ICAEW
CORPORATE FINANCE
FACULTY

Consultation on guidance for preparers of prospective financial information

DECEMBER 2018

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Contents

1. Overview

The accountancy profession is often portrayed as being fixated on historical reporting. But this interpretation ignores the profession's role in the cycle of accountability, including in helping businesses explore and prepare for what comes next, and in understanding and explaining why the outcome might be different. Businesses and other organisations routinely consult the accountants they employ or engage for predictions, thinking and analysis on both potential and actual performance, drawing on the profession's curiosity and its ability to make suggestions for dealing with the future.

ICAEW has been a pioneer in establishing principles for the preparation of forward-looking information. In 2003 it published a framework for preparing prospective financial information (PFI) that is subject to UK capital markets regulation. *Prospective Financial Information: Guidance for UK Directors* (the 2003 guidance) was warmly welcomed by regulators and businesses as it helped meet the information needs of users. Since then, the 2003 guidance has become embedded in the preparation of PFI in a regulated capital markets context.

In July 2017, ICAEW published *Consultation paper on prospective financial information* (the 2017 consultation). Developed by a Working Group set up by ICAEW's Corporate Finance Faculty (see Appendix I), the consultation paper set out the case for updating the 2003 guidance.

The 2017 consultation included the following proposals:

- to update the 2003 guidance for regulatory changes and market developments and to review the PFI preparation principles;
- to extend the scope of the updated framework to all PFI and to develop guidance for applying it; and
- to introduce two new attributes of useful PFI.

With this paper, the Working Group is publishing for consultation an Exposure Draft of new guidance for preparers of PFI. The Exposure Draft updates the 2003 guidance and includes general guidance for preparing any PFI, including, on a proportionate basis, any unpublished PFI. In addition, the Exposure Draft includes application notes for preparing specific types of PFI in certain regulated capital markets transactions – statements of sufficiency of working capital, profit forecasts, and synergy and stand-alone cost saving statements.

The updated framework and application guidance do not alter the PFI preparation approach set out in the 2003 guidance, which established high standards for forward-looking financial information published in connection with capital markets transactions. Nonetheless, the updated framework has been developed to reflect the extended scope of PFI that was proposed in the 2017 consultation. Moreover, a preparation principle has been included for the 'relevant' attribute.

In addition, the modular structure of the Exposure Draft shown below, is intended to accommodate the preparation of any PFI within scope, and application guidance can be added, amended or deleted as appropriate:

Principles for preparing prospective financial information

General application guidance

Application notes for PFI in capital markets transactions:

- Statements of sufficiency of working capital
- Profit forecasts and other profits guidance
- Synergy and stand-alone cost saving statements

The guidance in the Exposure Draft also aims to reflect developments since the 2003 guidance was published, such as demands for greater accountability, closer board engagement with management, higher standards of regulation, and investor expectations of cohesion between business strategy, corporate appetite for risk, and prospects. Calls for more improvements to performance reporting are likely to continue, given recent failures of high-profile businesses – some of which had repeatedly issued profit warnings – which have later been the subject of regulatory investigations and parliamentary scrutiny.

The updated framework aims to support universal application by preparers of PFI through general guidance that can be applied proportionately. It also takes into account the regulatory requirements for PFI prepared in the context of capital markets transactions, including the raising of capital from public markets, through specific application notes.

The updated framework reflects the view of most respondents to the 2017 consultation that the rigour embodied in the preparation principles adopted in regulated capital markets would benefit preparers and users of PFI in other circumstances, such as in private finance-raising situations. It provides commentary to help enable application in the absence of regulatory requirements, including where there is established custom and practice; for example, when applying to certain sources of private finance. The guidance for general application in Part II of the Exposure Draft can be used in all situations in which PFI is being prepared as it can be applied proportionately, depending on the circumstances.

The PFI principles and attributes in the Exposure Draft are those set out in the 2003 guidance, with certain modifications to reflect consultation feedback and a new principle for the 'relevant' attribute.

2. Consultation process and next steps

PROJECT HISTORY

The 2003 guidance is part of a suite of ICAEW market guidance for transactions that also includes:

- *Guidance on financial position and prospects procedures* (TECH 14/14CFF); and
- *Guidance for preparers of pro forma financial information* (TECH 06/15CFF).

This paper is the second consultation stage of ICAEW's project to review the 2003 guidance. The first consultation stage included the publication in July 2017 of *Consultation paper on prospective financial information*.

CONSULTATION STAGE

The Exposure Draft of updated guidance that forms the basis of the second consultation stage and is set out in section 4 is intended, when finalised, to replace the 2003 guidance. Development of the Exposure Draft has taken into account the feedback received on the 2017 consultation and from an extensive pre-consultation exercise starting in 2015, during which views were sought from a range of relevant stakeholders. The feedback received as well as the Working Group's thinking and further considerations are set out against each question in the 2017 consultation in section 5.

The current timeline for developing new guidance for PFI, including specific application notes for capital markets transactions, is shown below:

TIMING	OUTPUT
2015 - Q2 2017	Pre-consultation of market participants
July 2017	First consultation: the case for and scope of proposed new guidance
December 2018	Response statement: feedback on public consultation on scope Second consultation: Exposure Draft of new guidance
December 2018 – Q3 2019	Consultation period and engagement with market participants
Q4 2019 (est)	Response statement: feedback on second consultation ICAEW TECH XX/YYCFF Prospective financial information. New technical guidance, replacing the 2003 guidance

The Exposure Draft includes guidance for preparing useful PFI in any situation. This is contained in Parts I and II.

As part of this consultation, in question 1, ICAEW invites views on whether the guidance in Parts I and II will be readily understood and capable of application by a wider business audience. ICAEW will also seek views from organisations that represent segments of that wider audience.

CONSULTATION QUESTIONS

The Working Group invites responses to questions 1 to 5 from all interested parties.

Questions 2 to 10 are aimed at those experienced in applying, or with an understanding of, the requirements of capital markets regulation.

1. Do you think that the guidance in Parts I and II of the Exposure Draft will be readily understood and capable of application by a wider business audience that is not experienced in capital markets transactions?
2. Do you agree with the categories of PFI that are included in the scope of the guidance, as set out in section 3 of this consultation paper and in Part I of the Exposure Draft?
3. Are there any impending changes, including in regulation, that should be taken into account in finalising the guidance in the Exposure Draft?
4. Do you have any comments on the context or on the attributes and preparation principles of PFI set out in Part I of the Exposure Draft?
5. Do you have any comments on the general principles and procedures for the preparation of PFI set out in Part II of the Exposure Draft?
6. Do you have any comments on the application note for statements of sufficiency of working capital in capital markets transactions in Part III of the Exposure Draft?
7. Do you have any comments on the application note for profit forecasts in capital markets transactions in Part IV of the Exposure Draft, including the application of relevant aspects of the guidance in other circumstances such as where a listed company gives profit guidance to public investors in a less prescribed form (including guidance known as 'profit warnings'), and where profit guidance or forecasts are prepared for users other than public investors?
8. Do you have any comments on the application note for synergy and stand-alone cost saving statements in capital markets transactions in Part V of the Exposure Draft?
9. What, if any, transition arrangements are needed for applying the principles when the final guidance is published?
10. Are there any other matters that should be taken into account when finalising the guidance in the Exposure Draft?

HOW TO RESPOND

Comments may be sent by email or post.

The Working Group will be pleased to meet with interested parties who wish to provide feedback in person.

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The deadline for providing feedback, in writing or in person, is 30 April 2019.

NEXT STEPS

Following this consultation process the Working Group intends to publish guidance in the form of a technical release that will replace the 2003 guidance.

ICAEW will also review responses to question 1 and consider the need to develop application notes for further types of unpublished PFI.

As indicated in the 2017 consultation, ICAEW also intends to engage with relevant stakeholders regarding potential application of the updated PFI framework to PFI prepared for, or underpinning, corporate and financial reporting.

3. Basis for development of Exposure Draft

The 2017 consultation described the Working Group's thinking on:

- 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.

The Working Group has considered the responses to the consultation and other feedback to inform development of the Exposure Draft. While the 2017 consultation did not advocate a new approach to preparing PFI, the commentary in the Exposure Draft incorporates certain differences compared with the 2003 guidance. These differences, together with the Working Group's thinking and additional considerations, are highlighted in section 5, against the relevant question in the 2017 consultation.

WHAT'S NEW?

The principal changes to the 2003 guidance comprise the extension of the scope of the PFI preparation framework – to include all PFI – and the addition of a preparation principle for the 'relevant' attribute. The 2003 guidance was concerned with PFI published in connection with capital markets transactions and a preparation principle for the relevant attribute was not considered necessary given the precise requirements of the regulation. The new principle is, however, likely to be useful for preparers of PFI that is not subject to regulatory requirements. The proposals in the 2017 consultation have broadly been adopted with the exception of the inclusion of two proposed additional attributes for useful PFI as respondents generally considered those qualities to be inherent within other attributes.

SCOPE OF GUIDANCE

The general guidance in the Exposure Draft can be applied to all PFI, whether it is internal or external. Internal PFI is PFI prepared for internal use only. In a capital markets context, external PFI is PFI that is published, even if it is not reported on by an independent accountant or adviser. In other contexts, external PFI incorporates information that is provided to a third party (eg, a provider of private funding or investment), even if prepared or used for internal purposes.

THE CONTEXT, ATTRIBUTES AND PRINCIPLES FOR PREPARATION OF PFI AND ACCOUNTABILITY

PFI is typically prepared for specific users in a specific context. Users of PFI should reasonably expect that the preparer has, in good faith, ensured that the information does not give a view contrary to that which ought reasonably to be given; ie, the information is not misleading.

The guidance in the Exposure Draft does not intend to question when or where PFI should be produced, nor does it impose additional requirements to prepare or disclose PFI. Its purpose is to help preparers to meet the information needs of users, by preparing PFI that is:

- relevant;
- reliable;
- understandable; and
- comparable.

The theme of accountability of preparers of PFI to the users of the PFI underpins the guidance. PFI takes various forms and is prepared for differing purposes. Today's climate anticipates a demanding process for preparation and presentation of PFI: a disciplined approach to preparation, involvement of management, rigour in board oversight and consistency of PFI with strategy, performance and risk. The Exposure Draft is explicit on the discipline and accountability expected when preparing any external PFI, whether or not PFI is published or reported on.

Accountants are typically involved in the process for preparing and presenting PFI. The professional behaviours and ethical code to which accountants adhere (such as those in ICAEW's Code of Ethics or the IESBA Code of Ethics) help enhance accountability in that process.

Preparers of published PFI are also required by regulation or market practice to satisfy certain standards of care, including the expectation that the PFI is not misleading.

Preparers of PFI for new or extended private finance risk losing credibility if the PFI does not stand up to scrutiny, or cannot be supported.

MODULAR APPLICATION GUIDANCE

The structure of the Exposure Draft provides a modular approach to preparing PFI. General preparation procedures that are applicable to all types of PFI (including that to which the guidance may be applied on a proportionate basis) forms Part II of the Exposure Draft.

Additional practical guidance and preparation procedures, specific to different types of PFI prepared in the context of capital market transactions, are set out in separate application notes.

The structure allows for application notes to be added, revised or removed in the future without impacting on the framework or the general preparation principles.

TRANSITION ARRANGEMENTS

The guidance in the Exposure Draft is intended to replace ICAEW's publication, *Prospective Financial Information: Guidance for UK Directors*, published in 2003. Once the Working Group has completed its consideration of feedback on the Exposure Draft, ICAEW will publish the final text in the form of a Technical Release.

The Working Group welcomes views on any necessary transition arrangements to cater, for example, for transactions that are live when the Technical Release is published.

4. Exposure Draft

ICAEW
CORPORATE FINANCE
FACULTY

Exposure Draft

Guidance for preparers of prospective financial information

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Part I: Principles for preparing prospective financial information

1. INTRODUCTION

Definition of PFI

1. Businesses and other organisations prepare prospective financial information (PFI) in differing formats and for varying purposes, and refer to it using different terms including, but not limited to: forecasts, projections, budgets, business plans and revenue/profit/cost saving/synergy plans.
2. For the purpose of the guidance in this Technical Release (the guidance), PFI comprises either quantitative or qualitative statements that reflect the future financial performance and prospects of a business and may be issued in the form of:
   - primary financial statements;
   - elements, extracts and summaries of such statements (such summaries may be narrative in nature, and may reflect financial conclusions that the preparer has drawn); and
   - related financial disclosures and/or supporting calculations.

   This definition of PFI is broad and includes the forward-looking equivalent of any information that might subsequently be prepared to support, or to summarise historical financial information (such as financial statements or internal management accounts). It is not limited to any specific reports or formats.
3. For the purpose of the guidance, PFI does not include forward-looking financial information that is aspirational in nature where that aspirational nature is made clear. This is because a reasonable user of clearly identified aspirational forward-looking information will understand its nature and, accordingly, will not place a high degree of confidence in it. Terms such as 'goal', 'target', 'estimate'[1] and 'illustration' are commonly used to identify forward-looking financial information which is aspirational in nature.
4. PFI may be prepared solely for the internal use of an organisation (internal PFI) or PFI may be prepared in the expectation that the organisation will make it available to external parties for their use (external PFI). External PFI may be published or unpublished. External PFI is typically published in the context of the regulatory requirements of an applicable capital market. Unpublished external PFI, although private and confidential in nature, is made available to certain external parties for their use (eg, in connection with the private raising of debt or equity, or in connection with the private sale of a business).
5. For reasons of investor protection and the general promotion of the efficiency of the capital market, the relevant regulatory regime for a given form of published external PFI may specify the level of confidence that users may place in that published external PFI. For example, the requirement that there be 'very little risk' that the basis of a working capital statement published within an EU Prospectus is subsequently called into question.
6. ICAEW considers that the act of publishing PFI, or otherwise making PFI available to external parties, creates high expectations regarding that external PFI which are above and beyond those placed on internal PFI. In particular, in the absence of an explicit indication to the contrary by the external PFI user, a preparer of external PFI should

[1] However in the context of EU Prospectus and FCA regulation, a 'profit estimate' is defined to mean a profit forecast for a financial period which has expired and for which results have not yet been published and should carry a high degree of certainty.

reasonably assume that there is an expectation on the part of the external PFI user that the external PFI has been subject to a rigorous process of preparation and that a high level of confidence may be placed in the external PFI.

7. By applying the guidance, a preparer should produce PFI in which a user may have a high level of confidence. This does not mean the future outcome(s) set out in the PFI will be achieved, since PFI will necessarily remain subject to inherent uncertainties including *inter alia*, external factors, the nature of the business and the period covered by the PFI. Rather, the user of the PFI may be confident that it reflects a forward-looking analysis of the business based on facts known, or that ought reasonably to have been known, to the preparer at the time of preparation and that it is free from material error or omission.

A principles-based approach

8. The guidance applies a principles-based approach, and provides practical guidance and processes for the application of those principles in the preparation of all PFI. A modular approach has been adopted to provide further guidance on the application to specific types of PFI in specific situations. The areas for which application notes have been published are set out in paragraph 10; application notes for further types of PFI prepared in other situations and for which there is demand will be published in the future.

9. The guidance is designed to promote the preparation of high-quality PFI. It is also expected to help users and reviewers of PFI through setting out best practice for the preparation of PFI. However, the guidance does not cover how such reviewers of PFI discharge their responsibilities when reviewing PFI and/or reporting on PFI.

10. The guidance establishes a framework comprising three basic building blocks:

   - Part I (this Part) sets out and explains the required attributes and related preparation principles for useful PFI.
   - Part II sets out general procedures and techniques that, typically, will assist in the preparation of PFI that reflects the attributes and principles. These are illustrative and neither exhaustive nor prescriptive.
   - Separate modular application notes in Parts III to V provide additional guidance to help preparers prepare specific types of PFI in regulated capital markets transactions (statements of sufficiency of working capital, profit forecasts, and synergy and stand-alone cost saving statements).

11. The principles in this guidance can be applied to all types of PFI, both internal and external. The guidance sets out basic attributes and related principles of useful PFI, together with explanatory and other material that provide guidance for the application of the principles. Where modular application notes have been published separately, these do not comprise stand-alone guidance. Rather Parts I and II of the guidance are the essential building blocks on which the material in separately published application notes is based and they should be read and applied together.

12. The guidance includes an illustrative list of matters that preparers of PFI, including directors who approve and adopt PFI, should consider in connection with their duties, responsibilities and potential liabilities. Each case will depend on the particular circumstances, and judgement is always required as following the guidance may not be sufficient or necessary to ensure compliance with relevant legal and regulatory requirements. As the skills and the experience of the preparer of PFI will vary along with the circumstances of the form and type of PFI, they should seek additional professional advice tailored to the specific circumstances if required.

13. Where preparers have had regard to the guidance, ICAEW recommends that, where possible, they include a statement to that effect within the PFI and/or supporting materials.

Scope of the guidance

14. The guidance is intended to apply to all PFI. While Parts III to V of the guidance specifically address the requirements of published external PFI required by capital markets regulation in a transactions context, it is envisaged that Parts I and II of the guidance can also be applied to external PFI that is unpublished or is published other than in a capital markets transaction context. ICAEW strongly encourages its application on a proportionate basis (unless subject to any agreement to the contrary with the external user). Parts I and II of the guidance will also aid in the preparation of high-quality internal PFI and it is envisaged that the preparers of internal PFI will wish to apply it on a proportionate basis.

15. Application of the guidance in the preparation of PFI is intended to aid and enhance user confidence in all such PFI, and to make the purpose for which the PFI was produced more efficient (including, for example, contributing to the efficient functioning of capital markets and the provision of private debt and equity financing).

16. For the purpose of the guidance, PFI is as defined in paragraph 2, and internal PFI and external PFI are as defined in paragraph 4. PFI is not limited to information about profits and cash flows, even though such information is the focus of many regulatory requirements and, often, the focus of unpublished PFI.

17. PFI represents only a part of the useful forward-looking information that companies can prepare and report. Forward-looking information on an entity's strategy and plans, the risks it faces and non-financial performance measures do not constitute PFI but they are important to investors, funders and certain other external parties. An entity's internal targets and other aspirational forward-looking financial information should not be judged against the principles of PFI set out in the guidance. The guidance seeks to encourage the preparation of high-quality PFI, but is not intended to exclude or discourage the provision of other forward-looking information.

18. Some types of PFI may include an element of historical financial information, because only part of the period under review is in the future. In such cases, the attributes and principles in the guidance should be applied to the whole period, even when some or most of the financial information is historical.

19. Publicly traded companies in the UK typically publish a wide range of external PFI including 'profit warnings' or updates, working capital statements, profit forecasts, synergy and stand-alone cost saving statements and announcements made under the general obligation of disclosure for companies under relevant capital markets regulations (eg, the Listing Rules, the Prospectus Rules, the AIM Rules for Companies, the City Code on Takeovers and Mergers, the Disclosure and Transparency Rules). The capital markets regimes of other jurisdictions may have similar requirements for published external PFI, and it is envisioned that the guidance may be of assistance to preparers of published external PFI in such jurisdictions.

20. Publicly traded companies may also issue pro forma financial information that involves presenting historical financial information to indicate the effects of a planned transaction or other future event. Although such pro forma financial information is forward looking, it is not PFI because it consists entirely of restated historical financial information and is not drawn up to a date, or for a period, in the future. The guidance therefore does not apply to pro forma financial information.

2. ATTRIBUTES AND PRINCIPLES

21. Prospective financial information should be useful when considered in the context of cost-benefit and materiality judgements. To be useful, PFI is prepared according to four principles and demonstrates four attributes. The attributes and principles are:

- **Relevant**, because PFI is prepared on the ***user needs*** principle so it has the ability, in a timely manner, to influence its users' economic decisions and has predictive value or confirmative value for its users.
- **Reliable**, because it is prepared on the principle that it is supportable or based on sound ***business analysis***.
- **Understandable**, because it is prepared on the principle of containing ***reasonable disclosure*** about what it relates to, its risks, uncertainties and mitigating actions.
- **Comparable**, because it is prepared on the principle that it is capable of ***subsequent validation*** by comparison with historical financial information.

22. If the above four principles are applied in the preparation of PFI, and the resultant PFI possesses the above four attributes, it would also be expected to be aligned (ie, the PFI is reflective of integrated and cohesive management thinking with, for most businesses, a link between the PFI and management's determination of the strategy, performance and risks of the business), not misleading (ie, the PFI does not give its users a view contrary to that which ought to be given) and fair, balanced and understandable.

23. That PFI, whether internal PFI or external PFI (and whether published or unpublished), should not be misleading is congruent with a PFI preparer's responsibilities under ICAEW's Code of Ethics (and the Code of Ethics of the IESBA, on which ICAEW's Code of Ethics is based) and specifically the fundamental principles of Integrity and Objectivity. In particular:

(i) A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:

(a) contains a materially false or misleading statement;

(b) contains statements or information furnished recklessly; or

(c) omits or obscures information required to be included where such omission or obscurity would be misleading.[2]

(ii) A professional accountant in business who is involved in the preparation and reporting of information that may be made public or used by others inside or outside of the employing organisation shall prepare such information fairly, honestly and in accordance with relevant professional standards so that the information will be understood in its context.[3]

24. For published external PFI there will typically be limited or no opportunity for users of the PFI to interact with the PFI preparer and examine the underlying business analysis upon which it is based. Consequently, the usefulness of published external PFI to its users will be driven by the underlying regulation covering the form/content of that published PFI, and by the preparer's application of the guidance.

25. For PFI that will be unpublished, and which has not been prepared to support published PFI, typically there will be an opportunity for the user of the PFI to interact with the preparer of the PFI before, and/or during, and/or after the preparation of that unpublished PFI. To be useful, such unpublished PFI (whether external PFI or internal PFI) should address the needs and requirements of its known users as articulated by

[2] Code of Ethics Part A 'General Application of this Code' paragraph 110.2/Code of Ethics Part C 'Professional Accountants in business' paragraph 320.4.

[3] Code of Ethics Part C 'Professional Accountants in business' paragraph 320.1.

them. However, it should be recognised that some users of unpublished PFI will be less sophisticated than others and so less able to articulate their requirements for the unpublished PFI. In some situations the actual user of the unpublished PFI will not be known at the time of preparation. Application of the guidance should, however, help to ensure that less sophisticated or unidentified users are provided with unpublished PFI that is useful to them.

2.1 Relevance and the user needs principle

26. PFI should be relevant through addressing the known or anticipated needs and requirements of the user(s) of the PFI. Generally, in the absence of any contrary instruction from a known user for whom unpublished PFI (whether external or internal) is being specifically prepared, PFI will only be relevant if it:
    - relates to and has the ability to influence economic decisions of PFI users;
    - is provided in time to influence economic decisions of PFI users; and
    - has predictive value for PFI users or, by helping to confirm or correct past evaluations or assessments, it has confirmatory value for PFI users.
27. The relevance of information is affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance. The guidance considers an item of information to be material if its omission or misstatement could influence the economic decisions of users taken on the basis of that information. Materiality depends on the size and qualitative nature of the item, judged in the particular circumstances in which it is presented.
28. The materiality considerations that apply to historical information will also generally apply to PFI. However, because PFI is inherently uncertain, there are additional considerations. Disclosure of uncertainties and related assumptions is ordinarily required in order for PFI to be relevant to, and understandable by, users for decision-making purposes, and it may also be necessary to disclose the sensitivities involved and alternative outcomes. Where, for certain types of published external PFI, disclosure of uncertainties/assumptions/sensitivities/alternative outcomes is prohibited by the relevant regulatory regime, the underpinning unpublished PFI would be expected to contain such disclosures for consideration by the parties responsible for approving or authorising the published external PFI.
29. Information is relevant only insofar as it comprises material items. Immaterial assumptions and risk factors that will not influence the decisions made by users of the PFI should not be disclosed to external users. This will require judgements to be made in practice, because what is material will always depend on the size of the amounts involved, the nature of the information and the circumstances in which it is presented.
30. Choices about the form and content of PFI should, as with historical financial information, reflect judgements as to:
    - how relevant and useful the chosen form and content will be for the users of the PFI in the exercise of their economic decisions; and
    - whether the benefit to users exceeds the cost.
31. For unpublished external PFI, the private external user for whom it is prepared may provide instructions or explicit requirements for the form and content of the PFI, but this will not always be the case and any such instructions or requirements may not be comprehensive. The form and content of published external PFI may be set by regulation (but this will not always be the case and, where any such regulations do exist, the requirements may not be set out in any great detail).

32. In some cases, choices about the form and content of PFI will involve trade-offs between the attributes of useful information. For example, producing PFI more quickly may make it more relevant but may make it less reliable.

33. PFI reflects future events which are inherently uncertain. The following factors are relevant when judging how useful PFI is to users and considering whether the benefit to users exceeds the cost.

    - In general terms, the degree of uncertainty associated with the outcome of an event or condition increases the further into the future a judgement is being made about the outcome of an event or condition.
    - Any judgement about the future is based on information available at the time at which the judgement is made. Subsequent events can contradict a judgement which was reasonable at the time it was made.
    - The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors all affect judgements regarding the outcome of events or conditions.

34. The length of period into the future to which PFI relates is only one, and not necessarily the most significant, factor affecting the confidence attached to such information. An established business may be able to predict with a high degree of certainty its results for the following year, particularly if it operates in a very stable environment. Conversely, PFI presented by a start-up or an established business entering a new field may be subject to a wide range of uncertainties.

2.2 Reliability and the business analysis principle

35. 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.

36. It is only possible to prepare and present reliable and useful PFI on the basis of a full knowledge of the entity's business and intentions. If PFI is not based on the entity's actual and expected performance, strategies, plans and risk analysis, it will not be reliable for users.

37. PFI is reliable if it:

    - can be depended upon by users as a faithful representation of what it either purports to represent or could reasonably be expected to represent;
    - is neutral because it is free from deliberate or systematic bias intended to influence a decision or judgement to achieve a predetermined result;
    - is free from material error;
    - is complete within the bounds of what is material; and
    - is prudent in that a degree of caution is applied in making judgements under conditions of uncertainty.

38. Against this background, reliable PFI should be capable of being described in the following terms:

    - It reflects a forward-looking analysis of the business based on facts and circumstances known (or that reasonably ought to have been known, at that time).
    - It only reflects future actions that are envisaged in the entity's current strategies and plans.
    - It only reflects future actions, events and circumstances for which the related risks have been analysed.

- It offers a faithful representation of the entity's strategies, plans and risk analysis or elements of them.
- It reflects the entity's business analysis in a way that is free from material error and materially complete.
- It is consistent with planned courses of action published or disclosed elsewhere by the entity.

It is not necessarily the case that, for PFI that meets the above criteria, only one outcome can be envisaged.

39. Reflecting the business analysis within PFI in a way that is free from material error means that it reflects the analysis accurately, not that the business analysis will be materially the same as the actual outcome. More specifically, to say that PFI is free from material error does not mean that it will be achieved.

40. In the context of PFI, other than stress testing-type forecasting exercises, neutrality also means that preparers of PFI should not use prudence as a pretext for applying a cautious discount when faced with the uncertainty that inevitably surrounds PFI. Preparers of PFI should enable users to take proper account of uncertainty by following the reasonable disclosure principle (see below) and disclosing assumptions, determining factors and alternative outcomes (unless prohibited by the relevant regulatory regime for a given form of published external PFI).

41. Care needs to be taken to understand how the concept of prudence can be applied consistently to historical financial information and PFI. Since PFI is drawn up to a future date it makes no sense to apply the concept of prudence to PFI by insisting that it only reflects gains that could be recognised today. Prudence needs to be applied from a vantage point in the future when preparing PFI. If prudence would allow a gain to be recognised today if specific conditions were satisfied, then prudence should also allow a similar gain to be recognised in PFI prepared to a future date if the same conditions are expected to be satisfied at that date.

42. The business analysis principle will help preparers decide on appropriate assumptions to deal with the inherent uncertainty attached to PFI. It will also indicate factors that might cause these assumptions to fail in practice and the alternative outcomes that would result from such failure. It therefore ensures that there is a basis for the disclosure of uncertainties required in order to make PFI understandable.

2.3 Understandability and the reasonable disclosure principle

43. To aid understandability, PFI should be accompanied by a clear description of what it represents and disclosure of the material assumptions on which it is based, (unless prohibited by the relevant regulatory regime for a given form of published external PFI. In such a case, the supporting unpublished PFI should contain such disclosures). In order for users to be able to evaluate these assumptions, the related risks, uncertainties and sensitivities will also need to be disclosed in a way that makes their significance understandable to users.

44. For unpublished external PFI, the extent to which material assumptions and uncertainties are disclosed and explained within the PFI may be set by the private external user for whom it is prepared. Where the actual user(s) of unpublished external PFI is not known at the point of preparation of the PFI, or where the user(s) has not given instruction to the preparer on the extent of disclosure, then the preparer should have regard to the reasonable disclosure principle set out in the guidance.

45. The degree of uncertainty associated with PFI will largely determine the complexity of disclosure and, hence, the understandability of PFI.

46. To be understandable, PFI should contain disclosure that is reasonable, and PFI should not be presented in situations of such uncertainty that the disclosure becomes too complex or extensive to be understood or used by the expected users of the PFI.
47. PFI should be structured in such a way that users encounter the more significant information first including, where appropriate, information relating to the uncertainty attaching to the PFI.
48. For PFI to be understandable, users will need sufficient information to be able to make judgements about the uncertainties attached to it. Thus, disclosure will need to deal with:
    - sources of *uncertainty*;
    - *assumptions* made relating to uncertainties;
    - *determining factors* that will affect whether assumptions will be borne out in practice; and
    - *alternative outcomes*, being the consequences of assumptions not being borne out.
49. For example, an increase in revenue next year might depend on obtaining regulatory approval for a new product. Disclosure could cover the following matters:
    - *Uncertainty*: whether or not regulatory approval will be obtained.
    - *Assumption*: that regulatory approval will be obtained by the end of the current financial year.
    - *Determining factors*: these could include:
        - meeting technical requirements;
        - passing relevant tests; and
        - obtaining expert support.

      These factors should be described and explained.
    - *Alternative outcomes*: no sales of the new product. In this example, the failure of an assumption to be fulfilled will have a simple consequence. However, in some cases, the preparer of the PFI may need to provide sensitivity analysis to explain the consequences of failed assumptions in terms of alternative outcomes.
50. As uncertainties become more significant, there will be a greater need to describe the assumptions that have been adopted to deal with them, the nature of the related determining factors and the impact of alternative outcomes. A point will be reached at which the interaction of multiple significant uncertainties relating to, for example, market demand, competitor actions, product acceptance or labour and raw material supplies may become too complex for the user to understand. The user's ability to understand places limits on the degree of uncertainty that can be accommodated by general purpose PFI, and may require preparers to be less ambitious in terms of the implied precision of the PFI presented.
51. For example, the implied precision may be reduced if the PFI is expressed in terms of
    - *a range (between x and y);*
    - *a floor (not less than, or at least, x); or*
    - *a ceiling (not more than, or at most, y).*

    This in turn can have the positive effect of reducing the extent of disclosures that PFI users might otherwise find difficult to understand. For this reason, ranges, floors and ceilings are accepted and acceptable methods of presenting certain PFI. However, a range suggests a breadth of outcomes within the given limits: it would be misleading for preparers to present a range if they did not believe that all the outcomes within the range were possible. Floors and ceilings are not generally interpreted literally but rather viewed in a wider context. So, for example, a floor that is excessively cautious, even though true, may be misleading if the intention is to give the impression of a level of profit that the preparer is aware is far below the expected actual performance shown by the underlying PFI.

52. Even where PFI could in principle be understood by users, preparers also need to consider whether it is presented in such a way as to make it understandable. Understandable financial information depends on the characterisation, aggregation and classification of transactions and other events in accordance with their substance and their presentation in ways that enable the significance of information to be understood by users. Such information is generally aggregated and classified in a hierarchy. The most significant summarised information is presented in such a way that the user encounters it first. Less important supporting detail is disclosed in supporting analyses or in notes that supplement users' understanding of the high-level information.

53. In summary, the degree of uncertainty attached to the business activities and period covered by general purpose PFI will be a major determinant of its understandability and usefulness. The reasonable disclosure principle recognises that the complexity and volume of supplementary disclosures about uncertainties will affect secondary characteristics of the understandability attribute: users' ability to understand, and the characterisation, aggregation and classification of the underlying transactions and other information. A point will be reached at which the complexity of the disclosure means that it is beyond users' ability to understand and/or is incapable of being structured in an understandable way. At this point, PFI is no longer useful.

2.4 Comparability and the subsequent validation principle

54. For PFI to be comparable, it should be capable of subsequent validation by comparison with outcomes in the form of subsequent historical financial information.

55. Financial information is comparable if it:

- can be compared with similar information for other periods and other entities so that similarities and differences can be discerned and evaluated;
- reflects consistency of preparation and presentation (within the bounds of what is material to the PFI), provided this is not an impediment to improvements in practice; and
- is supported by disclosure of the material accounting policies used in its preparation. Such disclosure may be by reference eg, to the accounting policies disclosed in the entity's historical financial information.

56. The need for profit-related PFI to be consistent with disclosed accounting policies not only allows comparison with the relevant historical numbers but also helps to ensure that profit-related PFI is capable of comparison with subsequent historical financial information.

57. In applying the principles of useful information to PFI, preparers should ensure that it is capable of being retrospectively validated. This means that it should be capable of being compared with subsequent historical financial information prepared for the period covered by the PFI so that differences and similarities can be evaluated, explained and assessed.

58. References to being capable of subsequent validation reflect the fact that, at the time when PFI is published or otherwise made available, it is not possible to state with certainty that comparable historical financial information will be drawn up in the future. What enhances the usefulness of PFI at the time it is prepared is the expectation that there could be appropriate future reporting (with the expectation for published external PFI being that there could be appropriate future public reporting). If users of PFI know

from the outset that they will never be able to compare PFI to what actually happens, then the PFI may be less useful. It is therefore important that PFI is perceived by users as being capable of validation.

59. Any particular amount included in PFI should be clearly defined so that users can identify it in comparisons to existing and subsequent historical financial information. If the label attached to a component of PFI means different things in different periods then this comparability will be lost. Generally, any particular piece of PFI should be comparable in format with existing historical data and expected future reporting.

60. It is important to appreciate that the subsequent validation principle is not about requiring specific actions in the future. The issue of whether PFI is required to be compared to subsequent historical information is separate from the issue of whether it is capable of comparison. A requirement for such comparisons is likely to have beneficial effects on the behaviour of preparers, and help users to perceive PFI as being more useful. For example, preparers will not wish to make available to external parties PFI that reflects events that they do not believe will happen, if they will subsequently be held to account. Preparers are also likely to be more diligent in monitoring PFI against actual performance and updating it promptly if they know that users of the PFI will themselves expect to have actual performance compared against PFI in due course.

Part II: General application guidance

1. INTRODUCTION

1. This Part identifies procedures that will assist in the preparation of PFI that is relevant, reliable, understandable and comparable, and therefore will be useful to the user of the PFI.
2. PFI is prepared for a variety of purposes and in a number of contexts, including to support M&A activity and the raising of equity and debt finance. As set out in Part I, to be useful and meet the needs of users, PFI should be prepared and judged against the following qualitative attributes which are applied in the guidance:
    1. Relevance *(user needs principle)*
    2. Reliability *(business analysis principle)*
    3. Understandability *(reasonable disclosure principle)*
    4. Comparability *(subsequent validation principle)*
3. For the purposes of this Part, the term 'preparer' means the person or persons with ultimate responsibility for the PFI, as well as such other persons or parties who they have directed or instructed to assist with the preparation of the PFI. For corporate entities, the directors would typically be expected (or required by regulation) to have ultimate responsibility for any PFI that is published or otherwise made available to an external party. Also, for the purposes of this Part, the term PFI means prospective financial information prepared for internal purposes and that for publication or for disclosure to external users as well as any underlying/supporting financial forecasts, projections or financial forecast model (referred to in this Part as 'supporting financial projections').
4. When preparing financial forecast models, consideration should also be given to applying appropriate elements of the ICAEW Corporate Finance Faculty's best-practice guideline, Financial Modelling[4].

2. Illustrative procedures adopted in preparing PFI

5. The preparation of PFI should be carefully planned, executed and documented. The practical considerations set out in the table below are categorised under these stages. They are also linked to the relevant PFI preparation principle (and attribute).
6. While the purpose and context of the PFI may differ, the preparation of PFI generally requires a wide range of business skills and commercial judgement as well as accounting expertise, and certain core processes and procedures are typically appropriate in all cases.

2.1 Illustrative practical considerations and techniques for preparation of PFI and supporting financial projections

7. The list below is not exhaustive or prescriptive; other considerations and techniques may be applicable. The preparer should assess those that are likely to be relevant having regard to the purpose and context of the PFI, the size, complexity and particular circumstances of the entity or group, the industry, and the general economic environment. Additional guidance in the form of application notes specific to certain types of PFI and situations, supplement, and, where applicable, should be read together with this Part.

[4] Available from icaew.com/cff

PLANNING

User needs principle (Relevant)

- The preparer should identify the purpose for which the PFI is being prepared and the appropriate period to be covered to ensure the form and content presented has the ability to influence economic decisions of the users of the PFI.
- The preparer should ensure that the PFI is being provided on a timely basis to influence the economic decisions and/or assist in confirming or correcting past evaluations or assessments.

Business analysis principle (Reliable)

- The preparer should identify whether appropriate business analysis and an up-to-date strategic plan exist on which the PFI should be based.
- If a strategic plan needs to be updated or developed, the preparer should determine who needs to be involved in this process.
- Consideration should be given to industry-specific regulatory requirements that may impact plans and performance and hence the PFI, for example regulatory capital requirements that apply to certain financial services institutions.
- Any regulatory requirements attached to the PFI being prepared/issued should be identified and the implications for the business analysis considered.
- Financial constraints such as banking agreements and covenants that may impact the plans and performance (and hence need to be reflected within the PFI) should be identified and the implications considered.
- The preparer should identify if a financial forecast model exists or whether a model needs to be built and, if so, who will be responsible for developing it and whether that person or party has appropriate financial modelling skills. The preparer should also determine whether independent testing of the financial forecast model should be undertaken to ensure it is fit for purpose.
- Directors (or equivalents in unincorporated businesses) and other senior members of financial and operational management with the necessary in-depth knowledge and experience of the business, its activities and the market, should be involved in the preparation of the PFI. Subsidiary, divisional, and business unit management should be involved as appropriate.
- Processes should be implemented for obtaining input from all relevant areas of the business, which, in addition to finance, may include some or all of: treasury, tax, operational, commercial and legal functions. Where such functions do not exist in-house, consideration should be given as to whether it is appropriate to obtain input from external service providers to the business. These processes should be planned, organised and communicated internally.
- Responsibilities should be clearly allocated and co-ordinated, including responsibility for the ultimate internal review and approval of PFI.
- A timetable for the preparation of PFI should be sufficient to permit the review and the formal approval process of the draft PFI by the persons responsible for its preparation/issue, to ensure that any necessary amendments can be made.

Reasonable disclosure principle (Understandable)

- The level of detail within the PFI and disclosures will vary depending on the circumstances of its preparation.
- The PFI should normally include monthly projected balance sheets, income statements, and cash flows, although depending on purpose, circumstances, materiality, seasonality, and the nature of trading cash flows, it may be appropriate for it to be prepared on a quarterly basis.
- Those involved with the preparation of the PFI should understand the legal and regulatory (where applicable) requirements of the proposed PFI and understand its use, issue and publication.

Subsequent validation principle (Comparable)

- The format and level of detail of the PFI should typically facilitate comparability with historical trends/performance in the management accounts. Including historical actual data in the financial forecast model facilitates this and facilitates PFI that will be in a form which is subsequently comparable.
- The format of the PFI, including what line items should be disclosed, should be identified by the preparer, ensuring it is capable of comparison with historical financial information and expected future reporting of actual financial performance.
- The preparer should identify whether there are any required or proposed accounting policy changes which would impact the subsequent validation of the PFI.
- The preparer should identify any other factors that might cause subsequent validation issues, such as the impact of a major acquisition or disposal or major strategic change in the business and how these issues should be addressed and disclosed.

EXECUTION

Business analysis principle (Reliable)

- As part of/as a result of the business analysis, the preparer should identify significant uncertainties where assumptions are required to be made.
- Where assumptions are required, the preparer should identify the sources of information to be used as the basis for those assumptions.
- The preparer should select the assumptions to be applied, considering for the purposes of sensitivity analysis (defined on page 26), the possible range of values for each assumption and the level of uncertainty underpinning the assumption.
- Consideration should be given to the inter-relationship between key assumptions - even if each assumption may appear reasonable in isolation, they may not all be reasonable in aggregate.
- To the extent not already available, a financial forecast model should be built which:
    - is prepared in the form of an integrated financial forecast model, (covering the income statement, cash flow and balance sheet) to ensure that all assumptions are consistently and appropriately reflected in each statement, thereby avoiding errors in the model. If, exceptionally, the model is not fully integrated, steps should be taken to ensure all assumptions are appropriately and consistently reflected in all PFI;

- to the extent appropriate, is prepared and presented in a consistent format with financial information presented in internal management accounts and in accordance with the entity's accounting policies;
- reflects an opening balance sheet consistent with the actual balance sheet in the latest available management accounts. To the extent further management accounts become available during the preparation/review period, the financial forecast model should be updated to reflect these;
- is driven by key assumptions and allows key assumptions to be flexed to enable modelling of the impact of business risks (sensitivity analysis);
- enables compliance with financial covenants to be determined; and
- is built using formulae and variable inputs and avoids hard coding of numbers within the financial forecast model.

- In preparing the financial forecast model, checks should be undertaken to ensure:
  - it does not contain arithmetical errors;
  - the projected income statement, cash flow and balance sheets reconcile with each other;
  - the stated assumptions are correctly applied; and
  - completeness of income statement, cash flow and balance sheet line items compared to historical information.
- The preparer should consider information about the key aspects of the economic and market environment within which the business operates and assess whether there are any economic, market, regulatory, legal, and political or other factors which may cause the market to change and impact trading and cash flows and so should be reflected in the PFI.
- The preparer should be able to articulate their business model and answer questions about how it works in a way that is consistent with any PFI they prepare. Such questions might include:
  - What are the objectives of the business?
  - What are the key drivers of success?
  - How well is the business model working currently?
  - How is it, and how might it be, impacted by external events?
  - How are risks that affect key processes and information being managed?
- Consideration should be given to any potential capacity constraints, for example relating to supply chains, staffing levels, production facilities, and distribution channels which may impact the ability to deliver projected results unless investment or other actions are planned to address these.
- The preparer should ensure that the PFI takes into account the range of potential outcomes arising from year-end accounting estimates and processes, for example annual impairment reviews of assets, and, if relevant, their impact on covenant calculations.
- A 'top-down' sense check of the PFI should also be undertaken. Typically, this will be achieved through analytical review of Key Performance Indicators (KPIs) and by comparing the PFI with recent actual performance to identify unusual/unexpected trends that indicate possible inconsistencies and potentially a need for amendments to the key assumptions and/or the workings of the financial forecast model.

- The preparer should apply sensitivities to the PFI (sensitivity analysis) to determine the impact on the PFI of risks and uncertainties and of changing relevant assumptions to gain an understanding of the impact of changes in the critical assumptions that underpin the financial projections.
- Mitigating actions should be considered which may counteract the impact of sensitivities. These should reflect only those areas within management's control in terms of quantum, timing and impact. The cost of implementing such actions should also be reflected.

Reasonable disclosure principle (Understandable)

- The preparer should identify the purpose of the PFI and clearly disclose the basis of preparation, distinguishing between the fundamental basis of preparation (scope, currency etc.) and assumptions.
- The preparer should identify and clearly disclose the period covered and, where relevant, the accounting policies applied.
- Using the sensitivity analysis, the preparer should identify the material assumptions and disclose them clearly.
- The preparer should consider whether, due to either the level of uncertainty attaching to certain assumptions or the sensitivity of the PFI to certain assumptions, further disclosure should be included to illustrate the effect on the PFI.

Subsequent validation principle (Comparable)

- PFI should be prepared in accordance with the entity's key accounting policies and disclosures of KPIs and Alternative Performance Measures (APMs) insofar as they are material to the PFI and its purpose.
- Consideration should be given to the impact of known changes in accounting standards that apply to the business in future financial periods beyond the current financial year and, if relevant, their impact on any covenant compliance calculations.

EVIDENCE AND DOCUMENTATION

Business analysis principle (Reliable)

- PFI should be supported by up-to-date business analysis that is properly grounded in reality, known facts and changes in circumstances. The preparer should have sufficient documentary support for the plans, strategies, risk analysis, business analysis and financial projections and assumptions which is consistent with other information generated within the business and with external sources such as key economic indicators and reliable industry statistics.
- Evidence to support assumptions underlying PFI should be generated from the information systems underpinning a company's operations and its processes of strategic and market analysis and risk management.
- Support for key assumptions, may also include:
  - historical performance/precedents (but it should be recognised that basing forecast assumptions on historical precedent may not always be reasonable, for example, it may not be reasonable for the business in question to both grow market share and maintain its historical pricing);

- the pipeline of work recorded in a customer relationship management system or similar;
- future planned actions/investments, qualified /supported by research and third party analysis; and
- third party documentary evidence such as commercial terms of key customer/ supplier contracts, market/economic studies, commercial due diligence, experts' reports etc.

Reasonable disclosure principle (Understandable)

- Key assumptions used in the generation of PFI should be clearly identified, documented and supported.
- Approval of PFI, including all relevant disclosures, by the directors (or equivalents in unincorporated businesses) should be evidenced in board meeting minutes.

Subsequent validation principle (Comparable)

- Accounting policies used in the generation of PFI should be clearly identified, documented and supported.

Part III: Application note for statements of sufficiency of working capital in capital markets transactions

1. INTRODUCTION

1. This application note applies to working capital statements included in an investment circular by regulation (and to the supporting underlying PFI which forms the basis for the statement). It should be used by directors and preparers. This Part should be considered and read together with Parts I and II of the guidance.

2. REGULATORY REQUIREMENTS

2.1 Overview of regulation

2. Capital markets regulation in many regimes requires that the investment circular issued in connection with a transaction contains a statement by the issuer, or in some regimes the directors of the issuer, that working capital is sufficient for the present requirements of the issuer (and its group where the issuer has subsidiaries) or, if not (where the regulation applicable to the transaction permits), how they propose to provide the additional working capital needed. Most regulators permit only two forms of working capital statement – either the issuer states that it has sufficient working capital (a clean statement) or that it does not (an adverse statement which is referred to in the ESMA Guidance (defined in 2.4) and in this Part as a qualified statement. The form of the statement is typically set by regulation.
3. Examples of such regimes and regulatory requirements, which include the UK and the member countries of the European Union, are set out in the Annex.

2.2 Definition of working capital and present requirements

4. For the purpose of working capital statements, working capital is considered to be an issuer's ability to access cash and other available liquid resources to meet its liabilities as they fall due. Present requirements are generally considered to be a minimum of twelve months from the date of the investment circular.

2.3 PFI in relation to working capital statements

5. Working capital statements published in an investment circular, while still PFI, are unusual because they are qualitative in nature. The underlying unpublished PFI, including financial forecasts/projections which support and form the basis for the statement are, however, quantitative in nature. The unpublished PFI is referred to as 'working capital projections' in this Part.

2.4 ESMA Guidance

6. The *ESMA update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive* (ESMA Guidance) provides guidance on the requirements for working capital statements

in EU Prospectuses, which may also be pertinent for other regimes. In particular, the ESMA Guidance:

- requires that, in making the working capital statement, there is very little risk that the basis of such a statement is subsequently called into question. Accordingly, issuers are expected to have undertaken appropriate procedures to support the statement being made;
- clarifies that the EU prospectus regulatory requirement is to make a statement that the issuer has sufficient working capital (a clean statement) or that it does not, and if so, how it proposes to provide the additional working capital needed (a qualified statement);
- prohibits the detailed disclosure of caveats or assumptions made in making the statement as this would put the onus on investors to reach their own conclusion on the adequacy of working capital. Similarly, an issuer is not permitted to state that it is 'unable to confirm' that it has sufficient working capital. Where a qualified statement is made, the ESMA Guidance sets out matters relating to the relative timing, shortfall, action plan and implications that should be disclosed to ensure that investors are fully informed.

7. These principles are also reflected in the guidance of other regulators, including, for example, in the UK Listing Authority (UKLA) Technical Notes.

2.5 Directors' accountability, including satisfying regulatory obligations

8. The directors are responsible for the working capital statement and must be fully engaged in the preparation process. This includes approving the working capital statement, the supporting working capital projections and considering and making decisions in relation to the need to obtain further facilities. Capital markets regulation imposes requirements on the content of information included in investment circulars, and on the processes and procedures (and standards of care) to be adopted by the directors in preparing such information. Such UK and EU regulatory obligations that apply to working capital statements are set out in the Annex.

9. While the obligations in the various regulations are articulated differently, the spirit of the obligations and standards of care are broadly aligned, and require that the process adopted by the directors is sufficiently robust. The directors should undertake appropriate procedures and make due and careful enquiry of the robustness of the supporting working capital projections to ensure they have a reasonable basis to make the working capital statement, such that there is very little risk that the basis of the statement is subsequently called into question. They must also ensure that the investment circular as a whole, is, to the best of their knowledge, in accordance with the facts, contains no omission likely to affect its import, is aligned with the working capital statement, and is not misleading.

10. In making a clean working capital statement, the onus is on the directors to be of the opinion that they are confident that the issuer (and its group, if applicable) can access sufficient cash and other available liquid resources such that it can meet its liabilities as they fall due during the present requirement period. The guidance sets out principles and processes for the preparation of working capital statements and the supporting PFI which help the directors to satisfy this obligation.

11. The guidance does not address legal obligations and directors should obtain legal and professional advice where appropriate.

3. APPLICATION OF PRINCIPLES AND ATTRIBUTES OF USEFUL PFI TO WORKING CAPITAL STATEMENTS

12. As set out in Part I, to be useful and meet the needs of users, PFI should be prepared and judged against the following qualitative attributes which are applied in the guidance:

    1. Relevance *(user needs principle)*
    2. Reliability *(business analysis principle)*
    3. Understandability *(reasonable disclosure principle)*
    4. Comparability *(subsequent validation principle)*

13. As noted above, the working capital statement included in an investment circular is itself PFI, as is the unpublished supporting PFI (including working capital projections) that forms the basis for the statement. The attributes and the way in which the principles apply to the working capital statement published in an investment circular are set out below. The practical application of the principles and the specific procedures and considerations which apply to working capital statements and the supporting PFI that forms a basis for the working capital statement are set out in section 4 below.

3.1 Relevance and user needs principle

14. Broadly, working capital statements should be relevant to users and have predictive value if they address the purpose for which they are being prepared, and are prepared in accordance with the applicable regulation and guidance. For example:

    - for an issuer that has subsidiary undertakings and is making a statement that relates to the company and its group, the working capital statement should be prepared on a consolidated basis covering the entire group;
    - certain regulation requires that the working capital statement is prepared on the basis that the transaction that is the subject of the investment circular (eg, acquisition, disposal, refinancing/reconstruction, purchase of own shares, rights issue, placing etc.) has been completed (provided, in the case of an equity fundraising, that the proceeds are fully underwritten).

3.2 Reliability and business analysis principle

15. As set out above, when an issuer is required to report publicly on working capital, the directors are expected to make a simple clean statement (unencumbered by disclosures of caveats and assumptions) that the issuer has sufficient working capital for its present requirements (ie, at least the next 12 months). Directors are required by ESMA Guidance to ensure that there is very little risk that the basis of the working capital statement will subsequently be called into question. If there were significant uncertainties attached to a clean working capital statement, then the principles established in Part I would require that there be appropriate disclosure of assumptions, explanation of the underlying uncertainties and analysis of the consequences of the assumptions not being borne out in practice. Since many regulatory regimes (including the UKLA and ESMA Guidance) do not permit disclosures in relation to a clean working capital statement, it is, therefore, assumed that there are no significant uncertainties.

16. The principles set out in Part I establish that, to be reliable, the PFI (including supporting working capital projections) that forms the basis of the working capital statement should be supported by analysis of the entity's business and should accurately represent factually based strategies, plans and risk analyses, such that they are aligned.

17. Consistent with this, the applicable core procedures, techniques and considerations set out in Part II should be undertaken, along with the specific procedures, techniques and considerations applicable to the working capital statement and the unpublished supporting PFI forming the basis for the working capital statement that are included in section 4 below.

3.2.1 Sensitivity analysis - reasonable worst case scenario

18. To help ensure that there is very little risk that the basis of the working capital statement is subsequently called into question, the directors should undertake sensitivity analysis to consider the reasonable worst case scenario. The analysis should focus on those assumptions believed by the directors to be subject to the greatest uncertainty (and where the range of possible assumed values is wide) and those assumptions that , if changed by a relatively small amount, can have a large impact on the forecast outcome. The sensitivity analysis can also be used to assess the extent to which working capital is sensitive to other assumptions. See the illustrative practical considerations and techniques in section 4.

19. Where, in considering the reasonable worst case scenario (and mitigating actions within the directors' control) the directors conclude that there is insufficient margin or 'headroom' between required and available funding to cover such a scenario, it will not be possible to make a clean working capital statement. In these circumstances, the directors will either need to reconsider their business plans, arrange additional financing or consider whether they should issue a qualified working capital statement – see the understandability section below. Consideration should also be given to disclosures elsewhere in the investment circular such as in the business analysis section.

3.2.2 Other aspects of reliability

20. The concept of neutrality is relevant to working capital statements in that directors should consider any statement required by the applicable regulation in a wider context. For example, if the statement was valid for the required 12-month period but difficulties were foreseen in the subsequent period, the information might be seen as biased and the lack of disclosure misleading. In these circumstances, the directors should consider if supplementary disclosures in other parts of the investment circular would be appropriate. In considering this issue, the directors should consider the unpublished PFI that supports the working capital statement beyond the 12-month period covered by the statement.

21. The directors should also consider the availability of committed facilities. Where required by regulation or local market practice, liquidity headroom should only take into account facilities for the period to the extent that they are legally committed. In assessing whether a facility is committed, any clauses in the facility agreements that may be breached, including those, for example, relating to a change of control, must be considered.

3.3 Understandability and reasonable disclosure principle

22. When making a working capital statement (the form of which is typically set by regulation), issuers should ensure that the statement or explanation is understandable; ie the working capital statement should be clear and unambiguous leaving no doubt in the user's mind as to whether, in the issuer's opinion, there is, or is not, sufficient working capital. The working capital statement also needs to be understandable in the context of the overall investment circular so care should be taken to ensure that there is alignment of information within the investment circular.

3.3.1 Form of the working capital statement

23. The directors should make their statement with a high degree of confidence and, hence, the working capital statement must be brief (in the case of a clean statement), track the wording of the applicable regulation, and be unencumbered by additional disclosures of risks and uncertainties even though it relates to the future. Both ESMA and the UKLA, for example, consider that such disclosure of assumptions, sensitivities, or risk factors only serves to qualify and confuse the statement for shareholders and investors and, hence, they are not permitted in a clean working capital statement. However, the market practice of disclosing the basis upon which the statement is made eg, 'taking into account existing bank facilities' (provided they are contractually committed) or 'taking into account the proceeds of the issue' (provided they are fully underwritten), is acceptable in many regimes, including, for example, by the ESMA Guidance and the UKLA.

3.3.2 Risk factors

24. The typical contents of an investment circular have evolved to include greater disclosure of risk factors affecting the issuer. While the ESMA Guidance and the UKLA prescribe that these risk factors must not constitute qualifications to the working capital statement, these expanded disclosures provide useful context for the basis upon which the rest of the investment circular, including the working capital statement, is prepared. It is therefore important that the PFI underpinning the working capital statement includes sufficient consideration of the potential impact of the issuer's principal risk factors.
25. Notwithstanding the expectation of there being limited additional disclosure directly supporting the issuer's working capital statement, the areas in 3.3.3 to 3.3.5 merit further consideration.

3.3.3 Qualified working capital statements

26. Where the directors consider that the issuer does not have sufficient working capital and it is not possible to arrange additional financing before the issue of the relevant investment circular then, (provided a clean statement is not an eligibility requirement for listing or admission) a qualified working capital statement must be made. Regulation or guidance issued by regulators typically specifies the additional matters that need to be disclosed in such cases. The Prospectus Directive (PD) Regulation for example requires the issuer to state how it proposes to provide the additional working capital required. The ESMA Guidance adds further disclosures designed to ensure that investors are fully informed as to the working capital position and the directors' plans to address the shortfall as follows:
    - relative timing of the working capital problem;
    - approximate quantum of the shortfall;
    - action plan to address the shortfall (including degree of confidence and timing); and
    - implications of proposed actions being unsuccessful.
27. The plans to address the working capital shortfall need to be detailed and progressed – not just a high level statement of intention.

3.3.4 Disclosure of relevant information beyond the 12-month present requirement period

28. Where the directors are aware of relevant information beyond the 12-month present requirement period that may adversely impact availability of working capital, consideration needs to be given to the need for supplementary disclosure.

3.3.5 Alignment and interaction with disclosures elsewhere in the investment circular

29. Disclosures elsewhere in the investment circular must be aligned and consistent with the working capital statement (and vice versa). There is particular potential for overlap between the business analysis, reason for offer and use of proceeds, and risk factor sections of an investment circular and the working capital statement. For example:
    - if the working capital assessment undertaken by the directors shows that working capital is sufficient over the next 12 months but that expansion opportunities may be constrained then the business analysis section should reflect this;
    - if the use of proceeds section of the investment circular states that the proceeds will be used for capital projects, then the working capital projections underlying the working capital statement need to be consistent with this;
    - a risk factor such as a risk that scheduled debt repayments within the next 12 months may be missed if the business is not generating sufficient cash, is fundamentally inconsistent with a statement that working capital is sufficient;
    - a risk factor that covenants attaching to facilities may limit expansion or acquisition opportunities is not, however, necessarily inconsistent with an unqualified working capital statement. In the instance of a fundraising where the use of proceeds states that the fundraising is for capital projects, it would be inconsistent if an unqualified working capital statement can only be made if capital projects are not undertaken, as this would not be aligned with the use of proceeds section; and
    - risk factors that are generically and broadly drafted to seek to cover all conceivable risks irrespective of materiality can start to stray into areas that overlap with the working capital statement.
30. Notably the ESMA Guidance and the UKLA in UKLA Technical Note 321.1 (December 2012) recognise this potential for overlap. The UKLA has consequently stated that where a clean working capital statement is made it 'will pay close attention to risk factors that suggest that the issuer will or may run out of working capital in the next 12 months'.

3.4 Comparability and subsequent validation principle

31. For PFI to be comparable, it should be capable of subsequent validation by comparison with outcomes in the form of historical financial information. Accordingly, the PFI supporting the working capital statement should be prepared on a consistent basis with historical financial information.
32. The principle of subsequent validation should not be interpreted too literally or narrowly in the context of working capital statements. Under the guidance a working capital statement is an example of PFI that satisfies the subsequent validation principle and is clearly capable of being reported against. A clean statement is that the working capital available to an entity is sufficient for its present requirements (that is, for at least the next 12 months). While companies do not explicitly report actual performance against a working capital statement, it will be apparent if a company has run out of working capital. Even before a company runs out of working capital, if it is in imminent danger of exceeding its working capital facilities, this will need to be considered for disclosure in the context of the general regulatory disclosure obligations that apply to the issuer (for example those contained in the FCA's Disclosure and Transparency Rules).

4. PRINCIPLES OF PREPARATION OF PFI IN CONNECTION WITH WORKING CAPITAL STATEMENTS (AND THE SUPPORTING UNPUBLISHED PFI)

33. Part II identifies general principles and core procedures for the preparation of PFI, along with illustrative practical considerations and techniques, which are applicable to the preparation of all PFI. These should be applied as appropriate, in the context of a working capital statement.

34. In preparing a working capital statement and the supporting unpublished PFI that forms a basis for the working capital statement, the techniques and considerations specific to working capital statements and set out in this section should also be considered.

35. Directors should assess those that are likely to be relevant having regard to the size, complexity, predictability, and particular circumstances of the group, the industry, the general economic environment, and, the transaction that is the subject of the investment circular. For example, the level of detail and analysis needed for a debt-free investment entity with no committed capital or investment expenditure undertaking a fundraising will be less than that required for a complex or highly leveraged trading group facing its most important trading period. The list is not exhaustive or prescriptive: other considerations and techniques may be applicable.

36. The table in 4.1 summarises the illustrative procedures, considerations and techniques specific to working capital statements. The table in 4.2 provides further detail and practical guidance for preparers and on the way in which they correspond to the preparation principles and attributes of useful PFI.

4.1 Summary of illustrative practical considerations and techniques specifically applicable to working capital statements: for directors

PLANNING

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to working capital statements and the underlying supporting PFI.

- Proper board engagement is required;
- process should be appropriately planned on a timely basis;
- applicable regulation and guidance (taking account of the transaction and its circumstances) should be followed;
- if appropriate, advisers should be engaged early in the planning process. This is likely to be required where public reports or confirmations to regulators are required from advisers (such as sponsors/nominated advisers);
- for a group proposing a major acquisition information from, and liaison with, target management will be required.
- the form and period of the working capital projections should be determined:
  - the working capital projections should be prepared to the appropriate level of detail;
  - the frequency of balance sheets in the working capital projections will be influenced by seasonality and the nature of cashflows – monthly being best practice;
  - the working capital projections should typically cover around 18 months or for a longer period if there are foreseeable working capital difficulties thereafter;
- if it is envisaged that the business has insufficient working capital and it will not be possible to arrange additional financing before the issue of the relevant investment circular, a qualified working capital statement (if permitted by applicable regulation) will need to be made. Proposals for securing the additional working capital need to be fully explained through disclosure. Early consultation with advisers is encouraged.

EXECUTION

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to working capital statements and the underlying supporting PFI.

- the working capital projections should be prepared on a consistent basis with the issuer's historical financial information;
- for groups, the supporting unpublished PFI (working capital projections) should be prepared on a consolidated basis;
- the working capital projections should be prepared on the basis that the transaction has occurred (other possible outcomes must also be considered);
- ensure that the opening balance sheet in the working capital projections is supported by an actual balance sheet. If not audited, the opening cash and loan balances should be supported by a bank reconciliation, and lender statements/ confirmations;
- for banks and insurance companies specific considerations including relating to solvency are necessary;
- other forecast information/ regulatory requirements must be addressed;
- detailed analysis of available borrowing facilities and terms and conditions is required which should be reflected in the working capital projections;
- other sources of finance and level of confidence in its availability should be considered;
- borrowing limits and covenant compliance should be factored into the working capital projections;
- consider if intra-month cash is representative of the month end position;
- consider impact of risk factors on the working capital projections;
- assess whether there is sufficient working capital to cover a reasonable worst case scenario;
- consider consistency of working capital statement with other disclosures in the investment circular (eg, risk factors, business analysis, reason for the offer, use of proceeds sections);
- consider the need to disclose the impact of funding of longer term commitments and contingencies (ie beyond the present requirement period) elsewhere in the investment circular;
- if working capital difficulties are foreseen in the subsequent period, the requirement for supplementary disclosure in the investment circular needs to be considered;
- where a qualified working capital statement needs to be made develop a plan to address the shortfall, and, based on this, consider disclosures required in the working capital statement.

EVIDENCE AND DOCUMENTATION

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to working capital statements and the underlying supporting PFI.

- key elements of the process should be evidenced through contemporaneous documentation;
- sufficient documentary support should be obtained, including for the business analysis and plans, working capital projections, key assumptions, risk analysis, and reasonable worst case scenario;

- the directors should formally document and approve the working capital statement and underlying PFI in the form of a board memorandum or paper covering the form of the published working capital statement and the basis for the statement.

4.2 Detailed illustrative practical considerations and techniques specifically applicable to working capital statements: for preparers

PLANNING

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to working capital statements and the underlying supporting PFI.

User needs principle (Relevant)

Applicable regulation

- The directors should ensure that the working capital statement and supporting unpublished PFI that forms the basis for the statement are prepared in accordance with the applicable regulatory requirements and guidance (ie, taking account of the transaction and its circumstances).

Where appropriate, advisers should be engaged early in the planning process, especially where confirmation to a regulator is required

- where a public report or confirmation to a regulator is required from an external adviser (such as a sponsor/nominated adviser), the advisers should be engaged early in the process, to enable involvement and input into planning the preparation of the PFI.

Business analysis principle (Reliable)

Proper board engagement

- the directors are responsible for the working capital statement and must be fully engaged in the preparation process including: approving the working capital statement, the supporting working capital projections (and accompanying board memorandum or paper) and considering and making decisions in relation to the need to obtain further facilities.

Timely planning

- the process must be appropriately planned on a timely basis. In the case of an acquisition, for example, this will entail consideration of the practical issues involved in obtaining access to target information.

Level of detail required in the working capital projections

- the level of detail within the working capital projections may vary depending on the circumstances of their preparation and the level of bank balances, liquid assets, credit facilities and headroom available to the issuer;
- where headroom is significant and projected working capital requirements are not volatile, the level of detail required in the working capital projections may be less than in circumstances where headroom is limited and the projected working capital requirements are subject to large fluctuations.

Frequency with which balance sheets in the working capital projections need to be prepared

- the frequency of balance sheets in the working capital projections will depend on the impact of seasonality, the profile and nature of trading cash flows and covenants set by lenders, but a monthly basis is considered best practice;
- where cash requirements fluctuate considerably, for example due to the seasonal nature of the business, the balances may need to be considered more frequently including on an intra-month basis as set out below.

Period covered by the working capital projections

- notwithstanding the 12-month present requirement period of the working capital statement, it will be necessary for the directors to consider any foreseeable working capital difficulties beyond the 12-month period of the required statement and they should consequently prepare their working capital projections to cover at least the next 18 months (although it may be appropriate for the period to terminate at the issuer's next reporting date following that date);
- if, however, the issuer's normal business cycle is greater than 18 months or the cash flow figures show an adverse trend at the end of the period which is projected to continue, then, it will be necessary for the directors to address any factors likely to pose a significant threat to the sufficiency of working capital thereafter (for example, substantial repayments of borrowings, deadlines for repayment of significant loans, continuing trading losses or other factors of which the directors are aware);
- where relevant, the sponsor or nominated adviser or broker may also have a view in relation to the period to be covered.

Working capital for a group proposing a major acquisition – liaising with target

- the preparation of working capital projections for a group proposing a major acquisition may entail practical difficulties;
- while the directors of the acquiring company will be able to assess the working capital needs of their own group, they will need to factor into their enlarged group working capital projections information relating to the potential working capital requirements of the target business. Unless the target business is already well known to the acquirer, the latter is likely to need to obtain some of this information from target management;
- while target management can be expected to have a detailed understanding of the existing requirements of the target business, they will not be in a position to take into account the consequences of the change of ownership (for example, on the availability of funding, the extent of intra-group trading, and the trading strategy) which will be matters that the acquirer will need to address in preparing the enlarged group working capital projections.

Reasonable disclosure principle (Understandable)

Anticipated qualified working capital statement – action plans and disclosure

- if it is envisaged that the business has insufficient working capital and it will not be possible to arrange additional financing before the issue of the relevant investment circular, a qualified working capital statement (if permitted by applicable regulation) will need to be made. Proposals for securing the additional working capital need to be fully explained through disclosure. Early consultation with advisers is encouraged.

Subsequent validation principle (Comparable)

- As noted above, the applicable practical procedures and considerations set out in Part II should be followed. In summary, the working capital projections should be prepared on a consistent basis with the issuer's historical financial information and in accordance with stated accounting policies insofar as they are material to the working capital statement and its purpose.

EXECUTION

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to working capital statements and the underlying supporting PFI.

User needs principle (Relevant)

Supporting unpublished PFI (working capital projections) should be prepared on a consolidated basis

- where the issuer has subsidiary and other undertakings, the working capital projections should be prepared on a consolidated basis covering the entire group throughout the working capital period and taking into account the financing arrangements in place across the group;
- restrictions on the ability to remit funds between subsidiaries (due, for example, to exchange control restrictions or the terms imposed by lenders) need to be taken into account in preparing the consolidated working capital projections;
- material cash flows with associated undertakings and any off-balance sheet financing vehicles should also form part of the information which the directors should analyse and appraise;
- the applicable regulation may require that the working capital projections cover both the consolidated position of the existing group and the group as enlarged by a proposed acquisition – see below.

Working capital projections should be prepared on the basis that the transaction has occurred

- certain regulation requires that the working capital statement, and the underlying working capital projections, be prepared on the basis that the transaction (eg, acquisition, disposal, refinancing/reconstruction, purchase of own shares, rights issues, placings etc.) has taken place (provided in the case of a fundraising that the proceeds are fully underwritten (ie, an underwriter has agreed to purchase the remaining securities that are not taken up by the public)). In the case of an EU prospectus, the working capital statement needs to address all outcomes (ie, if transaction or fundraising happens or not);
- in relation to a reverse takeover, the statement will need to take into consideration the enlarged group, and if the transaction also involves a fundraising that would proceed even if the reverse acquisition did not take place, a statement covering the existing group is also required to ensure that information on all possible scenarios is provided to users;
- it is usual to take account of offer proceeds (but only to the extent underwritten), placing proceeds (but only to the extent committed) and disposal proceeds. Their treatment in the working capital projections should be consistent with references to the use of such proceeds elsewhere in the investment circular;

- all relevant costs including transaction costs should also be factored into the working capital projections.

Business analysis principle (Reliable)

Opening cash and loan balances

- the opening balance sheet in the working capital projections should be supported by an actual balance sheet (and if not audited, the opening cash and loan balances should be supported by a bank reconciliation, and lender statements/ confirmations).

Working capital for banks and insurance companies

- regulatory 'solvency' requirements will be an aspect of, but not identical with, sufficiency of working capital and will need to be considered.

Other forecast information/ regulatory requirements

- the directors should consider other forms of forecast information that directly contribute to the issuer's ability to maintain sufficient working capital. These may be industry specific requirements, for example regulatory capital requirements that must be complied with by certain financial services institutions as noted above.

Borrowing facilities

- the directors should prepare an analysis of the sources of borrowings which they believe will be available over the working capital period, the amounts involved and the periods of availability (borrowing facilities)
- the directors should undertake an analysis of the terms and conditions relating to borrowing facilities so that risks relating to continued availability of the borrowing facilities can be assessed and addressed including, for example, determining if borrowings are linked to specific projects or purposes such that, even if committed, they cannot be used for general working capital requirements;
- the availability of borrowing facilities may be dependent upon the issuer's compliance with specific terms and conditions (covenants) and may also depend on the lender's assessment of the transaction and risks impacting security and repayment of borrowing;
- the working capital projections should appropriately reflect this analysis, the key financial terms of the banking/loan facilities and where required by regulation or local market practice should reflect only committed bank and other funding facilities;
- where required by regulation or local market practice, liquidity headroom should only take into account facilities for the period that they are legally committed. In assessing whether a facility is committed, the preparer should consider any clauses in the facility agreements that may be breached, including, those relating to change of control clauses.
- UK market practice is that 'committed' facilities are those that are in place throughout the present requirement guideline period, which cannot be withdrawn or reduced (subject to normal explicit conditions such as covenant compliance) and do not need to be renewed. An overdraft facility, if it can be withdrawn at the bank's discretion, is not considered to be a committed facility;

Other sources of finance

- the directors should prepare an analysis of other sources of funding (for example, the proceeds of a share offering);

- the level of confidence in other sources of finance should be considered. For example, an executed underwriting agreement in the case of an Initial Public Offering (IPO) would lead to a high degree of confidence in the receipt of the funds, however, placing letters or other such arrangements may require further consideration to ensure they have a sufficiently low level of risk;
- where the transaction that is the subject of the investment circular is conditional upon the issuer achieving a specified amount of net proceeds from an offer of securities, then consideration should also be given to any minimum level of net proceeds stated in the investment circular.

Borrowing limits and covenants

- the working capital projections should demonstrate that borrowing limits and covenants as defined under the Articles of Association, Debenture Trusts Deed, or borrowing facilities etc. will not be breached with regard to:
  - projected borrowings;
  - maximum utilisation of facilities; and
  - covenant tests
- consideration should be taken of any cross default provisions in borrowing facilities which could result in a default on one bank facility triggering an automatic default on all other facilities held by the same lender;
- in calculating projected financial covenant positions, the directors should ensure that all requirements of the facility agreements are met eg, calculating the covenants using the exact definitions included in the agreements, and taking into account related clauses such as the application of frozen GAAP or different foreign exchange rates compared to the underlying working capital projections.

Consider intra-month cash flows

- consideration should be given to whether cash/borrowings at the month-end as shown by in the working capital projections are representative of cash/borrowings during the month. If working capital requirements peak during the month, consideration should be given as to the extent of this additional cash requirement.

Risk factors

- consideration should be given to the risk factors impacting the group (including those set out in the investment circular) and their impact on the working capital projections. The risk factors must be appropriately addressed in the working capital projections.

Reasonable worst case scenario

- in order for the working capital statement to be made with a high degree of confidence, the directors must assess whether there is sufficient margin or headroom to cover a reasonable worst case scenario (ie, applying sensitivity analysis) to be confident that, in the event that such a reasonable worst case scenario unfolds in the working capital projections period, the working capital statement will still hold true;
- the 'base case' working capital projections should, therefore, be sensitised to reflect a reasonable worst case scenario and to determine the impact on working capital.

This will require:

- assessment of all relevant business, operational, industry specific and macroeconomic risks to the working capital projections, including the likelihood, timing and extent to which those risks might crystallise; and
- quantification of the estimated financial impact of those risks crystallising.

- the resulting reasonable worst case scenario will constitute separate PFI, which will also be relied upon by the directors in making their working capital statement. It will reflect the directors' view of a reasonable worst case, rather than the most likely outcome, and should otherwise adopt the same principles of preparation as the base case working capital projections;
- as with the base case working capital projections, the extent of the analysis should be proportionate to the size, complexity, particular circumstances of the issuer and the risks it faces;
- it may, depending upon the facts and circumstances, be appropriate to test the impact of changes of all or some of the following:
  - revenue shortfall (volume and/or price);
  - reliance on key customers or suppliers;
  - a customer or supplier failing;
  - higher than expected bad debts;
  - decrease in margin/ increase in raw material or labour costs;
  - increase in various categories of overheads;
  - changes in debtor or creditor payment profiles;
  - delays in cash inflows;
  - changes in regulation;
  - taxation rates;
  - interest rates;
  - exchange rates;
  - a planned acquisition or disposal not taking place.
- Typically, it will only be appropriate to take account of mitigating factors or corresponding upsides to offset the downside sensitivity analysis, where the mitigation/'upside' is reasonably certain and within the directors' control.
  Any expected time lag between the crystallisation of the vulnerability and the implementation of the mitigating action should also be addressed. It must also be recognised that certain mitigating factors/ 'upsides' may result in a short-term cash flow drain eg, a large contract win may require significant set-up costs;
- the core procedures and considerations in Part II relating to sensitivity analysis should be followed where applicable.

Reasonable disclosure principle (Understandable)

Other disclosures in the investment circular (eg, risk factors, business analysis, reason for the offer, use of proceeds sections)

- consideration should be given to the disclosures elsewhere in the investment circular and their impact on the working capital projections and working capital statement. There should be consistency between the disclosures elsewhere in the investment circular, the working capital statement and the working capital projections. For example, capital investment and expansion plans or opportunities referred to in the investment circular should be appropriately reflected in the working capital projections. If such opportunities are constrained by a lack of available working capital, then this should be stated in the business analysis section of the investment circular.

Impact of funding of longer term commitments and contingencies (ie, beyond the present requirement period)

- the funding of longer term commitments of a significant or potentially significant nature such as taxation liabilities, special pension scheme contributions, capital expenditure, potential damages or costs in legal disputes, and other commitments should be considered;
- if there is substantial doubt as to the ability of the issuer to fund such commitments that fall due after the period covered by the working capital statement, the investment circular will need to report this clearly.

Working capital difficulties in the subsequent period

- the working capital projections should cover a period of around 18 months to enable consideration of working capital difficulties beyond the present requirement period. Where the directors foresee such working difficulties, they should consider if supplementary disclosures in other parts of the investment circular would be appropriate.

Qualified working capital statement

- where the directors have determined that the business does not have sufficient working capital for its present requirements then (where permitted by the regulation governing the transaction/investment circular) a plan to address the shortfall should be prepared covering:
  - the estimated magnitude of the shortfall;
  - the relative timing of the working capital insufficiency;
  - an action plan to address the shortfall (including degree of confidence and timing);
  - the implications of the proposed actions being unsuccessful.

  This will form the basis for the disclosures required by the relevant regulation that the directors will need to make in the investment circular in connection with the qualified working capital statement.

Subsequent validation principle (Comparable)

Consistency with historical financial information and accounting policies

- As noted above, the applicable practical procedures and considerations set out in Part II should be followed. In summary, the working capital projections should be prepared on a consistent basis with the issuer's historical financial information and in accordance with stated accounting policies insofar as they are material to the working capital statement and its purpose.

EVIDENCE AND DOCUMENTATION

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to working capital statements and the underlying supporting PFI.

All principles and attributes

- key elements of the process should be evidenced through contemporaneous documentation;
- sufficient documentary support should be obtained, including for the business analysis and plans, working capital projections, key assumptions, risk analysis, and reasonable worst case scenario;
- the directors should formally document and approve the working capital statement and underlying PFI in the form of a board memorandum or paper covering the form of the published working capital statement and the basis for the statement.

Part IV: Application note for profit forecasts in capital markets transactions and other profits guidance

1. INTRODUCTION

1. This application note is primarily intended to assist directors making profit forecast statements for inclusion in an investment circular (where regulation applies to such profit forecast statements), and also those involved in the preparation of such profit forecasts and the supporting unpublished PFI. However, there are also a number of circumstances where directors will give profit guidance to investors in a less prescribed form. In such cases, the attributes and principles of useful PFI remain applicable, and so the guidance in this Part should be applied to the extent relevant (disregarding only those elements of the guidance that are driven by regulation that is not applicable in the specific circumstance).
2. In particular, directors have an overriding obligation to keep markets informed. Notifications to the markets of information about, or of changes in, a company's expectations in relation to its future performance constitute PFI as defined in the guidance. In these cases, it follows that the guidance in this Part should be applied to the extent relevant.
3. Additionally, this application note should be used proportionately when preparing profit guidance or forecasts or projections for users other than public investors, for example, banks or other private investors, where the level of rigour applied to the internal processes adopted in the preparation of the PFI supporting the profit forecast would be expected to be similar.
4. This Part should be considered and read together with Parts I and II of the guidance.

2. REGULATORY REQUIREMENTS

2.1 Overview of regulation

5. While capital markets regulation does not typically require a published profit forecast (see 2.2 for definition) to be made in connection with a transaction, where the directors choose to issue a profit forecast, regulation is likely to apply to that statement.
6. Furthermore, where the issuer has published a profit forecast prior to issuing an investment circular in connection with a transaction, capital markets regulation may require that the investment circular includes the profit forecast. Typically, this would include further disclosure of the basis of preparation and the assumptions underlying the profit forecast. Regulation typically requires the directors to provide a statement setting out whether or not the profit forecast is still valid at the time of the investment circular, and an explanation as to why it is no longer valid if that is the case. If the directors consider the previously published profit forecast no longer valid, they may choose to provide an updated profit forecast in the investment circular, or to withdraw the forecast entirely and disclose the reasons for its withdrawal.
7. Examples of such regimes and regulatory requirements, which include the UK and member countries of the European Union, are set out in in the Annex.

2.2 Definition of a profit forecast

8. The definition of a profit forecast typically includes any disclosure from which a profit (or loss) figure can be derived, and can be for all or part of a business. This includes statements such as 'We expect this year's profit before taxes to be between €30 million and €50 million' as well as narrative statements such as 'The profit / loss is expected to be higher than / lower than / in line with the previous year'.
9. The interpretation of the definition of a profit forecast can often involve some debate, and may require case-by-case discussion with the relevant regulatory authority. To assist directors in the context of an EU prospectus, ESMA has released detailed guidance in *ESMA Questions and Answers, Prospectuses*, Question 102 Definition of profit forecasts.
10. 'Profit estimate' is a term used by certain regulators. A profit estimate is typically for a financial period that has expired but for which the results have not yet been published. This guidance remains applicable to a profit estimate to the extent it is supported by unpublished PFI, ie, before actual results are available for the full period.

2.3 PFI in relation to profit forecasts

11. The profit forecast statement published in the investment circular is itself PFI. The profit forecast statement is also, however, supported by underlying PFI, including financial projections (which are unpublished) which form the basis for the statement; these are referred to as the supporting unpublished PFI.

2.4 ESMA Guidance

12. The ESMA Guidance on the requirements for profit forecasts included within EU prospectuses may also be pertinent to other regimes. In particular, the ESMA Guidance states that:
    - A profit forecast should follow the core principles of prospective financial information, that is, it should be understandable, reliable, comparable and relevant. The application of these core principles to profit forecasts is discussed further in section 3.
    - A profit forecast should normally reflect profit before tax (with separate disclosure regarding any non-recurrent items and tax charges if these are expected to be abnormally high or low).
    - Where a profit forecast is made on any basis other than profit before tax, the reasons for presenting another profit measure (such as operating profit or EBITDA) must be disclosed and clearly explained. Issuers are typically expected to clearly outline the reasons for presenting forecast figures on a basis other than profit before tax. The premise behind this requirement is that it provides shareholders with the ability to compare the profit forecast with an issuer's published results.
13. These themes are also reflected in the guidance of regulators, including, for example, in the UK Listing Authority (UKLA) Technical Notes.

2.5 Directors' accountability, including satisfying regulatory obligations

14. In most regulatory regimes the directors are responsible for the profit forecast statement, and, accordingly must be fully engaged in the preparation process. This includes considering and approving the profit forecast statement (including the assumptions upon which it is based), the supporting unpublished PFI and the assessment of the risks to achieving the profit forecast.
15. Capital markets regulation imposes standards on the content of information included in investment circulars, and on the processes and procedures adopted by the directors in

preparing such information. Such UK and EU regulatory obligations that apply to profit forecast statements are set out in the Annex.

16. While the obligations in the various regulations are articulated differently, the spirit of the obligations and standards of care are broadly aligned, and require that the process adopted by the directors is sufficiently robust. Typically:
    - there must be clear disclosure of assumptions upon which the profit forecast has been based;
    - the basis of accounting must be consistent with the accounting policies of the issuer; and
    - the profit forecast must be prepared on a basis comparable with the historical financial information that will be subsequently reported.
17. Some regulation requires that the profit forecast be publicly reported on by a reporting accountant, stating that, in its opinion, the profit forecast or estimate has been properly compiled on the basis stated and that the basis of accounting is consistent with the accounting policies of the issuer. Other regulation requires a similar statement to be made by one or more of the reporting accountant, the financial adviser and the directors.
18. The directors should, therefore, undertake appropriate procedures and make due and careful enquiry as to the robustness of the supporting unpublished PFI to ensure that they have a reasonable basis to make the profit forecast, such that they are highly confident that the forecast will be achieved and that there is very little risk that the basis of the profit forecast is subsequently called into question. They must also ensure that the investment circular as a whole is, to the best of their knowledge, in accordance with the facts, contains no omission likely to affect its import, is aligned with the profit forecast, and is not misleading.
19. In short, the onus is on the directors to ensure that they are confident that the issuer or business or group (as applicable) will meet its profit forecast. The guidance sets out principles and processes for the preparation of profit forecasts and the supporting unpublished PFI which help the directors to satisfy these obligations.
20. The guidance does not address legal obligations and directors should obtain legal and professional advice as appropriate.

3. APPLICATION OF PRINCIPLES AND ATTRIBUTES OF USEFUL PFI TO PROFIT FORECASTS

21. As set out in Part I, to be useful and meet the needs of users, PFI should be prepared and judged against the following qualitative attributes which are applied in the guidance:
    1. Relevance *(user needs principle)*
    2. Reliability *(business analysis principle)*
    3. Understandability *(reasonable disclosure principle)*
    4. Comparability *(subsequent validation principle)*

3.1 Relevance and user needs principle

22. Broadly, profit forecasts should be relevant to users and have predictive value if they follow the following criteria:
    - They have an ability to influence economic decisions of investors and are provided on a timely basis so as to influence such decisions and assist in confirming or correcting past evaluations or assessments.

- The forecast is drawn up on a relevant and appropriate basis that enables the user to assess the prospects of the issuer. If preparation of the forecast on the most relevant and appropriate basis is not practicable (as is sometimes the case if an acquisition or disposal is proposed), then this should be made clear in the principal assumptions upon which the forecast is based.
- The forecast is for an appropriate profit measure.

3.2 Reliability and business analysis principle

23. Users of profit forecasts have a strong expectation that an issuer will achieve a profit forecast that it publishes. If it fails to do so, and the difference is material (defined, for example, by the UKLA as a difference of 10 per cent or more), then, depending on applicable regulation, the directors may be required to disclose in the next annual report the relevant figure and explain any material variance so as to enable the forecast and actual results to be directly compared. Accordingly, the directors need to be able to demonstrate that they are acting responsibly in making a profit forecast and should ensure that they are highly confident that a profit forecast will be achieved and that there is very little risk that it will not.
24. These requirements necessitate any profit forecast to be reliable. In order to be reliable, consistent with the principles set out in Part I, the PFI (including supporting unpublished PFI) which forms the basis of the profit forecast should be underpinned by up-to-date business analysis and should accurately represent factually based strategies, plans and risk analyses.
25. Consistent with this, the applicable core procedures, techniques and considerations set out in Part II should be undertaken, along with the specific procedures, techniques and considerations applicable to profit forecasts which are included in section 4 below.
26. To the extent that a profit forecast relates to a financial period that has begun but not ended at the date of issue, it will include financial information relating to the expired part of the period. Normal considerations applicable to the integrity of published historical financial information will apply to any historical financial information incorporated into a profit forecast.

3.2.1 Sensitivity analysis, risks and opportunities

27. To help achieve a high degree of confidence in the ability of the issuer to achieve its profit forecast, the directors should undertake sensitivity analysis of the key assumptions. The analysis should focus on those assumptions which are believed by the directors to be subject to the greatest uncertainty (and where the range of possible assumed values is wide) and those assumptions which can, if changed by a small amount, have a large impact on the forecast outcome.
28. The sensitivity analysis can also be used to assess the extent to which the profit forecast is sensitive to other assumptions, as well as to assist the directors in determining which factors to highlight as key assumptions when making disclosures in relation to the profit forecast. See the illustrative practical considerations and techniques in section 4.
29. Where, in considering the sensitivity analysis, the directors conclude there is insufficient certainty of achieving the profit forecast such that it is not reliable, then it will not be possible to publish that forecast. In these circumstances, if a profit forecast has already been published then the directors will need to consider whether to update the profit forecast to reflect the latest available information, or to state that the profit forecast is no longer valid and withdraw it. In both cases, it is expected that the directors will give clear explanation of the reasons for the amendment or withdrawal of a profit forecast.

3.2.2 Other aspects of reliability

30. The concept of neutrality is relevant to profit forecasts because of the scope for providing forecast information for particular captions from a profit and loss account so as to convey a particular message. Selection of the most appropriate profit measure should be driven by consideration of what is most useful to the investor and take into account applicable regulation.
31. The concept of neutrality is also pertinent because of the risk that the forecast period introduces potential bias. For example, if the level of profits in the forecast period were not sustainable or if losses were expected in the subsequent period, supplementary disclosures should be considered.
32. Ranges can be used to indicate a level of uncertainty in relation to a forecast but they can be hard to interpret. For example, where a range is disclosed around the directors' best estimate of the result, investors might feel disappointed if profits were eventually reported at the lower level of that range.

3.3 Understandability and reasonable disclosure principle

33. When making a profit forecast issuers should ensure that the statement is understandable ie, the profit forecast should be clear and unambiguous and should contain disclosures that are not too complex or extensive for users to understand. The profit forecast also needs to be understandable in the context of the overall investment circular, so care should be taken to ensure that there is alignment of information in the investment circular.

3.3.1 Form of the profit forecast

34. The wording of the profit forecast itself is central to its understandability. There is significant variation in the phraseology used in published earnings guidance of what may or may not subsequently be deemed a profit forecast, in part driven by the lack of regulation governing the release of this guidance in the ordinary course of business (that is, prior to the publication of an investment circular) in many regulatory regimes.
35. The directors should pay particular attention to the form of profit forecast issued, and consider the interpretation of the forecast by investors and / or potential investors. A particular difficulty arises with unspecific or ambiguous profit forecasts. For example:
    - if it is stated that 'profits will be less than those of last year' and the relative figures are £100 million and £10 million respectively, there would be concern that without amplifying the statement to give a meaningful indication the scale of the drop in profit the statement would not be understandable and may be considered misleading;
    - if reference is made to 'a substantial improvement in profit this year' the increase should be by an amount that is sufficient to ensure that the statement remains understandable;
    - disclosing a minimum or a floor may imply that the most likely outcome is close to that number;
    - in cases of relatively high uncertainty that are subject to a broad range of likely outcomes, the use of a maximum or minimum might be misleading. In such circumstances, a carefully considered range may be more appropriate and provide more understandable and useful information for investors.
36. Disclosure of an exact profit figure is rare, given the uncertainty associated with the exact figure that will be achieved. This is particularly relevant when the profit forecast is published in an investment circular, given the rigorous expectations applicable to

such profit forecasts. If an exact figure is to be published, the directors should carefully consider the acceptable range around that figure that their profit forecast implies, and they should have a high degree of confidence of achieving a result within that acceptable range.

37. It is also important that useful information is not obscured through the inclusion of immaterial items or the use of headings or financial measures which are not meaningful to, or may be misunderstood by, the intended users. For example, if a profit forecast is presented as a single figure for profit before tax, and the figure is arrived at after taking into account a significant non-recurring item of income, such as a profit from the sale of a fixed asset, it should be considered whether additional disclosure is necessary to make the profit forecast understandable and meaningful.

3.3.2 Disclosure of assumptions upon which the profit forecast is based

38. Disclosure of the principal assumptions upon which the issuer has based its profit forecast is often required, including, for example, by the ESMA Guidance, the UKLA and the UK City Code on Takeovers and Mergers (the Code). In particular, the assumptions should:
    - be clearly segregated between assumptions relating to factors which the directors / issuer can influence and assumptions relating to factors which are exclusively outside the influence of the directors / issuer;
    - be readily understandable by investors;
    - be specific and precise; and
    - not relate to the general accuracy of the estimates underlying the profit forecast.
39. Care must be taken when disclosing assumptions. While appropriate disclosure will improve the understandability of the profit forecast, disclosure of a large number of insignificant uncertainties is likely to compromise that understandability. The directors should disclose only those assumptions that they consider could have a material effect on the achievement of a profit forecast.
40. A further aspect of understandability is the disclosure relating to the degree of uncertainty inherent in the information. For example, the disclosure of an assumption may not make the profit forecast understandable if the significance of that assumption is not apparent from the disclosure made.
41. Accordingly, the segregation of assumptions in relation to factors which the directors can influence from assumptions which are exclusively outside of their influence also aids understandability. In the former case, the assumptions are more likely to be borne out in practice, and so there should be a reduced need for disclosures regarding sources of uncertainty, determining factors and alternative outcomes.
42. What constitutes reasonable disclosure will therefore depend upon the particular circumstances of each profit forecast but will need to take into consideration:
    - sources of uncertainty and the related assumptions made in relation to these uncertainties;
    - the factors that will affect whether assumptions will be borne out in practice; and
    - alternative outcomes, being the consequences of assumptions not being borne out.

3.3.3 Alignment and interaction with risk factors and other disclosures elsewhere in the investment circular

43. Disclosures elsewhere in the investment circular must be aligned and consistent with the profit forecast (and vice versa). There is particular potential for overlap between

the business analysis and risk factors sections of an investment circular and the profit forecast.

44. The typical contents of an investment circular have evolved to include greater disclosure of risk factors affecting the issuer. These expanded disclosures may provide useful context for the basis upon which the rest of the investment circular, including the profit forecast, is prepared, however, they are not a substitute for the explicit disclosure of the principal assumptions upon which the profit forecast is based or the uncertainties that it is exposed to. It is important that the supporting unpublished PFI underpinning the profit forecast includes sufficient consideration of the potential impact of the issuer's principal risk factors, and, where these may materially affect the published result, the directors should consider additional disclosure to the profit forecast.

3.4 Comparability and subsequent validation principle

45. For PFI to be comparable, it should be capable of subsequent validation by comparison with outcomes in the form of historical financial information. The profit forecast should be prepared on a basis comparable with the historical financial information, and this is often prescribed by regulation (including under the ESMA Guidance).

46. In this guidance a profit forecast is an example of PFI that satisfies the subsequent validation principle and is clearly capable of being reported against. Indeed the directors are often required to reproduce the profit forecast in their next annual report, together with the actual result for the same period as covered by the profit forecast, including, if applicable, an explanation of why the profit forecast was not met.

47. It should be noted that, in certain circumstances, the assumptions upon which the profit forecast is based may reduce the comparability of the profit forecast, for example, where the forecast is for the acquirer in an acquisition investment circular, and it was prepared for the existing business only. The directors may still be required to disclose actual results on the same basis, depending on applicable regulation and the forecast should still enable this subsequent validation to be made.

4. PRINCIPLES OF PREPARATION OF PFI IN CONNECTION WITH PROFIT FORECASTS (AND THE SUPPORTING UNPUBLISHED PFI)

48. Part II identifies general principles and core procedures for the preparation of PFI, along with illustrative practical considerations and techniques, which are applicable to the preparation of all PFI. These should be applied as appropriate, in the context of a profit forecast.

49. In preparing the profit forecast itself, as well as the supporting unpublished PFI on which it is based, the following techniques and considerations that are specific to profit forecasts should also be considered and applied where appropriate.

50. Directors should assess those that are likely to be relevant having regard to the size, complexity, predictability and particular circumstances of the group, the industry, the general economic environment, and, the transaction that is the subject of the investment circular. For example, the level of detail and analysis needed for a stable business operating in a predictable market issuing its profit forecast near the end of the relevant financial period will be less than that required for an embattled trading group issuing its forecast at or before the start of the relevant financial period. The list is not exhaustive or prescriptive: other considerations and techniques may be applicable.

51. The table in 4.1 summarises the illustrative procedures, considerations and techniques specific to profit forecasts. The table in 4.2 provides further detail and practical guidance for preparers and on the way in which they correspond to the preparation principles and attributes of useful PFI.

4.1 Summary of illustrative practical considerations and techniques specifically applicable to profit forecasts: for directors

PLANNING

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to profit forecasts and the supporting unpublished PFI.

- The profit forecast should be prepared in all respects taking into account applicable regulation and guidance (as relevant to the circumstances under which the profit forecast is being issued).
- Appointment of professional advisers should be considered and completed early in the process, and those advisers should be engaged in the planning process, particularly if a public report is required from an independent accountant.
- The issuer's board should be engaged from the planning stage and throughout the process of preparing the profit forecast and the supporting unpublished PFI.
- The preparation of the supporting unpublished PFI should be appropriately planned, taking into account availability of resource and expertise throughout the business, as well as the level of detail that is considered appropriate in preparing the supporting unpublished PFI.

EXECUTION

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to profit forecasts and the supporting unpublished PFI.

- The supporting unpublished PFI should be prepared on an appropriate basis ie, at the level of consolidation at which the profit forecast is made.
- The latest available actual historical financial information should be reflected in the profit forecast.
- If required by regulation relevant to the issuer, other forecast information that might affect the issuer's profitability (such as meeting solvency requirements) may require preparation alongside the profit forecast.
- The profit forecast, including the latest actual results and the forecast results, should be prepared using accounting policies consistent with the accounting policies of the issuer and on a basis comparable with the historical financial information.
- Where the profit forecast is made for an adjusted profit measure, the appropriateness of that profit measure, as well as those items forecast to be recognised outside of that profit measure, should be considered. The forecast should also include disclosure and explanation of the reasons for using that adjusted profit measure.
- Taking into account all relevant factors and information, the directors should consider whether a high degree of confidence has been obtained in order to issue the profit forecast. Factors and information the directors may consider include:

- an assessment of all risks and opportunities to achieving the profit forecast;
- consideration of potential discretionary management actions that might increase the directors' confidence in the ability to achieve the profit forecast;
- the inclusion of an appropriate level of contingency between the published profit forecast and the supporting unpublished PFI; and
- the results of an appropriate sensitivity analysis to determine the impact of the identified risks and opportunities crystallising.

- The profit forecast should include clear disclosure and explanation of the basis of preparation, the principal assumptions and the treatment of any one-off or transaction specific items.
- The principal assumptions disclosed should be:
  - clearly segregated between those that are exclusively outside and those that are within the influence or control of the directors;
  - understandable by investors;
  - be specific and precise; and
  - must not relate to the general accuracy of the estimates underlying the profit forecast.

EVIDENCE AND DOCUMENTATION

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to profit forecasts and the supporting unpublished PFI.

- Key elements of the process should be evidenced through contemporaneous documentation.
- Sufficient documentary support should be obtained including for the business analysis and plans, forecast results, key assumptions, risk and opportunities, management actions, sensitivity analysis, contingency and overall conclusion of whether a high degree of confidence has been achieved.
- The directors should formally document and approve the profit forecast, together with the supporting unpublished PFI, in the form of a board memorandum or paper.

4.2 Detailed illustrative practical considerations and techniques specifically applicable to profit forecasts: for preparers

PLANNING

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to profit forecasts and the supporting unpublished PFI.

User needs principle (Relevant)

Applicable regulation

- the directors should ensure that the profit forecast and supporting unpublished PFI which forms the basis for the profit forecast are prepared in accordance with the applicable regulatory requirements and guidance (taking into account the circumstances).

Where appropriate, advisers should be engaged early in the planning process, especially where a report is required from a Reporting Accountant

- where a report is required from an external adviser, especially a public report on the profit forecast, the advisers should be engaged early in the process, to enable involvement and input into planning the preparation of the profit forecast and the supporting unpublished PFI.

Business analysis principle (Reliable)

Proper board engagement

- the directors are responsible for the profit forecast and must be fully engaged in the preparation process including approving the form and content of the published profit forecast and supporting disclosures of bases of preparation and principal assumptions (as well as the supporting unpublished PFI);
- as set out in the core techniques, activities and considerations in Part II the process must be appropriately planned on a timely basis. In the case of an acquisition where the target's forecast is relevant to the profit forecast, for example, this will entail consideration of the practical issues involved in obtaining access to target information, if applicable.

Period covered by the supporting unpublished PFI

- the directors should prepare their supporting unpublished PFI to cover the exact period(s) for which the profit forecast has been made;
- depending on the unpredictability and variability of the business and/or the industry in which it operates, it may also be appropriate to prepare supporting unpublished PFI for subsequent period(s), in order to assess whether disclosure of a change in the profitability of the business after the profit forecast period should be made.

Level of detail required in the supporting unpublished PFI

- the level of detail required within the supporting unpublished PFI may vary depending on the circumstances of its preparation, the form of the profit forecast itself, the level of contingency available over, under or within the profit forecast, and the time between publication of the profit forecast and the end of the relevant financial period;

- where the results of the business are predictable and the result is not sensitive to changes in circumstances, the level of detail required in the supporting unpublished PFI may be less than in circumstances where the margin for error is small and the trading results are subject to large fluctuations;
- similarly, where the profit forecast is published close to the end of the relevant financial period, the level of detail required in the supporting unpublished PFI may be less than, in circumstances where the financial period has just begun or the profit forecast relates to a financial period entirely in the future (however, significant rigour will also need to be applied to the determination of any actual results for past periods forming part of the overall profit forecast period);
- careful consideration should be given as to whether a forecast balance sheet and/or cash flow statement should be prepared as part of the supporting unpublished PFI to assess, for example, the unwinding of provisions / accruals and their impact on profit.

EXECUTION

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to profit forecasts and the supporting unpublished PFI.

User needs principle (Relevant)

Supporting unpublished PFI should be prepared on the appropriate basis

- regulation may not require the profit forecast be prepared on the basis that the transaction (eg, acquisition, disposal, refinancing/reconstruction, purchase of own shares, rights issues, placings etc.) has been completed, since the statement has often been made prior to contemplation of the transaction;
- the basis of preparation (which must be disclosed in the profit forecast) should be applied consistently across the supporting unpublished PFI, including all relevant subsidiary and other undertakings that comprise the group or business that is the subject of the profit forecast.

Business analysis principle (Reliable)

Historical information included in the forecast

- if the profit forecast is published part way through the financial period to which the forecast relates, it should be based on the latest available actual results together with the directors' profit forecast thereafter.

Other forecast information/ regulatory requirements

- the directors should consider other forms of forecast information that directly contribute to the issuer's ability to achieve its profit forecast. These may be industry specific requirements, for example regulatory capital and solvency requirements in the financial services sector, to the extent that these affect the profitability of the business.

Adjusted profit measures

- where the profit forecast relates to a profit measure other than profit before tax (for example, Earnings before Interest, Tax, Depreciation and Amortisation, or EBITDA), the directors should consider all profit and loss items recognised outside of the relevant profit measure, for example expenses recognised outside of an adjusted profit measure;

- where the profit forecast relates to profit before tax, consideration must be given to the identification and, where necessary, the disclosure of forecast non-recurrent items and tax charges if they are expected to be abnormally high or low.

Risks and opportunities

- the process of preparing the supporting unpublished PFI should include an assessment of all risks and opportunities to achieving the profit forecast;
- directors and other senior members of financial and operational management with the necessary in-depth knowledge and experience of the business, its activities and the market should be actively involved in the identification and ongoing monitoring of risks and opportunities to achieving the profit forecast;
- the ongoing monitoring of the risks and opportunities should continue up to the date of approval and publication of the profit forecast, to ensure the latest available information is being taken into account.

Management actions

- in preparing the supporting unpublished PFI and considering whether this gives the required confidence to issue the profit forecast, the directors may take into account actions and discretionary items within their control that could be initiated in the forecast period;
- examples of such actions include, but are not limited to, the following:
  - bonus and other discretionary pay-outs (and therefore the associated income statement expense) where contractual commitments allow variation;
  - delaying the introduction of new products or initiatives that will require front loaded investment in operating costs; and
  - delaying other operating expense items, such as non-essential events, travel, etc.
- management actions should only be taken into consideration where management has a high degree of confidence that it would be able to effect those actions in the profit forecast period;
- as with risks and opportunities, directors and other senior members of financial and operational management with the necessary in-depth knowledge and experience of the business, its activities and the market should be actively involved in the identification and ongoing monitoring of potential management actions.

Contingency

- in order to achieve a high degree of confidence in achieving the profit forecast, a contingency should be maintained between the published profit forecast and the supporting unpublished PFI;
- the level of contingency required will depend on a number of factors (for example, the sensitivity to key assumptions, the period of the forecast which is outstanding, and the wording of the profit forecast itself) and is a matter of judgement.

Sensitivity analysis

- the core procedures, activities and considerations in Part II which are applicable to sensitivity analysis in respect of all PFI should be undertaken;
- the directors should undertake sensitivity analysis to determine the impact on the forecast result in the event that the identified risks (and opportunities) crystallise during the relevant financial period;

- such sensitivity analysis involves measuring the impact on the forecast result of risks and uncertainties and of changing relevant assumptions within severe but plausible scenarios, to provide the directors with an understanding of the critical assumptions that underpin the profit forecasts and their impact;
- the extent of the analysis should be proportionate to the size, complexity, particular circumstances of the issuer and the risks it faces;
- typically, it will only be appropriate to take account of upsides (ie, potential profit beneficial events which have not been accounted for in the base case forecast results) to offset the downside sensitivity analysis, where the associated upside is a direct and automatic result of the downside sensitivity.

Overall consideration of whether a high degree of confidence has been achieved

- unlike working capital statements, where the concept of a reasonable worst case scenario has been developed and is used as the primary indicator of the level of confidence the directors have in the statement, in the context of profit forecasts, there is no single comparable measure that itself helps confirm a high degree of confidence has been achieved;
- instead, the directors must take into account a variety of different factors and indicators and consider whether they have sufficient certainty to issue the profit forecast. Examples of the key indicators in assessing the level of evidence obtained are as follows:
  - the level of uncertainty associated with the trading forecasts of the business and the industry in which it operates;
  - the timing of publication of the profit forecast compared with the time to expiry of the relevant financial period;
  - the sensitivity of the forecast result to the key assumptions upon which it is based;
  - the risks and opportunities to achieving the profit forecast, including the likelihood and magnitude of those risks and opportunities crystallising;
  - the level of contingency maintained within the supporting unpublished PFI; and
  - the actions available to management to influence the final result if risks or opportunities outside the control of the directors materialise.
  - the directors will need to consider all of the above and any other relevant information in deciding whether they have a sufficient level of confidence to conclude that there is very little risk that the profit forecast will not be achieved.

Reasonable disclosure principle (Understandable)

Form of the profit forecast statement

The profit forecast should include disclosure of the following:

- the basis of preparation, including:
  - confirmation that the accounting policies used are consistent with the accounting policies of the issuer;
  - confirmation that the basis of preparation is consistent with the historical financial information; and
  - the underlying audited or unaudited actual and/or forecast data upon which the profit forecast has been based.

- the principal assumptions upon which the profit forecast is based (see 'Disclosure of principal assumptions' below);
- the treatment of any one-off or transaction specific items that the directors consider to be relevant, material and contribute to the understandability of the profit forecast; and
- If applicable, for example as required by the City Code Rule 28.1, confirmation that the profit forecast has been properly compiled on the basis of the assumptions stated and the basis of accounting used is consistent with the issuer's accounting policies.

Adjusted profit measures

- If the forecast or estimate is not of profit before tax, the reasons for presenting another figure from the profit and loss account must be disclosed and clearly explained.

Disclosure of principal assumptions

The principal assumptions disclosed in the profit forecast should:

- be clearly segregated between those that are exclusively outside the influence or control of the directors and those that are within the influence or control of the directors;
- be readily understandable by investors ie, they should not include overly technical language that may in fact reduce the understandability of the profit forecast;
- be specific and precise; and
- not relate to the general accuracy of the estimates underlying the profit forecast.

Examples of assumptions that it may be considered necessary to disclose are as follows:

- the assumed foreign exchange rates used in translating the forecast results of foreign operations and sales/purchases denominated in a foreign currency; and
- the assumed changes, or lack thereof, in macroeconomic indicators such as interest rates, inflation indices, bases of taxes, legislation or regulatory requirements etc.

Subsequent validation principle (Comparable)

Basis of preparation

- the profit forecast should be prepared
  - using accounting policies consistent with the accounting policies of the issuer; and
  - on a basis comparable with the historical financial information;

Historical information included in the profit forecast

- consistent with the profit forecast as a whole, the actual results forming part of the profit forecast should be prepared using accounting policies that are consistent with those of the issuer and on a basis consistent with the historical financial information.

Adjusted profit measures

- the treatment of all profit and loss items recognised outside of the relevant profit measure, for example expenses reflected outside of an adjusted profit measure must be consistent with the historical financial information and the group's accounting policies to ensure comparability.

EVIDENCE AND DOCUMENTATION

The applicable practical procedures and considerations set out in Part II should be undertaken, in addition to the following which are specific to profit forecasts and the supporting unpublished PFI.

All principles and attributes

- key elements of the process should be evidenced through contemporaneous documentation;
- sufficient documentary support should be obtained including for the business analysis and plans, forecast results, key assumptions, risk and opportunities, management actions, sensitivity analysis, contingency and overall conclusion as to whether a high degree of confidence has been achieved;
- the directors should formally document and approve the profit forecast, together with the underlying forecast results, in the form of a board memorandum or paper.

Part V: Application note for synergy and stand-alone cost saving statements in capital markets transactions

1. INTRODUCTION

1. This application note applies to directors when making statements of anticipated synergies published in a merger and acquisition transaction related UK investment circular, and includes stand-alone cost saving statements published in a bid defence document under the Code (as defined below). The application note should also be used by those assisting with the preparation of such statements and the supporting unpublished information. Elements of the guidance and practical steps may also be applicable to the preparation of synergy statements in other regulatory regimes and in other circumstances.
2. There is no regulatory requirement for any such statement of anticipated synergies or stand-alone cost savings to be made. However, if the transaction is subject to The City Code on Takeovers and Mergers (the Code) or the FCA's Listing Rules then there are specific regulatory requirements governing any such statements that are made.
3. The Code governs, *inter alia*, the proposed acquisition of a UK public company. Statements of synergies or stand-alone cost savings made in relation to the proposed transaction are defined within the Code as a Quantified Financial Benefits Statement (QFBS) and must include certain disclosures when they are made. As the specific Code requirements in connection with a QFBS do not apply to a statement published by an all cash offeror under the Code, such statements are not included in the term QFBS used in this application guidance.
4. When a Class 1 circular issued under the Listing Rules includes a statement of synergy benefits (Synergy Benefits Statement), such a statement must also include certain disclosures.
5. The respective regulatory requirements that apply under the Code and Listing Rules, including the specific disclosure requirements, are set out in the Annex.
6. Where a premium segment listed business is seeking to acquire a UK public company it is possible that both the Code and the Listing Rules obligations may apply to statements of anticipated synergies made in connection with the proposed acquisition. While the disclosure requirements are broadly similar, there is more regulatory guidance in respect of the Code requirements. In addition, there is a Code requirement for a QFBS to be reported on by the financial adviser(s) and reporting accountant.
7. This application note is predominately focused on a QFBS made in the context of a transaction subject to the Code and, unless stated to the contrary, can also be applied to a Synergy Benefits Statement made in the context of a transaction subject to the Listing Rules.
8. This Part should be considered and read together with Parts I and II of the guidance.

1.1 PFI in relation to synergy and stand-alone cost saving statements

9. Any Synergy Benefits Statement or QFBS (either of which is considered a Statement for purpose of this Part) published in a merger and acquisition transaction related

investment circular is itself PFI. There will be further PFI (which is unpublished) specifically prepared to directly support the Statement which may include:

- the underlying detailed plan developed by the company making the announcement, including the documentation of assumptions underpinning the planned financial benefits (in the context of a synergy announcement, this is often known as the 'Synergy Plan'); and
- a separate summary board document that summarises the Synergy Plan (or cost savings plan for cost saving statements).

2. REGULATORY REQUIREMENTS

2.1 Code definition of QFBS

10. A QFBS is defined in the Code as either:

    a) a statement by a securities exchange offeror or the offeree company quantifying any financial benefits expected to accrue to the enlarged group if the offer is successful; or

    b) a statement by the offeree company quantifying any financial benefits expected to accrue to the offeree company from cost saving or other measures and/or a transaction proposed to be implemented by the offeree company if the offer is withdrawn or lapses.

2.2 Overview of Code regulation

11. The Code is issued by the Panel on Takeovers and Mergers (the Panel), and governs all bids for UK public companies (whether listed or not).
12. There is a general standard of care under the Code that states each document, announcement or other information published, or statement made, during the course of an offer must be prepared with the highest standards of care and accuracy. The language used must clearly and concisely reflect the position being described and the information given must be adequately and fairly presented. These requirements apply whether the document, announcement or other information is issued by the party concerned or by an adviser on its behalf.
13. The Code sets out specific regulatory requirements (including required disclosures) that apply to any QFBS made in connection with a proposed takeover or merger in any document or announcement published during an offer period (or in an announcement which commences an offer period). These are set out in detail in the Annex and the table below highlights the key areas covered by the disclosure requirements:

QFBS
• Analysis, explanation and quantification of the constituent elements of the QFBS.
• Base figure where a comparison is made with the historical costs or existing cost base.
• Details of any dis-benefits expected to arise.
• Statement that it is directly attributable to the offer and could not be achieved independently.
• An indication of the timing for achievement of QFB.
• An indication of recurring vs non-recurring financial benefits and clear identification of those which are non-recurring.

• Costs of realising financial benefits.
Supporting public disclosure
• Bases of belief supporting the QFBS (identifying principal assumptions and sources of information).

14. When a QFBS is first published, the Code requires a reporting accountant and financial adviser(s) to each issue public reports containing the relevant opinion (see the Annex for form of opinion required).
15. Any further documents or announcements published in connection with the offer must, unless superseded by information included in the new document or announcement, include a statement by:

    (i) the directors confirming that the QFBS remains valid; and

    (ii) the directors confirming that the reporting accountant and financial adviser(s) have confirmed that their reports continue to apply.

2.3 Listing Rules definition of Synergy Benefit

16. The Listing Rules define a Synergy Benefit as when a premium segment listed company includes details of estimated synergies or other quantified estimated financial benefits expected to arise from a transaction in a Class 1 circular.

2.4 Overview of Listing Rules regulation

17. A Synergy Benefits Statement made in a Class 1 circular must comply with the disclosure requirements under the Listing Rules. These are broadly consistent (though not identical) with those in the Code and are set out in detail in the Annex. The table below highlights the key areas covered by the disclosure requirements:

Synergy Benefits Statement
• Analysis and explanation of the constituent elements of synergies or other quantified estimated financial benefits (including costs), including timing for achievement, and whether they are recurring. • Base figure for any comparison drawn. • Synergies or other quantified estimated financial benefits are required to be contingent on the Class 1 transaction (that is, they could not be achieved independently). • Synergies or other quantified estimated financial benefits are required to reflect both the beneficial elements and relevant costs.
Supporting public disclosure
• Bases of belief that the synergies or other quantified estimated financial benefits will arise.

18. While the Listing Rules do not specify the other requirements covered by the Code in relation to a QFBS (as set out in the Annex), the directors should undertake similar procedures to those for a QFBS when preparing a Synergy Benefits Statement under the Listing Rules.

2.5 Directors' accountability, including satisfying regulatory obligations

19. The directors are responsible for a Statement and, accordingly, must be fully engaged in the preparation process, including approving the Statement. Publication of a Statement in an investment circular sets a strong expectation that the Statement will be met.
20. Prior to deciding to make such Statements the directors should consider the risks associated with making such a public statement and the fact that the directors are accountable for the Statement and associated disclosure requirements.
21. While the obligations under the Code and Listing Rules are articulated differently, the spirit of the obligations and standards of care are broadly aligned and require that the process adopted by the directors is sufficiently robust. The directors should, therefore, undertake appropriate procedures to ensure a Statement has been properly compiled on the basis stated and prepared with due care and consideration.
22. The directors must also ensure that the investment circular as a whole, is to the best of their knowledge, in accordance with the facts, contains no omission likely to affect its import, is aligned with the Statement, and is not misleading.
23. The onus is thus on the directors to ensure that users of the investment circular will not be misled, and, that the Statement has been properly compiled and prepared with due care and consideration.
24. In order for the directors to satisfy themselves that the Statement made under the Code or Listing Rules has been properly compiled on the basis stated and prepared with due care and consideration, they should ensure the Statement meets the relevant regulatory disclosure requirements and be able to demonstrate that they have applied the general attributes and principles set out, or cross referred to, in this application guidance.
25. Where a public statement of anticipated synergies is made that is not captured by the Code or Listing Rules there is a rebuttable presumption that the directors should follow the relevant guidance within this application guidance. While requirements relating to the public disclosures as set out by the Code or Listing Rules will not apply, the internal processes and procedures that support the preparation of a Statement, Synergy Plan and any other supporting unpublished PFI should be followed.
26. The guidance does not address legal obligations and directors should obtain legal and professional advice as appropriate.

3. APPLICATION OF PRINCIPLES AND ATTRIBUTES OF USEFUL PFI TO SYNERGY AND STAND-ALONE COST SAVING STATEMENTS

27. As set out in Part I, to be useful and meet the needs of users, PFI should be prepared and judged against the following qualitative attributes which are applied in the guidance:
    1. Relevance *(user needs principle)*
    2. Reliability *(business analysis principle)*
    3. Understandability *(reasonable disclosure principle)*
    4. Comparability *(subsequent validation principle)*
28. The attributes and, where relevant, the way in which the associated principles apply to a Statement are set out below. Where application is specific to either a QFBS (under the Code) or a Synergy Benefit Statement (under the Listing Rules) this is highlighted, though in most instances they are equally applicable to both.

3.1 Relevance and user needs principle

29. For a Statement to be relevant and capable of influencing users' economic decisions, it would be made at the commencement of, during an offer period, or before shareholder approval in the case of a transaction subject to the Listing Rules (and in this latter case usually within the Class 1 circular).

3.1.1 Offeror perspective (Code and Listing Rules)

30. In the case of an acquirer or offeror, a Statement will relate to quantified financial benefits expected to accrue to the enlarged group following a successful acquisition or offer which could not be achieved independently of the offer. When such a Statement is made, it will be subject to the full relevant disclosures set out in the Annex.

3.1.2 Offeree perspective (Code)

31. The Panel will not normally permit an offeree company to publish a statement quantifying the financial benefits expected to accrue from an offer by a particular offeror unless that statement is published with the consent of the offeror.
32. More commonly, in the case of a bid defence document, the offeree's QFBS will relate to quantified financial benefits expected to accrue to it from cost savings or other measures if the offer is withdrawn or lapses.

3.2 Reliability and business analysis principle

33. The Code specifically requires that:

    The statement must be supported by a thorough analysis of the target company's and/or the acquirer's business and must represent factual and not hypothetical strategies, plans and risk analysis.

3.2.1 Business analysis

34. Specific post-transaction integration/implementation plans (or for bid defence scenarios, stand-alone implementation plans) should be developed to help enable benefits to be quantified and delivered. This application guidance promotes the preparation of a Statement based on an analysis of the strategic purpose of a transaction, specific post-transaction integration plans and an understanding of the risks involved in implementing those plans.
35. There may be significant challenges around the supporting business analysis for a Statement when a company:
    - is keeping different strategic options open;
    - has limited information about (i) the other party (for example, if no access to the target is available); or (ii) the financial consequences of alternative plans (for example, cost savings plans being planned or implemented by the offeree);
    - has limited opportunity to validate its plans by reference to external evidence and opinion; or
    - is restricted in its ability to provide detailed support on its own information due to the status of the offer and ability to share commercially sensitive data.
36. Where access and information are limited, cost savings may only be able to be quantified under an outside-in approach ie, where information is limited to publicly available sources. As there may be inherent uncertainties in the source information

under such an approach, the process adopted should build in sufficient allowances (eg, risk-weighted adjustments, contingencies etc) when estimating the relevant cost saving. For example, a potential acquirer might have an adequate basis for stating that it plans to eliminate certain duplicate costs which are disclosed in sufficient detail in the financial statements or other publicly available information but will require a higher contingency to be able to quantify and publish other cost savings (such as procurement) where there is no access to detailed information or commercially sensitive information.

37. When considering the attribute of reliability, the directors should consider in relation to the constituent parts (i) how obvious the benefit is (for example, duplicated board costs and central overheads); (ii) the degree of access and information available to support the benefit; and (iii) whether they will have control over the implementation.

38. A further aspect of reliability is the disclosure relating to the degree of uncertainty inherent in the information. If a significant degree of uncertainty in relation to the quantified financial benefits exists, doubt is cast over the appropriateness and reliability of a Statement. The directors' analysis of contingencies in relation to the Statement may assist in identifying the need for disclosures of uncertainties relating to material bases of belief or other aspects of the Statement.

3.2.2 Other aspects of reliability

39. Neutrality requires that the costs of implementing post-acquisition plans are required to be reported as well as any expected benefits. For example, where there are synergy savings in salary costs from planned redundancies then the associated redundancy costs should be included within the announced quantum of one-off costs.

3.3 Understandability and reasonable disclosure principle

40. The attributes of understandability and principle of reasonable disclosure are reflected in the Code which requires that:

    The statement (and bases of belief) must not be so complex or include such extensive disclosures that it cannot be readily understood.

3.3.1 Form of the Statement

41. The regulatory disclosure requirements set out in the Annex promote presentation of a clear and understandable Statement and include the requirement to include an analysis, explanation and quantification of the constituent elements sufficient to enable the context and relative importance of those elements to be understood.

42. A Statement may take a variety of forms that could include, for example, cost synergies, revenue synergies, overall earnings enhancements or stand-alone cost savings anticipated in a bid defence scenario. It is therefore important that the Statement is clear as to the form of the synergies arising. For example, when disclosing cost synergies it should be clear in the Statement whether they relate to trading costs, capital costs or working capital requirements.

43. A Statement should not only distinguish between cost synergies and revenue synergies (if any) but also set out the main constituent elements of the respective cost or revenue synergies.

44. There is a strong expectation that the Statement will be met and there should therefore be very little risk that the quantum of synergies announced is not realised. Consequently, the directors often (and should) adopt a prudent approach in making a Statement and in doing so may opt to disclose the quantum as the minimum level they expect to achieve. The quantum of the overall synergies or cost savings that the

directors announce within the Statement should be adequately supported by the amount that is reflected in the underlying synergy or cost saving plan.

45. A Statement normally will disclose the overall synergies as either a run-rate figure or an in year figure that is to be achieved by a certain year. While either approach is acceptable, the Statement needs to be clear as to the approach adopted.

3.3.2 Bases of Belief

46. The bases of belief included for a Statement should set out the principal assumptions and sources of information in connection with the Statement and in a manner that is also readily understandable, specific and precise.

47. It is important that useful information is not obscured through the inclusion of immaterial items or the use of terminology, which is not likely to be meaningful to, or may be misunderstood by, the intended users.

3.3.3 Alignment with disclosures elsewhere in the investment circular

48. Within an investment circular (or during an offer period) there may be other disclosures or statements relating to the transaction such as post-merger intention statements, post-merger undertakings, quantification of the potential impact on employees (ie, redundancies) or risk factors. When making a Statement it is important that the Statement is aligned with any other disclosures or statements that would influence the Statement and that these are taken into consideration when developing the Statement. Where such disclosures or statements directly influence the Statement, then the directors should also make the necessary disclosures within the bases of belief supporting the Statement.

3.4 Comparability and subsequent validation principle

49. There is no UK regulation that requires the achievement or otherwise of the benefits reported in a Statement to be monitored. Comparability and the principle of subsequent validation is, however, a core attribute of PFI and an expectation of users. Therefore, the ability of the preparer of the Statement to be able to monitor the Statement on an ongoing basis and to ensure it is capable of being reported against is important to users (including investors). A Statement that can be monitored effectively, also acts as an incentive for directors to produce high-quality information to assist investors in their decision-making. Certain forms of Statement that companies may wish to make will fail this test. For example, a statement that post-merger overhead savings in three years' time will reach an annual rate of £x million is unlikely to be capable of subsequent validation unless it is made by reference to existing cost bases and structures, and to specific and identifiable future savings.

50. The supporting Synergy Plan for a Statement should be in a format that facilitates the ongoing monitoring of synergies achieved so that the company maintains the ability to update the market in respect of overall delivery of the synergies or cost savings.

4. PRINCIPLES OF PREPARATION OF PFI IN CONNECTION WITH A STATEMENT

51. Part II identifies general principles and core processes and procedures for the preparation of all PFI, along with illustrative practical considerations and techniques. Some form of underlying PFI (including, for example, a Synergy Plan) will be required to support a Statement, but the form of Statement may not necessitate the preparation of full financial projections. Accordingly, the guidance in Part II should be applied on a proportionate basis where relevant to the Statement being made and the supporting

unpublished PFI. In addition, this application guidance has identified a number of additional specific matters requiring consideration in connection with making a Statement.

52. The table in 4.1 summarises the illustrative practical considerations and techniques specific to a Statement (including its bases of belief). The table in 4.2 provides further detail and practical guidance for preparers.

4.1 Summary of illustrative practical considerations and techniques applicable to the Statement: for directors

PLANNING

Where supporting business analysis is derived from prospective financial information contained in the company's financial projections the applicable practical procedures and considerations set out in Part II should be undertaken on those financial projections. The procedures, considerations and techniques set out below are specific to the preparation of a Statement (including bases of belief) and the supporting Synergy Plan (or cost savings plan).

- Obtain and review the relevant market rules and regulation (taking into account the circumstances) and consider appointment of financial advisers, reporting accountants and other professional advisers.
- Proper board engagement is required.
- Identify subject matter expertise and experience to prepare and evaluate the Statement (to the extent permitted by time, confidentiality and access constraints).
- Consider level of access to management and information (target and acquirer).
- Develop key messages in the context of the rationale for the acquisition/merger or stand-alone cost savings and any intention statements or post-merger undertakings.
- Consider how and when the Statement can be monitored or reported against in the future if required by stakeholders including shareholders, employee groups and regulators.

EXECUTION

Where supporting business analysis is derived from prospective financial information contained in the company's financial projections the applicable practical procedures and considerations set out in Part II should be undertaken on those financial projections. The procedures, considerations and techniques set out below are specific to the preparation of a Statement (including bases of belief) and the supporting Synergy Plan (or cost savings plan).

- Preparation of draft of Statement in compliance with relevant market rules and regulation and where required public opinions/reports commissioned from financial advisers and reporting accountants in respect of a QFBS.

- Preparation of the board memorandum for approval including a summary of the relevant regulation, outline of the relevance of the Statement to the transaction, its context and its audience and directors' confirmations.
- Preparation of detailed Synergy Plan on the basis of the following considerations:
  - Availability of underlying data and management capabilities together with operational, legal and regulatory constraints.
- Obtain and consider details of the existing cost bases of each business.
- Identification and specification of cost savings and other financial benefits (and associated costs) within each business.
- Risk adjust the targeted benefits based on the level of or access to detailed information and information sources.
- Ensure an appropriate compilation process is undertaken.
- Consideration of compliance of Statement with bases of belief disclosure requirements.
- Consideration of compliance of Statement with disclosure requirements – ie, provide indication of constituent elements, balance potential benefits with dis-benefits and costs to achieve, clarify timing, specify recurring vs non-recurring.
- Wording should be transparent and concise and be consistent with and based on the detailed Synergy Plan.
- Consider consistency of Statement with other disclosures in the investment circular.
- Consideration of post transaction monitoring such as in trading updates, interim financial information and the annual report.

EVIDENCE AND DOCUMENTATION

Where supporting business analysis is derived from prospective financial information contained in the company's financial projections the applicable practical procedures and considerations set out in Part II should be undertaken on those financial projections. The procedures, considerations and techniques set out below are specific to the preparation of a Statement (including bases of belief) and the supporting Synergy Plan (or cost savings plan).

- Key elements of the process should be evidenced through contemporaneous documentation;
- Board review and approval of (i) board memorandum, (ii) Statement; and (iii) Synergy Plan.
- Detailed analysis of the benefits, dis-benefits and costs to achieve should be prepared.
- Wording of Statement to be compiled by the company's management team from Synergy Plan, financial and operational records with input from board and having regard to advice from any external advisers that have been appointed.
- Document bases of belief and any assumptions.
- Statement, Synergy Plan and supporting business analysis should be formally considered in a format that facilitates the ongoing monitoring of synergies achieved.

4.2 Detailed illustrative practical considerations and techniques specifically applicable to the Statement: for preparers

53. The list is not exhaustive or prescriptive: other considerations and techniques may be applicable. In the Execution section, under the heading "Understandable", bullets in italics relate to specific Code requirements and are largely consistent with the Listing Rules requirement as set out in the Annex.

PLANNING

Where supporting business analysis is derived from prospective financial information contained in the company's financial projections the applicable practical procedures and considerations set out in Part II should be undertaken on those financial projections. The detailed procedures, considerations and techniques set out below are specific to the preparation of a Statement (including bases of belief) and the supporting Synergy Plan.

User needs principle (Relevant)

Obtain and review the relevant market rules and regulation (taking into account the circumstances) and consider appointment of financial advisers, reporting accountants and other professional advisers

- the directors should ensure that the Statement, Synergy Plan and other supporting unpublished PFI which forms a basis for the Statement are prepared in accordance with the relevant regulatory requirements and guidance (as set out in the Annex) and having regard to this application guidance.
- where public opinions/reports are required from financial advisers and reporting accountants in connection with a QFBS under the Code, the directors should appoint them early on in the process.
- consider whether any third party professional adviser should be commissioned to advise and assist in the development of the Synergy Plan.

Business analysis principle (Reliable)

Proper board engagement is required

- the directors are responsible for the Statement and must be fully engaged in the preparation process including approving the form and content of the published Statement and supporting disclosures of bases of belief (as well as the supporting unpublished PFI);

Identify subject matter expertise and experience required to prepare and evaluate the Statement and Synergy Plan (to the extent permitted by time, confidentiality and access constraints)

- the directors are likely to benefit from ensuring the appropriate involvement of senior operational and financial management in the development of the detailed Synergy Plan and assumptions that underlie it.

Consider level of or access to target management and information (target and acquirer) in contemplation of a Statement;

- a key factor determining the likely nature and quantum of a Statement will be the level of access to the acquirer and target underlying information and the timing of the Statement.

- in a price sensitive scenario where the number of insiders is understandably restricted, it may be difficult to obtain the information to support appropriate business analysis on both the acquirer and the target. This will have implications for the Statement that can be made.

Reasonable disclosure principle (Understandable)

Develop key messages in the context of the rationale for the acquisition/merger or stand-alone cost savings and any intention statements or post-merger undertakings

- intention statements and post-merger undertakings have specific meanings if the transaction is subject to the Code (as set out in the Code).
- the directors should familiarise themselves with those rules to ensure the Statement complies with the requirements.

Subsequent validation principle (Comparable)

Consider how and when the Statement can be monitored or reported against in the future if required by stakeholders including shareholders, employee groups and regulators.

EXECUTION

Where supporting business analysis is derived from prospective financial information contained in the company's financial projections the applicable practical procedures and considerations set out in Part II should be undertaken on those financial projections. The detailed procedures, considerations and techniques set out below are specific to the preparation of a Statement (including bases of belief) and the supporting Synergy Plan.

User needs principle (Relevant)

Statement should be prepared in compliance with relevant market rules and regulation and where required public opinions/reports commissioned from financial advisers and reporting accountants in respect of a QFBS

Preparation of the board memorandum for approval including a summary of the relevant regulation, any directors' confirmations, and outlining the relevance of the Statement to the transaction, its context and its audience

- the purpose of the board memorandum is to formally record the directors' basis for the Statement and their responsibilities in relation to it. The directors should prepare and adopt a formal record of the evidence which has been compiled to support the information to be published (eg, in the board memorandum or Synergy Plan).
- the directors need to consider whether all factors that could have a material bearing on the Statement have been addressed.

Directly attributable

- in practice some synergies, for example the elimination of duplicate head office costs, clearly fall into the category of directly attributable to the transaction. However, other benefits such as operational efficiencies may be less clear-cut. It will need to be demonstrated that the acquisition will allow one of the parties access to methodologies, technologies or similar which would not otherwise be available to it.

Business analysis principle (Reliable)

Preparation of detailed Synergy Plan

The Statement should be supported by and consistent with preparation of an underlying Synergy Plan and individual synergy initiatives and analysis that support the Synergy Plan.

When developing the Synergy Plan the directors or senior operational and financial management should consider:

- rationale for the acquisition;
- plans for the merged business and integration strategy;
- principal assumptions;
- macro-level benchmarking (eg, comparison of targeted benefit with synergies achieved in prior acquisitions);
- potential areas for upside, including quantified and non-quantified aspects where appropriate;
- what level of contingency will be factored into the Synergy Plan;
- associated costs and timing of implementation; and
- analysis supporting and explaining any dis-benefits expected to arise.
- underlying data together with operational, legal and regulatory constraints.

Obtain and analyse the existing cost bases of each business

In identifying and analysing the base-lines upon which individual synergies/cost savings are derived the directors or senior operational and financial management may consider:

- cost base detail, at the greatest level of detail readily available, which may include:
  - overall profit and loss schedule; and
  - detailed analysis by business unit/function/location, as applicable, including a split of personnel versus non-personnel costs.
- headcount detail, at the greatest level of detail readily available, which may include:
  - headcount and full time employee by function by business unit/location (ideally this should take the form of anonymised payroll data);
  - determining the assumptions that need to be used – eg, target based on public information, disaggregated into greater granularity using acquirer cost base ratios and other known factors;
  - considering differences in financial periods and age/basis of data – eg, average for the year or headcount as at a specific date.
- principal operating key performance indicators – eg, those used in monthly management reporting.
- recent and projected capital expenditure, analysed into maintenance and expansionary expenditure.
- total IT spend (including operational expenditure, capital expenditure and people costs).
- material cost savings programmes planned, in progress or recently completed, including benefits targeted, current status, and implementation costs.

All cost data should be for a full year.

Identification and specification of cost saving and other financial benefits within each business

The directors or senior operational and financial management should consider the following against each synergy:

- cost and headcount baseline (linked to the overall cost and headcount baseline as above).
- description of and rationale for the saving.
- quantum of saving, phased (eg, over a three year period, including end run-rate or in-year rate).
- for headcount savings, number of full time employees impacted.
- split of headcount and non-personnel savings, where relevant.
- key assumptions made.
- one-off costs, including phasing (eg, redundancy costs).
- recurring costs of implementation (where relevant).
- comparison to benchmarks, where available (whether internal or external).
- key implementation considerations and potential execution risks.

There should be clarity on which cost base (ie, acquirer or target) the cost or saving is expected to come from.

Risk adjusting the targeted benefits based on the level of or access to detailed information and information sources

- the directors should consider whether a contingency should be built into the Synergy Plan and Statement. The level of any contingency provision will depend on the profile of the businesses, the nature of the quantified financial benefits identified, the plan to achieve them and the quality of the information/evidence available.
- the directors should assess the level of access in respect of their own and the target's information which will help inform the level of contingency to be applied to the Statement.
- the contingency should take into consideration operational management's previous experience of achieving relevant cost savings/synergy initiatives.
- each element contributing to the total quantified financial benefit should be considered separately in determining the level of the contingency required.
- in the circumstances of a hostile offer (and sometimes in the case of a recommended offer), where access to information relating to the target is limited to that which is publicly available, it is likely that the Statement will necessarily be more limited than if greater access had been available. The directors should establish that the published information is sufficiently detailed and specific to enable them to justify their quantification of financial benefits. Since significant assumptions may have to be made in such situations, the degree of confidence in the level of synergies which may be achieved may be reduced. In practice, this may be expected to result in a more prudent public statement of the expected quantified financial benefits.

Compilation process

- The Statement and the Synergy Plan should be subject to computational checks by the preparer to ensure that:
  - there are no mathematical or clerical errors in the compilation;
  - the Statement has been accurately computed based on the disclosed basis of belief;
  - the bases of belief (or principal assumptions) are consistent with the directors' analysis of the business;
  - assumptions have not been misapplied; and
  - historical financial information which forms part of the analysis does not contain misstatements which have not been corrected.

Compilation process in development of Synergy Plan

- the directors should ensure that detailed and specific plans have been developed to support and deliver the benefits.
- the directors should be able to demonstrate that the business analysis carried out has been used by them in compiling the Statement and supporting unpublished PFI. The extent and nature of the analysis that is required to support the Statement, will be dependent upon the specific circumstances in which the Statement is being prepared.
- the supporting detailed Synergy Plan and underlying assumptions should be based on:
  - supportable assumptions based on rigorous business analysis and adequate access to information about the other party which ensures that the directors are highly confident that the Statement will be realised;
  - consideration of the integration strategy and plans of the business and related implementation risks; and
  - assessment of the neutrality of the Statement and in particular whether all costs of realising the expected benefits have been identified.
- the directors should prepare their supporting unpublished Synergy Plan and individual synergy initiatives to cover the period for the synergies in the Statement to be realised.
- the directors should be able to demonstrate:
  - appropriate levels of review and challenge within the organisation and involvement of senior operational and financial management;
  - the agreement of senior operational and financial management to the assumptions on which the quantified financial benefits/synergies are based; and
  - development of information on a 'bottom-up' basis.

Consider compliance of Statement with bases of belief disclosure requirements

Bases of belief (principal assumptions):

- *the bases of belief must support the QFBS;*

- *the bases of belief should provide useful information as to the reasonableness and reliability of the QFBS. The bases of belief should:*
  - *be readily understandable;*
  - *be specific and precise; and*
  - *not relate to the general accuracy of estimates underlying the QFBS.*
- *there must be a clear distinction between bases of belief about factors which the directors (or other members of the company's management) can influence and those which they cannot influence.*
- principal assumptions upon which the Statement is based must be supported by robust analysis and where applicable demonstrate consistency with management's past experience.
- the bases of belief should demonstrate a credible strategy for preparing the Statement. This strategy should be supported by the appropriate operational people within the acquirer and/or target as appropriate and be fully costed.
- specific costs that will be impacted should be identified and evaluated.
- the bases of belief should set out whether the synergy assumptions have been risk adjusted.
- the benefits identified relating to cost savings are more likely to be readily supportable and within the control of management to deliver, than revenue enhancements.
- the approach adopted by the directors to compiling a Statement relating to a group will need to include measures to ensure that (particularly with regard to an assessment of dis-benefits) all subsidiaries, and, where relevant, all material associated undertakings are considered.

Reasonable disclosure principle (Understandable)

Consideration of compliance with disclosure requirements – ie, provide indication of constituent elements, balance potential benefits with dis-benefits and costs to achieve, clarify timing, specify recurring vs non-recurring.

Constituent elements

- *the analysis, explanation and quantification of the constituent elements of the statement should be sufficient to enable the context and relative importance of these elements to be understood.*
- the cost savings should be presented net of ongoing costs required to deliver them.

Base figure

- *a base figure is required where any comparison is made with historical financial performance or with existing cost bases and structures.*
- a base figure should also be provided where comparison is made with future anticipated cost bases and structures.
- compelling evidence is required where the base figure is predicated on a future anticipated cost structure.
- base figures provide context for interpreting the Statement. They must be readily understandable, and calculated and presented on a consistent basis.

- unless clearly disclosed and explained base figures should not include any one-time or exceptional items (including those arising from a change in accounting policy).
- in the calculation of a financial benefit, the treatment adopted must be consistent with the entity's accounting policies.

Dis-benefits

- *details of any dis-benefits expected to arise must be disclosed in the QFBS.*
- dis-benefits should be calculated and disclosed – these may include any likely inefficiencies or consequences of increased scale within the entity's markets.

Directly attributable to the transaction

- *in respect of a statement by the offeror, the Code requires that the financial benefits of synergies must accrue as a 'direct result' of the success of the offer and could not be achieved independently of the offer.*

Timing for achievement of Statement

- *the QFBS must set out the preparers' expectation of when the financial benefits are expected to arise.*
- a Statement may specify the timing of benefits as either in-year benefits or exit run-rate benefits. It is important that the Statement makes clear the basis of the phasing statement.
- a lengthy timeframe or excessively short timeframe for delivery of expected benefits, may raise concern over the inclusion of these benefits in the Statement.

Recurring vs non-recurring financial benefits

- *the QFBS must include an indication as to whether the expected financial benefits will be recurring, clearly identifying any non-recurring benefit(s).*
- the directors should prepare analysis to support the relevant categorisation of the expected financial benefits between recurring and non-recurring.

Costs of realising expected financial benefits

- *the recurring and non-recurring costs of realising the expected financial benefits.*
- analysis to support the recurring and non-recurring anticipated costs of realising the expected financial benefits.

Wording should be transparent and concise and be consistent with and based on the detailed Synergy Plan

Consider consistency of Statement with other disclosures in the Investment Circular

- Post-merger intention statements, post-merger undertakings or risk factors disclosed in the investment circular that impact the Statement should be taken into consideration when developing the Statement (and where they directly influence the Statement then disclosure should also be made in the bases of belief supporting the Statement).

Subsequent validation principle (Comparable)

Consideration of post transaction monitoring and related market updates such as in in trading updates, interim financial information and the annual report

- the business analysis that supports a Statement should be in a format that facilitates the ongoing monitoring of synergies achieved (or is capable of being developed into such a format).

so that the company maintains the ability to update the market in respect of overall delivery of the synergies.

EVIDENCE AND DOCUMENTATION

Where supporting business analysis is derived from prospective financial information contained in the company's financial projections the applicable practical procedures and considerations set out in Part II should be undertaken on those financial projections. The detailed procedures, considerations and techniques set out below are specific to the preparation of a Statement (including bases of belief) and the supporting Synergy Plan.

All principles and attributes

Key elements of the process should be evidenced through contemporaneous documentation.

Board review and approval of (i) board memorandum; (ii) Statement; and (iii) Synergy Plan is required.

Business analysis principle (Reliable)

Detailed analysis of the benefits, dis-benefits and costs to achieve

- There should be documentary support for the plans, strategies and risk analysis, consistent with the analysis of the business. Support should also include information generated from within the organisation and from external sources, such as detailed and specialist benchmarking information.

The bases of belief should be documented.

Reasonable disclosure principle (Understandable)

Wording of Statement should be compiled by the company's management team from financial and operational records with input from board and having regard to advice from any external advisers that have been appointed.

The directors should confirm in the documentation that the minimum disclosures required by the relevant regulation, as set out in the Annex, have been made (for example, for a QFBS the amount of the quantified financial benefits and the assumptions relating to them).

Any assumptions should be documented.

Subsequent validation principle (Comparable)

Statement, Synergy Plan and business analysis should be in a format that facilitates the ongoing monitoring of synergies achieved.

Annex: Regulatory requirements and guidance applicable to published PFI in capital markets transactions

1. STATEMENTS OF SUFFICIENCY OF WORKING CAPITAL

1.1 UK

Summary of UK regulation relating to working capital statements

UK Prospectus Rules (PR), Listing Rules (LR), AIM Rules for Companies and NEX Exchange Growth Market Rules require that in certain circumstances an investment circular (prospectus, circular, admission document etc.) contains a working capital statement.

Investment circulars requiring a working capital statement	Regulation Reference
For a prospectus containing a share securities note	PR Appendix 3 Annex III Item 3.1
For a prospectus containing share securities note in connection with a rights issue	PR Appendix 3 Annex XXIV Item 3.1
Premium listing of equity shares: Application by a commercial company *(Note: LR6.1.1R contains exceptions such that this only applies to new applicants)*	LR 6.7.1R *(must be a clean statement)*
Premium listing of equity shares: Class 1 disposal by companies in severe financial difficulty	LR 10.8.4 R (8)
Premium listing of equity shares: Class 1 transaction	LR 13 Annex 1R (as applied by LR 13.4.1R)
Premium listing of equity shares: Circular for reconstruction or refinancing	LR 9.5.12 R (3)
Premium listing of equity shares: Circular for purchase of >25% of own equity shares	LR 13.7.1 R (2) (f)
AIM Admission Document	AIM Rules for Companies paragraph (c) of Schedule Two *(must be an unqualified statement)*
NEX Exchange Admission Document	NEX Exchange Growth Market: Rules for Issuers – Appendix 1 paragraph 40. NEX Exchange Growth Market: Practice Note on Working capital for issuers seeking admission
Migration to a premium listing	LR 5.4A

NOTE: LR16.2.1R contains a dispensation for a Premium Listing: Open-ended investment funds (there are no equivalent derogations in the PD Regulation, therefore working capital statements are required to be included in a document that is a prospectus subject to the PD Regulation).

NOTE: Where an issuer is preparing a prospectus in addition to undertaking a significant acquisition, for the purposes of the prospectus, it is not appropriate to include a working capital statement limited to an enlarged group basis. This is because it does not cover eventualities such as the acquisition not taking place. However, the issuer may wish to include a single PR compliant working capital statement, which in a combined document would also satisfy the Class 1 LR requirements or, if the issuer prefers, two statements, one prepared on a PR basis and one on an enlarged group basis.

Summary of regulatory guidance applicable to directors

ESMA Update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive (ESMA Guidance)	
Para 107-108	Definitions (Working Capital and Present Requirements)
Para 109-112	Introduction
Para 113-115	Clean working capital statements
Para 116-123	Qualified working capital statements
Para 124-126	Principles for preparing working capital statements

UKLA Technical Notes	
UKLA / TN / 320.1	Working capital statements - Basis of preparation
UKLA / TN / 321.1	Working capital statements and risk factors
Summary of other relevant regulation and guidance	
Role of Sponsor: Premium Listing – Listing Rules	LR 8.4.2 R (5) – Application for admission LR 8.4.8 R(3) – Application for admission: further issues LR 8.4.12 R (3) – Class 1 circulars, refinancing and purchase of own equity shares LR 8.4.15 R (5) – Applying for a transfer between listing categories
Sponsor – UKLA Technical Notes	UKLA / TN / 704.3 - The sponsor's role on working capital statements UKLA / TN / 705.2 - Sponsors: uncertain market conditions
Role of nominated adviser	AIM Rules for Nominated Advisers – Schedule Three (Nominated Adviser Responsibilities) – AR 3 Due Diligence
Reporting accountants	Standards for Investment Reporting 1000 – investment reporting standards applicable to all engagements in connection with an investment circular (SIR 1000)

Regulatory obligation – standards of care required

Capital markets regulation in the UK imposes standards on the content of information (including working capital statements) included in investment circulars, and on the processes and procedures adopted by the directors in preparing such information including the following:

- the standard required by the UK LR is that the directors have a reasonable basis on which to make the working capital statement;
- the standard required by the AIM Rules for Companies is that the statement is made by the directors after 'having made due and careful enquiry';
- in relation to a working capital statement contained in a UK prospectus for a premium listed company or a Class 1 circular, UK LR require that the issuer's sponsor confirms to the UKLA that they have come to a reasonable opinion, after having made due and careful enquiry, that the directors have a reasonable basis on which to make the working capital statement;
- in relation to an AIM admission the nominated adviser has responsibility in relation to the working capital statement as part of its general consideration of the suitability of the AIM applicant. This entails assessing the extent to which the directors can demonstrate that they have undertaken appropriate procedures to support the statement being made and being satisfied that appropriate working capital procedures have been undertaken (this usually includes commissioning work in connection with working capital and obtaining applicable reports or letters from a reporting accountant);
- the ESMA Guidance requires that in making the working capital statement there is very little risk that the basis of such a statement is subsequently called into question. Accordingly, issuers are expected to have undertaken appropriate procedures to support the statement being made;
- in addition, the LR (for Class 1 circulars), the PD Regulation (for prospectuses) and the AIM Rules for Companies (for admission documents) require that a declaration is given by the directors in relation to the information contained in an investment circular that, having taken all reasonable care to ensure that such is the case, the information is, to the best of their knowledge, in accordance with the facts, and contains no omission likely to affect its import.

Example wording of clean working capital statement

Prospectus

"The Company is of the opinion that, [taking into account the net proceeds of the Offer], the Group has sufficient working capital for its present requirements, that is, for at least the next 12 months from the date of this Prospectus."

AIM Admission Document

"The Directors are of the opinion having made due and careful enquiry that, [taking into account the net proceeds of the [Placing/Offer]], the Group has sufficient working capital for its present requirements, that is, for at least the next 12 months from the date of Admission."

1.2 EU

Summary of EU regulation relating to working capital statements

The European Commission has established a requirement for companies making a public offer within the EU or seeking admission to a European regulated market to prepare a prospectus.

European Commission Regulation (EC) No. 809/2004 (PD Regulation) specifies the contents of a prospectus and Annex III, Item 3.1 requires the inclusion of a working capital statement in a prospectus filed in connection with share securities offerings within the EU.

Investment circulars requiring a working capital statement	**Regulation Reference**
For a prospectus containing a share securities note	Annex III Item 3.1

Summary of regulatory guidance applicable to directors

ESMA Update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive (ESMA Guidance)	
Para 107-108	Definitions (Working Capital and Present Requirements)
Para 109-112	Introduction
Para 113-115	Clean working capital statements
Para 116-123	Qualified working capital statements
Para 124-126	Principles for preparing working capital statements

Regulatory obligation – standards of care required

The PD Regulation imposes standards on the content of information (including in relation to working capital statements) included in investment circulars, and on the processes and procedures adopted by the directors in preparing such information including the following:

- the standard required by the PD Regulation is that the directors take reasonable care to ensure that the information contained in the investment circular is to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import; and
- the ESMA Guidance requires that in making the working capital statement there is very little risk that the basis of such a statement is subsequently called into question. Accordingly, issuers are expected to have undertaken appropriate procedures in preparing PFI to support the statement being made.

2. PROFIT FORECASTS

2.1 UK

Summary of UK regulation relating to profit forecasts

UK Prospectus Rules (PR), Listing Rules (LR), AIM Rules for Companies, NEX Exchange Growth Market Rules and The City Code on Takeovers and Mergers (the Code) require that in certain circumstances an investment circular (prospectus, circular, admission document, offering document etc.) contains a profit forecast.

Investment circulars, documents and announcements that may include a profit forecast	**Regulation Reference**
For a prospectus containing a Share Registration Document	Appendix 3 Annex I Item 13
For a prospectus containing a Debt and Derivative securities Registration Document (Debt and derivative securities with a denomination per unit of less than EUR 100,000)	PR Appendix 3 Annex IV item 9
For a prospectus containing a Debt and Derivative securities Registration Document (Debt and derivative securities with a denomination per unit of at least EUR 100,000)	R Appendix 3 Annex IX item 8
For a prospectus containing Depositary Receipts issued over shares	PR Appendix 3 Annex X Item 13
For a prospectus containing the Banks Registration Document	PR Appendix 3 Annex XI Item 8
For a prospectus containing a Share Registration Document for Rights Issues	PR Appendix 3 Annex XXIII Item 8
For a prospectus containing a Share Registration Document for SMEs and companies with reduced market capitalisation	PR Appendix 3 Annex XXV Item 13
For a prospectus containing a Debt and Derivative Securities <100,000 EUR Registration Document for SMEs and companies with reduced market capitalisation	PR Appendix 3 Annex XXVI Item 9
For a prospectus containing a Debt and Derivative Securities ≥100,000 EUR Registration Document for SMEs and companies with reduced market capitalisation	PR Appendix 3 Annex XXVII Item 8
For a prospectus containing Depositary Receipts issued over shares for SMEs and companies with reduced market capitalisation	PR Appendix 3 Annex XXVIII Item 13
For a prospectus containing Issues by Credit Institutions referred to in Article 1(2)(j) of Directive 2003/71/EC	PR Appendix 3 Annex XXIX Item 8
Class 1 Circular	LR 13.5.32 R LR 13.5.33 R
All documents regulated by the Prospectus Rules or the Listing Rules	PD Regulation Article 2 'Definitions' Item (10)
AIM Admission Document	AIM Rules for Companies – Schedule Two (d) AIM Rule 17
NEX Exchange Admission	NEX Exchange Growth Market: Rules for Issuers – Appendix 1 paragraph 20.
Document or Announcement covered by the City Code of Takeovers and Mergers	The City Code on Takeovers and Mergers, Section K, Rule 28 and definitions.

Summary of regulatory guidance applicable to directors

ESMA Update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive (ESMA Guidance)	
Para 38-50	Profit forecasts or estimates
ESMA Questions and Answers – Prospectuses (ESMA Q&A)	
Question 20	Supplement to prospectuses: profit forecast
Question 25	Profit forecasts or estimates
Question 102	Definition of profit forecasts
UKLA Technical Notes	
UKLA / TN / 340.2	Profit forecasts and estimates
Premium listing of equity shares: Continuing obligations	
LR 9.2.18 R (2)	Reproduction and explanation of a profit forecast in the next annual report and accounts: • LR 9.2.18 R (2)(a) – Publication of unaudited financial information • LR 9.2.18 R (2)(b) – produce and disclose the actual figures for the same period • LR 9.2.18 R (2)(c) – where there is a difference of 10% or more, provide an explanation of the difference
AIM Rules: Disclosure of miscellaneous information	
AIM Rules for Companies; Rule 17	Notification of any material change between actual trading performance or financial condition and any profit forecast, estimate or projection made public.
Disclosure and Transparency Rules	
DTR 2.2	Disclosure of inside information via Regulatory Information Service • DTR 2.2.3 – Identifying inside information • DTR 2.2.6 – Information which is likely to be considered relevant to a reasonable investor's decision
Market Abuse Regulation	
MAR Article 17	Article 17(1) – Informing the public of inside information

Summary of other relevant regulation and guidance

Role of Sponsor: Premium Listing – Listing Rules	LR 8.4.2 R – Application for admission LR 8.4.8 R – Application for admission: further issues LR 8.4.12 R – Class 1 circulars, refinancing and purchase of own equity shares LR 8.4.15 R – Applying for a transfer between listing categories

Role of Nominated Adviser to AIM traded companies	AIM Rules for Nominated Advisers OR1 – responsibility to maintain regular contact with the AIM company in order to advise the AIM Company on its obligations under the AIM Rules for Companies and to identify any breaches, including in respect of Rule 17 disclosures
Reporting accountants	Standards for Investment Reporting 1000 – investment reporting standards applicable to all engagements in connection with an investment circular (SIR 1000) Standards for Investment Reporting 3000 - investment reporting standards applicable to public reporting engagements on profit forecasts (SIR 3000)

Regulatory obligation – standards of care required

Capital markets regulation in the UK imposes standards on the content of information (including profit forecasts) included in investment circulars, and on the processes and procedures adopted by the directors in preparing such information including the following:

- the UK LR and PR require the directors to take reasonable care to ensure that the information contained in the investment circular is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import; and
- the ESMA Guidance requires that due care and diligence must be taken to ensure that profit forecasts or estimates are not misleading to investors.

2.2 EU

Summary of EU regulation relating to profit forecasts

The European Commission has established a requirement for companies making a public offer within the EU or seeking admission to a European regulated market to prepare a prospectus.

European Commission Regulation (EC) No. 809/2004 (PD Regulation) specifies the contents of a prospectus.

Investment circulars that may include a profit forecast	Regulation Reference
For a prospectus containing a Share Registration Document	PD Regulation Annex I Item 13
For a prospectus containing a Debt and Derivative securities Registration Document (Debt and derivative securities with a denomination per unit of less than EUR 100,000)	PD Regulation Annex IV item 9
For a prospectus containing a Debt and Derivative securities Registration Document (Debt and derivative securities with a denomination per unit of at least EUR 100,000)	PD Regulation Annex IX item 8
For a prospectus containing Depositary Receipts issued over shares	PD Regulation Annex X Item 13
For a prospectus containing the Banks Registration Document	PD Regulation Annex XI Item 8

For a prospectus containing a Share Registration Document for Rights Issues	PD Regulation Annex XXIII Item 8
For a prospectus containing a Share Registration Document for SMEs and companies with reduced market capitalisation	PD Regulation Annex XXV Item 13
For a prospectus containing a Debt and Derivative Securities <100,000 EUR Registration Document for SMEs and companies with reduced market capitalisation	PD Regulation Annex XXVI Item 9
For a prospectus containing a Debt and Derivative Securities ≥100,000 EUR Registration Document for SMEs and companies with reduced market capitalisation	PD Regulation Annex XXVII Item 8
For a prospectus containing Depositary Receipts issued over shares for SMEs and companies with reduced market capitalisation	PD Regulation Annex XXVIII Item 13
For a prospectus containing Issues by Credit Institutions referred to in Article 1(2)(j) of Directive 2003/71/EC capitalisation	PD Regulation Annex XXIX Item 8

Summary of regulatory guidance applicable to directors

ESMA Update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive (ESMA Guidance)	
Para 38-50	Profit forecasts or estimates
ESMA Questions and Answers – Prospectuses (ESMA Q&A)	
Question 20	Supplement to prospectuses: profit forecast
Question 25	Profit forecasts or estimates
Question 102	Definition of profit forecasts

Regulatory obligation – standards of care required

The PD Regulation imposes standards on the content of information (including in relation to profit forecasts) included in investment circulars, and on the processes and procedures adopted by the directors in preparing such information including the following:

- the PD Regulation requires the directors to take reasonable care to ensure that the information contained in the investment circular is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import; and
- the ESMA Guidance requires that due care and diligence must be taken to ensure that profit forecasts or estimates are not misleading to investors.

3. SYNERGY AND STAND-ALONE COST SAVING STATEMENTS

3.1 UK

UK regulations do not require synergy and cost saving statements (Statements) to be made. They may, however, be made voluntarily by companies during the course of a transaction. If a company chooses to make a Statement, the relevant applicable UK regulation is set out below.

Code Requirements		**Listing Rule Requirements**	
Rule 28.3(a)	Any QFBS must be properly compiled and must be prepared with due care and consideration. The QFBS, and the assumptions on which it is based, are the responsibility of the relevant party to the offer and its directors.		
Rule 28.3(b)	A QFBS and the details included in accordance with Rule 28.6 (the additional disclosure requirements) must be: • understandable (it must not be so complex or include such extensive disclosures that it cannot be readily understood); and • reliable (it must be supported by a thorough analysis of the offeree company's and/or the offeror's business and must represent factual and not hypothetical strategies, plans and risk analysis).		
Rule 28.6	When a QFBS is included in any document or announcement published during an offer period (or in an announcement which commences an offer period), the document or announcement must include:	LR13.5.9A	Where a listed company includes details of estimated synergies or other quantified estimated financial benefits expected to arise from a transaction in a Class 1 circular, it must also include in the Class 1 circular:
Rule 28.6(a)	the bases of belief supporting the statement (identifying the principal assumptions and sources of information);	LR13.5.9A(1)	the basis for the belief that those synergies or financial benefits will arise;

Rule 28.6(b)	an analysis, explanation and quantification of the constituent elements sufficient to enable the context and relative importance of those elements to be understood;	LR13.5.9A(2)	an analysis and explanation of the constituent elements of the synergies or other quantified estimated financial benefits (including any costs) sufficient to enable the relative importance of those elements to be understood, including an indication of when they will be realised and whether they are expected to be recurring;
Rule 28.6(c)	a base figure where any comparison is made with historical financial performance or with historical cost bases and structures;	LR13.5.9A(3)	a base figure for any comparison drawn;
Rule 28.6(d)	details of any dis-benefits expected to arise;		
Rule 28.6(e)	in the case of a statement falling under paragraph (a) of the definition of a 'quantified financial benefits statement', a statement that the expected financial benefits will accrue as a direct result of the success of the offer and could not be achieved independently of the offer;	LR13.5.9A(4)	a statement that the synergies or other quantified estimated benefits are contingent on the class 1 transaction and could not be achieved independently; and
Rule 28.6(f)	an indication of when the financial benefits are expected to realised;		
Rule 28.6(g)	an indication of whether the expected financial benefits will be recurring, clearly identifying any non-recurring benefit(s); and		
Rule 28.6(h)	the recurring and non-recurring costs of realising the expected financial benefits.	LR13.5.9A(5)	a statement that the estimated synergies or other quantified estimated financial benefits reflect both the beneficial elements and relevant costs.

Rule 28.4(b)	The bases of belief included for a QFBS should provide useful information as to its reasonableness and reliability. They must: • be readily understandable; • be specific and precise; and • not relate to the general accuracy of the estimates underlying the QFBS.		
Rule 28.4(c)	There must be a clear distinction between bases of belief about factors which the directors (or the members of the company's management) can influence and those which they cannot influence.		
Rule 28.1(a)	The document in which the QFBS is first published must include: • a report from its reporting accountants stating that, in their opinion, the statement has been properly compiled on the basis stated; and • a report from its financial adviser(s) stating that in its (or their) opinion, the statement has been prepared with due care and consideration.		

Summary of other relevant regulatory guidance applicable to others but also of note to directors

Reporting accountants	Standards for Investment Reporting 1000 – investment reporting standards applicable to all engagements in connection with an investment circular (SIR 1000)
[Transactions – UKLA Technical Notes]	[UKLA / TN / 315.1 [Guidance consultation] Quantified Financial Benefits Statements - Reports on Quantified Financial Benefits Statements and Confirmatory Statements included in prospectuses

Other regulatory obligation including standards of care required

Capital markets regulation in the UK imposes standards on the content of information (including Statements) included in investment circulars, and on the processes and procedures adopted by the directors in preparing such information including:

- Rule 28.1 requires that in relation to a quantified financial benefits statement contained in a document subject to the Code except with the consent of the Panel if the offeree company or a securities exchange offeror publishes a quantified financial benefits statement, the document or announcement in which the statement is first published must include a report from its reporting accountant and its financial adviser(s).
- Rule 19.1 under the Code requires that each document, announcement or other information published, or statement made, during the course of an offer must be prepared with the highest standards of care and accuracy. The language used must clearly and concisely reflect the position being described and the information given must be adequately and fairly presented. These requirements apply whether the document, announcement or other information is published, or the statement is made, by the party concerned or by an adviser on its behalf.
- the LR require that an issuer must take reasonable care to ensure that any information it notifies to a Regulatory Information Services (RIS) or makes available through the FCA is not misleading, false or deceptive and does not omit anything likely to impact the import of the information (LR1.3.3).
- in addition, the LR and PR require that the declaration to be given by the directors in relation to all information contained in an investment circular states that, having taken all reasonable care, the information (including the Statement) is, to the best of their knowledge, in accordance with the facts, and contains no omission likely to affect its import.

Glossary

APM	Alternative Performance Measure
Code	the City Code on Takeovers and Mergers, published by the Panel on Takeovers and Mergers
Class 1 transaction	a transaction classified as such under the LR
ESMA	European Securities and Markets Authority
ESMA Guidance	ESMA Update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive
ESMA Q&A	ESMA Questions and Answers – Prospectuses
EU	European Union
FCA	Financial Conduct Authority
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Practice
IESBA	International Ethics Standards Board for Accountants
IPO	Initial Public Offering
KPI	Key Performance Indicator
LR	Listing Rules, published by the FCA
PD Regulation	the Prospectus Directive Regulation (No 2004/809/EC)
PFI	Prospective Financial Information
PR	Prospectus Rules, published by the FCA
UKLA	United Kingdom Listing Authority
2003 guidance	Prospective financial information, Guidance for directors, published by ICAEW in 2003
2017 consultation	Consultation paper on prospective financial information, published by ICAEW in 2017

5. Feedback on 2017 consultation

THE CASE FOR UPDATED GUIDANCE

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?

Most businesses face uncertainty and increased pace of change, and PFI is being used more and more in these circumstances. This theme featured strongly in the Working Group's pre-consultations. Developments in the regulatory regime and in the wider business forecasting and reporting environment, together with the increasing use of PFI, are factors that contributed to a case for updating the framework for its preparation.

The Working Group wanted to understand the range of circumstances in which forward-looking financial information is prepared, as well as any other developments with the potential to affect preparation and use.

One respondent thought that, apart from the legal and regulatory changes relating to capital markets, the developments outlined in the consultation paper did not impact the applicability or relevance (or otherwise) of the 2003 guidance.

Other respondents listed the following developments in capital markets regulation as significant for the purpose of updated guidance in that area:

- the new Prospectus Regulations and associated guidance of the European Securities and Markets Authority (ESMA);
- ESMA policy including the proposal to remove the requirement for an accountant's report on profit forecasts in prospectuses and consistency in practice across Member States;
- revisions to the UK's Listing Rules and City Code which require directors in certain circumstances to make statements akin to those provided by reporting accountants in relation to 'proper compilation' and 'consistency with accounting policies'; and
- the International Accounting Standards Board's (IASB's) proposed conceptual framework.

One respondent suggested that certain market and emerging trends should help shape future guidance on the preparation of PFI. For example, more companies are applying for admission to public markets at an early stage, without the history of market reporting and sophistication of reporting systems of mature, existing listed businesses. The same respondent noted that, increasingly, directors are providing market guidance eg, synergy benefits and quantified financial benefits statements (QFBS). Finally, as a function of more international M&A activity, more overseas companies are having to reassess previously published PFI in the context of UK regulatory requirements. It needs to be explicitly recognised that companies report PFI in differing formats and for varying purposes and among the consequences of this are the differences in the relative levels of confidence applied in future forecasting.

The matters below were flagged during discussions in the consultation period with market participants, including regulators:

- The extent of volatility today means that communications on outlook 'quickly become out of line'. However, the tone of language used should mirror management's risk appetite.
- Transmission of information and the impact of ease of access and speed on what information is produced.
- Implications of xbrl[1] and, more generally, continuous financial reporting for corporate reporting and communications.
- The wider environment displays higher 'standards' in regulation, reporting, board rigour, advisers' involvement and risk management. Audit committees and auditors are also having to disclose more about what they have done due to a greater recognition of what investors want and links between strategy, performance, drivers and risk.
- Changes in business' approaches are resulting in a more demanding PFI process, including deeper and wider discipline in preparing PFI, closer CEO involvement with management and greater accountability.
- Businesses are increasingly using PFI to run the business, even if they are not publishing it, and not solely for a financing exercise.
- The behavioural consequences of projections should be recognised.

WORKING GROUP'S RESPONSE

Accountability and governance

The Working Group focused on the range of respondents' observations, including those that pointed to high expectations of accountability for PFI – for example, the ease and speed of access for information, continuous volatility, increasing use of PFI and its use in more situations.

This is aligned to ICAEW's position that PFI should meet high standards of preparation. Accountants have an important role and the professional behaviours they bring enhance accountability in the PFI process. ICAEW members perform their work in accordance with ICAEW's Code of Ethics (the Code of Ethics), which is aligned with the International Ethics Standards Board for Accountants' (IESBA's) Code, and the Working Group has reflected this in Part I of the Exposure Draft.

Specifically, the Code of Ethics provides that a professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:

a) contains a materially false or misleading statement;

b) contains statements or information furnished recklessly; or

c) omits or obscures information required to be included where such omission or obscurity would be misleading.

The Code of Ethics requires that when a professional accountant becomes aware that the accountant has been associated with such information, the accountant shall take steps to be disassociated from that information[2].

The standards of care imposed on preparers of published PFI by regulation or market practice, including the expectations that PFI is not misleading and is fair, balanced and understandable, have also been incorporated into the Exposure Draft.

Scope of the Exposure Draft

The Working Group noted the views of respondents that the updated guidance should address the myriad of situations in which PFI is prepared, and the differing circumstances of businesses – for example, more companies are applying for admission to public markets

[1] eXtensible Business Reporting Language

[2] Code of Ethics, paragraph 110.2

at an early stage, without the history of market reporting and sophistication of reporting systems of mature, existing listed businesses. The updated framework and guidance address this through a modular approach and provides for proportionate application, where appropriate.

The Working Group also noted the view of respondents that the guidance should cover PFI that underpins or supports company notifications or communications, such as trading updates. In its view, even though not published, such PFI should be prepared in accordance with the principles in the Exposure Draft. In Part IV, the guidance comments on the preparation of PFI supporting the notification to the market of information about, or changes in, expectations in relation to its future performance (eg, notifications commonly known as profit warnings).

The Working Group recognises that use of the ICAEW technical guidance may not be restricted to UK-based accountants, directors or businesses. Notwithstanding that regulatory requirements such as those relating to capital markets differ, the Exposure Draft makes clear the standards of care and accountability that are expected to be applied to all PFI. The application notes covering various types of PFI in a capital markets transactions context also provide general guidance relevant to the topic area such that their use is not restricted to the UK. Moreover, the application notes include guidance on how to demonstrate that the PFI has been properly compiled.

Regulatory changes

To address concerns raised by respondents that the 2003 guidance was out-dated due to legal and regulatory changes relating to capital markets, the Working Group has structured the Exposure Draft in modular form, whereby the application guidance can be revised without impacting on the framework or the general principles. To facilitate this further, application note references to detailed regulation are principally included in an Annex to the Exposure Draft.

A new Prospectus Regulation came into force in July 2017 and ESMA's related technical advice removes the requirement for profit forecasts in prospectuses to be reported on. Subject to EC endorsement, that technical advice will be adopted by 21 January 2019. The Working Group does not consider that guidance for the preparation of profit forecasts is affected by that change.

In March 2018, the IASB published *Conceptual Framework for Financial Reporting 2018*, including modifications to the attributes of useful information that influenced the 2003 guidance. Although the IASB replaced the attribute of 'reliable' with that of 'faithful representation', given that respondents to the 2017 consultation thought that the attributes in the 2003 guidance continue to be appropriate and fit for purpose, the Working Group has not proposed changes to bring them in line with the IASB's 2018 framework.

Other developments

As part of this consultation, in question 3, the Working Group also invites details of any impending developments.

EXPERIENCE OF APPLYING THE 2003 GUIDANCE

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?

The 2003 guidance provided a unified approach to producing high-quality PFI that complied with the circumstances in which UK regulators required companies to publish PFI in connection with capital markets transactions. The 2003 guidance was intended to assist directors in meeting the information needs of investors and regulators, and help to give users confidence in the quality of PFI.

The Working Group sought to establish the extent to which the 2003 guidance has served its intended purpose from the perspective of preparers, users and those reporting on PFI.

One respondent stated that they were not aware of systemic failures in the preparation of PFI since the publication of the 2003 guidance, suggesting that wholesale revision of the methodology was neither justified nor required.

Some comments referred to the extent of understanding of the 2003 guidance within the UK market. There was some regulatory support for explanation of the respective roles of reporting accountants and other advisers in the context of PFI for regulated capital markets transactions. One respondent pointed to a lack of awareness [among issuers and applicants for IPO] about the context of PFI and of the rigour and assurance that are expected to underpin PFI statements. The same respondent considered that providing guidance to issuers on the meaning of 'properly compiled', could enhance their understanding both of market expectations and the process by which the reporting accountant forms an opinion on PFI. More comments on what might be covered in an 'introduction' to PFI were given in the responses to Q3.

One respondent observed that it is not common practice in the UK to publish PFI voluntarily and attributed this to 'the fact that in the UK market, the consequences of a company not achieving against its published PFI can be significant, as the market participants do not view published PFI as a target or an aspiration in the way that it may be viewed in other countries'.

Another respondent disagreed with the suggestion that the PFI principles might be useful when preparing published non-financial, quantitative information. The respondent considered that non-financial information was outside ICAEW's remit.

Two respondents made additional observations in relation to the PFI principles. Responding to feedback that the term 'reliable' might be replaced by one that would better convey that PFI is 'a best estimate in the circumstances', one of the respondents felt that the risk of misunderstanding the nature of PFI could be addressed with an appropriate caveat, such as those used when introducing pro forma financial information. The other respondent felt that the 'understandable' attribute was not adequately explained in the 2003 guidance in contrast to the focus given to the clarity of disclosure. For example, there was no guidance to users on how to interpret a forecast range and individual points on it.

That the 2003 guidance is rarely referenced in practice is in large part due to the fact that the legal and regulatory references have not been updated. In the opinion of one respondent, explicit regulatory 'buy-in' would increase adoption of the guidance. This comment was made by another respondent who, in response to Q3, suggested that regulatory and market support would ensure that the guidance is also adopted by directors who are not members of ICAEW.

One respondent commented that the 2003 guidance and the concept of 'very little risk' was particularly appropriate for preparing PFI to be published in connection with a UK capital markets transaction, but that the need for investor protection so afforded was less acute in private financing situations.

Matters that merited improved guidance also came out of discussions during the consultation period. Many of these centred on risk and how transparency helps manage risk. Specifically, it was felt that the usefulness of the rigour in the forecasting process should be reinforced, but that such rigour could be diluted if risk analysis and forecasting are not connected. There was also a call for the consideration of the legal risks of providing PFI.

An area where guidance could help improvements was stress testing, including management actions when stress testing indicates the existence of a potential problem.

WORKING GROUP'S RESPONSE

The Working Group incorporated the following insights or suggestions from respondents in the guidance set out in the Exposure Draft:

- Part I reinforces ICAEW's position that rigorous preparation standards support a high level of confidence in PFI.
- The principles and attributes in the 2003 guidance have been retained, with some additional explanation.
- In Part I the explanation of 'understandable' has been expanded and is linked to interaction with the PFI user where applicable.
- Risk analysis is incorporated in the preparation procedures in Part II and in the application notes.
- Part V refers to the need for directors to consider the risks associated with publishing PFI.
- In Parts III, IV and V the concepts of 'very little risk' and 'properly compiled' are expanded upon within the commentary on directors' accountability.
- In Parts II, III, IV and V, the guidance on sensitivity analysis includes consideration of mitigations and management actions if risks or opportunities crystallise.

The Working Group did not perceive the purpose of preparation of PFI guidance to explain the respective roles of reporting accountants and other advisers in the context of PFI for regulated capital markets transactions. The Exposure Draft does, however, make reference to such roles and how regulatory requirements for such parties to provide public reports on PFI influence the rigour and standards of care expected in the preparation of published PFI.

The Working Group did not consider that it was for ICAEW to define and provide guidance to issuers on the term 'properly complied' that is used in some capital markets regulation. The general guidance in Part II and the application notes in Parts III to V do, however, set out the practical steps and considerations that are typically required to prepare useful PFI that has the required attributes, satisfies the preparation principles, and helps to demonstrate that PFI has been properly compiled

The Working Group accepted the view that non-financial, quantitative information is not in the scope of the guidance.

The Working Group did not see the need for a caveat to manage the risk of misunderstanding the nature of PFI as this is addressed by the principle of reasonable disclosure. Notwithstanding this, Part I includes commentary on the inherent uncertainty of future events.

The Working Group also considered that guidance on interpreting a range or point on a range was unnecessary as, through the attribute of 'understandability', the preparer is steered to see things through the eyes of the user when applying the guidance. It is also the case that the purpose of the guidance is to assist preparers of PFI, not to guide users on how to interpret a forecast range and individual points on it.

The Working Group did not see that it was for ICAEW to articulate the legal risks of providing PFI. The Exposure Draft states that the guidance is not a substitute for appropriate professional advice tailored to the circumstances.

THE PURPOSE AND STRUCTURE OF AN UPDATED FRAMEWORK

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?

The updated framework will serve to assist preparers of PFI in meeting the information needs of users and to facilitate the development of high-quality PFI.

The future is inherently uncertain and PFI is only a best estimate in the circumstances. The updated framework will help directors understand what they need to consider with regards to the preparation of PFI. It will set out attributes that PFI should have and principles of preparation, and processes that directors should have in place in order to produce high-quality PFI.

The Working Group wanted to establish an appropriate structure for an updated framework for preparers of PFI to follow.

All respondents agreed that the structure of the new framework should include general principles and guidance notes on applying the principles as well as application covering specific types of PFI. It will be important for the structure to allow for appropriate flexibility within general parameters so that it can readily be applied in different situations.

One respondent stated that an introductory section was needed to set out the objective of PFI in the context of regulation, audience and purpose. This section could cover the nature of PFI (what it is and is not) and the level of assurance/confidence in PFI. The respondent felt that it would also be useful to explain the differences in process and level of evidence required to support a statement that is presented as a forecast, as opposed to an estimate, a target or an illustration. In its response to Q6 (see page 100), the same respondent said that the introduction could be similar to introductions for pro forma financial information, albeit more tailored to specific circumstances.

One respondent felt that each application note should be clear on the situation to which it applies or scenarios for which PFI may be published. Another said that application notes should comprise generic guidance for the type of PFI being produced.

Two respondents felt that there was little need for regulatory rules and references, and application notes should move away from a focus on regulations, and instead give guidance on issues relevant to the type of PFI being produced. However, another respondent felt that it would be appropriate to include rule references so as to allow application notes to specifically address the relevant requirements.

WORKING GROUP'S RESPONSE

The modular structure of the Exposure Draft is broadly as proposed and enables application in different situations and flexibility.

Part I of the Exposure Draft defines PFI and describes the attributes of useful PFI and the principles for preparing PFI in which a high degree of confidence can be placed.

The general preparation procedures in Part II are applicable to all types of PFI and can be applied in all situations, and the degree of application of these generic procedures will be determined by the type of PFI being prepared and its purpose.

Some types of PFI require specific, additional considerations and procedures to be incorporated in the preparation process, for example to meet regulatory requirements or accepted market practice. Additional guidance and preparation procedures are included in Parts III to V for the preparation of certain types of PFI in connection with capital markets transactions. The Exposure Draft also references the principal regulatory requirements in an Annex.

All procedures, general and additional, are linked to attributes of useful PFI and the preparation principles. The modular structure of the Exposure Draft allows for application notes to be added, revised or removed in the future, should the need arise.

PRINCIPLES UNDERPINNING UPDATED GUIDANCE

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?

A principles-based approach can be readily applied in different situations while maintaining common standards. The principles and attributes in the 2003 guidance are embedded across relevant rules and consistent with regulation relating to capital markets transactions.

Based on some of the developments identified when exploring the case for updated guidance, the Working Group felt that two additional attributes would result in PFI that more explicitly meets user needs. PFI that is 'aligned' would promote integrated and cohesive management thinking, while PFI that is 'not misleading' will increase confidence that PFI is a best estimate in the circumstances.

The Working Group was aware that the 2003 principles and attributes are, however, well-established in a regulated capital markets transaction context. It also recognised that extending the definition of PFI would require a framework to be universally useful, with principles that 'work' for all PFI.

The description of feedback to this question includes written responses and matters raised in discussions with market participants in the consultation period.

Respondents were content that, in the context of developments, the four attributes of useful PFI remained appropriate and should be retained.

There was mixed reaction to the proposed additional attributes. Some commentators felt that they were inherent in existing attributes – for example 'aligned' was part of comparable while reliable captured 'not misleading'.

The investment community and from non-executive directors gave positive feedback about the 'aligned' attribute as it specifically addressed their expectations that business reporting and communications should be cohesive. Two professional services firms were supportive, provided the definition was improved. One stressed that while the business's expectations underlying PFI should not contradict the core business strategy, it is typical for PFI to contain adjustments to ensure it meets the 'very little risk' requirement. This respondent also felt that thought would also need to be given as to how the attribute might apply to less established businesses.

One respondent did not see that 'aligned' was a separate attribute and felt that application of the preparation principles would ensure the production of aligned information. Two respondents felt specifically that if PFI is reliable, having been based on proper business analysis, it will be aligned. Indeed paragraph 2.35 of the 2003 guidance requires the analysis to be consistent with planned courses of action published elsewhere by the entity. Another respondent was not clear what 'aligned' would add to the existing attributes of reliable and comparable.

The 'not misleading' attribute was supported by regulators for reasons including that it 'reinforced the element of accountability', 'adds to confidence' and 'helps maintain efficient functioning of the market and avoid false markets'.

The majority of respondents saw value in the 'not misleading' concept as an overriding safeguard, although not as an additional attribute. One felt it should include reference to adjusted measures within PFI and how they should not be more prominent than GAAP measures. 'Not misleading' as a concept was also consistent with the 'fair, balanced and understandable' requirement in the UK Corporate Governance Code, and with the ESMA guidance for Alternative Performance Measures (APMs) on not 'cherry picking'.

Two respondents objected to the proposed 'not misleading' attribute on the basis that if prepared in compliance with the existing attributes and preparation principles, PFI will not be misleading.

Another respondent pointed out that paragraph 4.6 of the 2003 guidance considers when PFI might be misleading and indicates that such 'misleading PFI' would represent a breach of one or more of the existing principles/attributes. That respondent suggested that instead of introducing the 'not misleading' attribute, consideration could be given to addressing the concept as an overriding principle – ideally, within an introductory section on PFI. Specifically, unless stated otherwise, PFI (excluding QFBS) should represent management's 'best estimate of the outcome (or range of outcomes) taking account of their knowledge of the strategies and plans of the business and all known external factors'. That respondent identified as useful to include in the new guidance some wording for management representations within Standard for Investment Reporting SIR3000, published by the Financial Reporting Council and a rebuttable presumption that the accurate generation of PFI will require supporting unpublished internally consistent financial forecasts, including balance sheets and cash flows as well as income statements.

In one discussion it was observed that if the proposed new IASB concepts were not adopted, there would be a 'mismatch' between financial reporting and PFI.

Most respondents were also content that the principles of preparation remain appropriate and necessary.

However, one respondent felt that the distinction between attributes and principles was unnecessarily confusing and should be omitted, leaving just attributes with a clear explanation of what they are. Another also questioned whether 'doubling up' of attributes being expressed in other terms aided clarity. One respondent felt that coupling attributes with principles can raise questions about whether the terms are equivalent, whether one is a subset of the other, or whether they are separate and additional. That respondent was of the view that the principle of subsequent validation is conceptually flawed – while a preparer can reasonably ensure that PFI is consistent with historical financial information, it is not possible for a preparer to be satisfied that the PFI is consistent with financial information that does not yet exist and will be prepared and published in the future.

WORKING GROUP'S RESPONSE

The Working Group agreed with the majority view that 'not misleading' is a valuable overriding safeguard that is consistent with, or in the spirit of, other corporate and financial reporting regulations. For professional accountants involved in the preparation and publication of PFI, the fundamental principle of integrity encompassed in ICAEW's Code of Ethics clearly sets out the expectation that information should not be misleading. The Working Group was persuaded that there is no need for an additional attribute. However, it considered that it would be helpful to link the requirements of the Code of Ethics to preparers' accountability for PFI in the introduction to the PFI framework in Part I of the Exposure Draft.

The Working Group also agreed with the majority of respondents that an additional attribute of 'aligned' was not required as the application of the preparation principles, particularly the business analysis principle (and the expectation that business reporting and communications are cohesive) would ensure the preparation of aligned information.

Respondents had drawn attention to the 'fair, balanced and understandable' concept and the Working Group has included this as an overriding safeguard in the Exposure Draft.

The Working Group concurred with the view of respondents that the existing four attributes of useful PFI remained appropriate. However, as a result of its work in developing the general preparation guidance in Part II, and ensuring that such principles are universally applicable, the Working Group considered that the 'relevant' attribute should be expressly linked to users' needs and to a preparation principle of relevance through having timely influence and predictive or confirmatory value. This is important as, while regulation permits less discretion when considering the relevance of PFI in a capital markets transaction context, an expanded explanation in the form of a new principle is expected to be helpful where the preparer has fewer parameters for deciding what information satisfies users' needs.

In response to feedback, the 'understandable' attribute has been more clearly linked to what the user requires, particularly for unpublished external PFI where the user may be in a position to provide instructions or articulate its requirements. The disclosure required to achieve understandability depends on the extent of interaction between the business and a potential funder or investor.

PROPOSED SUBJECT MATTER OF UPDATED PRINCIPLES

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?

The 2003 guidance applies to PFI prepared for an external purpose, principally in a capital markets transaction context. The updated framework will continue to address such PFI, which has to comply with applicable law and regulation. The Working Group considers that an updated framework has a wider role to play as an enabler for all businesses to prepare (and communicate) PFI.

In particular, an updated framework with common principles for preparing PFI that meets the needs of and inspires the confidence of users would also benefit those preparing PFI to support private finance-raising. Application of the principles would be voluntary and in proportion to the situation.

The Working Group recognises that custom and practice as well as the individual requirements of potential funders typically determine what PFI is prepared for private finance-raising. Application of the framework will not conflict with such practices.

Most respondents supported the proposal to extend the scope of the framework to PFI that is prepared for private finance-raising situations. Some investors thought that application of a framework would be a good way for a business to start its fundraising journey. One respondent pointed out that the 2003 guidance remains available to the private financing arena on a voluntary basis.

One respondent felt that, although the attributes may be helpful to preparers in the context of private finance-raising, the focus of new guidance should be on PFI where users cannot request further information (which is principally that required by regulation).

Another respondent specified that PFI that is not prepared for external purposes, such as budgets and projections, should not be subject to the framework. The definition of PFI that is within scope will be important.

Respondents who supported the proposal considered the important differences with PFI prepared in connection with a capital markets transaction. They identified the following matters to help shape appropriate application guidance:

- Guidance and its communication must be accessible to businesses that might otherwise be put off by a capital markets-related framework.
- Additional guidance is likely to be needed on the 'understandable' attribute and the principle of reasonable disclosure, and the connection with the extent of interaction between prospective investors/funders with the business.
- Guidance should be light touch, proportionate and with core parameters.
- Guidance should be capable of coexisting with established custom and good practice,

including investors' procedures and criteria (in-house or commissioned from third parties).

- There should be focus on practical ways of turning the PFI framework into situation-specific guidance.
- Guidance may be necessary to help a business to show the extent to which it has achieved (or not) past PFI.

One respondent was of the view that achieving regulatory support for the guidance will be important, especially in cases where there is less scrutiny of information by parties that understand it.

WORKING GROUP'S RESPONSE

The Exposure Draft can be applied to all PFI – both that prepared solely for the internal use of an organisation (internal PFI) as well as PFI prepared in the expectation that the organisation will make it available to external parties for their use (external PFI). External PFI covers both published external PFI (typically that published in the context of the regulatory requirements of an applicable capital market) and unpublished external PFI (typically that which, while private and confidential in nature, is made available to certain external parties for their use eg, in connection with the private raising of debt or equity, or in connection with the private sale of a business). While the focus of the guidance is on achieving the quality expected of external PFI, preparers may wish to consider the extent to which the principles could helpfully influence the preparation of internal PFI.

Forward-looking financial information which is aspirational in nature is not included within the scope of PFI covered by the Exposure Draft. This is because a reasonable user of clearly identified aspirational forward-looking information will understand its nature and consequently will not place a high degree of confidence in it. Terms such as goal, target, estimate and illustration are commonly used to identify forward-looking financial information which is directional and aspirational in nature.

Guidance that is relevant to all PFI is included in the introduction in Part I and in the general preparation procedures in Part II. Parts III to V include additional application guidance for certain types of PFI prepared in connection with capital markets transactions.

When developing the guidance, the Working Group took into account the above matters identified by respondents. Specifically, commentary is included in Part I to provide guidance on the 'understandable' attribute, the principle of reasonable disclosure and the connection with the extent of interaction between the user of PFI and the business. In addition, the general preparation procedures in Part II are illustrative and the preparer of PFI will determine those that are relevant and are capable of co-existing with any established custom and practices or user requirements.

ICAEW is continuing engagement with regulators, business organisations and other bodies to secure their support for bringing the guidance in an appropriate way to the attention of businesses. ICAEW will use its communications channels to make its wider membership aware of such guidance.

APPLICATION IN CAPITAL MARKETS TRANSACTION CONTEXT

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?

In the context of PFI prepared for regulated capital markets transactions, there is a need for updated application guidance that assists preparers to meet regulatory requirements and the needs of investors and other users of the PFI.

The types of PFI that continue to be subject to regulation will be addressed by way of high-level application guidance reflecting the unified regulatory approach.

There was support for having applications notes for PFI in the context of capital markets transactions and for the focus of such notes to be on topics rather than specific regulatory requirements.

Three respondents commented on the inclusion of 'changes in expectations of performance' in the proposed topics for application notes. One was unclear about what this meant, while another pointed out that the 2003 guidance, largely derived from regulatory guidance on the identification of price sensitive information and to the form of announcement, did not relate to the preparation of PFI. The respondent considered that it was for the regulator rather than for ICAEW to provide guidance on notification. The third respondent asked how potential guidance would relate to rules on inside information.

Regarding the nature/depth of such application notes, one respondent considered that general application principles would be sufficient. Other respondents, however, gave examples of where a steer or commentary on individual regulatory approaches would be helpful; such as:

- the fact that the City Code does not require comparability to apply to a quantified financial benefits statement;
- how to interpret the reference by ESMA to 'reasonable worst case scenario' in the context of working capital statement sensitivity analysis; and
- where a specific market has its own requirements.

Some felt that there could be a case for including 'how to' guidance (for some PFI) that considers any overlapping requirements.

Another respondent suggested that application notes should provide guidance relevant to the circumstances of a transaction. By way of example, they contrasted the level of working capital analysis needed for a debt-free investment entity undertaking a fundraising without any committed capital expenditure, with a profit forecast to be published by an embattled listed trading company ahead of its most important trading period.

The same respondent said, in their response to Q8 of the 2017 consultation, that ICAEW should first focus on publishing the updated principles, guidance and application notes for the more common areas of published PFI, and then consider new application notes as the need arises. The respondent highlighted a specific need for guidance for directors on the preparation of forward-looking information in corporate and annual financial reporting.

WORKING GROUP'S RESPONSE

The Exposure Draft includes individual application notes for specific PFI in the context of capital market transactions – statements of sufficiency of working capital, profit forecasts and synergy and stand-alone cost saving statements. As proposed, the application notes focus on the topic and provide commentary on 'how to' rather than on the detailed regulatory requirements. However, commentary has also been included on certain individual regulatory approaches or the applicability (or otherwise) of PFI attributes and detailed regulatory requirements have also been included in an Annex.

As suggested by respondents, Part II addresses the ESMA reference to 'reasonable worst case scenario' when subjecting a working capital statement to sensitivity analysis.

As explained in the response to Q1, the Working Group considers that the guidance in Part IV on profit forecasts in a capital markets transaction is applicable in other circumstances, such as where a listed company gives profit guidance to public investors in a less prescribed form (eg, notifications known as trading updates or profit warnings), and where profit guidance or forecasts are prepared for users other than public investors. It is envisaged that this would cover companies with a premium listing in the UK or that are admitted to trading on AIM or NEX Exchange Growth Market, that must have procedures that help inform directors on a regular basis as to the financial position and prospects of the company and any changes to these (ie, trading updates published to inform the market about a company's expectations of its future performance, or changes to those).

The Working Group agrees that identification of when such notifications should be made and the format they take is not within the remit of ICAEW; accordingly Part IV does not address this. However, when a company has decided to make a notification, the preparation procedures in Part IV are applicable to any PFI underpinning or supporting or referred to in the notification.

The guidance focuses on the preparation of PFI – it does not tell issuers what PFI to disclose nor when. The Working Group has, therefore, not addressed how the guidance relates to rules on inside information. This is principally a matter for a listed entity and its legal and professional advisers. The Exposure Draft makes clear that professional advice tailored to the specific circumstances should always be sought.

The Exposure Draft does not include an application note covering the preparation of PFI that supports corporate and annual financial reporting. In a separate step to finalising the Exposure Draft, ICAEW will continue consulting on the value of having preparation principles in these areas.

APPLICATION IN PRIVATE FINANCE-RAISING SITUATIONS

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?

The Working Group proposes to extend the scope of the framework to capture all PFI. This includes PFI prepared for, and made available to, third party investors or finance providers outside the public capital markets arena.

If the framework is to apply, the preparation principles will also need to work for such PFI, and enable the specific requirements that private finance providers have of PFI to be met. Application must also be capable of reflecting the dialogue that is typically possible between a business and the provider of private finance. The latter often has an opportunity to input into the planning of the PFI preparation and to seek explanations and more detail from PFI providers.

Comments received concentrated on guidance for proportionate application. There was a feeling that it should address generic private financing situations and clearly define parameters for PFI in such scenarios.

On application notes for specific types of private finance-raising, there was support among representatives of finance providers. While one respondent said that methodologies and practice are already established in the private financing arena, another specified that application notes could address issues such as the links from historical information to management information to forecasts, constructing 'what if' scenarios, standard definitions and formats.

In relation to proportionate application, one respondent said it was important that a proportionate approach does not simply equate to less work being undertaken than was possible. Another respondent posed the question of whether PFI published on certain crowdfunding platforms should be considered akin to published PFI in the context of capital market transactions, in which case full application of the PFI framework would be relevant.

Suggestions for proportionality considerations included:

- the interactions between potential investors/funders and the business;
- the extent of due diligence;

- the time horizons of the PFI; and
- the nature of the business, its sector and stage of maturity.

To encourage adoption of the PFI principles in private financing situations, there was support for continuing engagement with the parties relevant to private finance (UK Finance, the British Private Equity and Venture Capital Association and the UK Crowdfunding Association) before developing proposed guidance. One respondent mentioned that a 'comply or explain' approach could be appropriate.

WORKING GROUP'S RESPONSE

As explained in the response to Q2 and Q3, Part I of the Exposure Draft describes the attributes of useful PFI and the principles for preparing PFI with such attributes. Part II sets out general preparation procedures that are applicable to all PFI, including that prepared in connection with generic private finance-raising. General procedures cover, *inter alia*, linkages between historical information and PFI, and sensitivity analysis. Application of the guidance, whether in full or on a proportionate basis, can be tailored according to the business, the type of PFI being prepared and the context. The Working Group did not therefore consider that it was necessary to prepare an additional application note for PFI prepared in connection with generic private finance raising. The guidance will not prevent preparation of PFI that meets specific user requirements.

During the consultation period the Working Group brought its proposal for general guidance to the attention of the FCA's crowdfunding policy team as well as to representatives of providers of private finance.

In question 1 of this consultation paper, ICAEW invites invites views on whether the general guidance will be capable of application by a wider business audience. In addition to taking account of that feedback, ICAEW will seek views from organisations who represent segments of that wider audience, such as providers of private finance.

POTENTIAL BROADER APPLICATION

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?

There has been an increasing trend for corporate and financial reporting requirements that rely on or are underpinned by PFI. PFI is also prepared for external purposes for reasons other than raising finance.

Users of such PFI may reasonably expect it to be aligned with other information used by the business and consistent with the preparer's knowledge of the business.

The proposal to explore extending the new framework to a wider range of PFI was well received by regulators. However, one respondent was unconvinced of the possible value and felt that, while possibly helpful to entities less familiar with the preparation of PFI, the existing significant level of practical execution in the areas identified would render the extension ineffective and unnecessary.

Another respondent saw merit in encouraging preparers of PFI to consider whether they will apply the PFI framework in doing so and, if so, whether they would make an explicit statement regarding compliance. The respondent thought that standard setters could be encouraged to consider whether compliance with the PFI framework should be mandated or referred to in the relevant standard or regulation. The respondent did not believe that ICAEW should extend the framework to specifically cover a wider range of PFI, as there are regular changes to the requirements of such wider reporting and PFI is either ancillary to such reporting (in which case specific guidance would not be appropriate) or potentially integral to it (when it would be better for the requirements to be set out in the specific standard or regulation). Another respondent questioned the appropriateness of self-declaration that information has been prepared in accordance with the framework.

Other respondents gave qualified support to the proposal and agreed that working groups with relevant expertise should be involved. Some saw potential value for the internal process involved in preparing information. One felt that the guidance would be helpful in those situations where users of PFI are not able to seek further information but would need careful explanation of the application of the understandability attribute, including the impact of context. By way of example, the respondent contrasted a profit warning issued by a listed company, often part of the ongoing communication of a company with the investment community, with a profit forecast in a prospectus or offer document that can be viewed as an event in its own right and often contains additional information, not only to meet regulatory requirements but also to ensure the PFI is understandable when viewed in isolation.

One respondent suggested that PFI used as a basis for warranties could benefit from the framework. Another pointed to disclosures for goodwill and the IASB's proposals which include indirect use of PFI.

One respondent suggested that the differences in methodology adopted, which depended on both the maturity of the company and the information being prepared, meant that application notes would be of fundamental importance in ensuring that directors undertake an appropriate approach dependent on the circumstances.

Another respondent highlighted likely challenges involved in trying to develop principles that could usefully be applied outside the context of capital markets regulation. That respondent said that the principles would need to be quite broad to encompass the range of forward-looking information and the contexts in which it is prepared and used, but at the same time very narrow and specific to help deliver concrete and usable guidance.

WORKING GROUP'S RESPONSE

Parts I and II of the Exposure Draft are applicable to all PFI within the scope of guidance. Specific application notes in the Exposure Drafted have been limited to those relevant to specific types of PFI prepared in capital markets transactions.

Having published general procedures and specific application guidance for capital markets in the Exposure Draft, ICAEW hopes to stimulate views on the value of the framework or specific application guidance to the above types of PFI and to engage with relevant stakeholders. The insights from the feedback summarised above will be incorporated into these discussions. This engagement is likely to be after the guidance in the Exposure Draft has been published.

Appendix I: Working Group members

We would like to thank the Working Group whose members are:

Robert Hodgkinson (chair)	ICAEW
Christopher Ersser	PwC
Moyra Grant	KPMG
Andrew Green	RSM
Katerina Joannou	ICAEW
Simon Parr	Grant Thornton
Charles Romaine	Romaine Corporate Services
Michelle Thomson	EY
Toby Tinniswood	Deloitte

Appendix II: Glossary

APM	Alternative Performance Measure
Code	the City Code on Takeovers and Mergers, published by the Panel on Takeovers and Mergers
Class 1 transaction	a transaction classified as such under the LR
ESMA	European Securities and Markets Authority
ESMA Guidance	ESMA Update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive
ESMA Q&A	ESMA Questions and Answers – Prospectuses
EU	European Union
FCA	Financial Conduct Authority
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Practice
IESBA	International Ethics Standards Board for Accountants
IPO	Initial Public Offering
KPI	Key Performance Indicator
LR	Listing Rules, published by the FCA
PD Regulation	the Prospectus Directive Regulation (No 2004/809/EC)
PFI	Prospective Financial Information
PR	Prospectus Rules, published by the FCA
UKLA	United Kingdom Listing Authority
2003 guidance	Prospective financial information, Guidance for directors, published by ICAEW in 2003
2017 consultation	Consultation paper on prospective financial information, published by ICAEW in 2017

Appendix III: Respondents to 2017 consultation paper

We are grateful to the following organisations that submitted responses to the 2017 consultation paper:

Deloitte

EY

Grant Thornton

KPMG

PwC

The responses may be viewed at www.icaew.com/pfi

In addition, the following provided valuable oral feedback:

Association for Financial Markets in Europe, ECM Committee

City of London Law Society Company Law Committee

Financial Conduct Authority

Financial Reporting Council

Jon Symonds, HSBC UK

UK British Angels Association

All feedback, written and oral, is incorporated in section 5.

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.

There are over 1.7m chartered accountants and students around the world – talented, ethical and committed professionals who use their expertise to ensure we have a successful and sustainable future.

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