

31 October 2017

Katerina Joannou
ICAEW Corporate Finance Faculty
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA

Dear Ms Joannou

Consultation paper on Prospective Financial Information

We welcome the opportunity to comment on the proposals in your consultation paper on Prospective Financial Information ("PFI").

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

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

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

The extent to which such developments need to be taken into account will depend upon the scope of the new PFI guidance and the approach taken to providing guidance to the application of the principles in specific circumstances (see response to question 6 below).

The most important recent and prospective developments impacting on future PFI guidance are likely to be:

- a) The implementation of the new Prospectus Directive Regulations to be introduced by December 2018 and associated revisions to the ESMA guidance;
- b) The development of alternative sources of private funding such as through crowd-sourcing platforms;
- c) Revisions to the Takeover Code which have more clearly made the link between Quantified Financial Benefits Statements ("QFBS") and Profit Forecasts. The SIRS may in the future be revised or extended to specifically cover QFBS;
- d) Revisions to the Listing Rules and Takeover Code which require directors in certain circumstances to make statements akin to those provided by Reporting Accountants in relation to "proper compilation" and "consistency with accounting policies";
- e) The proposed update by the IASB of the conceptual framework from which the PFI principles underlying the 2003 guidance were drawn; and
- f) The potential for UK Capital Markets guidance to change following Brexit.

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

In our experience, for PFI issued by Listed companies and companies planning for a UK IPO, there is sometimes lack of awareness about the context of UK PFI, and the level of rigour and assurance that is required in relation to the required form PFI statements.

In particular, contextual guidance on the meaning of “properly compiled” of the type currently used by reporting accountants in SIR3000 (paragraphs 12-13 and 33-38) would help issuers to understand the expectations of the market and reporting accountants who are required to opine publically and/or privately.

We believe ICAEW should consider limiting the guidance on applying the principles to particular PFI regulations and focus instead on providing guidance on a contextual framework and its application to PFI provided in different circumstances (e.g. Profit or synergy statements which are published in the context of a capital markets transaction, or to support a private fund raising, versus information prepared in the normal course of business to assist management such as annual budgets and trading updates).

Such an approach would also recognise that regulations impacting PFI may continue to change. Also, guidance has already and may continue to be developed, by regulators to deal with specific situations (eg recent UKLA Technical Notes and ESMA Recommendations).

The 2003 guidance was clearly split between Principles (Part A), the Legal Framework (Part B) and Guidance on Regulatory Requirements (Part C). However, around 85% of the guidance (Parts B and C) has been superseded since issue by changes to regulations (which in the case of the Listing Rules were amended shortly after the guidance was published) and the fact that the 2003 guidance has not been updated to reflect these changes, has we believe, considerably limited its use in practice.

In response to the comment in paragraph 48, in our view the PFI guidance should not be extended to cover published non-financial quantitative information relating to the future. We consider non-financial information to be outside the remit of the ICAEW.

We believe that ‘reliable’ remains an appropriate term to use as one of the underlying principles underpinning PFI (paragraph 49). Concerns about users misunderstanding the nature of PFI could potentially be addressed by the development of appropriate caveats (for example, akin to those used when introducing pro forma financial information) to use when describing PFI in different circumstances.

We agree with the comment in paragraph 57, as, in our opinion, the 2003 guidance is overly long and repetitive in nature. This is due to the detailed guidance on the application of the principles in Part A to specific regulations in Part C.

Q3: The proposed new framework for PFI will comprise:

- **general principles for the preparation of PFI; and**
- **guidance notes on applying the principles and application notes covering specific types of PFI, in certain circumstances.**

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

We agree that in developing a new framework for the production of PFI that a ‘principles’ based approach remains appropriate. However we believe that before the principles are described it is necessary to set out the objective of PFI in the context of regulation, audience and purpose. Such an introduction could cover the nature of the PFI (what it is and isn’t); and the level of assurance/confidence in the PFI. Explaining the differences in process and level of supporting evidence required to support statements which are presented as “forecasts” as opposed to “estimate”, “target” or “illustration”, would be useful.

We believe that guidance on the application of the principles to be followed should move away from a focus on regulations and instead focus on generic guidance based on the type of PFI being produced. For example:

- Profit estimates
- Profit forecasts
- Illustrative projections
- Quantified Financial Benefits Statements
- Profit warnings (market updates)
- Forecasts produced in support of Working Capital Statements
- Unpublished forecasts produced in support of private fund-raising

In our opinion, the updated guidance should refer to specific rules and regulations to the minimum extent possible in order to avoid the situation whereby the guidance becomes out of date as a result of changed regulations. To the extent that guidance is required on the application of specific market rules and regulations, that should be a matter for the regulator of the relevant market rather than the ICAEW guidance which should as far as possible be relevant to all markets for which PFI is published (or in the case of unpublished PFI, relevant to all types of fund-raising).

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

We strongly believe that the four attributes of useful PFI and the three principles for preparing PFI set out in the 2003 guidance remain appropriate and necessary.

Whilst we understand the desire to introduce consistency of phrasing across legal and regulatory requirements, we are not convinced of the necessity or benefit of adding the additional attributes of 'aligned' and 'not misleading'.

As regards 'aligned': it is not clear to us how that further attribute would be applied in practice (beyond the guidance already given) or what it would add to the existing attributes of 'reliable' & 'comparable' and the associated principles of supporting 'business analysis' and 'subsequent validation'. Taken together the existing attributes/principles would appear to already address the concepts of linking strategy, performance and risks and 'alignment' with other business reporting and communications.

As regards 'not misleading', Paragraph 81 of the Consultation Paper states "PFI that satisfies the existing principles could still be misleading if it gives users a view contrary to that which ought reasonably to be given". It is not apparent to us how such misleading PFI could be compliant with the 2003 guidance. In particular, paragraph 4.6 of the 2003 guidance considers specifically when PFI might be misleading and indicates that such 'misleading PFI' would represent a breach of one or more of the existing attributes/principles.

Consideration could be given to including in updated PFI guidance the wording of one of the suggesting management representations within Appendix 5 of SIR3000 (pulling together the principles of Understandable and Reliable) as follows: "The profit forecast is presented in a manner which is balanced and fair and not misleading and contains all information necessary for a proper understanding of the profit forecast".

Rather than introducing the further attribute of 'not misleading', consideration could be given to an over-riding principle that unless specifically stated otherwise PFI (excluding QFBS) should represent management's "best estimate of the likely outcome (or range of outcomes) taking account of their

knowledge of the strategies and plans of the business and all known external factors". Such a concept could be embedded within wording used to introduce published PFI.

Updated guidance should make a link between compliance with the guidance and the regulatory and/or legal requirements for PFI to be "prepared with due care and consideration/due and careful enquiry"/"properly compiled". See for example paragraph 17 of SIR3000.

Depending on the type and purpose of the PFI being referred to, the guidance could be extended to include reference to, the rebuttable presumption that, the accurate generation of PFI will require supporting unpublished internally consistent financial forecasts including balance sheets and cash flows as well as income statements.

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

We agree with the proposal to extend the scope of the PFI guidance to PFI that is prepared for private finance-raising initiatives (i.e. it is still PFI which is produced primarily for an external purpose rather than internal PFI such as budgets or projections which should not be subject to the guidance).

Consideration should be given to defining 'financial forecasts' and 'financial projections' (see AICPA guidance on financial forecasts and projections) to avoid misunderstandings regarding the nature of assumptions underlying the PFI.

The main area where additional guidance is likely to be required in applying the principles and attributes of useful PFI to such PFI produced for private finance-raising is in respect of the attribute 'Understandable' and its associated principle of 'Reasonable Disclosure'.

In particular, where there is extensive interaction between the prospective investors/funders with management and/or due diligence providers, the extent of disclosures in respect of assumptions, risks and uncertainties including scenario analysis is likely to be much greater than would be appropriate for Published PFI. In these circumstances, the complexity and potential for mis-understanding of such detailed disclosure related to the PFI is likely to be mitigated by the ability of recipients to access the detailed forecasts and ask questions and seek appropriate clarification of the main assumptions and risks.

If there is little or no interaction with prospective investors/funders and/or no due diligence carried out on their behalf, the PFI presented should more closely apply the 'reasonable disclosure' principle.

An area where more information might be expected for PFI produced in the context of private finance-raising (as opposed to Published PFI for a Capital Markets transaction) is the extent to which the business has previously achieved (or not achieved) its previous PFI.

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

We strongly agree that in respect of PFI for capital markets transactions: "high-level guidance for topics ... would be more useful than specific references to the detailed rules and individual requirements" (paragraph 91).

As noted in our response to Question 2, we suggest that published PFI should be preceded by an introduction to provide context and explain the purpose and nature of the PFI. This could be similar to introductions for pro forma financial information but we would expect that it would require more tailoring to specific circumstances rather than simply being generic caveats.

As regards Working Capital Statements, we would question whether a Working Capital Statement is itself PFI to which the guidance applies – the 2003 guidance was drafted on the basis of applying the PFI principles to the Working Capital Statement itself (i.e. that it constituted such PFI).

Instead, we believe that the PFI guidance should apply to the PFI supporting the Working Capital Statement. Such a difference in concept might significantly impact on the drafting of relevant guidance. There will be a number of similarities in this respect to guidance produced for unpublished PFI in the context of private finance-raising where there is a greater emphasis on cash flows and the adequacy of funding as opposed to income statement forecasts and accounting policies. It should also be noted that since the 2003 PFI guidance was produced, guidance in respect of working capital statements has been included in the ESMA Recommendations and UKLA Technical Notes (UKLA/TN/320.1 and 321.1). It should not be necessary to duplicate such guidance within the updated PFI guidance.

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

See answer to Q5 above.

In general, we would suggest that the ICAEW avoids developing application notes for specific types of private finance-raising and focuses instead on how proportionate application might apply in generic private finance-raising situations, distinguishing between such factors as:

- the interactions between potential investors/funders and the management of the business;
- the extent to which due diligence has been carried out;
- the time horizons reflected within the PFI; and
- the nature of the business producing the PFI – e.g. stage of maturity and business sector etc .

It may be, for example, that PFI published on certain crowd-funding platforms should be considered akin to published PFI in the context of Capital Markets transactions and should therefore be expected to fully apply the PFI principles.

Encouragement for companies to adopt a “comply or explain” approach to the principles in the PFI guidance akin to that used for listed companies reporting on compliance with the UK Corporate Governance Code might be an appropriate way in which to encourage adoption of the PFI principles (on a proportionate basis as necessary) to PFI produced in the context of private finance-raising initiatives.

We would recommend that prior to publishing a detailed Consultation Paper on the proposed PFI Framework that the ICAEW PFI Working Group continues to pre-consult with relevant parties (e.g. BBA, British Private Equity and Venture Capital Association and UK Crowdfunding Association) concerning the application of the framework to PFI produced in the context of private finance-raising.

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

In our opinion, the new framework could make passing reference to the fact that PFI is produced by businesses in a wide variety of circumstances and for many different purposes. Preparers for PFI could be encouraged to consider whether they will apply the PFI framework in preparing such PFI and if so whether they will make an explicit statement regarding compliance.

Preparers of other standards and reporting requirements could be encouraged to consider whether compliance with the revised PFI framework should be mandated or referred to in the relevant standard/regulation but we do not believe that ICAEW should extend the new framework to specifically cover a wider range of PFI as there are regular changes to the requirements of such wider reporting and PFI is either ancillary to such reporting or potentially integral to it. If PFI is ancillary, specific application guidance would not seem appropriate. If PFI is integral then it is better for the specific standard/regulation to set out as necessary the requirements of such PFI rather than that being included in generic PFI guidance such as the ICAEW framework.

If you would like to discuss this further or have any questions, please contact Yvette Allen (yallen@deloitte.co.uk or 020 7303 0996).

Yours sincerely

A handwritten signature in black ink that reads "Deloitte LLP". The word "Deloitte" is written in a cursive style, and "LLP" is written in a simpler, blocky font.

Deloitte LLP