ICAEW
CORPORATE FINANCE FACULTY

Consultation paper on prospective financial information

July 2017

FINANCING CHANGE INITIATIVE

The ICAEW Corporate Finance Faculty is a network of 7,000 professionals involved in corporate finance and a centre of professional excellence. The faculty's thought leadership initiative, Financing Change, seeks to advance the economic and social contribution of corporate finance activity by promoting better understanding of the value it can create as well as its role in improving efficiency and practice in capital markets.

This consultation paper is part of the Financing Change initiative.

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1. Introduction

1.1 OVERVIEW

1. This consultation paper is about ICAEW's plans to update *Prospective Financial Information: Guidance for UK Directors* which was published in 2003. The 2003 guidance was developed in the context of the UK regulatory environment, because directors who are ICAEW members have to prepare prospective financial information (PFI) and ICAEW members (ie, reporting accountants) have to report on matters relating to certain PFI that directors include in investment circulars.
2. The 2003 guidance sets out a framework of principles and application notes for preparing and publishing PFI in a capital markets transaction context. There are regulatory requirements relating to PFI in that context – for example, when raising capital on equity markets. Such PFI includes profit forecasts and warnings, working capital statements, merger benefit statements and a range of other financial projections.
3. ICAEW is embarking on an exercise to update the 2003 guidance and believes that a new framework has a wider role to play as an enabler for businesses to communicate PFI.
4. There is an increasing number of funding options available to businesses, irrespective of size and stage of growth. What is typical across these funding options is the requirement for businesses to prepare high quality, credible prospective information - information that is useful ie, that meets the user's needs. ICAEW plans to refresh the preparation principles in the 2003 guidance and to promote application to all PFI but subject to a proportionate approach outside of a capital markets transaction context.
5. ICAEW plans to update the guidance for application in a capital markets transaction context. As the application of principles in a private finance-raising situation will not be the same as it is in the context of a regulated capital market transaction, ICAEW is consulting on whether separate application guidance is needed for other finance-raising.
6. Other areas where ICAEW believes the PFI framework may be of value, while outside the scope of this paper, are flagged for further research.

1.2 CONSULTATION QUESTIONS

7. ICAEW has taken initial soundings on its proposals from stakeholders and market participants and now seeks input from all interested parties on the consultation questions below.

	Section
Q1: ICAEW has identified many developments in recent years which affect businesses' preparation of PFI, for example in relation to: • Capital markets regulation • Business fundraising markets • Business reporting • Information availability • Accountability and governance In your view what are the most important recent and prospective developments that ICAEW will need to take into account when updating the 2003 guidance?	2.1
Q2: ICAEW has received feedback from preparers, regulators, advisers and users of PFI on the application of the 2003 guidance. Do you have any comments on the feedback summarised in this section and any additional observations?	2.2
Q3: The proposed new framework for PFI will comprise: • general principles for the preparation of PFI; and • guidance notes on applying the principles and application notes covering specific types of PFI, in certain circumstances. Do you have any comments on whether this is an appropriate structure?	2.3

Q4: ICAEW intends to keep the four attributes of useful PFI and the three principles for preparing PFI that are set out in the 2003 guidance, while adding two new attributes. Do you believe that the existing attributes and principles continue to be appropriate and necessary? Do you have any comments on the proposed additional attributes of useful PFI that it should be aligned and 'not misleading'? Do you believe that new preparation principles are needed for the additional attributes?

Q5: ICAEW proposes extending the scope of the framework to PFI that is prepared for private finance-raising situations. Do you have any comments on applying the principles and attributes of useful PFI to private finance-raising and the forms of PFI and private finance-raising involved?

Q6: ICAEW proposes developing new application notes for preparing PFI in the context of regulated, capital markets transactions. Such notes will address topics (eg, profit forecasts and estimates, changes in expectations of performance, working capital statements, and synergy benefits and quantified financial benefits statements) but will not reproduce specific detailed regulations. Do you have any comments in relation to the topics identified and the nature of the application guidance?

Q7: ICAEW proposes to develop an application note for private finance-raising situations where proportionate application of the PFI framework is appropriate. What other form of application support might be useful for preparing PFI for private finance-raising? Do you have any comments as to how this might be developed in conjunction with specialist groups, and whether additional application notes should be developed for specific types of private finance-raising?

Q8: ICAEW plans to explore whether the new framework could be extended to a wider range of PFI, such as PFI that underpins financial reporting and broader corporate reporting requirements and PFI prepared for purposes other than finance-raising. Do you have any comments on whether such extended application would be beneficial and what sorts of PFI might be covered?

1.3 BACKGROUND

8. The 2003 guidance promoted a unified approach to producing high-quality PFI that complied with the circumstances in which UK regulators required companies to publish PFI in a capital markets transaction context. The guidance helped to give users confidence as to the quality of PFI and was welcomed by UK regulators and directors.

9. The principal purpose of the 2003 guidance is to assist directors to meet the information needs of investors and regulators and to promote the publication of high-quality PFI in a capital markets transaction context. Such PFI is subject to regulatory requirements. Application notes for directors within the 2003 guidance assist them to understand what they need to consider with regard to the preparation of PFI, by setting out the attributes of useful PFI and the principles for preparing PFI (together, the PFI framework) as well as processes that directors should have in place to produce it.

10. The 2003 guidance also assists reporting accountants, as it helps lead to the development of information with attributes that are capable of being reported on. However, the 2003 guidance does not cover how the reporting accountant discharges their responsibilities when reporting on PFI, which is within the scope of the Standards for Investment Reporting (SIRs) published by the Financial Reporting Council (FRC).

11. It is not the purpose of the 2003 guidance to question when or where PFI should be produced. It is also not intended to impose additional requirements to prepare or disclose PFI, or to create roadblocks for the preparation and publication of PFI.

12. The 2003 guidance mainly applies to published PFI in a capital markets transaction context, rather than to unpublished PFI. The 2003 guidance is based on the listing rules and other regulatory requirements that were extant when it was published. Since then, that body of regulation has undergone both fundamental changes - most notably with the implementation of the prospectus and transparency/reporting elements of the European harmonisation programme - and routine updates. While the principles in the 2003 guidance continue to inform the preparation of published PFI, most of the regulatory references have been superseded.

13. It is not known what capital markets regulation in the UK will look like once the UK leaves the European Union (EU). A PFI framework, however, is expected to continue to be relevant in the UK as well as in the EU as the PFI principles seek to meet users' needs.

14. ICAEW proposes an updated framework of PFI principles. It also proposes new application notes for PFI in the context of capital markets transactions, that are consistent with regulation and market practice, but which will not reproduce each specific rule.

15. Given changes in the wider business forecasting and reporting environment, ICAEW has considered the relevance of guidance beyond the capital markets transaction focus of the 2003 guidance. ICAEW considers that updated guidance would, specifically, be useful in private finance-raising situations and should promote voluntary application of the updated framework more explicitly than the 2003 guidance does. There is a public interest in having common standards for the preparation of PFI and, in the new framework, it is proposed to define PFI more widely, to include all financial information that relates to a future period or has a future date.

1.4 OUR APPROACH

16. ICAEW, through its Corporate Finance Faculty, established a Working Group, whose members are listed in Appendix 1, to help review the need for updated guidance to replace the 2003 guidance. Assuming such a need exists, the Working Group will also develop such guidance. The Working Group members are experienced in advising businesses that publish PFI and in regulated reporting on published PFI.

Pre-consultation with market participants

17. To help review the need for up-to-date guidance, the Working Group identified other market participants whose views could influence the decision to update the 2003 guidance. In a series of meetings starting in 2015, the Working Group consulted the parties listed in Appendix 2 to understand whether published PFI meets users' needs and the extent and nature of application guidance needed.

18. The discussions indicated broad support for refreshing the PFI principles and for updated application guidance for PFI in a capital markets transaction context. Other themes explored in the pre-consultation were:
    - changes in the regulatory regime since the 2003 guidance was published;
    - developments in markets and business forecasting;
    - the potential relevance of the PFI principles to the preparation of projections prepared for purposes other than in a capital markets transaction context; and
    - trends for forward-looking information in financial and corporate reporting.

19. A summary of relevant pre-consultation feedback is included in section 2.2. Certain other topics were flagged during the pre-consultation and, in section 2.8, ICAEW signals its intention to explore the appropriateness of the framework to other PFI. This, however, will be a separate exercise, beyond the scope of this consultation paper.

Aim of consultation paper

20. With this consultation paper, the Working Group seeks a mandate for the proposed scope of new PFI guidance. The commentary sets out the Working Group's thinking for:
    - updating the PFI attributes and principles;
    - developing up-to-date guidance and commentary for applying the principles (application notes); and
    - the scope of the new PFI framework.

21. Section 1.5 invites comments on the Working Group's proposals and other relevant issues. The Working Group will develop and publish for consultation an exposure draft of new guidance for preparers, which will be informed by feedback on this consultation paper. This is likely to be in 2018.

Anticipated benefits

22. The consultation process and issue of an exposure draft will likely increase awareness of the best-practice framework among preparers, reporting accountants and users and will encourage such groups to refer to and apply it.

23. The introduction of updated guidance can also have the following benefits for preparers and users of PFI:
    - The updated framework will provide a reference for cohesive business reporting that meets relevant requirements.
    - PFI prepared under the updated framework can help enhance understanding of the business and encourage users' confidence in their relationship with the business.

- The new framework will promote principles for preparing PFI that are generally accepted as appropriate for use in capital markets transactions, and for proportionate use in private finance-raising, and that are compatible with other requirements.
- Application of the principles will encourage rigour and accountability in the preparation of PFI, without overriding other requirements.
- Updated guidance will be concise and principles-based. It will include application notes in a UK capital markets transaction context that reflect up-to-date regulatory requirements and market practice, without reproducing detailed rules. It will also include guidance for private financing situations where proportionate application may be more appropriate.
- Individual application notes can, where necessary, be updated or added without requiring the whole framework to be revised.

Timeline

24. The consultation process is summarised in the timeline below.

Timing	Output
2015 - Q2 2017	Pre-consultation exercise
July - 31 October 2017	Public consultation: the case for and scope of proposed new guidance
Q2 2018 (est)	Response statement: feedback on public consultation on scope Public consultation: exposure draft of new guidance
Q1 2019 (est)	Response statement: feedback on public consultation on exposure draft New technical guidance for preparers of prospective financial information, replacing the 2003 guidance after a transition period

1.5 INVITATION TO COMMENT

25. The Working Group is seeking responses from interested parties to any or all of the questions in section 1.2. The questions aim to:
    - enable the consideration and identification of the preparation and publication issues with PFI and the 2003 guidance;
    - understand the range of circumstances in which forward-looking financial information is prepared and the impact of developments; and
    - seek market support for the proposed scope of updated guidance.
26. The Working Group would be particularly interested to hear views of preparers and those in business, investors, professional advisers, providers of private capital and regulators.
27. Comments may be sent by email as a Word file, or by post to:

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    Please supply comments by 31 October 2017.
28. It would be helpful, where appropriate, to provide reasons to support your answers.
29. The Working Group would welcome the opportunity to receive feedback through roundtables or separate meetings. Please contact Katerina Joannou if you would like to discuss the matters in this paper in person.

2. *Areas for consultation*

2.1 THE CASE FOR UPDATED GUIDANCE

30. Since the 2003 guidance was published, much has happened in the legal and regulatory framework and also in the environment in which businesses prepare PFI. Increasing uncertainty and pace of change faces most businesses. The guidance for preparing high-quality, useful PFI needs to be updated to take developments into account and this section sets out those with the potential to influence, or that are already influencing, business practices.

Capital markets regulation

31. Changes in law and regulation include, fundamentally, changes to implement the applicable EU regulations and directives. In the UK in 2005, much of the law and regulation that is referred to in the 2003 guidance was superseded by the Listing Rules, the Prospectus Rules and the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority (FCA). The rules of existing and new multilateral trading facilities such as AIM and NEX Exchange Growth Market (formerly, ISDX Growth Market), have also changed and developed since 2003.

32. The requirements for profit forecasts and quantified financial benefits statements (QFBS) - formerly merger benefits statements - in the City Code on Takeovers and Mergers (the Takeover Code) were amended in 2013, in part to improve consistency with other regulations, standards and guidance, including the 2003 guidance.

33. A new market abuse regime (MAR) came into force in the EU on 3 July 2016, to strengthen EU rules on market integrity and investor protection. The scope of MAR is also extended to new markets and trading venues including to 'unregulated' exchanges and so, for example, now applies to AIM and NEX Exchange Growth Market. Unlawful behaviour in the context of market abuse has three elements – insider dealing, unlawful disclosure of information and market manipulation. The MAR also includes market soundings, which capture communications to gauge the interest of investors in a potential transaction and passed orally by issuers to shareholders, for example in meetings before major business changes or corporate events.

34. At the date of this paper, it is not known what capital markets regulation in the UK will look like once Britain leaves the EU. A PFI framework, however, is expected to continue to be relevant in the UK as well as in the EU, as the PFI principles seek to meet users' needs. The 2003 guidance has continued to be used since the EU's regulations and directives were implemented, despite the outdated regulatory references, but needs to be updated for the reasons set out above.

Business fundraising markets

35. Options other than public equity or debt markets have become mainstream sources of new funds for business investment: private equity, corporate debt, private placements, bank debt, crowdfunding (investment- and loan-based) and alternative sources of finance.

36. In 2011, *The Kay review of UK equity markets and long-term decision-making*, an independent review commissioned by the UK Government, reported that equity markets have not been an important source of capital for new investment in British business for many years. This was supported by Bank of England data showing that net equity issuance of private, non-financial companies was negative between 2003 and 2011. A subsequent report in 2015 by TheCityUK, *Review of the European Listings Regime*, stated that, across the EU, capital markets play 'too small a role' in financing European businesses – in particular SMEs. And in a recent discussion paper in 2017, *DP17/2 Review of the effectiveness of primary markets: The UK primary markets landscape*, the FCA reported that discussions with market participants suggested that more companies stay private for longer than in the past.

37. Policymakers internationally have aimed to diversify the sources of finance available to, and used by, businesses – in particular in the aftermath of the financial crisis when there was a reduction in the supply of bank debt. The relevance of this is that businesses tend to prepare PFI when applying to such sources for new or extended funding, despite the sources being private. The attributes of useful PFI that is prepared for finance raising, whether from private sources or public markets, traditional or newer sources, are likely to be common. While such PFI is not within the scope of the 2003 guidance, it is proposed that the preparers of PFI for private financing purposes could benefit from applying the principles for published PFI.

Business reporting

38. While the environment may have become more sophisticated, well-established constraints on preparing PFI persist, namely business systems' capability, availability of appropriate skills and the time required to ensure the reliability of information produced. Added to these are shortening reporting cycles, differing levels of risk appetite (eg, between preparers and users), the complexity of particular industries and challenges in selecting appropriate approaches to modelling (eg, granular, bottom-up forecasting v an approach that focuses on key drivers and material items) and stress-testing. Forecasts may be based on Monte Carlo analysis or other complex method or they may be based on a list of contracts. In addition, some businesses are using more non-financial information and other indicators to paint a more complete picture of their position and prospects, the risk factors and the risk mitigation strategy.

Information availability

39. Digitalisation and data analytics have the potential to be transformational for predictive and business analysis of data. The impact of digital transformation extends to data availability and immediacy, simulation analysis, power for experimentation and predictive modelling. Technological improvements in systems security and integrity processes, coupled with increases in the types and capabilities of predictive models and evolution of accuracy measures, undoubtedly have enhanced businesses' ability to forecast and prepare PFI. These outcomes may help to mitigate some of the typical constraints in forecasting, which include time, money and effort.

40. In this context, technological developments can potentially also have a negative impact. The risks that data is inaccurate, inconsistent, duplicated or out of date are amplified with big data. Moreover, more data being available more quickly does not ensure the granular quality of data – there can be a trade-off between data speed and volume versus quality. More sophisticated predictive models still require robust assumptions to underpin the input as well as skilled judgements of the output. ICAEW's 2014 report Big data and analytics – what's new, observed that it is a big step from gaining insights from data to predicting outcomes. It is then a further step to generating PFI that is consistent with accounting policies.

Accountability and governance

41. Businesses are striving more and more towards cohesive, integrated reporting. This stems from a greater recognition that investors need to understand links between strategy, performance, drivers and risk. Integrated reporting is enabled by better risk management and improved enterprise resource planning. CEOs are more closely involved and PFI is increasingly used to run businesses – even if that PFI is not published. This leads to heightened board expectations for rigour and risk management in both the preparation of the PFI they scrutinise, and in management's response to any problems identified in stress-testing. The disciplines for preparing PFI have become deeper and wider and, thus, more sophisticated and this aids accountability.

42. To respond to the range of factors with the potential to influence PFI, ICAEW believes that voluntary application of the updated framework should be more explicit than it is in the 2003 guidance and the updated guidance should not be limited to published PFI. For the purpose of this section and in the remainder of this paper, the term 'PFI' will include all financial information that relates to a future period or has a future date.

Q1: ICAEW has identified many developments in recent years which affect businesses' preparation of PFI, for example in relation to:

- Capital markets regulation
- Business fundraising markets
- Business reporting
- Information availability
- Accountability and governance

In your view what are the most important recent and prospective developments that ICAEW will need to take into account when updating the 2003 guidance?

2.2 EXPERIENCE OF APPLYING THE 2003 GUIDANCE

43. The 2003 guidance promotes a framework of best practice for preparing PFI that is to be published in the context of a capital markets transaction. It encourages the provision of high-quality PFI that is relevant, reliable, understandable and comparable – including where it is provided voluntarily, or not explicitly required. The framework helps give investors confidence in the quality of PFI and supports their decision-making.

44. ICAEW pre-consulted representatives of preparers and users of published PFI, including investors, regulators, legal advisers, financial advisers and reporting accountants, on the extent to which the 2003 guidance has served its intended purpose. Insights from applying the PFI principles, publishing PFI, using it and reporting on it, will help determine what users need from updated guidance.

45. A summary of pre-consultation feedback is set out under the themes below:

- UK market features
- Suitability of PFI principles
- Use of 2003 guidance

UK market features

46. Market participants reported having encountered differences in the approach to PFI across capital markets; there are variations in what preparers publish and what investors expect to receive as well as in the requirements of different regulators. There was a commonly-held view that the UK market is among the least open to publishing PFI, compared to the US and some European capital markets. The different levels of disclosure are, perhaps, surprising given the international nature of capital flows and financial reporting and, in the case of EU Member States, despite the existence of common guidance in *Update of the CESR recommendations on the consistent implementation of Commission Regulation (EC) No 809/2004 implementing the Prospectus Directive*, published by the European Securities and Markets Authority (ESMA Recommendations) on profit forecasts, profit estimates and working capital statements. Reasons given for the variations include the existence or not of 'safe harbours', and differences in the legal and regulatory requirements for published PFI to be reported on in specific circumstances.

47. The link was noted between the PFI preparation process promoted in the 2003 guidance, and the financial position and prospects (FPP) procedures of a company. FPP procedures are the procedures that enable directors to be informed on a regular basis as to the FPP of the company (and its group) and any changes to these. As part of its ongoing obligations under the Listing Rules, a company with a premium listing on the Main Market of the London Stock Exchange needs to have processes for preparing projections as part of its FPP procedures. Similar obligations exist for other markets such as AIM and NEX Exchange Growth Market. FPP procedures must be established from the point a company is admitted to a UK market and, in certain situations, it is market practice for such procedures to be privately reported on by a reporting accountant. ICAEW's technical release, TECH 14/14CFF *Guidance on financial position and prospects procedures*, illustrates procedures that will help inform directors whether PFI, such as a profit warning, needs to be published. PFI is considered to represent one aspect of the whole picture of a company's prospects. As all parts of the picture should give 'joined up', consistent messages, there is an expectation that the models and processes used for the preparation of published PFI are consistent with those used by the company for its ongoing obligations.

48. Some of those pre-consulted thought that the PFI principles could also help provide rigour to the preparation of published non-financial, quantitative information.

Suitability of PFI principles

49. In the context of capital markets transactions, the principles in the 2003 guidance were generally considered to be relevant and sensible. There was some debate about the 'reliable' attribute, and the extent to which it conveys an appropriate message to investors and other users of PFI. Some observed that the term 'reliable' could give the impression that such information alone could form the basis of a decision, and that another term, such as 'supportable' or a term that would convey that PFI is 'a best estimate in the circumstances', might prevent misunderstanding.

50. The attribute of reliability is, notwithstanding, very important. The qualities prescribed by the FRC for a company's strategic report - to be fair, balanced and understandable - are also considered important so that communications, including PFI, are not misleading.

Use of 2003 guidance

51. Discussions focused on whether the 2003 guidance helps provide preparers with a basis for determining whether the information they prepare is of appropriate quality to be useful for investors. They also explored whether the 2003 guidance supports regulators' efforts to ensure an orderly market by way of high-quality information flows and helps investors to judge if:

- the PFI they receive is consistent with other information from directors; and
- it is reasonable to use PFI to help inform their decisions.

52. Although the scope of the 2003 guidance included voluntarily published PFI, as such PFI is relatively rare, it is hard to say how much the guidance is used for this purpose. This contrasts with the application of the guidance in a regulated capital markets transaction content.

53. Application of the 2003 guidance does not appear to constrain the publication of PFI. Rather, constraints identified by preparers on providing voluntary PFI included the capability of systems and the time required to ensure the reliability of information, as well as the inherent risk that the actual outcome might differ substantially from the published PFI. Many of those pre-consulted perceived there is a reticence among issuers to publish voluntary PFI, due to the fear of being held hostage to fortune. While companies may want to communicate their expectations, they do not want to be unreasonably bound by them. The observation that published PFI – when not required by law or regulation – is rare, is supported by informal, anecdotal evidence from businesses, advisers and regulators. It is perceived to be a challenge to achieve an acceptable risk: benefits balance when publishing PFI voluntarily. The absence of a 'safe harbour' in the UK has meant that some users find published PFI 'vague' or 'anodyne'.

54. In this context, some observed that, with the relative rarity of voluntarily published PFI, such as profit forecasts and estimates, it might be expected that profit warnings would be a regular market occurrence. Profit forecasts and estimates and profit warnings are all within the scope of the 2003 preparation guidance. Better appreciation of the nature and, thus, constraints of PFI among a wider audience could encourage more issuers to publish it voluntarily, thus improving transparency. New guidance would also help improve the communication of this.

55. Some reporting accountant engagement letters and management representation letters make reference to the 2003 guidance, though there is little other evidence that it is being consciously used by preparers. This may in part be because the principles and basis of preparation are embedded in practice and because companies do not use them regularly as they do not often publish PFI voluntarily, but also because the regulatory references in the 2003 guidance are out of date.

56. Clearly presented strategic plans give investors insights into the prospects of the business and can lessen fixation on short-term earnings performance. However, if published PFI constitutes a profit forecast, it typically has to be reported on by law or regulation when the issuer is subsequently involved in specified transactions, and the perception of certain preparers and advisers is that this can adversely impact a transaction timetable. Despite the existence of a principles-based framework for published PFI, the requirement for PFI to be reported on may constrain the flow of information if the costs of publishing are harder to justify compared to the benefits of disclosure.

57. Some preparers who commented on the 2003 guidance felt that it is too long and detailed, while others suggested that more application notes would be useful. Some felt that the 2003 guidance does not help with how to deal with risk effectively. This can leave directors more vulnerable to criticism when actual performance differs from that projected. Paragraphs 114 and 115 of ESMA Recommendations consider the potential overlap between the working capital statement and the risk factors section of a prospectus. In UKLA Technical Note TN 321.1 *Working capital statements and risk factors*, the FCA states that it 'will pay close attention to risk factors that suggest the issuer will or may run out of working capital in the next 12 months'. Some preparers felt that updated application notes should also take risk into account, to the extent permitted by regulation.

58. Fund managers want to see a company with good growth prospects and a strong strategy. They also want to see the company delivering on market expectations, without surprises when actual accounts are published or when profit warnings need to be made. They consider that a deep understanding of the company's story and its strategy and management's view of prospects, requires an understanding of the context of management's view, including in relation to risk. The ability to link PFI with risk factors would thus be desirable – echoing feedback from preparers.

59. In the UK, regulators tend neither to encourage nor to discourage PFI. However they do require any PFI that is published voluntarily to be prepared in a prescribed form. For instance, in specific circumstances where profit forecasts are made, typically when the company is subsequently involved in specified transactions, such profit forecasts have to be prepared and reported on in accordance with one, or a combination, of the following requirements:
   - The Listing Rules.
   - The Prospectus Rules.
   - ESMA Recommendations.
   - ESMA Questions and Answers, Prospectuses.
   - The AIM Rules for Companies.
   - The NEX Exchange Growth Market Rules for Issuers.
   - Rule 28 of the Takeover Code, which sets outs requirements for profit forecasts and QFBS published during an offer period.
   - UKLA Technical Notes 320.1 *Working capital statements - basis of preparation*; 321.1 *Working capital statements and risk factors;* and 340.1 *Profit forecasts and estimates*.
   - The FRC's *SIR 3000 Public reporting engagements on profit forecasts*, which sets out suitable criteria for the evaluation of profit forecasts by the reporting accountant.

60. The 2003 guidance created a unified approach to complying with different regulatory requirements that were extant when it was published. Preparers will be best served if updated application notes also take into account, and are consistent with, relevant regulatory approaches.

Q2: ICAEW has received feedback from preparers, regulators, advisers and users of PFI on the application of the 2003 guidance. Do you have any comments on the feedback summarised in this section and any additional observations?

2.3 THE PURPOSE AND STRUCTURE OF AN UPDATED FRAMEWORK

Purpose

61. The 2003 framework aims to assist preparers of published PFI meet the information needs of users, and facilitate the publication of high-quality PFI in a capital markets transaction context.

62. It is not the purpose of guidance to question when or where PFI should be produced and it is not intended to impose additional requirements to prepare and disclose PFI. It is also not intended to create roadblocks for the preparation and publication of PFI.

63. The updated framework will likewise help directors understand what they need to consider with regard to the preparation of PFI. It will set out principles that PFI should meet and processes that directors should have in place to produce it.

64. As proposed in section 2.1, the updated framework will cover PFI in the wider sense, so it will apply to all financial information that relates to a future period or has a future date. Accordingly, the purpose of the updated framework will be to promote preparation of high-quality PFI, whether it is published or it is prepared for private purposes.

65. An appropriate framework for preparing PFI can be a solid foundation for high-quality predictions. However, the future is inherently uncertain and PFI can only be a best estimate in the circumstances. Actual outcomes will be different to those projected by the PFI and such differences may be material. It is already possible to apply the 2003 guidance where PFI is prepared and provided to third parties voluntarily, in circumstances where it is not explicitly required by law or regulation, and feedback suggests that the guidance is implicitly used for this purpose.

66. Updated guidance will aim to improve understanding of the nature of PFI and its inherent limitations. It will also be more explicit that it can be applied to PFI that is prepared voluntarily, or is not published, but subject to a proportionate approach.

Structure

67. The existing framework introduced some high-level principles for PFI and the likely outcomes of useful PFI, as well as a process for preparing PFI. It also includes application notes on how to address individual legal and regulatory requirements in a capital markets transaction context.

68. Feedback from ICAEW's pre-consultation indicated continuing support for the principles-based approach and that the principles are embedded in UK market practice for preparing PFI.

69. Up-to-date application notes on how to apply the principles in the context of capital markets transactions regulation was supported by the regulators that were pre-consulted. The Working Group also considered feedback that while application notes are useful for areas subject to regulatory requirements (such as the preparation of profit forecasts or working capital statements), they are not so necessary at rule level, for example, on the individual requirements of different UK markets for PFI.

70. The Working Group proposes to adopt the same structure as the existing framework – ie, general principles and a process for preparation of PFI, plus application notes for topics where there is demand.

71. The 2003 guidance advocates a process designed to achieve PFI that is relevant, understandable, reliable and comparable. The 2003 guidance states that in this process preparers:
    - plan, organise and communicate internally the process of preparing and issuing PFI;
    - involve directors and other members of management with the necessary in-depth experience of the business and expertise across all its activities;
    - clearly allocate and coordinate responsibilities;
    - satisfy themselves that there are appropriate systems to generate the reports underpinning published PFI; and
    - produce clear contemporaneous documentation to evidence key elements of the process.

72. The Working Group considers that this series of actions continues to capture and reflect relevant governance and operational processes and should be retained in the updated framework. The series of actions is also compatible with the FPP procedures referred to in section 2.2. Moreover, they do not conflict with the preparation procedures in the capital markets regulation or guidance listed in the same section. The Working Group considers that the process for preparing PFI should be possible for most businesses to incorporate, as appropriate, in their normal systems of financial management and control.

Q3: The proposed new framework for PFI will comprise:
- general principles for the preparation of PFI; and
- guidance notes on applying the principles and application notes covering specific types of PFI, in certain circumstances.

Do you have any comments on whether this is an appropriate structure?

2.4 PRINCIPLES UNDERPINNING UPDATED GUIDANCE

Purpose of PFI principles

73. The 2003 framework is underpinned by the four attributes of useful information in financial statements that were adopted by the International Accounting Standards Board (IASB), namely: 'relevant', 'understandable', 'reliable' and 'comparable'. Three preparation principles help ensure that the resulting PFI is useful. Under the 2003 framework, PFI is likely to be useful if it is:
    - relevant;
    - understandable, because it is prepared on the principle of containing reasonable disclosure about uncertainties and mitigating actions;
    - reliable, because it is prepared on the principle that it is supportable or based on sound business analysis; and
    - comparable, because it is prepared on the principle that it can be subsequently validated by comparison with historical financial information.

74. The 2003 framework also sets out key elements of a process that companies need for the preparation of PFI. The 2003 framework does not seek to provide standalone guidance on each type of PFI but instead, it promotes a principles-based approach for its preparation. The benefit of having a common, principles-based approach is that it can readily be applied in different situations and can be adapted when laws and regulations change.

Relevance of the principles and attributes

75. In considering the continuing appropriateness of the PFI principles, the Working Group sought feedback during the pre-consultation exercise. There was strong support for retaining the PFI principles. The principles are well established and, individually, the attributes of useful PFI were judged as continuing to be appropriate.

76. In a regulatory context, it is worth noting that the same attributes are embedded across relevant rules. For example, they underpin paragraph 40 in ESMA Recommendations and the Takeover Code's Rule 28 on profit forecasts and QFBS. They are also in related rules such as ESMA's guidance on Alternative Performance Measures (APMs).

77. There are regulatory requirements in the UK for published profit forecasts to be reported on in specific circumstances by reporting accountants. The PFI principles are aligned with the relevant reporting standard, SIR 3000, with which the reporting accountant engaged to report on profit forecasts has to comply. SIR 3000 requires that information prepared must be complete and neutral, in addition to being relevant, reliable and understandable. The definition of 'reliable' in the 2003 PFI guidance specifically captures completeness and neutrality. In addition, for PFI to be reliable, it should be supported by analysis of the entity's business and should faithfully represent factually-based strategies, plans and risk analysis.

78. At the time of writing, the IASB is revising the conceptual framework from which the PFI principles were originally drawn. Notwithstanding this, based on feedback, and given their consistency with current regulation, the Working Group proposes retaining the existing PFI principles in updated guidance. As explained below, the Working Group considers that two additional attributes would also be appropriate.

'Aligned'

79. The Working Group's own experience and evidence from pre-consultations point to increasing expectations that business reporting and communications should display integrated and cohesive management thinking. For most established businesses there needs to be a link between strategy, performance and risks, and the Working Group proposes that PFI should be aligned with other business reporting and communications.

'Not misleading'

80. The 'not misleading' attribute can be traced across legal and regulatory requirements. For example, as stated in paragraph 40 in ESMA Recommendations, due care and diligence must be taken to ensure that profit forecasts or estimates are not misleading to investors.

81. In the experience of the Working Group, PFI that satisfies the existing principles could still be misleading if it gives users a view contrary to that which ought reasonably be given. To counter this, the Working Group believes that as an overall test, in addition to the existing attributes, the 'not misleading' attribute should be applied to PFI. While adherence to the existing attributes helps achieve that outcome, its inclusion will bring the PFI principles into line with other requirements and guidance.

82. PFI that passes the overarching 'not misleading' test will help increase confidence in PFI, improve trust between preparers and users and help achieve more acceptance of the status of PFI as a best estimate in the circumstances, rather than a definitive outcome.

83. The proposals above would result in the updated PFI principles comprising the current three preparation principles and six attributes, including two new ones. Useful PFI will thus be:

- relevant;
- understandable, because it is prepared on the principle of containing reasonable disclosure about uncertainties and mitigating actions;
- reliable, because it is prepared on the principle that it is supportable or based on sound business analysis;
- comparable, because it is prepared on the principle that it can be subsequently validated by comparison with historical financial information;
- aligned; and
- not misleading.

Q4: ICAEW intends to keep the four attributes of useful PFI and the three principles for preparing PFI that are set out in the 2003 guidance, while adding two new attributes. Do you believe that the existing attributes and principles continue to be appropriate and necessary? Do you have any comments on the proposed additional attributes of useful PFI that it should be 'aligned' and 'not misleading'? Do you believe that new preparation principles are needed for the additional attributes?

2.5 PROPOSED SUBJECT MATTER OF UPDATED PRINCIPLES

84. The 2003 PFI framework sets out principles and a process for preparing certain published PFI, and application notes for applying the principles. The definition of PFI comprises 'primary financial statements and elements, extracts and summaries of such statements and financial disclosures drawn up to a date, or for a period, in the future'.

85. The 2003 guidance applies to published PFI as its focus is on the external purpose of PFI, principally in a capital markets transaction context. Such published PFI that has to comply with law and regulation will continue to be addressed in the updated framework.

86. Businesses also prepare PFI for an external purpose, when applying for new or extended funding from private sources. The attributes of useful PFI that is prepared for finance-raising, whether from private sources or public markets, traditional or newer sources, are likely to be common. Such PFI is not within the scope of the 2003 guidance and the Working Group considers that the preparers of PFI for private financing purposes could benefit from applying the principles for published PFI.

87. A business seeking established forms of private finance (whether debt or equity) will typically prepare projections. So, both an application for bank lending and a business plan pitched to private equity investors or debt funders, will typically be supported with cash flow and profit forecasts. Industry guidance tends to be generic such as that found on betterbusinessfinance.co.uk and the Lending Code, both published by the British Bankers Association, and in the Services for Entrepreneurs section on the UK Business Angels Association's website. Individual funding providers may also specify their own requirements. This type of PFI is prepared with very specific needs in mind and users often have the ability to challenge and question the PFI and its basis of preparation.

88. Crowdfunding (both loan- and investment-based) has become more frequently used since the 2003 guidance was issued. Applications often involve the presentation of cash flow and profit forecasts through the crowdfunding platforms. Such PFI is accessible to anyone who joins the platform; however, the PFI is not tailored and further investigation and questioning by the potential funder is possible though may be limited. Start-up and early-stage businesses will also have no or little historical financial information. Regulation in this area is developing in parallel with the sector's evolution. The presentation of forecasts is governed by fairly high-level guidance from the FCA for fair, clear and not misleading communications although this is being reviewed, and the FCA has published interim feedback in *FS 13/16 Interim feedback to the call for input to the post-implementation review of the FCA's crowdfunding rules*.

89. The financial crisis reduced the supply of business finance from traditional sources such as banks, and also heightened the importance of credible PFI when applying for new or renewed sources of funding. ICAEW and its members are actively involved in supporting businesses' access to finance and awareness of new forms of finance as well as businesses' efforts to become investment ready. That experience is of increasingly varied requirements for PFI.

90. The Working Group considers that efforts to improve the quality of PFI prepared for private finance-raising can be supported within an updated PFI framework and envisages that a PFI framework with common standards would benefit preparers and users of PFI for private finance-raising situations. This would require the subject matter of the updated framework to be extended to such PFI and, in this extended context, the definition of PFI in new guidance would need to include terminology typically used in private finance-raising sectors.

Q5: ICAEW proposes extending the scope of the framework to PFI that is prepared for private finance-raising situations. Do you have any comments on applying the principles and attributes of useful PFI to private finance-raising and the forms of PFI and private finance-raising involved?

2.6 APPLICATION IN A CAPITAL MARKETS TRANSACTION CONTEXT

91. The Working Group established from pre-consultation feedback that there was continuing demand for application notes for preparing PFI for capital markets transactions that are subject to regulatory requirements. The Working Group thus proposes to prepare updated application guidance that assists preparers to meet the requirements of regulators and the needs of investors and other users of PFI. Feedback also revealed that high-level guidance for topics - profit forecasts and profit estimates, changes in expectations of performance, working capital statements, and synergy benefits and quantified financial benefits statements - would be more useful than specific references to the detailed rules and individual requirements.

92. The 2003 guidance is based on the regulatory requirements that were extant when it was published. Since that date, the regulatory environment has undergone changes, most notably in the UK in 2005 with the implementation of the prospectus element of the European harmonisation programme. PFI is today published by an issuer in accordance with some of: the Prospectus Rules, the Listing Rules or the relevant rules of the market where it is admitted to trading, the Disclosure Guidance and Transparency Rules, ESMA Recommendations or the Takeover Code.

93. In addition, the FRC's SIR 3000 provides guidance for the reporting accountant engaged to report publicly on profit forecasts to be included in an investment circular under the Prospectus Directive Regulation or other regulations with similar requirements, the Takeover Code, if required by the London Stock Exchange in respect of an AIM admission document, or if required in respect of a NEX Exchange Growth Market admission document.

94. The updated framework will address the PFI topics below. Although relevant regulation sets out prescriptive rules for the preparation and publication of information relating to traded securities, in response to the feedback described in section 2.2, it is proposed that application notes for PFI will not reproduce specific regulatory rules.

Profit forecasts and profit estimates

95. The Prospectus Rules and paragraphs 38-50 in ESMA Recommendations govern profit forecasts or profit estimates that an issuer includes in a prospectus. The AIM Rules for Companies and the NEX Exchange Growth Market Rules for Issuers govern profit forecasts or profit estimates that are included in admission documents of applicants to those markets.

96. Profit forecasts or estimates in a Class 1 circular are governed by the Listing Rules.

97. The Takeover Code sets out requirements in relation to certain profit forecasts or profit estimates published by an offeree company or a securities exchange offeror.

Changes in expectations of performance

98. Under the Listing Rules and Disclosure Guidance and Transparency Rules, issuers must notify the markets of changes in the issuer's expectations about its future performance and changes thereto. Such notifications include profit warnings.

99. Similarly, under the AIM Rules for Companies and the NEX Exchange Growth Market Rules for Issuers, a company must issue notification without delay of a change in its expectation of its performance.

100. The MAR has wider scope than its predecessor regime, provides new enforcement tools to the FCA and also captures 'market soundings', which may include PFI-like information.

Working capital statements

101. Under the Prospectus Rules and Listing Rules respectively, prospectuses and certain share buyback circulars and Class 1 circulars are required to contain statements regarding the sufficiency of the issuer's working capital for at least the next 12 months. Applicants to AIM and to NEX Exchange Growth Market are required to make similar statements in admission documents.

102. Paragraphs 107-126 in ESMA Recommendations also address working capital statements.

Synergy benefits and quantified financial benefit statements

103. The Listing Rules govern synergy benefits and quantified estimated financial benefits statements that are included in a Class 1 circular.

104. The Takeover Code's requirements regarding QFBS are similar to the Listing Rules on synergy benefits, with some additional requirements. The Takeover Code requirements also extend to statements by an offeree company.

Q6: ICAEW proposes developing new application notes for preparing PFI in the context of regulated, capital markets transactions. Such notes will address topics (eg, profit forecasts and estimates, changes in expectations of performance, working capital statements, and synergy benefits and quantified financial benefits statements) but will not reproduce specific detailed regulations. Do you have any comments in relation to the topics identified and the nature of the application guidance?

2.7 APPLICATION IN PRIVATE FINANCE-RAISING SITUATONS

105. This category includes PFI that is prepared for, and made available to, third party investors or fund providers outside the public capital markets and hence is private, rather than published.

106. The Working Group had exploratory discussions with members of the banking and crowdfunding industries and advisers to businesses seeking private finance. Common features of what such users expect emerged from those discussions including: involvement of relevant business personnel in the preparation of the business plan and subjecting it to various 'what if' scenarios, understandable information that is consistent with what users already know about the business and with management information that is used on an ongoing basis, and comparability with historical information.

107. The Working Group recognises that the principles will also need to 'work' for such PFI, and enable businesses to meet any specific requirements of individual private finance providers. The Working Group found similarities between the features above of PFI for private finance-raising, and the outcome of the PFI principles. The Working Group also considers that the PFI principles are not likely to conflict with relevant regulations and/or industry guidance.

108. In the Working Group's view, it should be possible for most established businesses to achieve PFI for private finance-raising purposes that meets the proposed attributes described in section 2.4, within their normal system of financial management, control and reporting.

109. The Working Group considered the importance of the concept of 'reasonable disclosure' in a private finance-raising situation. PFI that is subject to regulatory requirements should be accompanied, to the extent permitted, by full disclosure of assumptions, risks, uncertainties and sensitivities, but such disclosure should not place unreasonable demands on users. In contrast to published PFI in a capital markets transaction, third party finance providers tend to have opportunities to seek explanations and more detail from the preparers of PFI. That may be in the form of a potential funder of the business pressing for more detail and supporting evidence, or a potential investor in the business carrying out due diligence, or by asking questions of a business seeking funding via a crowdfunding platform. Due to the dialogue that is typically possible between the business and the provider of private finance, the importance of reasonable disclosure is not the same in private finance-raising situations as it is with published PFI.

110. This is relevant when applying the PFI principles and suggests that a proportionate approach to applying the PFI principles may be more appropriate in some private finance-raising situations. The Working Group thus proposes to develop guidance on proportionate application.

111. Extending the subject matter to which the PFI principles apply, to include PFI for private finance-raising, raises the question of whether application guidance would be helpful for specific types of such PFI. In considering the desirability of specific application notes for PFI in private finance-raising situations, there would also be a need to determine how such PFI can be compared with actual historical comparatives. Thereafter, the general principles around preparing PFI could be overlaid to provide specific application guidance. The Working Group recognises that any application notes should not seek to constrain the preparation of PFI; rather it should complement any industry guidance and underpin what users require, and should be developed by relevant experts. The Working Group would like to invite views on the need for specific application notes in private finance-raising situations.

PFI for bank borrowing applications

How forward-looking information is currently prepared

112. Applications made by businesses for bank borrowings will usually include a business plan, cash flow projections and profit projections. Requirements will vary by lending institution, business size and whether the business is a new or existing customer.

113. The lender assesses the projections, aided by its knowledge of the business and its capacity growth, and of management's track record.

114. High-quality projections tend to include input from all parts of the business as well as supporting analysis. Integrated cash flow and profit projections are desirable so that the lender can perform sensitivity analysis for covenant setting, and compare the results to its own metrics and drivers for the business's sector. Cash flow is typically key. The lender will focus on this area in the audited accounts, management accounts, budgets and projections and will often seek further corroborative evidence and may undertake additional probing or challenge. A lender can ask the business preparing PFI to vary its assumptions and, in an iterative process, lender and business arrive at PFI that will be used by the lender to monitor performance against covenants.

Potential usefulness of the PFI principles

115. In the case of projections for bank borrowing applications, adoption of the PFI principles would create a consistent basis of preparation that could underpin industry guidance, such as the British Bankers' Association's (BBA's) *Lending Code* regarding bank lending applications by micro enterprises and that on betterbusinessfinance.co.uk, and lender-specific requirements.

PFI on crowdfunding platforms

116. The FCA regulates investment-based and loan-based crowdfunding platforms. The FCA applies a high-level rules approach to the disclosure regime and platforms must ensure that all communications are 'fair, clear and not misleading' (Principle 7 in the FCA's Principles for Businesses). The FCA does not ban specific terms or disclosure practices. In the policy statement *The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media (March 2014)* the FCA states that, in satisfying the financial promotion rules, sufficient detail must be provided to give a balanced indication of the benefits and the risk involved, including whether or not any due diligence has been carried out on an investee company, the extent of the due diligence, and the outcome of any analysis. In 2015, in *A review of the regulatory regime for crowdfunding and the promotion of non-readily realisable securities by other media* the FCA identified concerns with investment-based platform websites such as a lack of balance; insufficient, omitted or cherry-picked information; and the downplaying of important information.

How forward-looking information is currently prepared

117. Businesses seeking to raise investment via a crowdfunding platform may be required by the platform to publish a business plan and financial projections on its website. Information in the business plan and projections must be fair, clear and not misleading. In their guidance to businesses applying for funds, platforms stress the need for evidence to validate any claims made in the business plan or projections. Some platforms stipulate additional disclosure requirements and compulsory elements for projections. They may also require the key drivers. Some platforms use a standard way of displaying projections to which risk warnings such as 'any financial forecasts are not a reliable indicator of future performance' are attached.

Potential usefulness of the PFI principles

118. In addition to the financial promotion principles - fair, clear and not misleading – platforms may also require disclosures to be validated and supported by identified assumptions. The PFI principles could provide a consistent basis of preparation that, if adopted, could help underpin industry guidance and help improve the quality of PFI published on platforms and enhance the sector's reputation.

119. In December 2016, following its *Call for input to the post-implementation review of the FCA's crowdfunding rules*, the FCA signalled its intention to boost the standard of disclosures made on platforms with more prescriptive rules. A credible reputation is in the interest of all stakeholders. If this sector were to adopt common preparation principles, this could help improve projections prepared by start-up businesses through to more established ones seeking to raise funding through platforms. As well as increasing the confidence of potential investors, industry guidance on preparation could lessen the need for prescriptive regulation.

PFI for private equity investors

120. Business angels, venture capital and private equity houses are all sources of private equity. A business seeking private equity will typically be expected to present a business plan and financial projections and comparable historical financial information. Preparation guidance, where available, largely stems from industry bodies, while equity providers (both individuals and institutions) may stipulate their own criteria.

How forward-looking information is currently prepared

121. The UK British Angels Association (UKBAA), the industry body for business angels, has online resources for entrepreneurs/businesses seeking to raise funds, such as recommendations regarding information a business will present to a potential investor. The UKBAA highlights that, in accordance with the Financial Services and Markets Act 2000, a business plan should be a fair and reasonable summary of the investment proposal and contain no misleading statements.

122. The UKBAA's checklist for financials includes a profit and loss, balance sheet and cash flow forecast. Material supporting a business plan should include 'detailed and accurate financial projections and comparable, actual historical profit and loss'. Financial forecasts should be based on 'sound, researched assumptions' and the UKBAA emphasises that the ability to justify profit and cash flow projections should underpin the whole financial analysis. Start-ups are encouraged to present reviews, details of future orders or anything to suggest that forecast sales are 'credible'.

123. Business angels often invest through networks or groups of investors, and groups may provide directions for businesses submitting business plans.

124. The British Private Equity and Venture Capital Association (BVCA) does not promote particular preparation standards for business projections that are prepared in order to attract private equity or venture capital investment.

Potential usefulness of the PFI principles

125. The PFI principles could provide a consistent basis of preparation that, if referenced, could help underpin generic industry guidance to businesses applying for investment and to help meet specific investor requirements.

Q7: ICAEW proposes to develop an application note for private finance-raising situations where proportionate application of the PFI framework is appropriate. What other form of application support might be useful for preparing PFI for private finance-raising? Do you have any comments as to how this might be developed in conjunction with specialist groups and whether additional application notes should be developed for specific types of private finance-raising?

2.8 POTENTIAL BROADER APPLICATION

126. When published in 2003, ICAEW's guidance provided an authoritative framework that addressed a lack of financial reporting standards or accepted practice in the UK, to help directors prepare PFI and to give investors more confidence in PFI quality.

127. ICAEW has a long history of experience of PFI. Its members have used the 2003 guidance across a broad spectrum of UK capital markets transactions. ICAEW considers that the benefit of a standard preparation framework could be extended to a wider range of forward-looking information and, as discussed in section 2.5, that the subject matter for the PFI principles could be widened to include PFI prepared for private finance-raising.

128. ICAEW recognises the upward trend for reporting requirements that rely on, or are underpinned by PFI. PFI is also prepared for third parties, for reasons other than raising finance. Examples within these categories are described below. As a separate exercise, ICAEW plans to explore the possible value of using the updated framework in these examples. A separate working group, with relevant expertise, is likely to be convened for this purpose.

Corporate reporting

129. Developments in corporate reporting in the UK that are aimed at encouraging investment and reducing 'surprises' for investors, require the publication in the annual report of information regarding future prospects.

130. UK company legislation brought in the strategic report requirement (for certain companies) for periods ending on or after 30 September 2013. The report is intended to provide shareholders with 'a holistic and meaningful picture of an entity's business model, strategy, development, performance, position and future prospects'. The FRC's guidance emphasises communication characteristics for good quality, clear and concise financial reporting.

131. Changes to the UK Corporate Governance Code introduced a directors' longer-term viability statement into annual reports for years beginning on or after 1 October 2014. It is likely that any forward-looking elements in these reports will be underpinned by the business's projections and forecasts and, thus, is reliant on the associated processes. The FRC has not issued specific guidance on the preparation of viability statements.

132. Under the EU Directive on non-financial reporting, for financial years beginning on 1 January 2017, certain large public-interest entities are required to disclose in their management report relevant and useful information on their policies, main risks and outcomes relating to, at least, environmental matters, social and employee aspects, respect for human rights, anti-corruption and anti-bribery issues, and diversity in their board of directors.

Financial reporting

133. In financial reporting standards such as IFRS and UK GAAP, the use of PFI as the basis of creating historical financial information has become more explicit than ever.

134. For example, PFI forms the basis for impairment testing. IAS 36 is fairly prescriptive regarding the compilation and development of cash flow projections, for example on the budgets or forecasts to be used, on growth rates and on excluded items. The factsheet *Impairment - Applying IAS 36,* produced by ICAEW's Financial Reporting Faculty and updated in 2014, comments that cash flow projections should be based on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining life of the asset.

135. IFRS 9, the new standard for financial instruments, will replace IAS 39 for EU preparers once the standard has been endorsed by the EU. A principal change is that IFRS 9 replaces IAS 39's 'incurred loss' approach to impairment of financial assets with an 'expected loss' approach that relies on forward-looking information on expected credit losses (ECL). ECL information will necessarily be derived from a range of sources: credit risk systems, economic forecasts and assumptions. The outcome will need to be reconciled to accounting systems. Financial institutions have developed, or are developing, proprietary methodologies for financial reporting, that also comply with relevant frameworks, such as the Basel Committee on Banking Supervision's (BCBS's) 239 Risk Data Aggregation and Reporting Principles, and Sarbanes Oxley Section 404.

136. PFI also forms the basis for fair value measurement. IFRS 13 prescribes how the fair value of an item is to be measured, where another reporting standard permits or requires it to be measured. Valuation techniques are performed using PFI. For example, the income approach converts future cash flows (or income and expenses) to a current, discounted amount. The valuation reflects current market expectations about the future flows.

Performance measures

137. Companies also report performance measures that are not prescribed under the applicable financial reporting framework, but which they believe more appropriately reflect their performance, both historical and future.

138. Non-financial information is also increasingly popular among companies for describing their prospects. In June 2017 the EC published Guidelines on non-financial reporting *methodology for reporting non-financial information*. The guidelines focus on the disclosure of environmental and social information.

139. Regulators acknowledge that APMs can be useful for investors. They consider that a common approach to using them is necessary to promote market confidence and clarify their status compared to regulatory obligations. ESMA has published Guidelines on *Alternative Performance Measures* and *Questions and Answers, Alternative Performance Measures* (the guidelines). The guidelines do not apply to measures included in a prospectus to which the prospectus regime applies, such as profit forecasts, profit estimates and working capital statements, although there is consistency between the guidelines and ESMA's material on prospectuses. During 2017, the FRC will conduct a second thematic review into the use of APMs in annual reports and accounts.

PFI other than for finance-raising

140. Businesses prepare PFI for third parties for a variety of reasons, such as for competitive tenders or for inclusion in information memoranda for corporate transactions.

141. The level of detail and the format of such PFI as well as various analyses are often specified by the third party. As with projections for bank lending, PFI that will be used by the third party may be the outcome of an iterative process. Regardless of the extent to which PFI is tailored to the user's needs, such PFI should be consistent with other information used by the business and the preparer's knowledge of the business.

Q8: ICAEW plans to explore whether the new framework could be extended to a wider range of PFI, such as PFI that underpins financial reporting and broader corporate reporting requirements and PFI prepared for purposes other than finance-raising. Do you have any comments on whether such extended application would be beneficial and what sorts of PFI might be covered?

Appendix 1 Working group members

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Appendix 2 Parties pre-consulted

The Working Group is grateful to representatives of the following organisations for their informal feedback:

Association for Financial Markets in Europe
British Bankers Association
British Private Equity and Venture Capital Association
City of London Law Society, Company Law Committee
European Securities and Markets Authority
Financial Reporting Council
Hundred Group
Investment Association
Takeover Panel, Executive
UK Crowdfunding Association
UK Listing Authority

The Working Group would also like to thank the following for their valuable contributions:

Graeme Coles	NatWest
Mike Conroy	British Bankers Association
Andrew Downes	Lloyds
Paul Doyle	RBS
James Gardiner	RBS/NatWest
Lee Green	NatWest
Kenneth Lever	non-executive director
Amar Madhani	Gibson Dunn & Crutcher
Selina Sagayam	Gibson Dunn & Crutcher
John Simms	NatWest
Steve Webster	non-executive director
Paul Witter	HSBC

Appendix 3 List of abbreviations

2003 guidance	*Prospective Financial Information: Guidance for UK Directors,* published by ICAEW in 2003
APM	Alternative performance measures
BBA	British Bankers Association
BVCA	British Private Equity and Venture Capital Association
CEO	Chief executive officer
ECL	Expected credit losses
ESMA	European Securities and Markets Authority
ESMA Recommendations	*Update of the CESR recommendations on the consistent implementation of Commission Regulation (EC) No 809/2004 implementing the Prospectus Directive,* published by ESMA
EC	European Commission
EU	European Union
FCA	Financial Conduct Authority
FPP	Financial position and prospects
FRC	Financial Reporting Council
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
MAR	Market abuse regime, EU regulations effective from 3 July 2016
PFI	Prospective financial information
QFBS	Quantified financial benefits statements
SIR	Standard for Investment Reporting, published by the FRC
SME	Small and medium-sized entities
UKBAA	UK Business Angels Association
UK GAAP	UK Generally Accepted Accounting Principles
UKLA	UK Listing Authority

The Corporate Finance Faculty's professional network includes 7,000 members and more than 80 member organisations. Its membership is drawn from major professional services groups, specialist advisory firms, companies, banks, private equity, venture capital, law firms, brokers, consultants, policymakers and academic experts. More than 40% of the faculty's membership is from beyond ICAEW.

The faculty is ICAEW's centre of professional excellence in corporate finance. It contributes to policy development and many consultations by international organisations, governments, regulators and other professional bodies.

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