impairment model. Therefore we were unable to obtain sufficient appropriate audit evidence about the carrying value of the Intangible assets as at 31 December 2018.

Consequently we were unable to determine whether any adjustments to the carrying value of the Intangible asset in the statement of financial position are necessary for the period ended 31 December 2018."

- C. SKN's Corporate Governance Statement for 2018 released on MAP on 29 September 2018 which provides confirmation that SKN complies with recommendation 4.2 of the ASX Corporate Governance Principles and Recommendations 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. SKN’s Annual Report for the year ended 30 June 2018 released on MAP on 31 October 2019 (‘Annual Report’), which included the following key audit matter ‘Carrying Value of Intangible Assets’ contained in the Independent Auditor’s Report (‘Auditor’s Report’) on page 78 of the Annual Report:

“Key audit matter

As disclosed in note 9 of the financial report, technology and formula intangible assets in relation to Soleo Organics, McArthur and Elizabeth Jane have been recognised at 30 June 2018.

As disclosed in accounting policy 1(m) the Group assesses at each reporting date whether there is an indication that an asset may be impaired.

The carrying value of these intangible assets is a key audit matter as the Group uses judgement to determine the recoverable amount of these assets.

As disclosed in note 1(f) of the financial report there is significant management judgement involved in management’s assessment of the recoverable amount of these intangible assets at 30 June 2018. These estimates center on the timing and quantum of future cash flows.

How the matter was addressed in our audit

Our procedures included, but were not limited to the following:

- *Obtaining evidence to support key inputs used in the discounted cash flow calculations including the following:*
 - *Forecasted sales growth rates attributed to product development plans and new sales channels and customers;*
 - *In conjunction with our valuation specialist, comparing the discount rate utilised by management to an independently calculated discount rate;*
- *Performing sensitivity analysis on the revenue, growth rates, gross profit margins and discount rates; and*
- *Evaluating the adequacy of the related disclosures in notes 1(f), 1(m) and 9 of the financial report.”*

- E. 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.

- F. 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.

- G. 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 Review 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?
2. 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.
3. If the answer to questions 2 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.
4. In relation to the Half Year Accounts, did the Board receive the CFO and CEO declaration, as described in SKN's Corporate Governance – 2 Audit and Risk Management Committee Charter ('Corporate Governance Disclosure'), 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?
5. If the answer to Question 4 is 'no', why did the Board not receive the CFO and CEO declaration as described in SKN's Corporate Governance Disclosure?
6. 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?
7. 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?
8. As the qualified conclusion in the Auditor's Review Report relates to the Auditor's inability to obtain sufficient appropriate audit evidence about the carrying value of SKN's intangible assets, as a result of the Auditor's inability to satisfy themselves as to the appropriateness and reliability of the forecast, please

explain how the directors of SKN satisfied themselves that the carrying values are appropriate and adhere to the current Australian Accounting Standards.

9. We note the Auditor's Report in SKN's Annual Report highlighted the carrying value of intangible assets as a key audit matter. The Auditor's Report identified the procedures used to address the matter in the audit. What circumstances have changed in the period subsequent such that those procedures were unable to be relied on in the review of the carrying value of intangible assets in SKN's Half Year Accounts? Please explain with reference to the Auditor's finding of insufficient audit evidence and the qualified conclusion in SKN's Half Year Accounts.
10. What steps does SKN intend to take to obtain an unqualified audit conclusion with regards to its future financial statements?
11. Please confirm that SKN is complying with the Listing Rules and, in particular, Listing Rule 3.1.
12. Please confirm that SKN's responses to the questions above have been authorised and approved in accordance with 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.

When and where to send your response

Please note that ASX reserves its right under Listing Rule 18.7A to release this letter and SKN's response to the market. Accordingly, SKN's response should address each question separately and be in a format suitable for release to the market.

Unless the information is required immediately under Listing Rule 3.1, a response is requested as soon as possible and, in any event by no later than **5.00 pm AWST Friday, 15 March 2019**.

Any response should be sent to me by return email at ListingsCompliancePerth@asx.com.au. It should not be sent to the ASX Market Announcements Office.

Enquiries

If you have any queries regarding any of the above, please contact me.

Yours sincerely

Penelope Reid
Adviser, Listings Compliance (Perth)