

Prospective Financial Information

Guidance for UK directors

SEPTEMBER 2003



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Guidance for UK directors

Overview of principles

Scope of this Guidance

This Guidance applies to published PFI. For the purpose of this Guidance, PFI comprises primary financial statements and elements, extracts and summaries of such statements and financial disclosures drawn up to a date, or for a period, in the future. This definition of PFI is drawn widely and includes the forward-looking equivalent of any information that might subsequently be prepared as historical financial information. It is not limited to any specific reports or formats. Nor is PFI limited to information about profits even though such information is the focus of many regulatory requirements. *(Paragraph 1.11)*

Principles of useful PFI

Prospective financial information should be useful when considered in the context of cost-benefit and materiality judgements. In order to be useful, PFI should be:

- understandable;
- relevant;
- reliable; and
- comparable. *(Paragraph 2.1)*

Choices about the form and content of published PFI should, as with historical financial information, reflect judgements about how useful the PFI is to investors and about whether the benefit to investors exceeds the cost. *(Paragraph 2.11)*

Understandability and the reasonable disclosure principle

The degree of uncertainty associated with published PFI will largely determine the complexity of disclosure and hence the understandability of PFI. To be understandable, PFI should contain disclosure that is reasonable, and so PFI should not be presented in situations of such uncertainty that the disclosure becomes too complex or extensive to be understood or used by investors. PFI should be structured in such a way that users encounter more significant information first, including, where appropriate, information relating to the uncertainty attaching to the PFI. *(Paragraph 2.17)*

Reliability and the business analysis principle

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. *(Paragraph 2.29)*

Comparability and the subsequent validation principle

For PFI to be comparable, it should be capable of subsequent validation by comparison with outcomes in the form of historical financial information. *(Paragraph 2.42)*

Principles for the preparation of PFI

Published PFI is the responsibility of the board of directors. Directors should identify why the PFI is being prepared and how it is intended to be used, and hence assess the usefulness of proposed published PFI against the qualitative characteristics of understandability, relevance, reliability and comparability in the context of cost-benefit and materiality judgements. *(Paragraph 3.1)*

Directors should establish processes to apply the principles of reasonable disclosure, business analysis and subsequent validation to the preparation of published PFI. *(Paragraph 3.3)*

In relation to published PFI, directors should:

- plan, organise and communicate internally the process of preparing and issuing PFI;
- involve directors and other members of management with the necessary in-depth experience of the business and expertise across all its activities;
- clearly allocate and co-ordinate responsibilities;
- satisfy themselves that there are appropriate systems to generate the reports underpinning published PFI; and
- produce clear contemporaneous documentation to evidence key elements of the process. *(Paragraph 3.8)*

Prospective Financial Information

Guidance for UK directors

1. Introduction

A principle-based approach

- 1.1 This Guidance is designed to help directors meet the information needs of investors and regulators, and to promote the publication of high-quality prospective financial information (PFI). It is also expected to be of assistance to auditors and reporting accountants. However, this Guidance does not discuss how reporting accountants discharge their responsibilities when reporting on PFI. This is a matter that falls within the remit of the Auditing Practices Board.
- 1.2 This Guidance establishes a framework comprising three basic building blocks:
 - Part A sets out principles for PFI and processes that directors should have in place to produce it, derived from the International Accounting Standards Board's *Framework for the preparation and presentation of financial statements*; it is based on the fundamental premise that the qualities of useful information used to set financial reporting standards for historical financial statements are applicable to PFI;
 - Part B shows how EU and UK law and regulators reinforce these principles; and
 - Part C uses the principles identified in Parts A and B to develop guidance to help directors prepare specific types of PFI for publication, so as to support markets and investors in their decision making.
- 1.3 This Guidance is principle based. In practical terms, this means that it does not seek to provide standalone guidance on each type of PFI considered in Part C. To develop and apply guidance on the preparation of different types of PFI on a consistent basis it is necessary to understand the principles presented in Part A and the legal and regulatory requirements summarised in Part B and Appendix I. The first two parts of this Guidance are the essential building blocks on which the material in Part C is based.
- 1.4 The alignment of the law and regulations outlined in Part B with the principles set out in Part A is essential to the success of such principle-based guidance. The importance of such alignment can be seen in the related area of company financial statements where the concept of the 'true and fair view' enshrined in company law is consistent with the principle-based approach to financial reporting with its emphasis on understandability, relevance, reliability and comparability.
- 1.5 EU and UK law and regulators rightly emphasise the idea that information for investors, including PFI, should support investors' decision making. Unless investors are seen as ultimately responsible for their decisions, then liability avoidance rather than usefulness can become the driving force behind the provision of information to investors.
- 1.6 Part C sets out detailed guidance for directors to help them comply with regulatory requirements affecting a wide variety of published PFI. It is based on a common set of principles designed to help ensure that PFI meets the needs of users. This approach promotes consistency and transparency and helps directors and their advisers to respond appropriately to complex situations and new developments in business practice. It also prevents the regulatory overload that can occur where

detailed rules are developed to cope with all the eventualities that may arise in practice.

- 1.7 Part C deals first with voluntary PFI, such as that presented in the Operating and Financial Review (OFR). Next it covers the requirements of the UK Listing Authority (UKLA) as the regulator of the primary market in circumstances where there are equivalent requirements in other EU Member States. It then deals with the UK-specific UKLA requirement regarding changes in expectations and then in turn with the requirements of three UK bodies: the Panel on Takeovers and Mergers (Takeover Panel), AIM and OFEX.
- 1.8 This Guidance sets out basic principles, which are shown in bold type, together with explanatory and other material. The principles should be read in the context of the explanatory and other material that provide guidance for their application.
- 1.9 This Guidance does not purport to provide a comprehensive list of matters that directors need to consider in connection with their duties, responsibilities and potential liabilities. Each case will depend on the particular circumstances and judgement is always required. Nor should anything in this Guidance be seen as a substitute for advice tailored to specific circumstances. Consequently, following this Guidance may not be sufficient or necessary to ensure compliance with relevant legal and regulatory requirements or demonstrate due care and process.
- 1.10 Where preparers have had regard to this Guidance, it is recommended that a statement to that effect is included with the PFI.

Scope of this Guidance

- 1.11 **This Guidance applies to published PFI. For the purpose of this Guidance, PFI comprises primary financial statements and elements, extracts and summaries of such statements and financial disclosures drawn up to a date, or for a period, in the future. This definition of PFI is drawn widely and includes the forward-looking equivalent of any information that might subsequently be prepared as historical financial information. It is not limited to any specific reports or formats. Nor is PFI limited to information about profits even though such information is the focus of many regulatory requirements.**
- 1.12 PFI can be broadly categorised as serving two main purposes: internal and external. Internally, PFI such as budgets or capital expenditure appraisals assists directors and management to translate plans and aspirations into information that supports decision making, that can be readily understood by people within the business and that serves as a management tool against which subsequent results are measured. PFI also provides a means of explaining to people outside an entity the financial consequences of the entity's plans with a view to helping them make investment and other decisions.
- 1.13 The scope of this document is published rather than unpublished PFI. UK companies publish a wide range of PFI including profit warnings, working capital statements, estimates of funding requirements, profit forecasts, merger benefits statements, illustrative financial projections and announcements made under the general obligation of disclosure for companies under the Listing Rules. In addition, the OFR may contain a wide variety of PFI including predictions for individual items of financial information relating to sales, expenditure levels and profitability.
- 1.14 This Guidance is concerned with the external purpose of PFI. It does not seek to constrain the use of PFI by companies to meet internal management needs or the specific requests of third parties. Such unpublished information may also be used to underpin published PFI.
- 1.15 PFI represents only a part of the useful forward-looking information that companies can report. Forward-looking information on an entity's strategy and plans, the risks it

faces and non-financial performance measures does not constitute PFI but is important to investors. Nor should targets be judged against the principles of PFI set out in this Guidance (see paragraphs 6.7 and 6.8 below). This Guidance seeks to encourage the provision of PFI, but not at the expense of other forward-looking information. Because share values are driven by views about future events and cash flows, all forms of useful forward-looking information are vital to markets.

- 1.16 'Profit estimate' is a term used by UK regulators. A profit estimate is for a financial period which has expired but for which the results have not yet been published. This Guidance applies to profit estimates, even though a profit estimate is historical financial information rather than PFI as defined, because the principles set out in the Guidance are equally applicable.
- 1.17 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 principles in this Guidance should be applied to the whole period even when some or most of the financial information is historical.
- 1.18 Companies may 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 does not introduce new information about future performance. This Guidance therefore does not apply to it.

Prospective
Financial Information
Part A: Principles



2. Principles of useful PFI

- 2.1 Prospective financial information should be useful when considered in the context of cost-benefit and materiality judgements. In order to be useful, PFI should be:
- understandable;
 - relevant;
 - reliable; and
 - comparable.
- 2.2 The term 'useful' is used in the specialised sense of meeting the criteria for usefulness of general purpose information set out in the *Framework for the preparation and presentation of financial statements* (the Framework) issued by the International Accounting Standards Committee (IASC) in 1989 and subsequently adopted by the International Accounting Standards Board (IASB).
- 2.3 The Framework sets out the four principal qualitative characteristics, or attributes, that make the information included in financial statements useful to users: understandability, relevance, reliability and comparability. The usefulness of information is judged against these characteristics. In the context of prospective rather than historical financial information, the characteristics of understandability, reliability and comparability are interpreted and reinforced in this Guidance using the principles of reasonable disclosure, business analysis and subsequent validation respectively. These three principles are considered below.
- 2.4 The *Statement of principles for financial reporting* (SOP), published by the UK Accounting Standards Board in 1999, is based on the Framework. However, it is more detailed and deals with certain matters on which the Framework is silent. This Guidance also draws on ideas in the SOP. The IASC developed the Framework to support the development of financial reporting standards for full general purpose financial statements. This Guidance applies the same criteria for usefulness to general purpose PFI, including PFI that is not presented in full financial statements. The focus on prospective information and presentations other than full financial statements represents a deliberate extension of the application of the Framework and the SOP.
- 2.5 Usefulness is assessed primarily in the context of the decision-making needs of investors. Investors are used as a proxy for all users of external PFI, in line with the view put forward in the Framework that financial statements that meet the needs of investors will also meet most of the needs of other users that financial statements can satisfy.
- 2.6 The scope of this Guidance is published PFI. In line with paragraph 6 of the Scope section of the Framework, this constitutes general purpose rather than special purpose information. Special purpose PFI is prepared at the request of, and in the form specified by, users of that information who have the authority to make sure that it is useful in meeting their needs. Preparers of special purpose PFI interact directly with all users of that information. This interaction does not occur with general purpose PFI.

Relevance

- 2.7 Relevance does not lead to any PFI-specific principles in this Guidance, so it is considered here before the other principles of usefulness. PFI should be relevant and will only be relevant if it:
- has the ability to influence economic decisions of investors;
 - is provided in time to influence economic decisions of investors; and
 - has *predictive value* or, by helping to confirm or correct past evaluations or assessments, it has *confirmatory value*.

- 2.8 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. For example, disclosure of an uncertainty may affect the assessment of the risks and opportunities facing the entity irrespective of the financial impact of that uncertainty. The Framework defines an item of information as 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 nature of the item judged in the particular circumstances in which it is presented.
- 2.9 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 required in order for PFI to be understandable by users for decision-making purposes. It may also be necessary to disclose the sensitivities involved and alternative outcomes.
- 2.10 Materiality considerations would, for example, preclude the listing within PFI of standard risk factors without regard to whether they will influence the decisions made by users of that PFI. Information is relevant only in so far 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. 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.
- 2.11 Choices about the form and content of published PFI should, as with historical financial information, reflect judgements about how useful the PFI is to investors and about whether the benefit to investors exceeds the cost.**
- 2.12 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 will make it more relevant but may make it less reliable.
- 2.13 Consideration of costs and benefits also involves trade-offs. Potential adverse effects on an entity's performance of obtaining information and making it available to potential competitors as well as investors always involves costs. However, it is the overall impact on shareholder value that needs to be addressed. In particular, it is necessary to consider the benefits for the entity's cost of capital of providing PFI that generates greater understanding and confidence amongst investors.
- 2.14 PFI reflects future events which are inherently uncertain. The following factors are relevant when judging how useful PFI is to investors and considering whether the benefit to investors 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.
- 2.15 The length of period into the future to which PFI relates is only one, and not necessarily the most significant, factor affecting the confidence to be 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. On the other hand, PFI presented by a start-up or an established business entering a new field may be subject to a wide range of uncertainties.

- 2.16 Because PFI is inherently uncertain, directors who publish PFI make assumptions about events and circumstances that may occur in the future and possible actions that they will take. This has implications for published PFI.
- Published PFI should be accompanied by disclosure of the assumptions on which it is based. 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. This is discussed further below in the context of the reasonable disclosure principle.
 - PFI should be based on assumptions that are supportable in relation to expected economic conditions and intended courses of action. This is discussed further below in the context of the business analysis principle.

Understandability and the reasonable disclosure principle

- 2.17 **The degree of uncertainty associated with published PFI will largely determine the complexity of disclosure and hence the understandability of PFI. To be understandable, PFI should contain disclosure that is reasonable, and so PFI should not be presented in situations of such uncertainty that the disclosure becomes too complex or extensive to be understood or used by investors. PFI should be structured in such a way that users encounter more significant information first including, where appropriate, information relating to the uncertainty attaching to the PFI.**
- 2.18 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;
 - *alternative outcomes*, being the consequences of assumptions not being borne out.
- 2.19 For example, an increase in turnover next year might depend on obtaining regulatory approval for a new product. Disclosure should 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 product. In this example, the failure of an assumption to be fulfilled will have a simple consequence. However, in some cases, the issuer of the PFI may need to provide a sensitivity analysis to explain the consequences of failed assumptions in terms of alternative outcomes.
- 2.20 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 and labour and raw

material supplies may become too complex for the user to understand. Under the Framework, the user is assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study information with reasonable diligence. The user is not expected to be able to build a model to deal with multiple uncertainties. Users' abilities therefore place 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 captions or periods to be covered by PFI, or its precision.

- 2.21 One practical technique is to consider expressing financial outcomes or financial statement highlights 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 can reduce the uncertainty attaching to PFI and its sensitivity to deviations occurring in respect of individual assumptions. This in turn can have the positive effect of reducing the extent of disclosures that investors might otherwise find difficult to understand. For this reason, ranges, floors and ceilings are accepted and acceptable methods of presenting PFI. However, a range suggests a breadth of outcomes within the given limits: it would be misleading for directors 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 literally true, will be misleading because it is likely to be far below actual performance.
- 2.22 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 notes that supplement users' understanding of the high-level information. This view of how financial information is structured is consistent with the widely-held belief that incorrect accounting in primary statements cannot be rectified by note disclosure.
- 2.23 These ideas can be applied to PFI. Consider illustrative projections comprising a summarised five-year profit and loss account with supporting notes. If a value is presented for sales in five years' time, it is reasonable for a user to take this figure to be the most important piece of summary information about sales in that year because it aggregates and summarises all the more detailed information that is available. However, where that number has only been arrived at by making heroic assumptions, then reading the notes in which the relevant uncertainties, assumptions, determining factors and alternative outcomes are disclosed becomes essential and more important than the high-level number presented in the profit and loss account. In this case of sales in five years' time, the information hierarchy has been turned on its head. Such inversions need to be avoided in order to satisfy the principle that PFI should be structured in such a way that users encounter more significant information first including, where appropriate, information relating to the uncertainty attaching to the PFI.
- 2.24 For example, in the case described above, users might first be presented with information about the most important uncertainties affecting future sales and what the directors are planning to do to manage them. Any potential resulting sales numbers that might appear in future financial statements might be presented, if at all, as supplementary information.
- 2.25 In other instances, an uncertainty and a related assumption may be so fundamental that without it the PFI would be meaningless. Examples would include an assumption that regulatory approval will be obtained for a new product that a start-up has been established to exploit; or that loan facilities will be continued to enable a business to

continue as a going concern. In such instances, issuers should draw attention to the significance of the assumption in front of the PFI or on the face of any prospective primary statement. In this way, the expectation that users are presented with the most significant information first could be respected.

- 2.26 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 usefulness. The reasonable disclosure principle recognises that the complexity and volume of supplementary disclosures about uncertainties will have effects in terms of the two secondary characteristics of understandability discussed above: namely, users' abilities and aggregation and classification. A point will be reached at which the complexity of the disclosure means that it is beyond users' abilities and/or incapable of being structured in an understandable way. At this point, PFI is no longer useful.
- 2.27 It is because of such considerations that it may be inappropriate to publish various types of PFI which are subject to considerable levels of uncertainty and which circulate within companies and in private between companies and providers of finance. Whereas the term 'forecast' is usually reserved for PFI that is subject to relatively little uncertainty, the terms 'projection', 'illustrative projection' and 'hypothetical illustration' usually indicate increasing degrees of uncertainty. This Guidance does not seek to define any of these terms or to draw bright lines to distinguish PFI that should and should not be published. It seeks instead to encourage directors to apply the underlying reasonable disclosure principle in judging the usefulness of any PFI that they consider publishing.
- 2.28 Where the publication of general purpose PFI is precluded because the uncertainties involved prevent it from being understandable, the provision of other useful forward-looking information becomes particularly important. Directors should always be able to explain their strategy and plans, the related risks and their responses in a way that investors can understand. However, to the extent that it would be irresponsible to publish PFI that specifies financial outcomes and elements of financial statements relating to future periods, such financial information – for example, in the form of budgets – should be reserved for internal use.

Reliability and the business analysis principle

- 2.29 **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.**
- 2.30 It is only possible to present useful PFI on the basis of a full knowledge of the reporting entity's business and intentions. If PFI is not based on the reporting entity's actual strategies, plans and risk analysis it will not be reliable for users.
- 2.31 Information is reliable if it:
- can be depended upon by investors 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.
- 2.32 There is an apparent problem in applying the reliability characteristic of faithful representation to PFI. Historical information is mainly about what has happened, and so whether it faithfully represents its subject matter is a question that can be approached on the basis of evidence about past transactions and events. However, PFI is about the future and the fact that future transactions and events have not

happened raises doubts about the nature of the evidence that is available to support PFI.

- 2.33 This apparent problem actually raises difficulties for historical as well as prospective financial information. The recognition and measurement of assets and liabilities in historical financial statements reflect views about the future, and accounting on the basis of fair values increases the importance of the future to such statements. The preparation of historical financial statements on a going concern basis and the drafting of disclosures related to uncertainties about the going concern basis also reflect views about the future.
- 2.34 The principles adopted in this Guidance for preparing PFI respond to these challenges by stating that to be useful and reliable, PFI should faithfully represent not only what has happened but also a forward-looking analysis of the business which is based on facts. This will mean that a wide range of business as well as accounting skills will need to be brought to bear in preparing PFI.
- 2.35 Against this background, PFI should be capable of being described in the following terms:
- 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 complete*.
 - It is consistent with planned courses of action published elsewhere by the entity.

It is not a necessary quality of PFI that meets the above criteria that only one outcome can be envisaged.

- 2.36 Reflecting the business analysis 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 a forecast is free from material error does not mean that it will be achieved.
- 2.37 The concepts of neutrality and prudence are equally applicable to PFI as to historical financial information.
- 2.38 Neutrality means avoiding deliberate or systematic bias intended to influence a decision or judgement to achieve a predetermined result. It is a quality that always needs to be upheld in relation to general purpose information including PFI. If preparers are not committed to the concept of neutrality, users of PFI have to make their own adjustments to compensate for the presumed intentions of the preparer.
- 2.39 Upholding 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 and disclosing assumptions, determining factors and alternative outcomes.
- 2.40 Care needs to be taken to understand how the concept of prudence can be applied consistently to historical 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.

- 2.41 The business analysis principle will help preparers to 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.

Comparability and the subsequent validation principle

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

2.43 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 provided this is not an impediment to improvements in practice; and
- is supported by *disclosure* of the accounting policies used in its preparation.

2.44 Application of the characteristic of comparability to historical financial information requires historical information for different periods and different entities to be prepared on a consistent basis in accordance with disclosed accounting policies. A similar straightforward application of the characteristic of comparability to PFI requires PFI for different periods and different entities to be prepared on a consistent basis in accordance with disclosed accounting policies (which need not necessarily be repeated in the PFI). The need for PFI to be consistent with disclosed accounting policies not only allows comparison with historical numbers but also helps to ensure that the PFI will be comparable with subsequent historical financial information.

2.45 However, it will further increase the predictive value, and hence the usefulness, of PFI and the confirmatory value of historical financial information, if PFI is also comparable with historical information. In particular, PFI should be capable of subsequent validation by reference to historical financial information.

2.46 Therefore, in applying the principles of useful information to PFI, directors should make sure that it is capable of being retrospectively validated. This means that it should be comparable – in the sense of being capable of comparison – with subsequent historical financial information prepared for the period covered by PFI so that differences and similarities can be evaluated, explained and assessed.

2.47 Reference to being *capable* of subsequent validation reflects the fact that at the time that PFI is published 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 published is the expectation that there could be appropriate future 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 to them. It is therefore important that PFI is perceived by users as being capable of subsequent validation.

2.48 A working capital statement under the Listing Rules is an example of PFI that satisfies the subsequent validation principle. It states that the working capital available to an entity is sufficient for the entity's present requirements: that is, for at least the next 12 months. Even though companies do not issue statements to the effect that during the past 12 months their working capital was sufficient for their requirements, it will be obvious if a company has run out of working capital facilities.

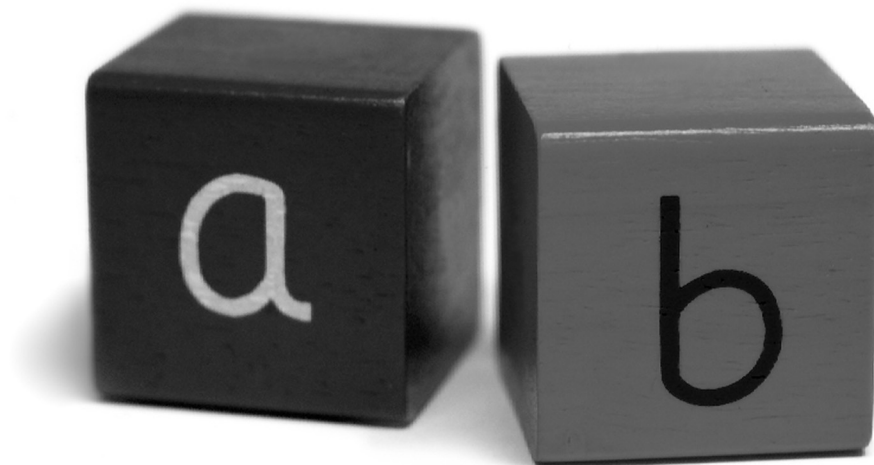
- 2.49 Any particular amount included in published PFI should be clearly defined so that users can subsequently identify it in subsequent comparisons. If the label attached to a component of PFI means different things in different periods then this comparability will be lost. Generally, any particular piece of PFI should be comparable in format with existing historical data and expected future reporting.
- 2.50 In general, a statement in the form that ‘future profits will increase by £x million’ will satisfy the subsequent validation principle provided that the base figure for the comparison is clear; for example, profits for the previous financial year. However, satisfying the subsequent validation principle may be more problematical for a statement in the form of ‘future profits will be £x million higher if a company does y instead of z’. If the company does y, and there has never been an indication of the outcome expected if it had done z, it will be difficult to know if actual profits have turned out to be £x million higher. Disclosure of the expected future profits under each of the alternative scenarios would be one way to address this problem.
- 2.51 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, directors will not wish to publish PFI that reflects events that they do not believe will happen if they will subsequently be held to account. Directors 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. In the case of regulated PFI, the board of directors will often be required to be identified and disclosed as responsible for the PFI, and such disclosure will generally be useful.

3. Principles for the preparation of PFI

- 3.1 **Published PFI is the responsibility of the board of directors. Directors should identify why the PFI is being prepared and how it is intended to be used, and hence assess the usefulness of proposed published PFI against the qualitative characteristics of understandability, relevance, reliability and comparability in the context of cost-benefit and materiality judgements.**
- 3.2 It is important for directors to have in place appropriate processes in order to help to ensure that the PFI they publish will be useful for the decision-making purposes of investors. This chapter suggests features that would be expected in such processes in order to help to ensure that published PFI is understandable, relevant, reliable and comparable.
- 3.3 **Directors should establish processes to apply the principles of reasonable disclosure, business analysis and subsequent validation to the preparation of published PFI.**
- 3.4 In accordance with the reasonable disclosure principle, preparers of published PFI should:
- identify and consider the disclosure of:
 - uncertainties,
 - assumptions,
 - determining factors that will affect whether the assumptions will be borne out in practice, and
 - alternative outcomes, being the consequences of assumptions not being borne out;
 - consider the understandability of the assumptions and related explanations of uncertainties that are presented.
- 3.5 In accordance with the business analysis principle, preparers of PFI should:
- have a robust and up-to-date business analysis to ensure that they can support the PFI they issue;
 - consider the PFI and the neutrality of captions and periods selected for reporting in the context of the strategy and plans of the business;
 - compile the PFI in accordance with the assumptions and bases set out in the company's business plans; and
 - exercise judgement about the extent to which assumptions are a likely representation of future events and circumstances, taking account of risks associated with implementing their strategy and plans and of external evidence and opinion.
- 3.6 In accordance with the subsequent validation principle, preparers should:
- consider whether the PFI is capable of subsequent validation;
 - compile the PFI on a basis consistent with the entity's accounting policies and address matters arising where any aspect of the PFI is not covered by existing accounting policies or where new accounting policies will be followed in preparing subsequent financial information; and
 - consider whether the factors that might give rise to the need to explain subsequent differences between PFI and actual results have been properly reflected in the PFI.
- 3.7 For the purposes of applying the principles in paragraph 3.1 it will be helpful for directors to satisfy themselves that processes for preparing PFI satisfy the following additional principles.

- 3.8 In relation to published PFI, directors should:**
- **plan, organise and communicate internally the process of preparing and issuing PFI;**
 - **involve directors and other members of management with the necessary in-depth experience of the business and expertise across all its activities;**
 - **clearly allocate and co-ordinate responsibilities;**
 - **satisfy themselves that there are appropriate systems to generate the reports underpinning published PFI; and**
 - **produce clear contemporaneous documentation to evidence key elements of the process.**
- 3.9 Depending on the size and complexity of the business and the nature of the PFI, there should be a formal process for preparing the PFI, including a plan, timetable and schedule of responsibilities. The formal process should address the specific scope and content of the proposed PFI and be designed to ensure that the appropriate information is drawn together for inclusion in the PFI. A project manager or a co-ordinating group may be put in place to co-ordinate the project, set timetables and monitor progress.
- 3.10 The people involved in the preparation of the PFI should provide in-depth experience of the business and expertise across all its activities. Involvement should be based on depth of knowledge and experience, rather than job titles. Those involved should understand the legal and regulatory requirements of the proposed PFI and understand the principles applicable to its publication and issue.
- 3.11 Where the size and complexity of the business demand it, clear and full instructions should be distributed to those involved in the preparation process. The timetable should be sufficient to permit review of the draft PFI by the person or group responsible for its issue, to ensure that any necessary amendments can be made.
- 3.12 The basis of preparation of PFI should be consistent with information reported by the entity both internally and externally. Support for PFI should be generated from the information systems underpinning a company's operations and its processes of strategic and market analysis and risk management.
- 3.13 Thus, in making sure that PFI is supported by up-to-date business analysis that is properly grounded in reality and facts, directors should be doing no more than reflecting information that they need for business planning purposes. The publication of PFI should not trigger an extensive specific exercise in business analysis that is performed solely to satisfy this Guidance.
- 3.14 Expecting PFI to reflect appropriate business analysis is also not the same as encouraging bureaucratic corporate strategies and business plans. What is important is that directors can articulate their business model and answer questions about how it works in a way that is consistent with any PFI they publish. What are the objectives of the business? What are the key drivers of success? What are the directors doing about them? 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?

Prospective
Financial Information
Part B: Legal framework



4. Legal themes

- 4.1 The UK environment surrounding the publication of information for investors, including PFI, is highly regulated. The relevant legal and regulatory framework is complex in structure and in detail. It is both proscriptive and prescriptive in terms of the standard and content of PFI and broadly comprises:
- prohibitions on information of an insufficient standard being issued to the market and on certain types of behaviour; and
 - positive requirements that information should meet as to quality and content.
- 4.2 Whilst it is the UK environment which is described below, it is important to acknowledge that substantial parts of it are rooted in EU law, notably in successive directives relating to listing particulars, prospectuses and reporting. For example, the test for content of listing particulars referred to in paragraph 4.9 below is based on Article 21 of the Consolidated Admissions and Reporting Directive – Directive 2001/34/EC of the European Parliament and of the Council (CARD) as interpreted by the UK legislature. Equally, it is expected that development of the legal landscape is likely to reflect new directives currently in development – for example on market abuse and prospectuses. In framing guidance for UK directors, the European backcloth is relevant. Equally, the extent to which the UK regime is rooted in EU law suggests that the approach adopted in this Guidance will have validity in other EU Member States which have implemented the directives.
- 4.3 There are four underlying themes of the UK legal environment as it relates to PFI:
- there is an absolute prohibition on deception, deliberate falsehoods and any deliberate attempts to mislead investors;
 - there is a prohibition on omission of material information;
 - information must be compiled and presented such that it is not misleading;
 - information must meet current market and user expectations as to content and quality of preparation.
- 4.4 Whereas the first three themes could be seen as essentially static, the fourth theme means that standards applicable to PFI are dynamic and evolving and, like the IASB Framework, established by reference to markets and users of information. The Framework is relevant in providing a structured way of identifying the sort of information that is useful to markets and users in making investment decisions.
- 4.5 The four underlying themes of the legal and regulatory environment in which PFI is prepared and published are explained in more detail in the remainder of Part B. They are consistent with the characteristics of useful information established in Part A and together they support the guidance offered in Part C about the preparation of specific types of PFI.
- 4.6 Considering the third theme, information could be misleading because of failures in respect of any of the qualitative characteristics in the Framework, including understandability, relevance, reliability and comparability. Information referred to in the first theme that is deliberately misleading would also always be characterised by a lack of neutrality, one of the characteristics of reliability. In relation to the second theme, omission of material information would always involve a failure in respect of the reliability characteristic of completeness.
- 4.7 Where directors publish PFI that does not meet the standards of useful information set out in the Framework, there will be reputational risks. However, the legal and regulatory environment carries with it the additional potential for significant sanctions against directors. It should be borne in mind that although there are some exemptions, these largely reflect efforts to avoid dual regulation. In the UK, there are no safe harbours from the rigour of the legal and regulatory environment applicable to PFI published for investors simply on the grounds that the information is forward looking.

Current expectations

- 4.8 It is highly significant in the context of PFI that the standards required of preparers and advisers are in part set by current user expectations, particularly in view of the sanctions for failure to meet those standards. Whilst not a universal measure for content and quality, market and user expectations are an established feature of the landscape.
- 4.9 Both the Financial Services and Markets Act 2000 (FSMA) and the Public Offers of Securities Regulations 1995 (POS Regulations) set out prescriptive rules for the preparation and publication of information relating to listed securities and unlisted securities respectively. The theme of needing to meet current user expectations is reflected in the requirement in both FSMA and the POS Regulations that listing particulars and prospectuses must contain all such information as investors would *reasonably require* and *reasonably expect* to find there for the purposes of making an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the issuer and the rights attaching to the securities.
- 4.10 Against this background, PFI is highly relevant because market prices are driven by expectations of future performance. Specific rules with regard to price sensitive information clearly reflect this dynamic. For example, the continuing obligations in Chapter 9 of *The Listing Rules* of the UK Listing Authority are designed to reflect the importance of expectations of future performance underlying market prices.
- 4.11 The market abuse regime introduced under FSMA also employs current user expectations as a key measure. Market abuse itself is defined by reference to behaviour falling below a standard which a regular market user would reasonably expect. Relevant information, which is an integral part of the regime regarding the need for disclosure or an announcement, is also defined by reference to matters which a *regular market user* would *reasonably expect* to be disclosed to users of the market in question. It is expected that the test which triggers disclosure will also influence the regulator's assessment of the adequacy of the content of what is disclosed.
- 4.12 Whilst these are ostensibly objective tests, it is clear that their application will evolve with market practice, and reflect the outlook of regulators and their enforcement teams. The standard to be met by preparers of PFI will be influenced and shaped by developing practice, in particular by regulators' views of what it is reasonable to expect. The development and application of clear principles to underpin PFI should improve PFI and also, in turn, shape expectations.

5. Regulatory background

Financial promotion

- 5.1 The key, overarching provision of the current legal and regulatory environment with regard to the preparation and publication of PFI is the prohibition on financial promotion contained in Section 21 of FSMA. This provides that a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless he is an authorised person or the content of the communication is approved by an authorised person.

FINANCIAL SERVICES AND MARKETS ACT 2000

PART II REGULATED AND PROHIBITED ACTIVITIES

Financial promotion

21. Restrictions on financial promotion

- (1) A person (“A”) must not, in the course of business, communicate an invitation or inducement to engage in investment activity.
- (2) But subsection (1) does not apply if—
 - (a) A is an authorised person; or
 - (b) the content of the communication is approved for the purposes of this section by an authorised person.

- 5.2 Beneath this wide umbrella, financial promotions fall into two segments: those which are exempted from the requirement for approval by an authorised person by virtue of being regulated directly or indirectly in some other way; and the remainder, which must have such approval before publication. By their nature, prospectuses and listing particulars are financial promotions and Section 21 of FSMA would require them to be issued or approved by an authorised person. However, prospectuses and listing particulars will generally be in the exempt category because they are regulated in another way.
- 5.3 Article 71 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (Financial Promotion Order) contains an exemption for listing particulars and prospectuses approved in accordance with the Listing Rules, i.e. prospectuses relating to securities which are, or are to be, admitted to the Official List. Article 72 of the Financial Promotion Order sets out the exemption for prospectuses issued in accordance with the POS Regulations, i.e. prospectuses relating to securities which are not, and are not going to be, listed.
- 5.4 Article 59 of the Financial Promotion Order provides an exemption from the prohibition in Section 21 of FSMA for a company’s statutory accounts and directors’ reports and extracts from the accounts. This exemption extends to any other document, such as an Operating and Financial Review, that accompanies the statutory accounts and directors’ report, but not where such a document is provided separately. However, there are complex limits to this exemption and these must be considered carefully if it is intended to rely on the exemption.
- 5.5 Formal published PFI generally falls within one of the many exemptions. In relation to unlisted securities, if an offer does not fall within Part II of the POS Regulations as requiring a prospectus, other exemptions in the Financial Promotion Order may apply, for example the Article 19 exemption for investment professionals. In relation to listed securities, if there is no prospectus or listing particulars, then the financial promotion exemptions in Article 67 and Article 71, which relate to documents required or permitted to be issued under a specified regulated market or under the Listing Rules, may apply. If not, other exemptions in the Financial Promotion Order may be relevant; for example, Article 29 for communications required or authorised

by other legislation or Article 69 for some promotions of securities already admitted to recognised markets.

- 5.6 Where no exemption is available, approval by an authorised person is required. By virtue of the rules applicable to these persons in carrying out their authorised activities, the four underlying themes set out in the previous chapter are imprinted on the process and are underpinned by disciplinary sanctions against the authorised person in the event of a failure to apply appropriate rigour in the approval process.

Market abuse

- 5.7 In addition to the rules on financial promotion, FSMA also contains the market abuse regime which prohibits behaviour which relates to, or has an impact on, investments traded on a market and which does not meet the standard reasonably expected of persons in that market. Detailed provisions defining and applying this regime are set out in statutory instruments enacted under FSMA.

FINANCIAL SERVICES AND MARKETS ACT 2000

PART VIII PENALTIES FOR MARKET ABUSE

Market abuse

118. Market abuse

- (1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert)—
 - (a) which occurs in relation to qualifying investments traded on a market to which this section applies;
 - (b) which satisfies any one or more of the conditions set out in subsection (2); and
 - (c) which is likely to be regarded by a regular user of that market who is aware of the behaviour as a failure on the part of the person or persons concerned to observe the standard of behaviour reasonably expected of a person in his or their position in relation to the market.
- (2) The conditions are that—
 - (a) the behaviour is based on information which is not generally available to those using the market but which, if available to a regular user of the market, would or would be likely to be regarded by him as relevant when deciding the terms on which transactions in investments of the kind in question should be effected;
 - (b) the behaviour is likely to give a regular user of the market a false or misleading impression as to the supply of, or demand for, or as to the price or value of, investments of the kind in question;
 - (c) a regular user of the market would, or would be likely to, regard the behaviour as behaviour which would, or would be likely to, distort the market in investments of the kind in question.

- 5.8 FSMA requires the Financial Services Authority (FSA) to issue a code to give guidance to determine whether behaviour amounts to market abuse. The code issued by the FSA for this purpose is called the *Code of Market Conduct (COMC)*. The COMC specifies descriptions of behaviour that, in the opinion of the FSA, amount or do not

amount to market abuse and factors that, in the FSA's opinion, are to be taken into account in determining whether behaviour amounts to market abuse. There are no safe harbours in the COMC that are specifically related to PFI.

Listing Rules

- 5.9 FSMA contains a number of provisions which can be viewed as either positive or negative requirements in relation to the issue of information to markets and investors. With regard to positive requirements, Part VI of FSMA contains provisions in relation to the powers of the UK Listing Authority (UKLA), applications for the admission of securities to the Official List of the UKLA, and the requirements and responsibilities in relation to listing particulars and prospectuses in respect of securities listed, or to be listed, on the Official List. The UKLA is the FSA.
- 5.10 One of the UKLA's functions under FSMA is to formulate and enforce listing rules that provide an appropriate level of protection for investors in listed securities and seek to maintain the integrity and competitiveness of UK markets for listed securities. Paragraphs I.1 to I.25 of Appendix I of this Guidance summarise the regulatory framework established by the UKLA and the expectations established under the Listing Rules in relation to PFI. These expectations cover not only the information itself but also the procedures and systems that support the processes used to generate PFI. Chapters 7, 8 and 9 cover specific types of PFI required under the Listing Rules.

Sanctions

- 5.11 The penalties for breaches of the regimes established by FSMA vary depending on the regulatory provision in question:
- Criminal penalties of fines and/or imprisonment for exceptional cases. For example, breach of Section 21 of FSMA on financial promotion is an offence punishable by a fine and/or up to two years' imprisonment.
 - Civil financial penalties of fines, damages and compensation. For example, breach of Section 118 of FSMA on market abuse is an offence punishable by an unlimited fine and potentially a restitution order to pay compensation.
 - Civil non-financial penalties. For example, breach of Section 118 of FSMA on market abuse is also punishable by public censure.
 - Non-statutory penalties. For example, breach of the Exchange's Admission and Disclosure Standards for Listed Companies is punishable by removal of the listing of the relevant shares and a public or private censure.

Remedies for investors

- 5.12 There are two sources of civil liability providing remedy for investors: statute and common law. Statutory remedies are provided for by Section 90(1) of FSMA and, in the case of unlisted companies, by Regulation 14(1) of the POS Regulations (see Appendix I). The statutory remedies are more extensive and it is easier to prove their applicability than the civil liability remedies under common law. They are therefore more likely to be the basis of a claim arising from publication of PFI. However, there still remains potential for parties to bring an action in tort for negligent misstatement.

**FINANCIAL SERVICES AND MARKETS ACT 2000
PART VI OFFICIAL LISTING**

Compensation

90. Compensation for false or misleading particulars

- (1) Any person responsible for listing particulars is liable to pay compensation to a person who has—
- (a) acquired securities to which the particulars apply; and
 - (b) suffered loss in respect of them as a result of—
 - (i) any untrue or misleading statement in the particulars; or
 - (ii) the omission from the particulars of any matter required to be included by section 80 or 81.

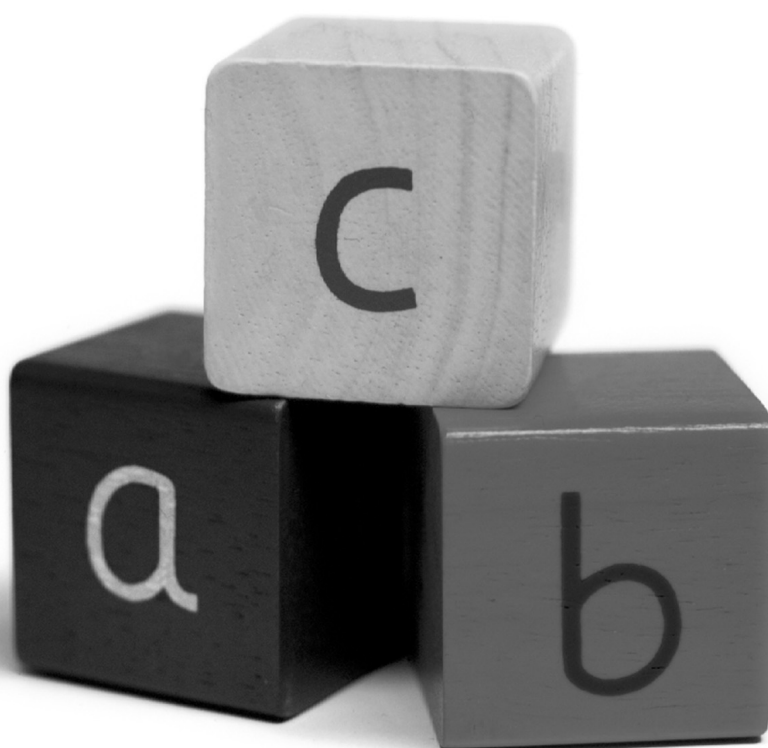
5.13 Section 90 of FSMA provides key rights of action to an investor who has acquired securities which are the subject of listing particulars, against any person responsible for the relevant document, including an adviser who has authorised or accepted responsibility for all or part of it. To bring an action under Section 90, an investor must show that he has suffered loss as a result of false or misleading information in the document, or as a result of the omission of any matter required to be included in it. However, there is no need for the injured party to show that he actually relied on the statement or omission in question. These statutory remedies are in addition to any other available statutory or common law remedy.

5.14 Civil liability for misstatements or omissions in PFI may arise under common law under the heading of negligent or fraudulent misstatement. If a person suffers loss as a result of any untrue statement or omission, he may be able to claim damages in tort or contract or to rescind any resulting contract. The amount of damages will be such as will compensate the person for the loss he has suffered as a result of the misleading statement. This remains a complex area of law.

Criminal liability

5.15 In addition to the criminal penalties for breaches of Section 21 of FSMA as referred to above, under Section 397 of FSMA it is an offence for any person to knowingly or recklessly make a statement, promise or forecast which is materially misleading, false or deceptive. It is also an offence for a person to dishonestly conceal material facts if he makes a statement, promise or forecast or conceals the facts for the purpose of inducing (or is reckless as to whether it may induce) another person to, inter alia, exercise rights conferred by a relevant investment.

Prospective
Financial Information
Part C: Guidance on regulatory requirements



6. Voluntary PFI

- 6.1 This chapter looks at circumstances in which companies may choose to publish PFI voluntarily in order to meet legal, regulatory or other reporting requirements. Chapters 7, 8 and 9 provide guidance on circumstances in which the UK Listing Authority requires PFI to be published. Chapters 10, 11 and 12 look at the specific requirements of, respectively, the Panel on Takeovers and Mergers, AIM and OFEX.
- 6.2 Whilst most voluntary PFI will be entirely voluntary, some requirements that do not explicitly require PFI may nevertheless be appropriately satisfied by the publication of PFI. Such voluntary PFI might be published in a variety of contexts, including:
- the OFR presented in a company's annual report;
 - interim, preliminary and other announcements made by listed, AIM, OFEX and other companies; and
 - listing particulars, Class 1 and other circulars, prospectuses, offer documents, admission documents, private placing memoranda or any other investment circulars.
- 6.3 Although much of the PFI that companies might consider publishing voluntarily will not be subject to specific regulatory requirements, it will still be subject to:
- the general legal requirements of the four themes set out in Part B, Chapter 4 and the COMC; and
 - general regulatory requirements and expectations applicable to companies subject to the Listing Rules, the AIM Rules, the OFEX Rules or the City Code set out in Appendix I.
- 6.4 In addition, the principles of useful PFI set out in Part A, Chapters 2 and 3 apply to all published PFI. This Guidance thus establishes principles for maintaining consistent quality of PFI in the absence of specific requirements.
- 6.5 Although it is often desirable to meet certain requirements through the use of voluntary PFI, there can be a danger of providing PFI inadvertently or of providing inadequate or misleading PFI. Directors are encouraged to use the principles in this Guidance to determine whether it would be appropriate to publish PFI; and, if so, to ensure that it achieves the appropriate standard. There may be cases in which applying the principles suggests either that the proposed PFI needs to be improved, or that non-financial information might be more appropriate.
- 6.6 For example, directors may be considering disclosing in the OFR the amount of research and development expenditure expected to be incurred in the following period. Asking a series of questions prompted by the principles of reasonable disclosure, business analysis and subsequent validation will help to determine whether the proposed disclosure reaches the desired standard of usefulness.
- *Reasonable disclosure.* Is a single number appropriate, or should a floor or range be disclosed? Is sufficient information given about the assumptions and risks underlying the amount for a user to be able to make judgements about the uncertainties associated with it? Are the complexities associated with disclosing the uncertainties such that disclosure of an amount is inappropriate for meeting users' needs?
 - *Business analysis.* Is the proposed PFI in line with the company's current strategies and plans? Does it take proper account of the risks and uncertainties identified in those strategies and plans that might cause it not to be borne out in practice?
 - *Subsequent validation.* Is the PFI presented in such a way that it is comparable with the way information is expected to be reported in the future?

Where such questions suggest that the proposed PFI is not sufficiently useful, it will generally be preferable to improve the quality of the disclosure or in some circumstances to make a non-financial disclosure.

Targets

- 6.7 It is important to differentiate PFI, which comprises one or more statements about the future, from a target, which is a statement of the company's current intentions or objectives. Targets are aspirational and should not be judged against the principles of PFI set out in this Guidance. It is therefore important that the user should not be led into thinking that a target is PFI, and the issuer should make the status of the information clear.
- 6.8 The distinction between PFI and a target may not always be clear-cut. For example, if a company says that it is aiming for five per cent sales growth, this is a target: it is not necessary to meet the reasonable disclosure principle by examining the related uncertainties that might prevent the company from achieving the target, nor for the target to be supported by a business analysis. The more predictive a piece of information becomes, the more likely it is to be PFI. For example, stating that sales will grow by five per cent in the next financial period is prima facie PFI to which the principles in this Guidance will apply. The issuer will need to consider the nature of the information and the period to which it applies in order to determine whether information is PFI.

Requirements relevant to voluntary PFI

- 6.9 The most basic instance of a requirement that can be satisfied by PFI applies to the directors of all UK companies who are required to report on future developments in their annual report.

COMPANIES ACT 1985

SCHEDULE 7 MATTERS TO BE DEALT WITH IN DIRECTORS' REPORT

PART I MATTERS OF A GENERAL NATURE

Miscellaneous

6. The directors' report shall contain –
- (b) an indication of likely future developments in the business of the company and of its [subsidiary undertakings], ...

- 6.10 PFI may also be included in ad hoc regulatory announcements, for example in trading statements provided to the market in compliance with the Listing Rules to prevent a false or disorderly market. There is a general requirement to make announcements of major new developments which are not public knowledge and which may lead to a substantial movement in the price of listed securities or significantly affect the ability of a company with listed debt to meet its commitments. This is derived from the Consolidated Admissions and Reporting Directive – Directive 2001/34/EC of the European Parliament and of the Council (CARD) on the admission of securities to official stock exchange listing and on information to be published on such securities.

UK LISTING RULES

CHAPTER 9, CONTINUING OBLIGATIONS

General obligation of disclosure for companies

9.1 A company must notify a Regulatory Information Service without delay of any major new developments in its sphere of activity which are not public knowledge which may:

- (a) by virtue of the effect of those developments on its assets and liabilities or financial position or on the general course of its business, lead to substantial movement in the price of its listed securities; or

CARD Art.68

- (b) in the case of a company with debt securities listed, by virtue of the effect of those developments on its assets and liabilities or financial position or on the general course of its business, lead to substantial movement in the price of its listed securities, or significantly affect its ability to meet its commitments.

CARD Art.81

Listing Rules transaction requirements on prospects

6.11 Listing particulars and Class 1 circulars are required to contain information on prospects for at least the current financial year.

UK LISTING RULES

CHAPTER 6, CONTENTS OF LISTING PARTICULARS

INFORMATION REQUIRED FOR THE ADMISSION OF SHARES OR CONVERTIBLE DEBT SECURITIES TO LISTING

The recent development and prospects of the group

6.G.1 Unless otherwise agreed by the UK Listing Authority in exceptional circumstances:

CARD Ann. I Sch A, Chpt 7 Para 7.1

- (b) information on the group's prospects for at least the current financial year. Such information must relate to the financial and trading prospects of the group together with any material information which may be relevant thereto, including all special trade factors or risks (if any) which are not mentioned elsewhere in the listing particulars and which are unlikely to be known or anticipated by the general public, and which could materially affect the profits.

CARD Ann. I Sch A, Chpt 7 Para 7.2

- 6.12 Generally, companies comply with the requirements relating to prospects by preparing narrative disclosures that do not contain PFI. Nevertheless, any PFI prepared to comply with this requirement should be prepared in accordance with Chapter 9 of this Guidance on announcements insofar as it identifies changes in expectations of performance. If the PFI falls within the definition of a profit forecast, for example because it specifies a minimum or maximum level of profits, Chapter 8 of this Guidance on profit forecasts should be followed.
- 6.13 Where Chapter 9 of this Guidance applies, it may need to be modified in one respect. In the context of a Class 1 circular issued on an acquisition or disposal, information drawn up on the basis that the acquisition or disposal takes place will be relevant and have predictive value. Adoption of such a basis is required by the Listing Rules and any alternative (as opposed to additional) basis would have to be specifically agreed by the UKLA.

UK LISTING RULES

CHAPTER 10, TRANSACTIONS

Contents of Class 1 circular

10.41 The information required by the appendix to this chapter must be presented on the following basis save where the UK Listing Authority otherwise agrees:

- (c) the information required by paragraph [...] 6.G.1(b) (information on group prospects):
 - (i) in the case of an acquisition, in a single statement for the listed company and its subsidiary undertakings (on the basis that the acquisition has taken place); or
 - (ii) in the case of a disposal, in a single statement for the listed company and its subsidiary undertakings (on the basis that the disposal has taken place); [...]

7. Funding statements under the Listing Rules

Working capital statements: Listing Rules transaction requirements

- 7.1 Listing particulars and Class 1 circulars are required to contain statements regarding the sufficiency of working capital for at least the next 12 months.

UK LISTING RULES

CHAPTER 3, CONDITIONS FOR LISTING

Conditions relating to applicants

Working capital

- 3.10** An issuer preparing listing particulars, a Class 1 circular or any circular containing proposals to be put to shareholders in a general meeting concerning a refinancing or reconstruction of the issuer or its group must include a working capital statement (see paragraph 6.E.16 or 6.L.10) in the listing particulars or circular. In making this statement the issuer must be satisfied after due and careful enquiry that it and its subsidiary undertakings, if any, have available sufficient working capital for the group's present requirements, that is for at least the next 12 months from the date of publication of the relevant document (also see paragraph 2.18 (sponsor's confirmation)). In the case of an application for listing of securities by an issuer with securities already listed, the UK Listing Authority may nevertheless admit these securities to listing where the applicant does not have available sufficient working capital, if the listing particulars or circular contains satisfactory proposals for the provision of the additional working capital thought by the issuer to be necessary.
- 3.11** The UK Listing Authority will not require a working capital statement to be made by an issuer whose business is entirely or substantially that of banking, insurance or the provision of similar financial services, provided that the UK Listing Authority is satisfied that:
- (a) the inclusion of such a statement would not provide significant information for investors; and
 - (b) the issuer's solvency and capital adequacy are regulated by the FSA or suitably regulated by another regulatory body.

UK LISTING RULES

CHAPTER 6, CONTENTS OF LISTING PARTICULARS

INFORMATION REQUIRED FOR THE ADMISSION OF SHARES OR CONVERTIBLE DEBT SECURITIES TO LISTING

The issuer's assets and liabilities, financial position and profits and losses

- 6.E.16** A statement by the issuer that in its opinion the working capital available to the group is sufficient for the group's present requirements, that is, for at least the next 12 months from the date of publication of the listing particulars, or, if not and the issuer has securities already listed, how it is proposed to provide the additional working capital thought by the issuer to be necessary (see paragraphs 3.10 and 3.11).

UK LISTING RULES

CHAPTER 6, CONTENTS OF LISTING PARTICULARS

INFORMATION REQUIRED FOR THE ADMISSION OF DEBT SECURITIES TO LISTING

The issuers' assets and liabilities, financial position and profits and losses

6.L.10 A statement by the issuer that in its opinion the working capital available to the group is sufficient for the group's present requirements, that is, for at least the next 12 months from the date of publication of the listing particulars or, if not and the issuer has securities already listed, how it is proposed to provide the additional working capital thought by the issuer to be necessary (see paragraphs 3.10 and 3.11).

- 7.2 Listing Rule 3.10 allows an issuer whose securities are already listed to publish listing particulars or a circular containing a statement that the issuer does not have sufficient working capital. A condition for this is that the document should contain proposals for the provision of the additional working capital that the issuer considers necessary. Such situations give rise to what is referred to in this chapter as a qualified working capital statement. Where an issuer is planning to publish a document containing a qualified working capital statement, it may be advisable to contact the UKLA at an early stage.

Relevance

- 7.3 In the context of a Class 1 circular issued on an acquisition or disposal, information drawn up on the basis that the acquisition or disposal takes place will be relevant and have predictive value. Adoption of such a basis is required by the Listing Rules and any alternative (as opposed to additional) basis would have to be specifically agreed by the UKLA.

UK LISTING RULES

CHAPTER 10, TRANSACTIONS

Contents of Class 1 circular

10.41 The information required by the appendix to this chapter must be presented on the following basis save where the UK Listing Authority otherwise agrees:

- (c) the information required by paragraph 6.E.16 (working capital statement) [...]:
 - (i) in the case of an acquisition, in a single statement for the listed company and its subsidiary undertakings (on the basis that the acquisition has taken place); or
 - (ii) in the case of a disposal, in a single statement for the listed company and its subsidiary undertakings (on the basis that the disposal has taken place); [...]

Understandability and reasonable disclosure

- 7.4 The wording of a working capital statement is highly circumscribed by the Listing Rules. As a matter of principle, it is appropriate for the statement to be brief and unencumbered by disclosures of risks and uncertainties even though it relates to the future. This is because directors are expected to make the statement with a high degree of confidence. However, two issues merit further consideration: the disclosures associated with qualified working capital statements; and the understandability of an unqualified statement.
- 7.5 Where there is a qualified working capital statement, readers of the investment circular should be left in no doubt regarding the importance of the qualification, the directors' proposals for resolving the problem, any uncertainties and assumptions associated with the proposals, the factors that might cause the proposals to fail and the consequences of failure. To achieve this, it will be appropriate to present these disclosures prominently, under suitable clear headings, in bold type and at the front of the document.
- 7.6 All the relevant rules require a statement by the issuer that in its opinion the working capital available to the group is sufficient for the group's present requirements, that is, for at least the next 12 months. Although such a statement and its import are well understood by investors familiar with UK investment circulars, directors might be concerned that other investors may not understand the language used and in particular the meaning of 'working capital' in this context. There is no reason why an issuer should not provide further explanation of the working capital statement provided that such explanation does not affect the prominence and clarity of the statement and cannot be construed as a qualification.

Reliability and business analysis

- 7.7 When a company is required to report publicly on working capital it is expected to make a simple unqualified statement that it has sufficient working capital for its present requirements for at least the next 12 months. Therefore, one of the principal issues that will concern directors is ensuring that there is very little risk that the basis of such a statement will subsequently be called into question. If there were significant uncertainties attached to such a statement then the principles established in Part A 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 it is presumed that there can be no such disclosures, it is also assumed that there are no significant uncertainties. For example, the mere fact that overdraft facilities are due to be renewed during the period being reported on would not itself give rise to significant uncertainty unless there are specific factors that cast doubt on the ability of the company to renew them.
- 7.8 The business analysis that the directors carry out to support a working capital statement covers:
- the cash flows of the business;
 - the terms and conditions and commercial considerations associated with banking relationships and other financing arrangements; and
 - related sensitivity analysis.
- 7.9 Where the directors conclude that there is insufficient margin or 'headroom' between required and available funding to cover a reasonable worst case scenario, it will not be possible to make an unqualified working capital statement. In these circumstances, the directors will need to reconsider their business plans or line up additional financing.
- 7.10 In exceptional cases, where a business has insufficient working capital and it is not possible to arrange additional financing before the issue of the relevant listing

particulars or circular, under the Listing Rules the issuer will need to make a qualified working capital statement. This depends on there being satisfactory proposals for securing the additional working capital. Such proposals could relate to transactions to restructure the finances or operations of the business or to raise additional funds that are the subject of the document in question or which are fully explained in the document.

- 7.11 It is expected that appropriate business analysis will involve consideration of the strategy and plans of the business, including any acquisition, and the related implementation risks together with checks of these against external evidence and opinion. These plans should also form the basis of unpublished supporting PFI in the form of internally consistent cash flow, profit and loss and balance sheet information.
- 7.12 The necessary procedures are likely to be very similar to those that directors of listed companies are expected to carry out on an annual basis to support the statement in the annual report that the business is a going concern. Because these procedures are likely to be highly relevant for the purposes of supporting a working capital statement, extracts are reproduced below from *Going concern and financial reporting: Guidance for directors of listed companies registered in the UK*. This was prepared by a joint working party made up of representatives of the Hundred Group of Finance Directors, the ICAEW and the Institute of Chartered Accountants of Scotland.

GOING CONCERN AND FINANCIAL REPORTING: GUIDANCE FOR DIRECTORS OF LISTED COMPANIES REGISTERED IN THE UK

PROCEDURES

26. Some major areas in which procedures are likely to be appropriate are set out below. They may contain some matters which the directors consider do not apply to their company. They should, however, be given some consideration to see whether they could become significant.

Forecast and budgets

29. Budgets and forecasts should be prepared to cover the period to the next balance sheet date as a minimum. They may be prepared on a rolling basis for at least twelve months ahead. Further periods are generally covered by medium or long term plans which give an indication in general terms of how the directors expect the business of the company to fare.

Borrowing requirements

30. The facilities available to the company should be reviewed and compared to the detailed cash flow forecasts for the period to the next balance sheet date, as a minimum. Sensitivity analyses on the critical assumptions should also be used in the comparison. The directors should seek to ensure that there are no anticipated:

- shortfalls in facilities against requirements;
- arrears of interest; or
- breaches of covenants.

31. The directors have responsibility to manage borrowing requirements actively. Any potential deficits, arrears or breaches should be discussed with the company's bankers in order to determine whether any action is appropriate. This may prevent potential problems crystallising. The onus is on the directors to be satisfied that there are likely to be appropriate and committed financing arrangements in place.

...continued

Liability management

33. Directors should ensure that the financial plans indicate adequate matching of projected cash inflows with known cash outflows. The outflows should include all known liabilities, such as loan repayments, payment of tax liabilities and other commitments which may be recorded off-balance sheet.

Contingent liabilities

34. Directors should consider the company's exposure to contingent liabilities. Not only should the directors consider contingent liabilities experienced by the company in the past, such as legal proceedings, guarantees and product liability, but they should also consider whether there are any new contingencies such as environmental clean-up costs.

Products and markets

35. Directors should have information about the major aspects of the economic environment within which the company operates. They should consider the size of the market, its strength, their market share and assess whether there are any economic, political or other factors which may cause the market to change. This should be done for each of the main product markets.

Financial risk management

37. There are many types of financial risk facing a company and directors should identify which risks are most significant to their company. For example, the exposure to fixed price contracts and to movements in foreign currency rates may be the most significant risks for a construction company exporting overseas. The directors should consider how such risks could affect the company and decide how best to manage these.

Other factors

38. There are many other factors which could affect the ability of a company to continue in operational existence. Directors should consider how sensitive the company has been to particular past events; they can use this information to assess the likely effect of any potential recurrence of such events.

Financial adaptability

40. Financial adaptability is the ability to alter the amounts and timing of cash flows to respond to unexpected needs or opportunities. As such, it can mitigate any of the factors above.

Other aspects of reliability

- 7.13 The concept of neutrality is relevant to working capital statements in that directors should consider any statement required by the Listing Rules in a wider context. For example, if the statement were valid for the required 12-month period but difficulties were foreseen in the subsequent period, the information might be seen as biased. In these circumstances, supplementary disclosures would be appropriate. In order to address this issue, companies should consider extending the period covered by the unpublished PFI that supports the working capital statement beyond the 12-month period covered by the statement.

Comparability and subsequent validation

- 7.14 The principle of subsequent validation should not be interpreted too literally or narrowly in the context of working capital statements. As noted in Chapter 2,

under this Guidance a working capital statement is an example of PFI that satisfies the subsequent validation principle. It states that the working capital available to an entity is sufficient for its present requirements: that is, for at least the next 12 months.

- 7.15 Companies are not required explicitly to report actual performance against a working capital statement and they do not issue statements to the effect that during the past 12 months their working capital was sufficient for their requirements. However, a working capital statement is clearly capable of being reported against. Moreover, 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 obligations contained in Listing Rules 9.1 and 9.2.

Principles of preparation

- 7.16 The Listing Rules set a standard of 'due and careful enquiry' for directors' working capital statements. In the case of listed companies, the relevant rules also require sponsors to satisfy themselves that such enquiry has taken place.

UK LISTING RULES

CHAPTER 2, SPONSORS

Services to be provided by a sponsor

2.18 Working capital

Where an issuer prepares listing particulars, a Class 1 circular or any circular containing proposals to be put to shareholders in general meeting concerning a refinancing or reconstruction of the issuer or its group which includes a working capital statement (see paragraph 6.E.16 or 6.L.10), the sponsor must report to the UK Listing Authority in writing that:

- (a) it has obtained written confirmation from the issuer that the working capital available to the group is sufficient for its present requirements, that is for at least the next twelve months from the date of publication of the relevant document; and
- (b) it is satisfied that this confirmation has been given after due and careful enquiry by the issuer and that the persons or institutions providing finance have stated in writing that the relevant financing facilities exist.

- 7.17 Chapter 3 identifies general principles for the preparation of PFI, which can be applied in the circumstances of this chapter. In addition, the foregoing paragraphs have identified a number of matters requiring consideration before making a working capital statement. It is evident that these require a wide range of business skills and commercial judgement as well as accounting expertise, and that a process of due and careful enquiry may incorporate but should not necessarily be restricted to:

- business analysis covering both the cash flows of the business and the terms and conditions and commercial considerations associated with banking and other financing relationships;
- assessment of whether there is sufficient margin or headroom to cover a reasonable worst case scenario;
- consideration of the strategy and plans of the business and the related implementation risks together with checks against external evidence and opinion;
- preparation of unpublished supporting PFI in the form of internally consistent cash flow, profit and loss and balance sheet information;

- completion of detailed procedures based on those performed in connection with a going concern review for annual accounts purposes;
- consideration of any foreseeable working capital difficulties beyond the 12-month period of the required statement;
- formulation of proposals for the provision of any additional working capital that is considered necessary;
- consideration by the directors of the form of the published working capital statement and approval of the underlying working capital forecasts or projections; and
- prominent disclosure of any proposals for additional working capital, any related uncertainties and assumptions, the factors that might cause the proposals to fail and the consequences of failure.

7.18 An appropriate process of due and careful enquiry will need to be carefully planned, organised and communicated, particularly in complex, dispersed or diverse groups. Directors should also make sure that key elements of the process are evidenced through contemporaneous documentation.

Mineral companies

7.19 The Listing Rules impose additional disclosure requirements relating to funding requirements and cash flows on mineral, oil and natural gas companies, which are collectively referred to as mineral companies. The requirements are additional to the working capital statement covered in paragraphs 7.1–7.18 of this Guidance and specifically involve the preparation and publication of PFI.

UK LISTING RULES

CHAPTER 19, MINERAL COMPANIES

Listing particulars

19.4 A new applicant which is a mineral company, must [...] include in its listing particulars:

- (g) the following information on financial matters (in addition to the statement as to the sufficiency of working capital required by paragraph 6.E.16 or 6.L.10):
 - (i) an estimate of the funding requirements of the company for at least two years following publication of the listing particulars;
 - (ii) particulars of estimated cash flow for either the two years following publication of the listing particulars or, if greater, the period until the end of the first full financial year in which extraction of mineral resources is expected to be conducted on a commercial scale; such particulars must include details of the relevant mineral resources to be extracted, the expected prices and grade structures of the saleable resources, mineral concentrates or products, the expected extraction costs of the various extraction stages and the evidence and assumptions on which this information is based; and
 - (iii) confirmation from the sponsor that it is satisfied that the estimated cash flow has been stated by the company after due and careful enquiry; [...]

Understandability and reasonable disclosure

- 7.20 One of the key disclosure issues is to ensure that investors are not misled about the nature and usefulness of the cash flow and funding information presented for an extended period of at least two years.
- 7.21 It should be made clear whether the particulars that are required to be presented under Listing Rule 19.4(g)(ii) relating to mineral resources extraction, prices and grade structures of saleable resources, mineral concentrates or products and extraction costs are themselves assumptions or are based on more detailed assumptions. In addition, assumptions could be presented for other uncertainties which might reasonably give rise to material fluctuations in estimated cash flows, and these may include interest, inflation, exchange and tax rates, proceeds and costs of fundraising and environmental conditions and legislation.
- 7.22 It may be helpful to present sensitivity analysis showing the impact on total cash flows of percentage variations in individual quantifiable assumptions. However, it should be recognised that it may be difficult for users of the PFI to draw meaningful conclusions from this where there are multiple interrelated uncertainties, qualitative assumptions and no reliable indicators of the relative likelihood of departures from the stated assumptions. Care should also be taken that such information is not presented when it would lead to unreasonably long and complex disclosures.
- 7.23 In circumstances where users of the PFI are unable to draw meaningful conclusions about the likelihood of different specific cash outcomes, the cash flow estimates may need to be prefaced with cautionary words to the effect that the cash flow estimates:
- are subject to significant economic, geological, competitive and other uncertainties beyond the control of the issuer;
 - are illustrative of possible cash flows based upon directors' current best estimates; but
 - should not be relied upon as showing cash flows that are likely to occur in practice.

Reliability and business analysis

- 7.24 The requirements applicable to mineral companies should be satisfied by performing the same type of underlying business analysis proposed in this Guidance for a working capital statement, except that the period covered by the analysis should be extended. In addition, some of the supporting PFI that would remain unpublished in the case of a working capital statement should be supplemented by disclosures that make it suitable for publication.
- 7.25 Much of the information on which cash flow forecasts are based will be derived from the Competent Person's Report (CPR) required under Chapter 19 of the Listing Rules. It is important that the assumptions underlying the cash flow forecast are consistent with the content of the CPR.

Other aspects of reliability

- 7.26 Because estimated funding requirements and cash flows need to be presented for a period of at least two years, there will be significant uncertainty in many areas including the quality and quantity of minerals extracted, sales prices, extraction costs, payment periods and rates of interest, inflation, exchange and tax. Neutrality requires that these uncertainties be addressed by making best estimate assumptions that represent most likely outcomes based on disclosed evidence. Whilst directors are at liberty to apply a conservative estimate in reporting the effect of transactions in unpublished prospective profit and loss and balance sheet information, such prudence should not be applied to the preparation of published cash flow and funding information.

- 7.27 Neutrality should also be supported by extending the period covered by unpublished PFI beyond that which is required to be covered by published PFI. For example, if such PFI highlighted a potential funding requirement beyond the period covered by the published PFI, supplementary disclosures would be appropriate. In addition, preparers should consider whether the periods for which estimated cash flows are presented fail to highlight cash flow difficulties within periods.

Comparability and subsequent validation

- 7.28 Estimated cash flows should be presented in a format that allows comparison with the cash flow information that the business reports in its historical financial statements. In addition, it may be helpful to present estimated cash flows on a half-yearly basis to facilitate comparison with subsequent half-yearly reports. The accountability of the directors is also enhanced if assumptions that they can influence are identified separately from those which are beyond the directors' control.
- 7.29 Comparability requires that estimated funding requirements and cash flows are presented on a consistent basis. Consequently, any disclosed funding requirement would be matched by a negative cash balance in the published cash flow estimates.

Principles of preparation

- 7.30 There are a number of matters, additional to those identified in paragraphs 7.1–7.18 of this Guidance in relation to working capital statements, that help to build on the idea of due and careful enquiry in the case of mineral company disclosures. These additional matters mean a process of due and careful enquiry in relation to the PFI required of mineral companies may also incorporate:
- identification and disclosure of best estimate assumptions and related sensitivity analysis; and
 - drafting of appropriate cautionary language regarding the nature of the PFI.

Scientific research based companies

- 7.31 The Listing Rules impose additional disclosure requirements relating to funding requirements and business plans on scientific research based companies without an adequate trading record that want to raise finance by listing their securities. These requirements are applicable to companies primarily involved in laboratory research and development of chemical or biological products or processes, including pharmaceutical companies and those involved in the areas of diagnostics, agriculture and food. The requirements are additional to the working capital statement covered in paragraphs 7.1–7.18 of this Guidance and specifically involve the preparation and publication of PFI.

UK LISTING RULES

CHAPTER 20, SCIENTIFIC RESEARCH BASED COMPANIES

Listing particulars

20.8 The listing particulars of a new applicant under this chapter [...] must:

- (c) contain an estimate of its funding requirements for a period of two years following the listing and state that these requirements can be met, under current estimates, from existing resources and from the proceeds of the issue of securities made at the time of the listing;
- (d) contain in a separate prominent section entitled “Business development and prospects”, a detailed explanation of the issuer’s business plan and strategic objectives and the assumptions on which the plan is based. This section should include a detailed analysis of the programme of developments to date and those which are key strategic objectives in the development of the business;

Understandability and reasonable disclosure

7.32 Since it may not be clear to investors what is meant by the term ‘funding requirements’ it may be helpful to provide an explanation. Listing Rule 20.8(c) refers to funding requirements being met both from existing resources and the proceeds of the issue of securities at the time of listing. Accordingly, in the language of UK Financial Reporting Standard No. 1 (revised) *Cash Flow Statements*, the term appears to be equivalent to a total net cash outflow before financing cash flows.

Reliability and business analysis

7.33 The requirements applicable to scientific research based companies contained in Listing Rule 20.8(c) may be satisfied by performing the same type of underlying business analysis proposed in this Guidance for a working capital statement.

7.34 However, the importance of external analysis and validation of the company’s products and research will be far greater than for a conventional business. In addition, the period covered by the analysis should be extended to allow statements of funding requirements and of the ability to meet funding requirements to be made for a two-year period. There is a demanding obligation on issuers to make a statement that funding requirements can be met from existing resources and from the proceeds of the issue at the time of listing. To support such a statement, the underlying unpublished PFI will need to cover a reasonable worst case scenario and show that there is sufficient headroom.

7.35 As for the requirements in Listing Rule 20.8(d) relating to the issuer’s business development and prospects, this is not seen as requiring or even encouraging the publication of PFI, as defined in this Guidance. Accordingly, this Guidance does not consider how directors should satisfy this requirement although it is important that the material presented under Listing Rule 20.8(d) is consistent with the business analysis that supports the disclosures under Listing Rule 20.8(c).

Other aspects of reliability

7.36 An estimate of the issuer’s funding requirement for a period of two years needs to be disclosed. The concept of neutrality suggests that uncertainties associated with making an estimate for a two-year period may be addressed by making best estimate assumptions that represent most likely outcomes. It may be appropriate to apply prudence in reporting the effect of transactions in unpublished prospective profit and

loss and balance sheet information, but prudence should not be allowed to detract from the neutrality of a published funding requirement.

- 7.37 Neutrality also provides the rationale for extending the period covered by the unpublished PFI that supports a funding requirement statement beyond the two-year period to which the requirement relates. For example, if such PFI highlighted a significant additional funding requirement beyond the two-year period, supplementary disclosures would be appropriate. In addition, preparers should consider whether the periods for which estimated funding requirements are presented fail to highlight higher peak funding requirements within a period.

Comparability and subsequent validation

- 7.38 Companies do not explicitly report actual performance against estimates of funding requirements or statements that these requirements can be met from existing resources and the proceeds of the issue of securities made at the time of listing. However, the relevant statements are clearly capable of being monitored by investors. If a company making such statements is subsequently in imminent danger of having insufficient funding to continue its activities, this will also be a matter requiring disclosure under the general obligations contained in Listing Rules 9.1 and 9.2.

Principles of preparation

- 7.39 There is no requirement for a sponsor to report on the issuer having performed 'due and careful enquiry' on the statements specifically required of scientific research based companies. Nonetheless, the statements made are sufficiently similar to a working capital statement to suggest that it may be helpful for the process adopted by the directors to meet the standards set out in paragraphs 7.1–7.18 of this Guidance after taking account of the matters identified for consideration above in relation to scientific research based companies.

Innovative high growth companies

- 7.40 The Listing Rules impose additional requirements relating to capital expenditure plans and funding requirements on innovative high growth companies without an adequate trading record that want to raise finance by listing their securities. These requirements are applicable to companies able to demonstrate that the company's business is innovative in nature, whether through the development of new products and/or services or new methods of business and whose activities can be expected to generate significant organic growth in revenues. The requirements are additional to the working capital statement covered in paragraphs 7.1–7.18 of this Guidance and specifically involve the preparation and publication of PFI.

UK LISTING RULES

CHAPTER 25, INNOVATIVE HIGH GROWTH COMPANIES

Listing particulars

25.6 The listing particulars of a new applicant under this chapter [...] must contain:

- (e) an explanation of capital expenditure plans and financial commitments together with an estimate of the funding requirements of the business for a period of two years following the listing and a statement explaining how these requirements will be met, under current estimates, with reference to existing resources and the proceeds of any issue of securities made at the time of listing;

- 7.41 The UKLA may also exercise a right to require an innovative high growth company to present it with financial projections. This right is not addressed in detail in this document since it does not result in general purpose PFI for use by investors. Nevertheless, any such PFI should be consistent with the PFI published under Listing Rule 25.6(e).

UK LISTING RULES

CHAPTER 25, INNOVATIVE HIGH GROWTH COMPANIES

General

- 25.2** The UK Listing Authority reserves the right to require the presentation to it of material such as market research and financial projections to assist it assess the eligibility of an applicant. This information may be shared with the UK Listing Authority's independent expert advisers.

Understandability and reasonable disclosure

- 7.42 Since it may not be clear to investors what is meant by terms such as 'capital expenditure', 'financial commitment' and 'funding requirements', it may be helpful to provide explanations.

Reliability and business analysis

- 7.43 The requirements applicable to innovative high growth companies to provide an estimate of the funding requirements of the business and a statement of how they will be met may be satisfied by performing a similar type of underlying business analysis to that proposed in this Guidance for a working capital statement and that referred to in paragraph 7.33 for scientific research-based companies.
- 7.44 In addition, some of the PFI that supports the statements on funding requirements should be published, supplemented by appropriate explanations to satisfy the additional requirements of Listing Rule 25.6(e) to explain capital expenditure plans, financial commitments and funding requirements.

Other aspects of reliability

- 7.45 The guidance set out in paragraphs 7.36 and 7.37 in relation to scientific research based companies will also be relevant to innovative high growth companies.

Comparability and subsequent validation

- 7.46 The guidance set out in paragraph 7.38 in relation to scientific research based companies will also be relevant to innovative high growth companies.

Principles of preparation

- 7.47 The guidance set out in paragraph 7.39 in relation to scientific research based companies will also be relevant to innovative high growth companies.

8. Profit forecasts under the Listing Rules

Listing Rules definition

- 8.1 The regulatory requirements of Chapter 12 of *the Listing Rules* only apply to a profit forecast when such a forecast appears in listing particulars, a Class 1 acquisition circular or any circular to be put to shareholders in general meeting concerning a financing or reconstruction. The requirements set out in this chapter apply to PFI published by listed companies that satisfies the definition of a profit forecast in the Listing Rules. Chapter 10 of this Guidance looks at profit forecasts in a takeover governed by the City Code.
- 8.2 Companies which, prior to issuing a document, have published PFI that satisfies the definition of a profit forecast will have to decide whether to update the PFI before submitting it to the rigorous regulatory expectations applicable to profit forecasts.

UK LISTING RULES

CHAPTER 12, FINANCIAL INFORMATION

Profit forecast and estimate

- 12.21** [...]. A profit estimate is for a financial period which has expired but for which the results have not yet been published.
- 12.23** A form of words which expressly or by implication states a minimum or maximum for the likely level of profits or losses for a period subsequent to that for which the audited accounts have been published, or contains data from which a calculation of an approximate figure for future profits or losses may be made, is a profit forecast or estimate, even if no particular figure is mentioned and the word “profit” is not used. A dividend forecast must be treated as a profit forecast where the issuer has a known policy of relating dividends to earnings, or has an insufficient level of retained earnings or the forecast otherwise implies a forecast of profit. In the event of uncertainty the UK Listing Authority must be consulted (see also paragraph 21.16 and 26.8A regarding investment entities and venture capital trusts).

- 8.3 Although they constitute historical not prospective financial information, profit estimates are also subject to the same rules as profit forecasts. This is justified on the basis that there is a continuum: a forecast for the year ending 31 December 2003 prepared on 31 December 2003 is not very different from an estimate for the same period prepared on 1 January 2004.
- 8.4 The following exemptions apply in relation to listed investment entities and venture capital trusts.

UK LISTING RULES

CHAPTER 21, INVESTMENT ENTITIES

Investment companies and investment trusts

Listing particulars or equivalent offering document

- 21.16** Statements of expected yield or forecasts of dividends will not be treated as profit forecasts even if they fall within the scope of paragraph 12.23 provided they are clearly stated not to be profit forecasts.

UK LISTING RULES

CHAPTER 26, VENTURE CAPITAL TRUSTS

Listing particulars

26.8A Statements of expected yield or forecasts of dividends will not be treated as profit forecasts even if they fall within the scope of paragraph 12.23 provided they are clearly stated not to be profit forecasts.

Relevance

8.5 In the context of a Class 1 circular issued on an acquisition or disposal, a profit forecast is relevant and has predictive value if it is drawn up on the basis that the acquisition or disposal takes place or it enables the user to arrive at a forecast drawn up on this basis. Adoption of such a basis is required by the Listing Rules and any alternative (as opposed to additional) basis would have to be agreed by the UKLA on a case-by-case basis.

UK LISTING RULES

CHAPTER 10, TRANSACTIONS

Contents of Class 1 circular

10.41 The information required by the appendix to this chapter must be presented on the following basis save where the UK Listing Authority otherwise agrees:

- (d) for a profit forecast:
 - (i) in the case of an acquisition, either in a single statement for the listed company and its subsidiary undertakings (on the basis that the acquisition has taken place) or in separate statements for the listed company and its subsidiary undertakings and for the undertaking, business or assets to be acquired; or
 - (ii) in the case of a disposal, either in a single statement for the listed company and its subsidiary undertakings (on the basis that the disposal has taken place) or in separate statements for the listed company and its subsidiary undertakings and for the undertaking, business or assets to be disposed of.

Understandability and reasonable disclosure

8.6 Understandability is central to the UKLA's approach to profit forecasts.

UK LISTING RULES

CHAPTER 12, FINANCIAL INFORMATION

Profit forecast and estimate

12.22 Any statement or information relating to the future prospects of an issuer, or an undertaking that is to become a significant part of an issuer's group, must be clear and unambiguous [...] Any profit forecast or estimate must be presented in an explicit manner.

- 8.7 There is a strong expectation that a profit forecast will be achieved. This means that its understandability is likely to be compromised by disclosure of a large number of insignificant uncertainties. The Listing Rules reinforce the need to keep things simple, permitting only the disclosure of assumptions that could have a material effect on the achievement of a forecast, and banning assumptions relating to the general accuracy of underlying estimates.

UK LISTING RULES

CHAPTER 12, FINANCIAL INFORMATION

Profit forecast and estimate

12.27 Assumptions

The profit forecast must include a statement of the principal assumptions for each factor which could have a material effect on the achievement of the forecast. The assumptions must:

- (a) be clearly segregated between assumptions about factors which the directors can influence and assumptions about factors which are exclusively outside the influence of the directors;
- (b) be readily understandable by investors;
- (c) be specific and precise; and
- (d) not relate to the general accuracy of the estimates underlying the forecast.

A profit estimate may be subject to assumptions only in exceptional circumstances.

- 8.8 Benefits result from the segregation of assumptions about factors which the directors can influence from assumptions which are exclusively outside their influence. 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 about sources of uncertainty, determining factors and alternative outcomes.
- 8.9 The definitions of forecasts in Listing Rule 12.23 refer to forecasts in the form of 'at least £x million' (a minimum or floor) or 'at most £x million' (a maximum or ceiling) but this does not preclude forecasts in the form of '£x million' (a point estimate or single number) or 'between £x million and £y million' (a range). A single number is particularly likely to be appropriate for a profit estimate.
- 8.10 The Listing Rules do not contain any provisions relating to the use of ranges. Like floors and ceilings, ranges help to increase the certainty of achieving forecasts and decrease the complex disclosures that would be more likely to accompany point estimates because of their greater uncertainty. When a minimum or maximum number is presented, people seem to understand that the most likely outcome is close to that number. However, in cases of relatively high uncertainty 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 useful information for investors.

Reliability and business analysis

- 8.11 A company is expected to achieve a profit forecast. If it fails to do so, and the difference is 10 per cent or more, the directors are required to provide an explanation in the annual report and accounts. One of the principal issues that will concern directors is therefore ensuring that they are highly confident that a forecast

will be achieved and that there is very little risk that it will not. In the event of failure, they will also want to be able to demonstrate that they were acting responsibly in making a forecast. These pressures call for any forecast to be underpinned by a robust and up-to-date business analysis. However, to the extent that a forecast relates to a current period it will include financial information relating to the expired part of the period. Normal considerations applicable to quality control over published historical information will apply to any historical information incorporated into a profit forecast.

- 8.12 Directors responsible for a forecast should have a clear understanding of the company's strategy and plans, including any acquisitions or disposals, and related implementation risks. The forecast should be consistent with the company's detailed management plans and should be prepared by people with sufficient experience in the business and expertise across all its markets and operations.
- 8.13 Directors should have access to non-financial leading indicators of performance and perform checks of the business analysis and the forecast against external evidence and opinion. Explanations must be sought and provided if the forecast is not consistent with past trends and a broad consensus of external information in the form of market surveys, general economic indicators and the views of people knowledgeable in the business and the industry.
- 8.14 Different skills and resources, principally in information systems and accounting and reporting, are needed to prepare the forecast itself. Whilst there will often be technical complexities associated with forecasting items such as tax and financing charges, companies should guard against placing too much emphasis on computational aspects and too little emphasis on the fundamental business analysis that should drive any forecast.
- 8.15 The business analysis should form the basis of the unpublished PFI that supports any published profit forecast. This should comprise internally consistent profit and loss accounts, cash flow statements and balance sheets to act as checks against omissions and inconsistencies. In practical terms this information will need to be derived from a comprehensive system for reporting budget and actual year-to-date numbers and full year budgets and forecasts.
- 8.16 There is a presumption that the period of a forecast prepared on a reliable basis will not extend beyond the current accounting period. The length of the future period for which a profit forecast can be prepared will depend in part on the quality of a company's business analysis and financial forecasting systems but also on the nature of the business. A longer forecast period may be expected for activities that display proven and consistent trends that are likely to persist over the forecast's time horizon, that are supported by regular forecasting systems which have a track record of reliability and accuracy and where forecasts are subject to a review process to incorporate lessons from experience and changing circumstances.
- 8.17 The greater the environmental risks, for example in the form of regulation, macroeconomic exposures, politics, market volatility and competitor action, the shorter the period for which directors will be able to prepare a forecast that can be appropriately supported. Likewise, the greater the risk attached to the company's own processes, for example raw material sourcing, physical production and service delivery, the shorter the period will be. Directors will need compelling evidence to rebut the presumption that the period of a forecast will not extend beyond the current accounting period.

Other aspects of reliability

- 8.18 The concept of neutrality is relevant to profit forecasts because of the scope for cherry picking particular captions from a profit and loss account so as to achieve a particular purpose. Selection criteria should be driven by consideration of what is most useful to the investor. The scope for bias is limited by the Listing Rules.

UK LISTING RULES

CHAPTER 12, FINANCIAL INFORMATION

Profit forecast and estimate

12.26 [...] The forecast or estimate should normally be of profit before tax (disclosing separately any exceptional items and tax charges if they are expected to be abnormally high or low). 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. [...]

- 8.19 The concept of neutrality is also relevant to profit forecasts because of the danger 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 following period, supplementary disclosures should be considered.
- 8.20 In a situation where close to its year-end a company's internal forecasts showed a best estimate profit of £103 million, it would be common to publish a profit forecast in the form that the company expects to make a profit of 'at least £100 million'. Although this might appear to be an application of the prudence concept, it reflects instead a desire to achieve faithful representation and minimise the risk that the forecast will not be achieved. However, if the forecast were to be expressed as a single number rather than by reference to a floor, it would be inappropriate for the company to forecast a profit of £100 million on the grounds that this was prudent. It would simply be misleading given that the best estimate is £103 million rather than £100 million.
- 8.21 Ranges can also be used to increase reliability and decrease the risk of missing a forecast, but they can be hard to interpret. For example, in the circumstances outlined above where the best estimate profit is £103 million, if the company forecasts profits in the range £100 million to £106 million, investors might feel disappointed if profits were eventually reported at £103 million on the grounds that it was misleading to have referred to profits as high as £106 million.

Comparability and subsequent validation

- 8.22 The Listing Rules and the UKLA's guidance on the dissemination of price-sensitive information, *The PSI Guide*, strongly reinforce the idea of comparability and the principle of subsequent validation. Not only do they establish expectations about the profit captions to be reported but they also ensure that profits are forecast for periods for which historical results will be reported and they require subsequent reporting against the forecast.

UK LISTING RULES

CHAPTER 12, FINANCIAL INFORMATION

Profit forecast and estimate

12.26 The period of the forecast or estimate should normally be to the end of the issuer's accounting period; if it is not, then it must be in respect of a period for which the results will be published or the issuer must make a new forecast for such a period. [...] When the results are published relating to a period covered by the forecast or estimate, the published financial statements must disclose the relevant figure so as to enable the forecast and actual results to be directly compared.

UK LISTING RULES

CHAPTER 12, FINANCIAL INFORMATION

Annual report and accounts

12.43 The following items must, unless the UK Listing Authority otherwise agrees, be included in the annual report and accounts:

Commentary on forecasts

- (b) if the results for the period under review differ by 10% or more from any published forecast or estimate by the company for that period, an explanation of the difference;

THE PSI GUIDE

SECTION 10, PROFIT FORECASTS

10.1. If a company has made a public forecast but it subsequently becomes aware that the outcome will be materially above or below the forecast figure, a further announcement should be made correcting the forecast as soon as possible.

Principles of preparation

8.23 The principal consequence of PFI in listing particulars or another document being classified as a profit forecast is that it triggers requirements for directors and third parties to confirm or determine that the directors have undertaken a process of due and careful enquiry. In the case of the Listing Rules, the issuer, the sponsor and reporting accountants are involved.

UK LISTING RULES

CHAPTER 6, CONTENTS OF LISTING PARTICULARS

INFORMATION REQUIRED FOR THE ADMISSION OF SHARES OR CONVERTIBLE DEBT SECURITIES TO LISTING

The recent development and prospects of the group

6.G.2 Where a profit forecast or estimate appears, the principal assumptions upon which the issuer has based its forecast or estimate must be stated (see paragraph 12.27); where so required by paragraph 12.24, the forecast or estimate must be examined and reported on by the reporting accountants or auditors and their report must be set out; there must also be set out a report from the sponsor confirming that the forecast has been made after due and careful enquiry by the directors (see paragraph 2.19).

UK LISTING RULES

CHAPTER 2, SPONSORS

Services to be provided by a sponsor

Profit forecast

2.19 Where a profit forecast or estimate (see paragraphs 12.21 to 12.27) appears in listing particulars, a Class 1 acquisition circular or any circular containing proposals to be put to shareholders in general meeting concerning a refinancing or reconstruction of the issuer or its group, the sponsor must report that it has satisfied itself that the forecast or estimate has been made after due and careful enquiry by the issuer. Such report must be included in the listing particulars or circular as appropriate.

UK LISTING RULES

CHAPTER 12, FINANCIAL INFORMATION

Profit forecast and estimate

12.22 [...] The issuer must determine in advance with its sponsor whether such a statement or information will constitute a profit forecast or estimate [...]

12.23A Where a profit forecast or estimate appears in an exempt listing document (see paragraph 5.24), the issuer must confirm to the UK Listing Authority in writing that the forecast or estimate has been properly compiled on a basis consistent with the accounting policies normally adopted by the company and has been made after due and careful enquiry.

UK LISTING RULES

CHAPTER 12, FINANCIAL INFORMATION

Profit forecast and estimate

12.24 A profit forecast or estimate of an issuer or an undertaking that is to become a significant part of an issuer's group included in listing particulars, a Class 1 acquisition circular, or any circular containing proposals to be put to shareholders in a general meeting concerning a refinancing or reconstruction of the issuer or its group must be reported on by the auditors or reporting accountants and by the sponsor (see paragraph 2.19). The accountants must report in the document their opinion as to whether:

- (a) the profit forecast or estimate has been properly compiled on the basis stated; and
- (b) the basis of accounting is consistent with the accounting policies of the issuer.

12.25 If an issuer has published a profit forecast or estimate, for a financial period for which the results have not yet been published, and subsequently is required to produce any of the documents referred to in paragraph 12.24, the issuer must either repeat or update the statement in the listing particulars or the relevant circular.

- 8.24 Chapter 3 identifies general principles for the preparation of PFI, which can be applied in the circumstances of this chapter. In addition, this chapter has identified a number of matters requiring consideration before making a profit forecast. Many of the principles of preparation set out in paragraph 7.17 above in relation to working capital statements will also be relevant in the case of a profit forecast. In particular, a process of due and careful enquiry may need to incorporate:
- a robust and up-to-date business analysis which ensures that the directors are highly confident that the forecast will be achieved;
 - consideration of the strategy and plans of the business and related implementation risks together with checks against external evidence and opinion;
 - comprehensive reporting systems and supporting forecast profit and loss accounts, cash flow statements and balance sheets; and
 - consideration of the neutrality of the captions and period selected for reporting and the simplicity and understandability of the numbers and assumptions that are presented.
- 8.25 An appropriate process of due and careful enquiry will need to be carefully planned, organised and communicated, particularly in complex, dispersed or diverse groups. Directors should also make sure that key elements of the process are evidenced through contemporaneous documentation.

9. Changes in expectations of performance under the Listing Rules

Requirements to notify changes

- 9.1 The Listing Rules contain explicit requirements to notify the markets of information about changes in a company's expectations about its future performance. These requirements are specific to the UK and are not derived from EU Directives. They will lead to the publication of PFI as defined in this Guidance.

UK LISTING RULES

CHAPTER 9, CONTINUING OBLIGATIONS

General obligation of disclosure for companies

- 9.2 A company must notify a Regulatory Information Service without delay of all relevant information which is not public knowledge concerning a change:

- (a) in the company's financial condition;
- (b) in the performance of its business; or
- (c) in the company's expectation as to its performance;

which, if made public, would be likely to lead to substantial movement in the price of its listed securities.

- 9.2 Compliance with these requirements is a serious matter given the important role that ad hoc reporting plays in UK securities market regulation. Apparent failure to comply may cause the UKLA to instigate investigations into a listed company and may be a breach of the market abuse regime.
- 9.3 Announcements under Listing Rule 9.2 are often generally referred to by market commentators as 'trading updates'. More specifically, announcements under Listing Rule 9.2(c) are often referred to in the media as 'profit warnings'. However, profit warning is not a term that is used in the Listing Rules and companies are not required to report only negative changes in expectations. Companies also rarely use the term in their announcements and they are not required to identify the precise nature of an announcement by reference to the relevant rules.
- 9.4 The requirements to notify changes in expectations might be expected to prompt companies to report their performance expectations in straightforward numerical terms, for example by disclosing expected, maximum or minimum amounts for current year profit before tax. However, directors may be reluctant to do this because such an announcement might subsequently be deemed to constitute a profit forecast in the event that a company issues listing particulars, a Class 1 circular or an offer document, before the actual results for the period have been reported. In these circumstances, a profit forecast triggers additional regulatory requirements including the involvement of reporting accountants.
- 9.5 The UKLA will apply the definition reproduced in Chapter 8 of this Guidance in determining whether an earlier announcement represents a profit forecast. This prospect underlines the importance to directors of following an appropriate process before making an announcement. However, it should not distract them from their obligation to issue announcements that are not misleading, false or deceptive, and to issue information in relation to future prospects that is clear and unambiguous.
- 9.6 One potential source of confusion in interpreting Listing Rule 9.2(c) is that it is triggered by a change in the *company's* expectation as to its performance. However, what if a company's expectations are out of line with the market not because those expectations have changed but because the market has, in the company's view,

made a mistake? Such mistakes may arise not just in relation to significant commercial issues, such as the level of demand in product markets, but also in other areas, for example the effective tax rate or the timing for recognising particular types of income and expenditure.

- 9.7 *The PSI Guide* indicates that such circumstances may trigger an announcement. However, there is no general obligation on companies to correct analysts' forecasts.

THE PSI GUIDE

SECTION 12, QUESTIONS FROM ANALYSTS AND CORRECTION OF ANALYSTS' FORECASTS

- 12.3. It is in the nature of analysts' forecasts that they should differ – sometimes significantly. In most circumstances a company is not obliged to make an announcement correcting public forecasts by analysts. However, a company should consider correcting serious and significant errors that come to its attention, which in its view have led to a widespread and serious misapprehension in the market.
- 12.4. Inaccurate forecasts by analysts are more likely to mislead the market in the case of small companies which may be researched by only one or two analysts and where there is little information on the company in the public domain. These companies may therefore be more likely to be in the position of having to make a corrective statement because the market is being seriously misinformed.

Relevance

- 9.8 The relevance of PFI is affected both by its ability to influence the economic decisions of investors and its timing. In general, companies would not be expected to make announcements related to developments outside of their sphere of activity which are already widely and promptly publicised by other parties, such as changes in interest rates and other general economic conditions and indicators. Where such changes lead a company to revise its own performance expectations, an announcement will be necessary unless the market already has a very good understanding of the linkage between the external change and the company's performance.
- 9.9 The timing of information is also important. The requirement to make announcements without delay places the onus on companies not only to have efficient decision-making processes and clear responsibilities. It also calls for investment in responsive systems that keep directors informed of developments in the company's product markets and operations, and that help them monitor analysts and others who help to set market expectations.

Materiality

- 9.10 Listing Rule 9.2 sets a threshold for disclosure of information about a company based on whether it 'would be likely to lead to substantial movement in the price of its ... securities.' The threshold quality for disclosure in the IASB Framework is materiality.
- 9.11 The concept of materiality in the IASB Framework is defined in terms of the effect of information in influencing the economic decisions of investors. The extracts from the Listing Rules provide more specific and authoritative guidance on how this concept should be applied in deciding whether developments and information should be announced to the market. Directors should also consult the supplementary guidance in *The PSI Guide*.

- 9.12 In deciding whether to make an announcement that includes financial information, companies should exercise caution before concluding that a matter is not material. In particular, they should not rely only on general quantitative materiality guidelines that they might use for financial reporting purposes. For example, suppose a company has decided that its materiality benchmark for financial reporting purposes is 5 per cent of pre-tax profits. This will not necessarily mean that there should be no disclosure of a new development affecting current year profits by 4 per cent.
- 9.13 The Listing Rules require directors to consider the likely consequences of an announcement on the share price or on the ability of a company with listed debt to meet its commitments. A company's sector will be an important consideration. Share prices in newer industries characterised by a dearth of historical information are likely to be more volatile in the face of changing expectations of performance. However, *The PSI Guide* does not offer formulae for identifying price-sensitive information nor specify the size of a price movement that might be substantial because no definition could ever capture every permutation of factors that might affect an issuer.

THE PSI GUIDE

SECTION 3, IDENTIFYING UNPUBLISHED PRICE SENSITIVE INFORMATION

Price sensitive information

- 3.3. [...] It is therefore not possible to set out a formula for identifying price sensitive information that will cover all possible permutations and situations.
- 3.4. To be prescriptive about the theoretical size of the price movement that the information would have to cause in order for an announcement to be necessary would also be of limited practical value and could give issuers false comfort. [...]

Understandability and reasonable disclosure

- 9.14 Directors should make announcements of changes in expectations of performance understandable to investors. There are two major challenges: making sure that investors understand what the company now expects; and appropriately communicating the uncertainties that surround any statement about the future. These challenges are made more demanding because of the need to communicate without delay.
- 9.15 An announcement to the effect that current market expectations of earnings of £x million are out of line with the company's expectations of £y million, is clearly understandable. Wariness of the regulatory requirements relating to profit forecasts that might become relevant in the event of having to issue an investment circular does not justify making an announcement that investors struggle to understand. Even professional investors with access to market expectations data need to be confident that the company has the same number in mind that they do. It is also unhelpful to expect investors to access historical expectations data in order to understand announcements.
- 9.16 It is unsatisfactory if the use of coded language means that it takes hours or even days for investors to work out if an announcement constitutes a profit warning and if different audiences and media commentators reach different conclusions. It is sometimes asserted that companies are wary of making clear statements that will be referred to by others as profit warnings because they might precipitate a disproportionately severe fall in share price. However, share prices are also adversely affected by the uncertainty engendered by unclear communication. Moreover, if a company makes a coded announcement which the market fails to interpret correctly, the directors may be required to make a further announcement.

- 9.17 Another potential source of market confusion arises where companies report expectations in terms of ranges or minimum or maximum numbers. Ultimately, the test of whether such communications need to be corrected by means of a further announcement is to compare subsequent market expectations with the company's expectations. For example, a company that confidently expects earnings to be between 95 and 105 is hardly likely to convey such an expectation effectively by saying that earnings will be not more than 110, or not less than 90, or between 85 and 105.
- 9.18 To address the danger that investors fail to appreciate the uncertainties that attach to any announcement concerning expectations, *The PSI Guide* encourages the disclosure of supplementary risk and other information in situations where investors may misinterpret or overreact to an announcement.

THE PSI GUIDE

SECTION 26, "HEALTH WARNINGS"

- 26.1. We believe that certain companies, especially those operating in volatile sectors, should consider including a statement of risks or contingencies in all announcements as a matter of best practice. This would be of particular relevance to companies that are heavily reliant on research and development and/or to companies subject to significant "cash burn". Examples of such issuers might be biotech or internet companies and, in fact, this practice has already been recommended in the BioIndustry Association Code. For instance, a biotechnology company announcing that initial trials of one of its drugs in development had been successful might add that there were still hurdles to overcome before the drug received approval from the medical regulators. This would help to ensure that the announcement is understood in its proper context.
- 26.3. [...] If companies do adopt this practice, the "health warning" should not be simply formulaic and perfunctory, but should be specific to the information released in the announcement.
- 26.4. We stress that these health warnings are not intended to be used as a formulaic defence to litigation, but as a way of explaining the context of information that the company announces in order to reduce the volatility of its share price.

- 9.19 A useful way of helping investors to adjust expectations without always having to rely on announcements may be to explain the company's perception of how external factors and other uncertain events impact the company's performance. For example, a company can do a lot to help markets understand the impact of exchange or interest rate changes, or consumer demand on its results.

Reliability and business analysis

- 9.20 Any announcement needs to be underpinned by a robust and up-to-date business analysis. Directors need to be clear about the company's strategy and plans, the related risks and the performance measures required to monitor implementation, if they are to build confidence amongst investors regarding the quality of their announcements.
- 9.21 The requirements of the Listing Rules related to financial reporting procedures and the risk management expectations of the *Combined Code on Corporate Governance* (Combined Code) and *Internal Control: Guidance for Directors on the Combined Code* (Turnbull Guidance) are supportive of this need. In particular, directors responsible

for an announcement should have access to non-financial leading indicators of performance and perform checks of the business analysis against external evidence and opinion.

- 9.22 The business analysis should form the basis of the unpublished PFI that supports any announcement. This should comprise internally consistent profit and loss accounts, cash flow statements and balance sheets to act as checks against omissions and inconsistencies. In practical terms this information will need to be derived from a comprehensive system for reporting budget and actual year-to-date numbers and full year budgets and forecasts.
- 9.23 There are also specific practical measures that boards may consider to help ensure that they identify all circumstances in which there is a need to make an announcement. These might include regular high-level reports setting out key indicators of the potential need to revise expectations, for example in the areas of order backlog, customer enquiries, tendering experience, competitor actions, accuracy of sales forecasts, trend analysis and comments. A common theme in cases where companies are criticised for saying too little too late is that management has either not been aware of warning signs or has been overoptimistic in explaining them away or assessing their ability to deal with them.

Other aspects of reliability

- 9.24 In the context of communicating changed expectations of performance, neutrality calls for an even-handed approach between good and bad news, and the Listing Rules require it. Association of the requirements of Listing Rule 9.2 with the term 'profit warnings' should not detract from the need for an even-handed approach. Directors are required to announce improved expectations of performance as well as downgrades.
- 9.25 The concept of prudence should also not be invoked to justify not disclosing good news, just as it should not be used to overstate bad news. In connection with PFI, prudence requires, for example, that an expected current year sales figure should be based upon an expectation that all the conditions required for the prudent recognition of sales will have been satisfied by the end of the year. Prudence does not require, and neutrality does not permit, an arbitrary amount to be deducted from an expected sales figure.

Comparability and subsequent validation

- 9.26 Announcements of changes in expectations should be capable of subsequent validation and comparison to subsequently reported information.

Principles of preparation

- 9.27 It is important to realise that companies are expected to report without delay. Delays are not excused on the grounds that a company was taking time to pull together precise figures. Consequently, directors need to ensure that company systems allow them to provide high-quality information without delay.
- 9.28 Chapter 3 identifies general principles for the preparation of PFI, which can be applied in the circumstances of this chapter. In addition, this chapter has identified a large number of specific considerations that will help ensure that announcements about changes in expectations constitute useful PFI. These considerations need to be addressed on an ongoing basis in a company's processes and systems which may as a result incorporate:
- a robust and up-to-date business analysis which enables directors to be confident that any announcement does not ultimately harm their credibility;
 - consideration of the strategy and plans of the business and related implementation risks together with external sense checks;

- comprehensive reporting systems and supporting profit and loss accounts, cash flow statements and balance sheets;
 - regular reporting of potential warning signs to board members with authority to act on them;
 - monitoring of market expectations against company expectations;
 - comparing proposed announcements against the qualitative characteristics of understandability, relevance, reliability and comparability, to assist in concluding that the information is not misleading, false or deceptive and does not omit any material information; and
 - external communication of causal relationships affecting reported performance.
- 9.29 Responsibilities should be clearly allocated and co-ordinated and there should be a clear documentation trail to show how the company has sought to comply with the relevant requirements of the Listing Rules. The share prices of companies that issue profit warnings are subject to a discount and companies that become known as serial profit warners are likely to suffer a fundamental loss of market confidence.

10. Panel on Takeovers and Mergers

Specific requirements

- 10.1 *The City Code on Takeovers and Mergers* (City Code) issued by the Takeover Panel deals with particular situations where PFI is likely to be relevant and lays down specific requirements for these situations. This is done principally through two Rules: Rule 28 Profit forecasts; and Rule 19.1 Note 8 Merger benefits statements. The detailed requirements of these rules are set out below. The regulatory background to the Takeover Panel is covered in Appendix I.
- 10.2 In summary, these two rules address the two most common forms of PFI in takeover situations. The two principal requirements are that, in certain circumstances, the assumptions underlying a profit forecast or merger benefits statement must be stated and the forecast or statement must be publicly reported on by both the company's financial adviser and the reporting accountant.
- 10.3 A key point to note is that these rules may apply to PFI published even before a company enters an offer period, that is before an announcement is made of a proposed or possible offer. The City Code can therefore impose certain detailed obligations which should be borne in mind by any company to which the City Code applies, regardless of whether it is subject to an offer at the time that PFI is published.

Profit forecasts in a takeover

- 10.4 The requirements for profit forecasts set out in this chapter apply to PFI published in takeover situations which meets the conditions set out below. These conditions have the same practical consequences as the conditions in the UK Listing Rules. In particular, an earlier announcement may represent a profit forecast even where no figure is mentioned, if it is possible to derive a figure for profits.
- 10.5 The City Code also extends the application of the idea in the Listing Rules that certain categories of historical financial information are treated in the same way as profit forecasts.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION K. PROFIT FORECASTS

RULE 28

28.6 STATEMENTS WHICH WILL BE TREATED AS PROFIT FORECASTS

- (a) When no figure is mentioned
Even when no particular figure is mentioned or even if the word "profit" is not used, certain forms of words may constitute a profit forecast, particularly when considered in context. Examples are "profits will be somewhat higher than last year" and "performance in the second half-year is expected to be similar to our performance and results in the first half-year" (when interim figures have already been published). Whenever a form of words puts a floor under, or a ceiling on, the likely profits of a particular period or contains the data necessary to calculate an approximate figure for future profits, it will be treated by the Panel as a profit forecast which must be reported on. In cases of doubt, professional advisers should consult the Panel in advance.
- (b) Estimates of profit for a completed period
An estimate of profit for a period which has already expired should be treated as a profit forecast.
- (c) Interim and preliminary figures
Except with the consent of the Panel, any unaudited profit figures published during an offer period must be reported on. This provision does not, however, apply to:

...continued

- (i) unaudited statements of annual or interim results which have already been published;
- (ii) unaudited statements of annual results which comply with the requirements for preliminary profits statements as set out in the "The Listing Rules";
- (iii) unaudited statements of interim results which comply with the requirements for half-yearly reports as set out in "The Listing Rules" in cases where the offer has been publicly recommended by the board of the offeree company; or
- (iv) unaudited statements of interim results by offerors which comply with the requirements for half-yearly reports as set out in "The Listing Rules", whether or not the offer has been publicly recommended by the board of the offeree company but provided the offer could not result in the issue of securities which would represent 10% or more of the enlarged voting share capital of the offeror.

The Panel should be consulted in advance if the company is not admitted to the Official List but wishes to take advantage of the exemptions under (ii), (iii), or (iv) above.

- (d) Forecasts for a limited period
A profit forecast for a limited period (e.g. the following quarter) is subject to this Rule.
- (e) Dividend forecasts
A dividend forecast is not normally considered to be a profit forecast unless, for example, it is accompanied by an estimate as to dividend cover.
- (f) Profit warranties
The Panel must be consulted in advance if a profit warranty is to be published in connection with an offer as it may be regarded as a profit forecast.

10.6 In addition, where a company complies with the requirements in Rule 24.2 to disclose financial and trading prospects by issuing PFI which constitutes a profit forecast, as defined in the City Code, then the guidance in this chapter should also be followed.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION J. DOCUMENTS FROM THE OFFEROR AND THE OFFEREE BOARD

RULE 24. OFFEROR DOCUMENTS

24.2 FINANCIAL AND OTHER INFORMATION ON THE OFFEROR, THE OFFEREE COMPANY AND THE OFFER

Except with the consent of the Panel:–

- (a) where the consideration includes securities and the offeror is a company incorporated under the Companies Act 1985 (or its predecessors) and its shares are admitted to the Official List or dealt in on AIM, the offer document must contain:
 - (x) the nature of its business and its financial and trading prospects;

...continued

- (b) where the consideration is cash only and the offeror is a company incorporated under the Companies Act 1985 (or its predecessors) and its shares are admitted to the Official List or dealt in on AIM, the offer document must contain:
 - (iv) the nature of the business and its financial and trading prospects;
 - [...]

10.7 In general, the guidance presented in Chapter 8 of this Guidance in relation to profit forecasts prepared under the Listing Rules will also be relevant to forecasts prepared under the City Code. This chapter does however highlight areas where there are differences in emphasis.

Understandability and reasonable disclosure

10.8 The City Code is committed to the concept of understandability and its guidance on the disclosure of assumptions is more explicit than the Listing Rules in presenting examples of inappropriate disclosures.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION K. PROFIT FORECASTS

RULE 28

28.2 THE ASSUMPTIONS

- (a) When a profit forecast appears in any document addressed to shareholders in connection with an offer, the assumptions, including the commercial assumptions, upon which the directors have based their profit forecast, must be stated in the document.
- (b) When a profit forecast is given in a press announcement commencing or made during an offer period, any assumptions on which the forecast is based should be included in the announcement.

NOTES ON RULE 28.2

1. *Requirement to state the assumptions*

- (a) *It is important that by listing the assumptions on which the forecast is based useful information should be given to shareholders to help them in forming a view as to the reasonableness and reliability of the forecast. This should draw the shareholders' attention to, and where possible quantify, those uncertain factors which could materially disturb the ultimate achievement of the forecast.*
- (b) *There are inevitable limitations on the accuracy of some forecasts and these should be indicated to assist shareholders in their review. A description of the general nature of the business or businesses with an indication of any major hazards in forecasting in these particular businesses should normally be included.*

[...]

...continued

2. General rules

(a) *The following general rules apply to the selection and drafting of assumptions.*

(i) *The shareholder should be able to understand their implications and so be helped in forming a judgement as to the reasonableness of the forecast and the main uncertainties attaching to it.*

(ii) *The assumptions should be specific rather than general, definite rather than vague.*

(iii) *Assumptions about factors which the directors can influence may be included, provided that they are clearly identified as such. However, assumptions relating to the general accuracy of estimates should be avoided. The following would not be acceptable:–*

“Sales and profits for the year will not differ materially from those budgeted for.”

“There will be no increases in costs other than those anticipated and provided for.”

Every forecast involves estimates of income and of costs and must obviously be dependent on these estimates.

Assumptions of the type illustrated above do not help the shareholder in considering the forecast.

(v) *The assumptions should relate only to matters which may have a material bearing on the forecast.*

(b) *Even the more specific type of assumption may still leave shareholders in doubt as to its implications, for instance:–*

“No abnormal liabilities will arise under guarantees.”

“Provisions for outstanding legal claims will prove adequate.”

Such phrases might be dismissed on the grounds that the first relates to the unforeseen and the second to the adequacy of the estimating system. In both these examples information would be necessary about the extent or basis of the provision already made and/or about the circumstances in which unprovided for liabilities might arise.

(c) *There may be occasions, particularly when the estimate relates to a period already ended, when no assumptions are required.*

Reliability and business analysis

10.9 The City Code holds out the possibility that a forecast might be qualified where full reliance cannot be placed on the system of accounting and forecasting. In practice, a company would be expected not to publish a forecast in these circumstances on the basis that it would not be reliable.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION K. PROFIT FORECASTS

RULE 28

28.2 THE ASSUMPTIONS

NOTES ON RULE 28.2

2. *General rules*

(a) *The following general rules apply to the selection and drafting of assumptions.*

(iv) *The assumptions should not relate to the accuracy of the accounting systems. If the systems of accounting and forecasting are such that full reliance cannot be placed on them, this should be the subject of some qualification in the forecast itself. It is not satisfactory for this type of deficiency to be covered by the assumptions. The following would not be acceptable:*

“The book record of stock and work-in-progress will be confirmed at the end of the financial year.”

Other aspects of reliability

10.10 The City Code contains specific requirements to support neutrality in the selection of captions.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION K. PROFIT FORECASTS

RULE 28

28.7 TAXATION, EXTRAORDINARY ITEMS AND MINORITY INTERESTS

When a forecast of profit before taxation appears in a document addressed to shareholders, there must be included forecasts of taxation (where the figure is expected to be significantly abnormal), extraordinary items and minority interests (where either of these amounts is expected to be material).

10.11 There is however a broader issue about how the concept of neutrality should be interpreted in the context of a forecast issued during a takeover when the purpose of a forecast issued by a target is generally to rebuff an offer or secure a better price. It is important to realise that the concept of neutrality applies in full to the forecast itself. There must be no cherry-picking of information. The fact that a company has a right to exercise discretion over whether and when it issues a forecast is not a matter for this Guidance.

Comparability and subsequent validation

10.12 In the context of a takeover, there are distinctive issues of comparability to address. The Takeover Panel is not in a position to require companies to present historical information after a transaction is completed to show whether or not a forecast was achieved. However, the City Code requires companies to remain accountable for their forecasts throughout the takeover process.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION K. PROFIT FORECASTS

RULE 28

28.5 SUBSEQUENT DOCUMENTS – CONTINUING VALIDITY OF FORECAST

When a company includes a forecast in a document, any document subsequently sent out by that company in connection with that offer must, except with the consent of the Panel, contain a statement by the directors that the forecast remains valid for the purpose of the offer and that the financial advisers and accountants who reported on the forecast have indicated that they have no objection to their reports continuing to apply.

- 10.13 The City Code also requires historical performance within a forecast period to be reported with comparatives. This helps to increase the accountability of directors publishing forecasts.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION K. PROFIT FORECASTS

RULE 28

28.8 WHEN A FORECAST RELATES TO A PERIOD WHICH HAS COMMENCED

Whenever a profit forecast is made in relation to a period in which trading has already commenced, any previously published profit figures in respect of any expired part of that trading period, together with comparable figures for the same part of the preceding year, must be stated.

Principles of preparation

- 10.14 The classification of PFI prepared in a takeover situation as a profit forecast is important because it triggers requirements for financial advisers and reporting accountants to satisfy themselves that expectations in respect of the directors' preparation of the PFI have been satisfied.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION K. PROFIT FORECASTS

RULE 28

28.1 STANDARDS OF CARE

There are obvious hazards attached to the forecasting of profits; this should in no way detract from the necessity of maintaining the highest standards of accuracy and fair presentation in all communications to shareholders in an offer. A profit forecast must be compiled with due care and consideration by the directors, whose sole responsibility it is; the financial advisers must satisfy themselves that the forecast has been prepared in this manner by the directors.

- 10.15 Chapter 3 identifies general principles for the preparation of PFI, which can be applied in the circumstances of this chapter. The City Code uses the phrase ‘due care and consideration’ whereas the Listing Rules refer to ‘due and careful enquiry’. The guidance relating to principles of preparation set out in Chapter 8 on profit forecasts should also be applied in takeover situations having regard to the additional material presented in this chapter.

Merger benefits statements

- 10.16 PFI on potential synergies between two businesses can often be useful to investors making decisions in takeover situations. Where such information is reflected in a profit forecast for the business that will be created as a result of a takeover, the rules and guidance on profit forecasts presented in Chapter 8 of this Guidance and the earlier part of this chapter should be applied. Where information is not intended to constitute a profit forecast, this needs to be made clear.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION K. PROFIT FORECASTS

RULE 28

28.6 Statements which will be treated as profit forecasts

- (g) Earnings enhancement and merger benefits statements

Parties wishing to make earnings enhancement statements which are not intended to be profit forecasts must include an explicit and prominent disclaimer to the effect that such statements should not be interpreted to mean that earnings per share will necessarily be greater than those for the relevant preceding financial period.

Parties should also be aware that the inclusion of earnings enhancement statements, if combined with merger benefits statements and/or other published financial information, may result in the market being provided with information from which the prospective profits for the offeror or the enlarged offeror group or at least a floor or ceiling for such profits can be inferred. Such statements would then be subject to this Rule. If parties are in any doubt as to the implications of the inclusion of such statements, they should consult the Panel in advance.

See also Note 8 on Rule 19.1.

- 10.17 Where PFI on the consequences of a transaction does not constitute a profit forecast, the City Code contains specific requirements to ensure that the City Code’s information standards are satisfied. PFI covered by these requirements is referred to as a merger benefits statement and can take the form of information about cost savings, revenue enhancements or overall earnings enhancements.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION I. CONDUCT DURING THE OFFER

RULE 19, INFORMATION

19.1 Standards of care

NOTES ON RULE 19.1

8. Merger benefits statements

In order to satisfy the existing standards of information set out in the Code, certain additional requirements may need to be complied with if a party makes quantified statements about the expected financial benefits of a proposed takeover or merger (for example, a statement by an offeror that it would expect the offeree company to contribute an additional £x million of profit post acquisition). These requirements will only need to be complied with in securities exchange offers and will not normally apply in the case of a recommended securities exchange offer unless a competing offer is made and the merger benefits statement is subsequently repeated by the party which made it or the statement otherwise becomes a material issue. These additional requirements include publication of:

- (a) the bases of the belief (including sources of information) supporting the statement;*
- (b) reports by financial advisers and accountants that the statement has been made with due care and consideration;*
- (c) an analysis and explanation of the constituent elements sufficient to enable shareholders to understand the relative importance of these elements; and*
- (d) a base figure for any comparison drawn.*

These requirements may also be applicable to statements to the effect that an acquisition will enhance an offeror's earnings per share where such enhancement depends in whole or in part on material merger benefits.

Parties wishing to make merger benefits statements should consult the Panel in advance. See also Rule 28.6(g).

Understandability and reasonable disclosure

10.18 Note 8(c) to Rule 19.1 above enshrines the principles of understandability and reasonable disclosure. It is important to list the main sources of the expected benefits and to be as specific as possible when identifying and describing them. It may be helpful to itemise any particularly significant matters, and any costs that will be incurred in realising the benefits should also be disclosed, for example redundancy costs associated with headcount reduction savings. Any assumptions that underpin merger benefits should comply with the general guidance applicable to assumptions as set out in Rule 28 of the City Code.

Reliability and business analysis

10.19 This Guidance reflects the view that statements about merger benefits should be based on a rigorous analysis of the strategic purpose of a transaction, specific post-transaction integration plans and an understanding of the risks involved in

implementing these plans. Extreme caution should be exercised in presenting PFI about merger benefits when a company:

- is keeping different strategic options open; or
- has limited information about the other party or about the financial consequences of alternative plans; or
- has limited opportunity to validate its plans by reference to external evidence and opinion.

- 10.20 As a consequence, a potential acquirer might have an adequate basis for stating that it plans to eliminate duplicate head office costs involving annual lease commitments of £x million and annual salary costs of £y million. However, the potential acquirer might conclude that a more detailed analysis would be required in order to be able to specify additional quantifiable sales orders or revenue streams that would be won by an enlarged business.
- 10.21 In certain transactions, for example hostile takeover bids, it may not be possible to gain access to the other party for information purposes. In such cases, it is particularly important that care is taken in presenting PFI about merger benefits.

Other aspects of reliability

- 10.22 Neutrality requires that the costs of implementing post-acquisition plans should be reported as well as any expected benefits. For example, redundancy costs should be reported along with the ongoing savings in salary costs that result from planned redundancies.

Comparability and subsequent validation

- 10.23 Even though the Takeover Panel is not in a position to monitor the achievement or otherwise of the benefits reported in merger benefits statements, it is important that investors can and that this ability acts as an incentive for directors to produce high-quality information to assist investors in their decision-making. Certain forms of merger benefits statements that companies 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.

Principles of preparation

- 10.24 Chapter 3 identifies general principles for the preparation of PFI, which can be applied in the circumstances of this chapter. In addition, this chapter has identified a number of matters requiring consideration before making a merger benefits statement. As a result, a process of due care and consideration will incorporate:
- 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 merger benefits will be realised;
 - consideration of the integration strategy and plans of the business and related implementation risks together with external checks;
 - assessment of the neutrality of the statement and in particular whether all costs of realising the expected benefits have been identified; and
 - consideration of whether the statement is capable of subsequent validation and is readily understandable.

11. AIM

- 11.1 Chapters 7 to 9 of this Guidance deal with working capital statements, profit forecasts and changes in expectations of performance regulated under the Listing Rules. These chapters are relevant to AIM companies and should be referred to by AIM companies publishing such PFI. This is because the AIM Rules contain equivalent requirements to the Listing Rules and these are considered in this chapter. The regulatory background to AIM is covered in Appendix I.

Working capital statements

- 11.2 The requirement for a working capital statement in an AIM admission document is similar to the Listing Rules requirement referred to in Chapter 7. However, the Exchange can authorise an AIM company not to publish a working capital statement in its admission document. This chapter does not offer any guidance as to the exceptional circumstances in which this might be appropriate, because any exemption would be granted on a case-by-case basis.

AIM RULES FOR COMPANIES – MAY 2003 – RULES

Schedule Two

A company which is required to produce an **admission document** must ensure that document discloses the following:

- (b) a statement by its **directors** that in their opinion having made due and careful enquiry, the working capital available to it and its group will be sufficient for its present requirements, that is for at least twelve months from the date of the **admission** of its securities;

Profit forecasts

- 11.3 The guidance set out in Chapter 8 also applies to PFI published by AIM companies that satisfies the definition reproduced below. This definition is substantially the same as the definition for listed companies. No distinction is drawn between the meanings of the terms 'forecast' and 'projection'.
- 11.4 The same concern for understandability seen in the Listing Rules is also reflected in the AIM Rules. In the case of an AIM company issuing a profit forecast or projection, the importance of principles for the preparation of PFI is reflected in the requirement that the directors and Nominated Advisers satisfy themselves that a process of due and careful enquiry has been completed. They are also required to monitor subsequent performance.

AIM RULES FOR COMPANIES – MAY 2003 – RULES

Schedule Two

A company which is required to produce an **admission document** must ensure that document discloses the following:

- (c) where it contains a profit forecast, estimate or projection (which includes any form of words which expressly or by implication states a minimum or maximum for the likely level of profits or losses for a period subsequent to that for which audited accounts have been published, or contains data from which a calculation of an approximate figure for future profits or losses may be made, even if no particular figure is mentioned and the words "profit" or "loss" are not used);

...continued

- (i) a statement by its **directors** that such forecast, estimate or projection has been made after due and careful enquiry;
- (ii) a statement of the principal assumptions for each factor which could have a material effect on the achievement of the forecast, estimate or projection. The assumptions must be readily understandable by investors and be specific and precise; [...]
- (iii) confirmation from the **nominated adviser** to the **applicant** that it has satisfied itself that the forecast, estimate or projection has been made after due and careful enquiry by the **directors** of the **applicant**;

AIM RULES FOR COMPANIES – MAY 2003 – RULES

NOMINATED ADVISERS

37. Only an adviser whose name appears on the **register** may act as a **nominated adviser**. The responsibilities which a **nominated adviser**, owes solely to the **Exchange** are to:

[...]

- review regularly an **AIM company's** actual trading performance and financial condition against any profit forecast, estimate or projection included in the **admission document** or otherwise made public on behalf of the **AIM company** in order to assist it in determining whether a **notification** is necessary under rule 15;

Changes in expectations of performance

- 11.5 As in the case of the Listing Rules, the AIM Rules contain explicit requirements to notify the market of information about changes in a company's expectations about its future performance. The Exchange may take action against an AIM company and its Nominated Adviser in the event of non-compliance.

AIM RULES FOR COMPANIES – MAY 2003 – RULES

GENERAL DISCLOSURE OF PRICE SENSITIVE INFORMATION

10. An **AIM company** must issue **notification** without delay of any new developments which are not public knowledge concerning a change in:
- its financial condition;
 - its sphere of activity;
 - the performance of its business; or
 - its expectation of its performance,
- which, if made public, would be likely to lead to a substantial movement in the price of its **AIM securities**.

12. OFEX

- 12.1 The regulatory background to OFEX is set out in Appendix I. In general, Chapters 7 to 9 of this Guidance will not apply to OFEX companies, since they are not subject to requirements equivalent to the Listing Rules in relation to working capital statements, profit forecasts or changes in expectations of performance.
- 12.2 However, Chapters 7 and 8 may be applicable to OFEX companies in limited circumstances in the context of specific requirements related to start-ups preparing working capital statements and illustrative financial projections. These requirements are dealt with in this chapter.

Working capital statements

- 12.3 Where a start-up is being admitted to OFEX, a letter to the OFEX Board relating to working capital will be required as set out below. Such a letter does not constitute published PFI covered by this Guidance.

THE OFEX RULES

CHAPTER 8 – APPLICATION FOR ADMISSION TO OFEX

Additional Information Required from Start-ups

8.13 The following information (in addition to the information required by **rules 8.10 to 8.12**) is required for **start-up issuers**:

- (b) a letter from the directors stating that, in their opinion, having made due and careful enquiry, the working capital available to the **issuer** (and its **subsidiaries**, if applicable) is sufficient for its present requirements, that is the next twelve (12) months; [...]

- 12.4 In the case of a start-up raising funds, the company will be relieved of the requirement to address a letter on working capital to the OFEX Board. However, where an OFEX company is raising funds and a prospectus or a private placing memorandum is issued, a working capital statement will need to be included in the document. Such a letter constitutes published PFI and is covered by this Guidance.

THE OFEX RULES

CHAPTER 8 – APPLICATION FOR ADMISSION TO OFEX

Figure 5 – Guidance on start-ups which issue a prospectus or private placing memorandum

Where a prospectus or private placing memorandum is issued by a **start-up** in conjunction with the application under **rule 8.14** [...] A working capital letter is not required if a statement in the form set out in **rule 8.13(b)** appears in the prospectus or private placing memorandum. [...]

Figure 6 – Guidance where a prospectus is issued or private placing memorandum produced in conjunction with the application

Information under the following headings (or appropriate negative statements) will be required to be included in any prospectus or private placing memorandum:

- working capital statement in the terms set out in **rule 8.13(b)** on the basis that the minimum subscription is reached (if applicable); [...]

- 12.5 The OFEX Rules specifically envisage that the working capital statement made in the context of a fund-raising takes account of the proceeds of the fund-raising. This is because of the requirement that the statement is made on the basis that any minimum subscription amount is reached. In all other respects, the guidance set out in Chapter 7 should be applied.

Illustrative financial projections

- 12.6 Where a start-up is being admitted to OFEX, a business plan will need to be submitted to the OFEX Board and where this contains illustrative financial projections, these will need to be subject to a letter from the company's auditors. Such projections do not constitute published PFI covered by this Guidance.

THE OFEX RULES

CHAPTER 8 – APPLICATION FOR ADMISSION TO OFEX

Additional Information Required from Start-ups

8.13 The following information (in addition to the information required by rules 8.10 to 8.12) is required for **start-up issuers**:

- (a) six (6) copies of a business plan covering the next three years of operation. [...]
- (c) if illustrative financial projections are included in the business plan, confirmation from the **issuer's** auditors that the projections have been properly compiled, so far as the accounting policies and calculations are concerned, on the assumptions and bases set out in the business plan, and are presented on a basis consistent with the accounting policies adopted by the **issuer** and generally accepted accounting policies;

- 12.7 Where a prospectus is issued or a private placing memorandum is produced, a company will not normally be required to produce a business plan. However, if the company elects to publish PFI in the form of illustrative financial projections in a public document, an auditors' report will also need to be published, although the auditors will be relieved of any other requirement to address such a letter to the OFEX Board.

THE OFEX RULES

CHAPTER 8 – APPLICATION FOR ADMISSION TO OFEX

Additional Information Required from Start-ups

Figure 5 – Guidance on start-ups which issue a prospectus or private placing memorandum

Where a prospectus or private placing memorandum is issued by a **start-up** in conjunction with the application under **rule 8.14**, a business plan need not normally be submitted. [...] Similarly, the confirmation regarding illustrative financial projections required by **rule 8.13(c)** is not required if such confirmation appears in the prospectus or private placing memorandum.

...continued

Figure 6 – Guidance where a prospectus is issued or private placing memorandum produced in conjunction with the application

[...]

Information under the following headings (or appropriate negative statements) will be required to be included in any prospectus or private placing memorandum:

[...]

- if illustrative financial projections appear, confirmation from the auditors in the terms set out in **rule 8.13(c)** must be included.

- 12.8 The OFEX Rules clearly envisage that start-ups may be able to provide useful information to investors in the form of illustrative financial projections. In providing such information, it is appropriate for directors to have regard to the principles of useful PFI developed in Part A of this Guidance. These principles highlight the potential pitfalls of publishing illustrative financial projections and provide a robust framework against which directors can judge whether they are acting responsibly in publishing such projections. The guidance in this chapter on illustrative financial projections represents a substantial expansion of the guidance in Chapter 8 on profit forecasts.
- 12.9 In relation to illustrative financial projections, an OFEX company is subject to the general obligation under OFEX Rule 8.10 to meet the reasonable requirements and expectations of investors and their professional advisers. Issuers and Corporate Advisers are also obliged under OFEX Rule 9.4(c) to take all reasonable care that any information is not misleading, false or deceptive and does not omit anything likely to affect its import. Ultimately, directors need to judge whether they may subsequently be deemed to have recklessly made statements that are materially misleading and which would therefore constitute an offence under Section 397 of FSMA.

Understandability and reasonable disclosure

- 12.10 The overriding disclosure consideration is that investors are not misled about the nature and usefulness of the projections presented for an extended period. PFI should not be unnecessarily cluttered by disclosure of immaterial assumptions and risk factors that do not influence the decisions made by users of PFI. However, the greater the uncertainties associated with the business activities and the period covered by PFI, the more complex will be the related disclosures required to achieve faithful representation in the eyes of a user who cannot interact directly with the preparer.
- 12.11 Companies would always be expected to disclose all assumptions having a material bearing on PFI and it is also useful to segregate assumptions about factors which the directors can influence from assumptions which are exclusively outside their influence. The former are more likely to be borne out in practice and so there should be a reduced need for disclosures about sources of uncertainty, determining factors and alternative outcomes.
- 12.12 As uncertainties become more significant, there will be more need to describe assumptions that have been adopted to deal with them, the nature of the factors that will determine whether they are borne out and the impact of alternative outcomes, for example through sensitivity analysis. At some point the note disclosures explaining uncertainties and assumptions may become more important than the numbers in the illustrative financial projections themselves. This violates the normal principles of aggregation and summarisation which help to make financial information understandable.

- 12.13 It should also be recognised that, at some point, the interaction of multiple uncertainties may defy structured sensitivity analysis that investors can understand and use to reach meaningful conclusions. This is more likely to be the case where there are qualitative as well as quantitative assumptions and no reliable indicators of the relative likelihood of departures from the stated assumptions.
- 12.14 Whilst ranges, floors and ceilings are useful in the context of profit forecasts for reducing the uncertainty associated with PFI, they are of less relevance in the case of illustrative financial projections. Although there is no definition of 'illustrative financial projections', there is an expectation that, at a minimum, summary profit and loss, balance sheet and cash flow information will be published. Presenting ranges for such information is likely to be more of a challenge than for the summary profit and loss captions customary in a profit forecast.
- 12.15 It is possible to translate the ideas of floors and ceilings into worst and best case illustrative financial projections. Nevertheless, although the presentation of worst case scenarios is common in unpublished PFI provided to bankers, the value of such information for the general public investing in equity shares is questionable. Publishing best case scenarios is likely to be seen as highly irresponsible.
- 12.16 Where there is any concern that investors may be unable to draw meaningful conclusions about the likelihood of different overall outcomes but the directors still conclude that the publication of the projections is responsible, the PFI should be prefaced with prominent cautionary words, for example to the effect that the projections:
- are subject to significant economic, competitive and other uncertainties beyond the control of the company;
 - are illustrative of possible financial outcomes based upon directors' current estimates; but
 - should not be relied upon as showing financial outcomes that are likely to occur in practice.
- 12.17 Potential preparers of illustrative financial projections should bear in mind that published PFI should be accompanied by full disclosure of assumptions, determining factors, and alternative outcomes but that such disclosure should not place unreasonable demands on users. Consequently, publication of illustrative financial projections will often be precluded because of the uncertainties involved. Nevertheless, companies should describe their strategy and plans, the related uncertainties and their responses in circumstances where it would be irresponsible to publish PFI.

Reliability and business analysis

- 12.18 The quality of the underlying business analysis is fundamental to the quality of projections. It is not enough to produce projections based on a rudimentary accounting model with a simple set of assumptions for sales growth, gross margin and overheads. The information content of the resulting mathematical extrapolation is likely to be meagre. It is important that the directors and other members of management involved in the preparation have in-depth experience of the business and expertise across all its activities. This will help them to identify and communicate the most significant uncertainties for which assumptions are required; for example, in relation to competitors' products and pricing, technological change, customer wants, the potential impact of regulations, product sourcing and the effectiveness of distribution channels.
- 12.19 The business analysis principle requires PFI assumptions to be reasonable and supportable and to be based on expected economic conditions and courses of action that the directors intend to adopt. PFI should only reflect future actions that are

envisaged in the company's current strategies and plans and only reflect future actions, events and circumstances for which the related uncertainties and implementation risks have been properly analysed by the directors.

- 12.20 Checks of these strategies and plans against external evidence and opinion are also vital. Explanations must be sought and provided if the projections are not consistent with external information in the form of market surveys, general economic indicators and the views of people knowledgeable in the business and the industry. The importance of external analysis and validation of a company's strategy, products, services and marketing will be far greater for a start-up than for any other type of business. Where projections relate to activities with no track record directors would also be expected to have supporting evidence from thorough research and piloting.
- 12.21 The length of the future periods to which the PFI relates will significantly affect the confidence to be attached to such PFI. In addition, by its nature, PFI presented in a start-up situation will be subject to a wide range of uncertainties. The length of the future period for which illustrative financial projections can responsibly be prepared will depend in part on the quality of a company's business analysis and financial forecasting systems but also on the nature of the business. The greater the environmental risks, for example in the form of regulation, product acceptance, macroeconomic exposures, politics, market volatility and competitor action, the shorter the period will be.

Other aspects of reliability

- 12.22 Because it is implicit in the phrase 'illustrative financial projections' that the information will be presented for a period extending beyond the current accounting period, there is likely to be significant uncertainty in many areas. Neutrality requires that these uncertainties be addressed by making best estimate assumptions that represent most likely outcomes.
- 12.23 In addition, the concept of neutrality is relevant to illustrative financial projections because it places the onus on directors not simply to consider the period covered by the projections. If any published projections are unlikely to be indicative of the company's financial position or performance in a subsequent period, the information would be subject to bias. In these circumstances, supplementary disclosures would be appropriate.
- 12.24 Neutrality should also be considered in relation to the selection of the financial statement captions to be presented. Any selection of captions for presentation should not have the effect of giving a misleading impression and prompting accusations of cherry picking.

Comparability and subsequent validation

- 12.25 Illustrative financial projections should clearly be capable of being reported against in future. The requirement that the auditors report that such PFI is presented on a basis consistent with the accounting policies adopted by the issuer not only allows comparison with historical numbers but also helps to ensure that subsequent historical financial information will be comparable to illustrative financial projections.
- 12.26 In addition, once a company has published illustrative financial projections, it will be required to report actual performance against them under the continuing obligation of OFEX Rule 9.3. This requires companies to inform investors of any new developments which might have a material effect on the value of the company's securities. Clearly, differences between actual experience and matters reflected in projected financial outcomes or supporting disclosures could trigger a requirement to inform investors.

Principles of preparation

- 12.27 In relation to PFI, an expectation of 'all reasonable care' is placed on directors of OFEX companies and their Corporate Advisers.
- 12.28 Chapter 3 identifies general principles for the preparation of PFI, which can be applied in the circumstances of this chapter. In addition, this chapter has identified a large number of considerations that will help ensure that any illustrative financial projections that are published constitute useful PFI. It is evident that these require a wide range of business skills and commercial judgement as well as accounting expertise and that a process involving all reasonable care will incorporate:
- the involvement of directors and other members of management with in-depth experience of the business and expertise across all its activities so that they can identify and communicate the most significant uncertainties associated with assumptions;
 - consideration of the strategy and plans of the business and the related implementation risks together with checks against external evidence and opinion;
 - consideration of any factors that might arise in the period subsequent to that covered by the projections that would mean that the PFI was not indicative of the company's subsequent financial performance or position;
 - consideration of the neutrality of captions and periods selected for reporting and the simplicity and understandability of the numbers, assumptions and related explanations of uncertainties that are presented;
 - identification and disclosure of best estimate assumptions and related sensitivity analysis;
 - ensuring the projections are properly compiled on the assumptions and bases set out in the company's business plans and presented on a basis consistent with the accounting policies adopted by the issuer;
 - systems that support the accurate generation of internally consistent financial projections covering balance sheet, profit and loss and cash flow information; and
 - drafting of appropriate cautionary language regarding the nature of the illustrative financial projections.
- 12.29 An appropriate process of reasonable care will need to be carefully planned, organised and communicated. Responsibilities should be clearly allocated and co-ordinated and there should be clear contemporaneous documentation to evidence key elements of the process and show how the company has sought to comply with the relevant requirements of the OFEX Rules.
- 12.30 Finally, there will also be related expectations about the company's subsequent monitoring of actual experience against the illustrative financial projections so that the company can discharge its responsibilities under the continuing obligations of the OFEX Rules.

Appendices



Appendix I: UK regulators

- I.1 This Appendix provides background information on UK regulators that is relevant to understanding the PFI requirements to which this Guidance applies. The relevant regulators are the UK Listing Authority, the Panel on Takeovers and Mergers, the London Stock Exchange and AIM, and OFEX.

UK Listing Authority

- I.2 The FSA was appointed under Section 72 of FSMA as the UK's competent authority to regulate the admission of securities to the Official List with effect from 1 December 2001. Under Section 73(2) of FSMA the general functions of the competent authority for listing are making rules, giving general guidance, and determining the general policy and principles by reference to which it performs particular functions under Part VI of FSMA.
- I.3 In addition, the FSA is specifically charged with enforcing the Listing Rules, maintaining the Official List, determining which securities should be admitted to listing and, where relevant, the discontinuance and suspension of such listing.
- I.4 In discharging its general functions as the UK Listing Authority, the FSA must have regard to the criteria specified in Section 73(1) of FSMA.

FINANCIAL SERVICES AND MARKETS ACT 2000

PART VI OFFICIAL LISTING

The competent authority

73. General duty of the competent authority

- (1) In discharging its general functions the competent authority must have regard to—
- (a) the need to use its resources in the most efficient and economic way;
 - (b) the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits, considered in general terms, which are expected to arise from the imposition of that burden or restriction;
 - (c) the desirability of facilitating innovation in respect of listed securities;
 - (d) the international character of capital markets and the desirability of maintaining the competitive position of the United Kingdom;
 - (e) the need to minimise the adverse effects on competition of anything done in the discharge of those functions;
 - (f) the desirability of facilitating competition in relation to listed securities.

Objectives of the UKLA

- I.5 General and specific objectives, in addition to key operational performance targets, are agreed between HM Treasury and the FSA for each financial year. The regulatory objectives of the FSA in its capacity as the UK Competent Authority for Listing are to formulate and enforce Listing Rules that:
- provide an appropriate level of protection for investors in listed securities;
 - facilitate access to listed markets for a broad range of enterprises; and
 - seek to maintain the integrity and competitiveness of UK markets for listed securities.

Sponsors and directors

- 1.6 In certain circumstances the Listing Rules require issuers to appoint a sponsor. The UKLA maintains a list of sponsors that it has approved. In the case of an application for listing which requires the production of listing particulars, a sponsor's responsibilities include satisfying itself to the best of its knowledge and belief that the issuer has met all applicable conditions for listing and other relevant requirements of the Listing Rules. The sponsor does so having made due and careful enquiry of the issuer and its advisers.
- 1.7 The sponsor must also satisfy itself that the directors have had explained to them by the sponsor or another appropriate professional adviser the nature of their responsibilities and obligations as directors under the Listing Rules. In connection with listing particulars, each director is required to sign a letter confirming that they contain all such information within their knowledge as investors and their professional advisers would reasonably require and expect to find. The listing particulars are required to contain a related declaration that the directors take responsibility for the information in the document and a similar requirement applies in respect of Class 1 circulars.

UK LISTING RULES

CHAPTER 6, CONTENTS OF LISTING PARTICULARS

INFORMATION REQUIRED FOR THE ADMISSION OF SHARES OR CONVERTIBLE DEBT SECURITIES TO LISTING

The persons responsible for listing particulars, the auditors and other advisers

6.A.3 [...] The directors of [the issuer] whose names appear on page [], accept responsibility for the information contained in this document. To the best of the knowledge and belief of the directors (who have taken all reasonable care to ensure that such is the case) the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

- 1.8 If the UKLA considers that an issuer has breached any provision of the Listing Rules, it may impose a financial penalty or publish a statement censuring the issuer. Anybody who was a director of the issuer at the time of such a breach and was knowingly concerned in it may also be subject to a financial penalty or a published censure.

The Listing Rules and PFI

- 1.9 The Listing Rules apply to all companies whose securities are admitted to the Official List. The Listing Rules identify a number of different types of information that fall into the broad definition of PFI adopted in this Guidance. They can be divided into two categories: PFI to be included in listing particulars or shareholder circulars; and PFI that might be included in ad hoc regulatory announcements.
- 1.10 Certain types of PFI might be included under the general requirement in Section 80 of FSMA to disclose in listing particulars all the information that investors and their professional advisers would reasonably require and reasonably expect to find for the purpose of making an informed assessment of the profits and losses, assets and liabilities, financial position and prospects of the issuer and of the rights attaching to the securities to which the listing particulars relate. Examples might be merger benefits statements, estimates of future cost savings and profit forecasts. The latter are governed by a number of specific regulatory requirements.

FINANCIAL SERVICES AND MARKETS ACT 2000

PART VI OFFICIAL LISTING

Listing particulars

80. General duty of disclosure in listing particulars

- (1) Listing particulars submitted to the competent authority under section 79 must contain all such information as investors and their professional advisers would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment of—
 - (a) the assets and liabilities, financial position, profits and losses, and prospects of the issuer of the securities; and
 - (b) the rights attaching to the securities.
- (2) That information is required in addition to any information required by—
 - (a) listing rules, or
 - (b) the competent authority,as a condition of the admission of the securities to the official list.

- I.11 PFI may be required to be included in listing particulars or shareholder circulars in compliance with particular listing rules. One example of this would be the statement that, in the opinion of the directors, the company has sufficient working capital for its present requirements.

Overarching requirements related to PFI

- I.12 A number of overarching requirements are applied to PFI in the Listing Rules notwithstanding the method by which the information may ultimately be published.
- I.13 All PFI, whether included in listing particulars or a shareholder circular or notified to the market through a Regulatory Information Service is subject to the same standard of care set out in Listing Rule 9.3A, which reflects the first three legal themes identified in Chapter 4 of this Guidance.

UK LISTING RULES

CHAPTER 9, CONTINUING OBLIGATIONS

General obligation of disclosure for companies

9.3A A company must take all reasonable care to ensure that any statement or forecast or any other information it notifies to a Regulatory Information Service or makes available through the UK Listing Authority is not misleading, false or deceptive and does not omit anything likely to affect the import of such statement, forecast or other information.

- I.14 Information that is consistent with the qualitative characteristics of useful PFI outlined in Part A of this document and the IASB Framework – understandability, relevance, reliability and comparability – is likely to satisfy the requirements of Listing Rule 9.3.A. Information could be misleading or false because of failures in respect of any of the qualitative characteristics. As well as being misleading or false, information that is deceptive would also always be characterised by a lack of neutrality, one of the characteristics of reliability. The omission of anything likely to affect the import of

information would always involve a failure in respect of the reliability characteristic of completeness. However, the conditions and factors that issuers will need to take into account in determining whether requirements of Listing Rule 9.3.A have been met are likely to be different in each case.

- I.15 The importance of relevant, reliable and understandable information is positively underlined by the Combined Code through the principle that directors should present a balanced and understandable assessment of a company's position and prospects. This responsibility extends beyond annual reports to interim and other price-sensitive reports and reports to regulators. The Combined Code is annexed to but does not form part of the Listing Rules. However, listed companies are required to report how they have applied its principles and whether they have complied with its provisions.

THE COMBINED CODE ON CORPORATE GOVERNANCE

CODE OF BEST PRACTICE

SECTION 1 COMPANIES

C. ACCOUNTABILITY AND AUDIT

C.1 Financial Reporting

Main Principle

The board should present a balanced and understandable assessment of the company's position and prospects.

Supporting Principle

The board's responsibility to present a balanced and understandable assessment extends to interim and other price sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.

- I.16 Both the Combined Code and the Listing Rules also place an obligation on listed company directors to report annually that the business is a going concern. The guidance for directors related to this requirement establishes an expectation that directors will prepare unpublished PFI to support their statement on going concern.

UK LISTING RULES

CHAPTER 12, FINANCIAL INFORMATION

Annual report and accounts

12.43 The following items must, unless the UK Listing Authority agrees, be included in the annual report and accounts:

Going concern

- (v) in the case of a company incorporated in the United Kingdom, a statement by the directors that the business is a going concern with supporting assumptions or qualifications as necessary, as interpreted by the Guidance on Going Concern and Financial Reporting for directors of listed companies registered in the United Kingdom, published in November 1994; such statement to be reviewed by the auditors before publication.

Underlying procedures and systems

- I.17 As well as identifying principles to be met by listed companies' published information, including PFI, the Listing Rules also establish explicit expectations regarding the procedures and systems that should underpin such information.
- I.18 The strength of a company's internal reporting procedures is important in providing users with a certain degree of comfort on the information published by an issuer.

UK LISTING RULES

CHAPTER 2, SPONSORS

Services to be provided by a sponsor

2.15 Financial reporting procedures

In the case of a new applicant or, in exceptional circumstances where the UK Listing Authority so requires, of a listed issuer, the sponsor must obtain written confirmation from the issuer that the directors have established procedures which provide a reasonable basis for them to make proper judgements as to the financial position and prospects of the issuer and its group and be satisfied that this confirmation has been given after due and careful enquiry by the issuer. In cases where a declaration under paragraph 2.12 is not required, the sponsor must confirm its satisfaction in this regard in writing to the UK Listing Authority.

- I.19 The FSA recognises how important it is for a listed company to have robust internal reporting procedures that enable it to make proper judgements of its financial position and prospects, especially given the importance of ad hoc disclosures. The Listing Rules do not contain a continuing obligation requiring companies to maintain an adequate internal control system but this is clearly the expectation. In recognition of this, the Listing Rules place certain responsibilities on the issuer and the sponsor and require the sponsor to confirm in writing to the UKLA that it is satisfied that the statement made by the directors under Listing Rule 2.15 has been made after due and careful enquiry.
- I.20 Listed companies are also expected to have in place systems for assessing and managing risk. Part A of this Guidance emphasises the need for useful PFI to be supported by appropriate business analysis and this will be facilitated by initiatives prompted by the section of the Combined Code relating to internal control.

THE COMBINED CODE ON CORPORATE GOVERNANCE

CODE OF BEST PRACTICE

SECTION 1 COMPANIES

C. ACCOUNTABILITY AND AUDIT

C.2 INTERNAL CONTROL

Main Principle

The board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets.

Code Provision

- C.2.1** The directors should, at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report to shareholders that they have done so. The review should cover all controls, including financial, operational and compliance controls and risk management systems.

- I.21 Further guidance on how directors of listed companies should satisfy the expectations of the Combined Code in relation to internal control and risk management is set out in *Internal Control: Guidance for Directors on the Combined Code*. This guidance, also known as the Turnbull Report, was published by the ICAEW in September 1999. It establishes an expectation that every listed company board will thoroughly and regularly evaluate the risks to which the company is exposed. This will clearly facilitate the business analysis envisaged in Part A of this Guidance.

INTERNAL CONTROL: GUIDANCE FOR DIRECTORS ON THE COMBINED CODE

The importance of internal control and risk management

13. A company's objectives, its internal organisation and the environment in which it operates are continually evolving and, as a result, the risks it faces are continually changing. A sound system of internal control therefore depends on a thorough and regular evaluation of the nature and extent of the risks to which the company is exposed. Since profits are, in part, the reward for successful risk-taking in business, the purpose of internal control is to help manage and control risk appropriately rather than to eliminate it.

Specific requirements

- I.22 For some items of PFI, the Listing Rules require the sponsor to conduct a certain amount of due diligence on the information that a listed company proposes to publish. Confirmation that statements have been made after due and careful enquiry, whether published or addressed privately to the UKLA, provides additional comfort to investors and shareholders on the reliability of the information presented. The principal areas where such requirements are imposed is in relation to two of the most important items of PFI, working capital statements and profit forecasts, to which the investors will attach a great deal of importance.
- I.23 As discussed in Chapter 7 of this Guidance, where listing particulars or a Class 1 circular are to be published, the Listing Rules require the directors of an issuer to confirm that in their opinion, the company has sufficient working capital for at least the next 12 months. The sponsor is required to confirm to the UKLA that in its opinion, this confirmation has been given after due and careful enquiry.
- I.24 As discussed further in Chapter 8 of this Guidance, the Listing Rules set out detailed requirements governing the presentation of a profit forecast to be included in listing particulars or a Class 1 circular. The rules stipulate that a forecast must be clear, unambiguous and comparable both in terms of the figures disclosed and the period for which the information is presented. Reports are required from the reporting accountant and the sponsor.
- I.25 The detailed requirements relating to other ad hoc and industry-specific PFI published by listed companies are set out in Chapters 6, 7 and 9.

Panel on Takeovers and Mergers

- I.26 Offers for all listed and unlisted public companies considered by the Panel on Takeovers and Mergers (the Takeover Panel) to be resident in the United Kingdom are subject to a non-statutory code, *The City Code on Takeovers and Mergers* (City Code). Its main source of authority is that it represents the collective opinion of those involved in takeovers. It has also been recognised under the FSMA regulatory regime such that the FSA may take enforcement action at the request of the Takeover Panel.

- I.27 The City Code contains detailed rules governing a takeover offer, including provisions concerning the content of the documentation produced by the bidder and the target. Certain types of PFI, such as profit forecasts and merger benefits statements, are dealt with specifically. Chapter 10 of this Guidance summarises the regulatory framework and the expectations established under the City Code in relation to PFI. These expectations cover not only the information itself but also the processes applied in its preparation.

Regulatory framework

- I.28 The City Code applies to offers for all listed and unlisted public companies considered by the Takeover Panel to be resident in the United Kingdom. In addition, the City Code may also apply to certain types of private company.
- I.29 The City Code is concerned with takeover and merger transactions, however effected, of all relevant companies. These transactions include partial offers, offers by a parent company for shares in its subsidiary and certain other transactions where control of a company (as defined) is to be obtained or consolidated. References in the City Code to 'takeovers' and 'offers' include, where relevant, all such transactions.
- I.30 The City Code has not, and does not seek to have, the force of law. It has, however, been acknowledged by both government and other regulatory authorities that those who seek to take advantage of the facilities of the securities markets in the United Kingdom should conduct themselves in matters relating to takeovers in accordance with high business standards and so according to the City Code.
- I.31 It represents the collective opinion of those professionally involved in the field of takeovers about business standards and about how fairness to shareholders can be achieved. The City Code is kept under review by the Takeover Panel's Code Committee.
- I.32 The FSA may, at the request of the Takeover Panel, take enforcement action against persons authorised under FSMA, including public censure, fines, the removal of authorisation, the imposition of injunctions and orders for restitution. In addition, enforcement action can be taken against individuals who are 'approved persons' such as directors of authorised firms.
- I.33 With regard to enforcement against companies, the FSA's rules require a firm authorised under FSMA not to act for any person if the firm has reasonable grounds for believing that the person is not complying with or is not likely to comply with the City Code. Where a person has been named in a notice published by the Takeover Panel as someone who in the Takeover Panel's opinion is not likely to comply with the City Code, the FSA expects an authorised person not to act for that person.

Objectives of the City Code

THE CITY CODE ON TAKEOVERS AND MERGERS

INTRODUCTION

1. THE CODE

(a) Nature and purpose of the Code

[...]

The Code is designed principally to ensure fair and equal treatment of all shareholders in relation to takeovers. The Code also provides an orderly framework within which takeovers are conducted.

[...]

- I.34 The City Code itself is based upon a number of General Principles, which are essentially statements of high standards of commercial behaviour. In addition to the General Principles, the City Code contains a series of Rules of which some are effectively expressions of the General Principles and others are precise as governing specific aspects of takeover procedure. It is within this context that the City Code impacts directly on the nature of PFI.

The City Code and PFI

- I.35 It is clear that any statement publicly made by a party to a takeover offer might influence a shareholder's view of the merits of such an offer and thus his or her decision as to whether or not to accept an offer. This applies particularly to PFI, as such information will often have a direct bearing on interpretation of the financial merits of an offer.
- I.36 PFI is important in all offers, but is particularly sensitive in hostile takeover offers, where the consideration includes the offeror's securities or where the parties attempt publicly to quantify the benefits likely to accrue from a merger or acquisition.
- I.37 The City Code therefore reflects the paramount importance of ensuring that PFI, in the context of takeover offers, is only published according to the most stringent standards.

Overarching principles

- I.38 There are three key General Principles in the City Code relevant to PFI.

THE CITY CODE ON TAKEOVERS AND MERGERS

GENERAL PRINCIPLES

4. Shareholders must be given sufficient information and advice to enable them to reach a properly informed decision and must have sufficient time to do so. No relevant information should be withheld from them.
5. Any document or advertisement addressed to shareholders containing information or advice from an offeror or the board of the offeree company or their respective advisers must, as is the case with a prospectus, be prepared with the highest standards of care and accuracy.
6. All parties to an offer must use every endeavour to prevent the creation of a false market in the securities of an offeror or the offeree company. Parties involved in offers must take care that statements are not made which may mislead shareholders or the market.

- I.39 The main detailed rule which enshrines General Principles 4, 5 and 6 is Rule 19.1.

THE CITY CODE ON TAKEOVERS AND MERGERS

SECTION I. CONDUCT DURING THE OFFER

RULE 19. INFORMATION

19.1 STANDARDS OF CARE

Each document or advertisement issued, or statement made, during the course of an offer must, as is the case with a prospectus, satisfy the highest standards of accuracy and the information given must be adequately and fairly presented. This applies whether it is issued by the company direct or by an adviser on its behalf.

- I.40 The General Principles and Rule outlined above set the framework within which PFI must be considered in a takeover situation. It is clear that the General Principles of the City Code impose obligations on companies and advisers that are broadly consistent with the principles of useful PFI outlined in Part A of this Guidance, which are based on understandability, materiality, relevance, reliability and comparability.
- I.41 General Principle 4 like the IASB Framework emphasises that information should help investors to make decisions and it requires information to be relevant and complete. General Principle 5 requires information characterised by faithful representation, freedom from material error and prudence and sets expectations for the processes used to prepare information. To satisfy General Principle 6 and avoid being misleading, information needs to be material, neutral, supported by disclosure of how it has been prepared and understandable to users.
- I.42 In applying the principles developed in Part A of this document to situations covered by the City Code, preparers need to have regard to the very specific use to which PFI will be put and the serious potential consequences of deficiencies in PFI.

London Stock Exchange and AIM

- I.43 The London Stock Exchange plc (the Exchange) is a non-statutory body that operates and regulates its main market for listed securities and AIM. As the UK Listing Authority, the FSA rather than the Exchange is the authority that is competent under the provisions in FSMA to decide on the admission of securities to the Official List. There is therefore a separation of this listing concept and the concept of admission of securities to trading on the main market and AIM. The Exchange's ability to regulate in relation to securities derives entirely from its rules as regards the trading of those securities on the Exchange.
- I.44 The Exchange has produced *Admission and Disclosure Standards for Listed Companies* which sets out the procedures and requirements for admission to trading and continuing obligations for issuers with securities traded on the Exchange. These standards are not particularly extensive, and work in tandem with the Listing Rules. They relate to the Exchange's ability to regulate the trading of securities on the Exchange.
- I.45 In addition to the main market for listed securities, the Exchange operates and regulates AIM. There is no direct regulation of AIM securities by the FSA. Rules in relation to the admission and continuing obligations of securities traded on AIM are set out in the AIM Rules issued by the Exchange. It is these rules that apply to PFI published in relation to an application for admission to trading on AIM or companies whose securities are already traded on AIM, together with the rules in relation to the public offers of unlisted securities set out in Part II of the POS Regulations.

Regulatory framework

- I.46 AIM is operated by the Exchange as a regulated market of a Recognised Investment Exchange under FSMA. AIM companies are quoted and not listed as defined in FSMA and the requirements to be met by AIM companies are clearly distinct from those of the Official List. Because AIM securities are not listed, companies applying to join AIM or whose securities are already traded on AIM are also subject to the POS Regulations.
- I.47 The AIM market is solely owned and regulated by the Exchange. It is a market for smaller, young and growing companies. For companies wanting to join AIM, the admission criteria are more flexible than for those seeking admission to listing, making it an attractive market for growing companies. For example, there is no minimum market capitalisation and no minimum percentage of shares that has to be in the public's hands. The Exchange does not however market AIM on the basis that its information standards are less demanding than those of the listed market.

- I.48 Rules for AIM companies are contained within the AIM Rules and the rules for trading AIM companies are incorporated within the *Rules of the London Stock Exchange*. An AIM company must ensure that each of its directors accepts full responsibility collectively and individually for its compliance with the AIM Rules. Where the Exchange considers that an AIM company has failed to comply with the AIM Rules, it may suspend trading of its securities and institute disciplinary procedures that may result in the company being fined, censured and/or having its admission to AIM cancelled.
- I.49 In addition, Regulation 14 of the POS Regulations provides equivalent remedies to those available under section 90 of FSMA in respect of listed companies. These are discussed in paragraph 5.13 above.

PUBLIC OFFERS OF SECURITIES REGULATIONS 1995

PART II PUBLIC OFFERS OF UNLISTED SECURITIES

14. Compensation for false or misleading prospectus

- (1) Subject to regulation 15 the person or persons responsible for a prospectus or supplementary prospectus shall be liable to pay compensation to any person who has acquired the securities to which the prospectus relates and suffered loss in respect of them as a result of any untrue or misleading statement in the prospectus or supplementary prospectus or the omission from it of any matter required to be included by regulation 9 or 10.

Nominated Advisers

- I.50 When the Exchange introduced AIM it created the role of a Nominated Adviser. All AIM companies are required to have, at all times, a Nominated Adviser chosen from the register of such advisers published by the Exchange. The purpose of this requirement is to ensure that the directors of an AIM company who are responsible for complying with the AIM Rules are advised and guided on the application of the Rules, so providing reassurance to investors.
- I.51 The Nominated Adviser must be available to advise on the rules in relation to PFI and has responsibility for regularly reviewing clients' trading performance against PFI that is published in an admission document or otherwise made public on behalf of a company. It is through this relationship that the Exchange passes the judgement for PFI on to the Nominated Adviser.
- I.52 Any firm wishing to act as a Nominated Adviser will need to have been admitted to the Exchange's register of Nominated Advisers. The eligibility criteria are designed to promote high professional standards and Nominated Advisers must meet stringent minimum criteria to be accepted. Once approved as a Nominated Adviser, a firm is also obliged to meet all of the continuing responsibilities owed to the Exchange that are outlined in AIM Rule 37. The performance of Nominated Advisers is assessed on an ongoing basis and the Exchange will remove a firm from the register if it is considered that the integrity or reputation of AIM has been or may be impaired as a result of its conduct or judgement as a Nominated Adviser.

The AIM Rules and PFI

- I.53 PFI, as well as historical financial information, plays a key part in the market process and its importance is recognised in promoting an efficient, orderly and credible market. Nominated Advisers have a responsibility for ensuring that a company complies with the rules in relation to PFI. Apart from imposing requirements relating to ad hoc announcements and working capital statements, the AIM Rules are not

prescriptive or restrictive about the nature of PFI and it is left to the directors of the company and the Nominated Adviser to judge what to publish. Specific guidance for AIM companies publishing PFI is provided in Chapter 11.

- I.54 Paragraph (c) of Schedule Two is explicit on the definition of profit forecasts, estimates and projections and encompasses any forms of words which expressly or by implication state a minimum or maximum for the likely level of profits or losses for a period subsequent to that for which audited accounts have been published. It also covers data from which a calculation of an approximate figure for future profits or losses may be made, even if no particular figure is mentioned and the words profit or loss are not used.
- I.55 The AIM Rules require, for any profit forecast, estimate or projection, a statement of the principal assumptions for each factor which could have a material effect on the achievement of the forecast, estimate or projection. The AIM Rules expressly state that such assumptions must be readily understandable by investors and be specific and precise.

Overarching requirements relating to PFI

- I.56 As with the listed market, PFI may be required to be included in specific documents, in particular an AIM admission document, or in ad hoc notifications of information which if made public would be likely to lead to a substantial share price movement. There are overarching principles that apply to all information including PFI which reflect the first three legal themes identified in Chapter 4 of this Guidance. In relevant extracts from the AIM Rules, terms shown in bold are defined in the AIM Rules Glossary.

AIM RULES FOR COMPANIES – MAY 2003 – RULES

PRINCIPLES OF DISCLOSURE

9. [...]

An **AIM company** must take reasonable care to ensure that any information it **notifies** is not misleading, false or deceptive and does not omit anything likely to affect the import of such information.

- I.57 As with the similar obligation under the Listing Rules, the requirement that information is not misleading, false or deceptive and does not omit anything likely to affect its import would be met by information satisfying the principles of useful information identified in Part A of this Guidance.
- I.58 The AIM Rules also reflect the idea of relevance contained in the IASB's Framework by requiring timely information. Although the Combined Code does not apply to AIM companies, directors and Nominated Advisers will be keen to ensure that the company meets investors' expectations regarding a suitable standard of corporate governance.

**AIM RULES FOR COMPANIES – MAY 2003 – RULES
DIRECTORS' RESPONSIBILITY FOR COMPLIANCE**

29. An **AIM company** must ensure that each of its **directors**:

[...]

- discloses without delay all information which it needs in order to comply with rule 15 insofar as that information is known to the **director** or could with reasonable diligence be ascertained by the **director**;

[...]

- I.59 Paragraph (c) of Schedule Two states that for a forecast, estimate or projection to be included in an admission document, a statement by its directors that such PFI has been made after due and careful enquiry is required. This confirmation helps the Nominated Adviser and investors obtain assurance about the financial information. The Nominated Adviser must also confirm to the applicant that it has satisfied itself that any forecast, estimate or projection has been made after due and careful enquiry by the directors of the applicant.
- I.60 In addition, in making an application for securities to be admitted to AIM, directors make the declaration shown below. This echoes the requirements of Listing Rule 2.15 in respect of financial reporting procedures.

**AIM APPLICATION TO BE SIGNED BY COMPANY
DECLARATION**

- (vi) procedures have been established which provide a reasonable basis for the directors to make proper judgements as to the financial position and prospects of the applicant and its group.

- I.61 The AIM Rules also afford special recognition to the concepts of materiality and relevance by allowing the Exchange to specifically authorise the omission of information in limited circumstances.

**AIM RULES FOR COMPANIES – MAY 2003 – RULES
APPLICANTS FOR AIM**

Omissions from admission documents

4. The **Exchange** may authorise the omission of information from an **admission document** of an **applicant** where its **nominated adviser** confirms that:
- the information is of minor importance only and not likely to influence assessment of the **applicant's** assets and liabilities, financial position, profits and losses and prospects; or
 - disclosure of that information would be seriously detrimental to the **applicant** and its omission would not be likely to mislead investors with regard to facts and circumstances necessary to form an informed assessment of the **applicant's** securities.

OFEX

- I.62 OFEX is a secondary market for the securities of unlisted and unquoted companies operated by OFEX plc. It is a Prescribed Market for the purposes of Section 118 of FSMA and is regulated by the FSA. The *OFEX Rule Book* (OFEX Rules) contains the rules governing the operation and administration of the OFEX market including arrangements for the admission of securities to trading on OFEX and requirements on issuers, for example in relation to information disclosure, once their securities have been admitted.

Regulatory framework

- I.63 The market abuse regime that came into effect with the implementation of FSMA covers all securities traded on OFEX. Like AIM, the OFEX market is a Prescribed Market for the purposes of Section 118 of FSMA, but unlike AIM, the OFEX market is not operated by a Recognised Investment Exchange. Therefore, securities traded on OFEX are defined as unlisted and unquoted and are not traded on-exchange.
- I.64 The following extract from the OFEX Rules sets out the objectives of the OFEX market. Terms shown in bold are defined in Chapter 1 of the OFEX Rules.

THE OFEX RULES

CHAPTER 2 – GENERAL

Objectives of the OFEX Market

- 2.2 **OFEX** is regulated by the **FSA** under **FSMA** and is required to ensure that its **rules** and practices allow for business conducted on the **OFEX market** to be conducted in an orderly manner so as to afford proper protection to investors in **OFEX securities**. In accordance with this objective, **OFEX** will at all times seek to maintain a fair and orderly market in **OFEX securities** and ensure that its facilities are not used for any improper use.

- I.65 For some companies the OFEX market simply offers a straightforward way of allowing shareholders to buy and sell shares independently of the company. However, the OFEX market also enables companies to raise funds and it makes specific provision for start-ups. It is generally targeted at smaller companies than AIM and has a single market maker or 'specialist' for each company's securities, whereas most AIM companies have competing market makers. For many companies, OFEX is seen as a stepping-stone to AIM or the Official List.
- I.66 An application to OFEX can take the form of a fund-raising through a public offer or private placing to create new shares. Alternatively, it can be carried out by way of an introduction of existing shares. In the case of a fund-raising, the documentation submitted by a company through its Corporate Adviser must include a prospectus meeting the requirements of the POS Regulations, or where such a prospectus is not required, a private placing memorandum which complies with the financial promotion regulations of FSMA.
- I.67 The OFEX Rules govern the operation and administration of the OFEX market including arrangements and requirements for the admission of securities to trading and requirements relating to information disclosure by issuers once their securities have been admitted. Members and issuers seeking to use the OFEX market are required to observe the OFEX Rules and are required to retain a copy of these at all times. If an issuer breaches the OFEX Rules, there is a possibility, depending on the type of breach, that its securities will be suspended or withdrawn from trading by OFEX. Issuers may also receive a public or private censure from OFEX.

The OFEX Board and Panel and Corporate Advisers

- 1.68 Key players in the regulation of the OFEX market are the Board of Directors of OFEX plc (OFEX Board), a Panel of City-based professionals who advise the OFEX Board on admission (OFEX Panel), and Corporate Adviser members of OFEX who are appointed to each company seeking admission to the OFEX market. Each company application is reviewed by the OFEX Board and Panel. The OFEX Panel includes accountants, solicitors, fund managers of listed investment trusts and corporate bankers from the clearing banks.

THE OFEX RULES

CHAPTER 8 – APPLICATION FOR ADMISSION TO OFEX

Introduction

- 8.1 **OFEX** admits **securities** to trading on the **OFEX market** at the discretion of the **board**. An application for admission to the **OFEX market** is approved on the basis of documentation provided by the applicant **issuer** and its advisers. The **board** makes its own enquiries and subjects the documentation to independent review by the **OFEX panel**. Applications may only be made through the applicant **issuer's corporate adviser ...**

- 1.69 Any company considering making an application to OFEX must do so through an eligible Corporate Adviser who is authorised by the FSA to conduct regulated activities under FSMA and who is a Corporate Adviser member of the OFEX market. It is the responsibility of a Corporate Adviser to ensure an application is complete and that no information is omitted. The Corporate Adviser is also responsible for liaising with the Applications Manager at OFEX regarding the application and ensuring that requests for further information and explanations are promptly attended to. Once a company's shares are traded on OFEX, the Corporate Adviser may also be required to approve company announcements under Section 21 of FSMA.

THE OFEX RULES

CHAPTER 8 – APPLICATION FOR ADMISSION TO OFEX

Basic Documentation

- 8.12 At least fifteen (15) **business days** in advance of the date upon which it is intended that trading in the **issuer's securities** should begin, the following documents must be submitted for the attention of the **applications manager**:
- (m) a letter from the **issuer** or the **issuer's corporate adviser** to the **board** confirming the **issuer's** compliance with these **rules** generally and **rules 8.10** or **8.11** (as applicable) in particular;

The OFEX Rules and PFI

- 1.70 OFEX companies may publish PFI as part of the information that they produce in connection with an application to join the OFEX market or an initial or subsequent fund-raising or under the continuing obligations to notify investors on an ad hoc basis of new developments in the business.

THE OFEX RULES

CHAPTER 8 – APPLICATION FOR ADMISSION TO OFEX

Corporate Advisers

Objectives of the Submitted Documentation

8.10 **Issuers** who are legally required to do so must:

- (a) produce a prospectus in connection with an issue of **securities** to be admitted to trading on the **OFEX market**; and
- (b) subject to the exceptions set out in the relevant law, include in the prospectus all such information as investors and their professional advisers would reasonably require, and reasonably expect to find there, for the purpose of making an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the **issuer** [...]

8.11 Where a prospectus is not required in connection with an issue of **securities** to be admitted to trading on the **OFEX market**, **issuers** must make available to **OFEX** all such information as investors and their professional advisers would, having regard to the nature of the **issuer** and the **securities** in question, reasonably require, and reasonably expect to receive, for the purpose of making an informed assessment of:

- (a) the assets and liabilities, financial position, profits and losses, and prospects of the **issuer** [...]

THE OFEX RULES

CHAPTER 9 – CONTINUING OBLIGATIONS

General Principles

9.3 **Issuers** must inform investors and the **board** immediately via an announcement of any new developments in their sphere of activity which are not public knowledge and which might have a material effect upon the value of their **securities**.

NOTE: **issuers** must take appropriate advice when deciding whether it is necessary to provide information under this paragraph.

- I.71 In relation to ad hoc reporting, although a company may choose to publish PFI to satisfy the requirements of OFEX Rule 9.3, there is no obligation to do so.
- I.72 There is no minimum trading history requirement for a company wishing to be admitted to the OFEX market although the information disclosure requirements are more onerous for a start-up business that does not have a three-year trading record. A start-up is required to prepare a business plan for up to three years that may include illustrative financial projections. Companies prepare this information solely for submission to the OFEX Board and consideration by the OFEX Panel. Therefore any illustrative financial projections included in such a plan do not constitute general purpose PFI that falls within the scope of this document. However, where a company is also raising funds and is required to issue a prospectus or private placing memorandum and chooses to publish illustrative financial projections, auditors will need to report publicly on them.

- 1.73 A start-up is also required to prepare a working capital statement for submission to the OFEX Board. The statement will not constitute published PFI covered by this document unless the company is also required to issue a prospectus or private placing memorandum, in which case it will have to publish a working capital statement. This is the only requirement to publish PFI that applies to OFEX companies.

Overarching requirements relating to PFI

- 1.74 The OFEX Rules do not contain specific requirements relating to financial reporting procedures equivalent to those under the Listing Rules or the AIM Rules. Nor do they require the reporting on internal control and risk management that applies to listed companies. Nevertheless, where an OFEX company chooses to publish PFI, it is subject to general standards relating to the quality of information. In particular, as set out in OFEX Rules 8.10 and 8.11 reproduced above, it must meet the reasonable requirements and expectations of investors having regard to the nature of the securities and the issuer in question. This requirement reflects the fourth legal theme identified in Chapter 4 of this Guidance.
- 1.75 As referred to in paragraph 1.69 above, Corporate Advisers are also responsible for the completeness of information and, in addition, in relation to forecasts there is an explicit requirement that addresses the other three legal themes identified in Chapter 4 of this Guidance.

THE OFEX RULES

CHAPTER 9 – CONTINUING OBLIGATIONS

Objectives of Disclosure Obligations – Continuing Obligations

9.4 Each **issuer** and where applicable its advisers must:

- (c) take all reasonable care to ensure that any statement or forecast or any other information it notifies to **board** is not misleading, false or deceptive and does not omit anything likely to affect the import of such statement, forecast or other information.

- 1.76 There are further specific requirements in relation to working capital statements and published illustrative financial projections. The standard of 'due and careful enquiry' is applied to working capital statements. Companies should compile illustrative financial projections on bases and assumptions set out in the company's business plan as submitted to the OFEX Board. This is clearly consistent with the idea developed in Part A that the reliability of PFI needs to be reinforced through business analysis.
- 1.77 As with the AIM Rules, the OFEX Rules hold out the possibility of a waiver of certain requirements by the OFEX Board. Waivers will not be offered on the basis of materiality or relevance but on the basis of unfair or unintended results or unacceptable risks. It is highly unlikely that any waiver would be available in relation to any requirements relating to PFI.

THE OFEX RULES

CHAPTER 2 – GENERAL

Scope of the Rules

2.11 [...] The **board** may also if it considers it necessary waive or vary the application of any **rule** or **rules** should the **board** consider that the strict application of the **rule** or **rules** concerned would lead to an unfair or unintended result or would impose unacceptable risks on **OFEX**, a **member firm**, an **issuer** or a **client**.

Appendix II: The development of this Guidance

Background

- II.1 This Guidance was developed from the Consultation Draft *Prospective Financial Information – Guidance for UK directors* published by the ICAEW in June 2002. The Consultation Draft itself followed an October 2000 Discussion Paper *Prospective Financial Information – Challenging the assumptions*.
- II.2 Publication of the Consultation Draft was followed by a discussion forum to which preparers, users and regulators were invited. Further consultation meetings were held with a number of groups, including the Investment Circulars Subcommittee of the Auditing Practices Board, the London Investment Banking Association Corporate Finance Committee, the Hundred Group of Finance Directors Markets and Investor Relations Committee, and the National Association of Pension Funds Investment Council.
- II.3 Thirty-one substantive responses to the Consultation Draft were received, of which 30 were received in time to be included in the 'combined volume' placed on public record in the ICAEW Library. Copies of the combined volume are available on request.
- II.4 In general, the responses were very supportive and the principle-based approach was particularly welcomed. The responses were analysed to distinguish between major matters and points of detail, with similar comments on major matters then drawn together to provide an indication of the weight of opinion on a particular issue. This analysis both highlighted areas of general agreement and formed the basis for a summary of the major issues that needed to be addressed. These are considered below.

Points arising from responses to the Consultation Draft

Structure

- II.5 Various suggestions were put forward for restructuring the Guidance to make it more user-friendly. In response to these, background material on the regulatory bodies included in Part B of the Consultation Draft has been moved to an Appendix.
- II.6 Other suggestions were more difficult to accommodate. One idea was to reduce the repetition in the Guidance by using generic types of PFI in Part C rather than identifying all the separate categories. It was not possible to reconcile this approach with the views referred to in paragraph II.23 below that the Guidance should focus on the requirements of the UK Listing Authority. However, where appropriate, cross-references have been used to avoid repetition.
- II.7 Some commentators suggested that it was unnecessary to include detailed extracts from the regulations, as users would have access to this material elsewhere. There might also be an additional benefit in excluding extracts in that while the wording of the regulations might go out of date it would not be necessary to revise the Guidance as a result. However, on balance, it was concluded that there is a benefit, when explaining the application of the principles to specific regulations, if those regulations are included in the document.
- II.8 There was a suggestion that the Guidance could be made more approachable for users by relegating Part A to an Appendix. While a major objective is to make the Guidance practical, it does seem inconsistent to develop a principle-based approach and then downplay the principles. Part A was therefore retained, although it was significantly redrafted as explained in paragraph II.15 below.

Scope

- II.9 *Guidance on prospective non-financial information* A number of commentators identified a need for guidance on prospective non-financial information, and specifically non-financial information that might be included in the OFR. While this is a very important area, and the principles applicable to PFI can often be relevant to non-financial information, the Guidance does not purport to deal with it.

- II.10 *Voluntary PFI* A number of commentators suggested that the Consultation Draft paid insufficient attention to voluntary PFI. This is an important point, as this is an area in which the Guidance has the potential to have a major impact. Chapter 6 of the Guidance now provides a fuller discussion of the provision of voluntary PFI.
- II.11 *Guidance on process* Commentators called for more guidance on the processes directors should undertake in preparing PFI. The process guidance in Part C of the Consultation Draft was generally felt to be helpful, but in need of a more systematic and generic approach. Therefore, an entirely new chapter on 'Principles for the preparation of PFI' has been added to Part A to deal with this point.
- II.12 *Practical examples* There were several calls for practical guidance on what would constitute good PFI prepared in accordance with the principles. In response, it was felt to be undesirable to move towards providing examples that might be seen to be prescriptive. The inclusion of principles of preparation and enhanced guidance on voluntary PFI (see paragraphs II.10 and II.11 above) is designed to make the Guidance more practical without being prescriptive.
- II.13 *Share repurchases* Two commentators suggested extending the guidance to deal with the purchase of, and the giving of financial assistance for the acquisition of, a private company's own shares. It was decided on balance that the statutory declarations prepared in these situations would not sit easily alongside the kinds of PFI dealt with in the Guidance.

Principles

- II.14 *Articulation and development of the principles* There was a general welcome for the principles and their derivation from the ASB's Statement of Principles. However, in response to commentators' views, Part A was significantly redrafted:
- (a) the principles have been more clearly expressed using bold type;
 - (b) the terminology has been made more consistent (for example, by referring throughout to 'principles' instead of interchanging with terms such as 'concepts');
 - (c) process expectations have been tied more closely to the related principles (see paragraph II.11 above);
 - (d) the discussion of uncertainty has been extensively rewritten; and
 - (e) the IASB Framework rather than the ASB's SOP, has been used as the primary reference point for the development of the principles (see paragraph II.22 below).
- II.15 Given the general support for the way in which the principles were derived from the SOP, much of the detailed material explaining this derivation has been removed from the Guidance. This material is not necessary for an understanding of how to apply the Guidance.
- II.16 *Subsequent validation principle* Commentators generally welcomed the subsequent validation principle. However, there were concerns that the principle, as expressed in the Consultation Draft, might present logical problems for directors. The text has been reworked to make it clear that the application of the subsequent validation principle is not dependent on future actions.
- II.17 *Merger benefits statements* There was a view that the principle of subsequent validation might be difficult to apply to merger benefits statements and similar earnings enhancement statements. This is an important point. The Guidance was put forward on the basis that there was no logical conflict between the subsequent validation principle and merger benefits statements, although application of the principle might help preparers and users to obtain a better understanding of the nature of such statements. This view has been confirmed with the relevant parties, and some redrafting has been carried out to underline this view.

- II.18 *Legal framework* The fourth of the legal themes identified in the Consultation Draft says that information must meet current market and user expectations as to content and quality of preparation. It was pointed out that this might, given the context in which it was presented, be interpreted as setting a general standard of content and quality based on reasonable expectations. This was not the intention. The Guidance has been redrafted to make it clear that market and user expectations are not a universal measure for content and quality.

Law and regulators

- II.19 *Support of regulators* As pointed out by a number of commentators, it would be helpful if the Guidance could be adopted in some way by the relevant regulators. While the ICAEW Steering Group on Prospective Financial Information contains representatives of key regulators serving in a personal capacity, formal endorsement is inappropriate, because the Guidance is not intended to be included in the various rulebooks. However, it is expected that relevant pronouncements from the Auditing Practices Board will refer to reporting accountants having regard to the Guidance.

Practical issues

- II.20 *Maintenance* Commentators foresaw a heavy burden in keeping the Guidance up to date as detailed rules changed and other developments occurred. The ICAEW is committed to maintaining the relevance of the Guidance and updating it where necessary. However, it is not the intention to track every detailed rule change and provide real-time updating. Reference is made to detailed rules in order to indicate how the principles can be applied in specific circumstances. Users can draw on these examples to decide how best to apply the principles in other circumstances.

Wider relevance to European Union Member States

- II.21 As originally structured, the Guidance was very much orientated towards UK institutions and practices. While it was considered important not to lose sight of the fact that it is indeed Guidance for UK directors, there was seen to be a strong case for restructuring the Guidance to make it more generically applicable in a wider European context. To that end, a number of changes were made.
- II.22 The principles of PFI in the Guidance are now overtly based on the IASB Framework. In terms of its relevance to this Guidance, the Framework is functionally identical to the UK SOP, on which the principles in the Consultation Draft were based. Although the SOP is ostensibly more detailed than the Framework and deals with certain items on which the Framework is silent, these differences are dealt with in other parts of the IASB's literature (for example, IAS 1 *Presentation of financial statements*). This change was considered desirable in view of the EU Regulation that will require UK listed companies to prepare consolidated financial statements in accordance with the IASB's International Financial Reporting Standards from 2005.
- II.23 The whole of the Guidance, and Part C (Guidance on regulatory requirements) in particular, has been radically restructured to concentrate on the requirements of the UK Listing Authority. This is the regulator of the primary market in circumstances where there are equivalent requirements in other EU Member States. The Guidance deals separately with the UK-specific requirements of the Panel on Takeovers and Mergers, AIM and OFEX.

Other points

- II.24 Also as a result of the consultation process, the Guidance now:
- includes a specific warning that complying with the Guidance does not automatically lead to compliance with the Listing Rules, the City Code or other requirements (paragraph 1.9); and
 - specifically encourages preparers of PFI to make reference to the Guidance (paragraph 1.10).

Appendix III: Contributors

ICAEW Steering Group on Prospective Financial Information

Robert Hodgkinson	Chairman – Director, Technical, ICAEW
Desmond Wright	Secretary – Senior Manager, Corporate Reporting, ICAEW
Kevin Desmond	Director, PricewaterhouseCoopers
Peter Freeman	Director of Markets, OFEX
Nic Hellyer	Director, UBS Warburg
Peter Hughes	Partner, KPMG
Ken Lever	Finance Director, Tomkins PLC
Kevin Ludwick	Head of Policy and Compliance, UK Listing Authority
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John Stainsby	Vice-President, J P Morgan Investment Management Incorporated
Jon Symonds	Group Finance Director, Astra Zeneca Plc
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Jeff Ward	Head of Transaction Support Services, Numerica plc
Gillian Watson	AIM Policy Manager, London Stock Exchange
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Other contributors

Emma Channing	Solicitor, Herbert Smith
Richard Emery	Listing Manager, UK Listing Authority
Steve Hextall	Director, Ernst & Young
Steven Leonard	Project Director, Auditing Practices Board

Commentators on July 2002 Consultation Draft

Auditing Practices Board
Australian Securities & Investments Commission
BDO Stoy Hayward
Centrica plc
Chartered Institute of Management Accountants
Deloitte & Touche
Department of Trade and Industry
Ernst & Young
Financial Services Authority
GlaxoSmithKline plc
Grant Thornton
Hermes Investment Management Limited
HSBC Asset Management Limited
Institute of Certified Public Accountants of Cyprus
Institute of Chartered Accountants in Ireland
Institute of Chartered Accountants of Scotland
Institute of Chartered Secretaries and Administrators
Investment Management Association
Kingfisher plc
KPMG
Law Society
Liverpool Society of Chartered Accountants
London Society of Chartered Accountants
London Stock Exchange plc
Melrose Resources plc
National Association of Pension Funds
Pearson PLC
PricewaterhouseCoopers
Quoted Companies Alliance
Rod Sellers
South Western Society of Chartered Accountants

Appendix IV: Glossary

AIM	The AIM market operated by the London Stock Exchange plc as a regulated market of a Recognised Investment Exchange under FSMA
ASB	Accounting Standards Board
APB	Auditing Practices Board
CARD	Consolidated Admissions and Reporting Directive – Directive 2001/34/EC of the European Parliament and of the Council on the admission of securities to official stock exchange listing and on information to be published on those securities
City Code	The City Code on Takeovers and Mergers issued by the Takeover Panel
Combined Code	The Combined Code on Corporate Governance published by the FRC
COMC	Code of Market Conduct issued by the FSA
Corporate Adviser	Corporate adviser member of OFEX required to be appointed to each company seeking admission to the OFEX market
CPR	Competent Person's Report
Exchange	The London Stock Exchange plc
Financial Promotion Order	Financial Services and Markets Act 2000 (Financial Promotion Order) 2001
Framework	Framework for the preparation and presentation of financial statements, issued by the IASC and adopted by the IASB
FRC	Financial Reporting Council
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
ICAEW	Institute of Chartered Accountants in England & Wales
Listing Rules	The Listing Rules of the UK Listing Authority
Nominated Adviser	A nominated adviser as defined under the AIM rules
OFEX	A market for dealing in unlisted and unquoted securities. It is operated by OFEX plc, which is authorised and regulated by the FSA and is a prescribed market under Section 118 of FSMA. Securities traded on OFEX are within the scope of the FSMA market abuse regime
OFR	Operating and Financial Review
PFI	Prospective Financial Information
POS Regulations	Public Offers of Securities Regulations 1995 (SI 1995/1537)
PSI Guide	Price-sensitive Information Guide – guidance on the dissemination of price-sensitive information issued by the UKLA
Public Offers Directive	Council of the European Communities Directive 89/298/EEC, co-ordinating the requirements for the drawing up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public
SOP	Statement of principles for financial reporting, issued by the ASB
Takeover Panel	The Panel on Takeovers and Mergers
Turnbull Guidance	Internal Control: Guidance for Directors on the Combined Code
UKLA	United Kingdom Listing Authority – the FSA acting in its capacity as the competent authority for the purposes of Part VI of FSMA



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