

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

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Direct line: 020 7951 4636

Email: shextall@uk.ey.com

Dear Madam

Consultation Paper on prospective financial information

We welcome the opportunity to comment on the consultation on the ICAEW's plans to update *Prospective Financial Information Guidance for UK Directors* (the "Guidance").

We agree that it is an appropriate time to revisit the Guidance and are supportive of the ICAEW's initiative. Our experience has been that the Guidance has been useful to both company directors and reporting accountants working with profit forecasts published in investment circulars. However, awareness of the guidance amongst company directors is relatively low due to the fact that UK companies tend to be wary of publishing profit forecasts. Whilst the Guidance will benefit from some updating to reflect regulatory changes our view is that;

- The focus should be on PFI where the intended users cannot request further information, which is principally that required by regulation;
- There is no need for additional attributes but some of the existing attributes do need to be further developed and/or more clearly explained; and
- There is no need for extensive explanation of regulatory requirements

Our responses to the consultation questions are attached. We hope you will find our input helpful. Should you wish to discuss any points in more detail or would find it helpful to receive any additional information, please do not hesitate to contact me.

Yours faithfully



Steve Hextall
Associate Partner
for and on behalf of Ernst & Young LLP

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?

We believe that the focus of the ICAEW guidance should be on PFI where the users have no ability to make enquiries regarding the preparation of the PFI or receive further supporting analysis. This inevitably means that the focus will be PFI subject to capital market regulation where there has been little significant regulatory development in the UK since 2003. The current ESMA proposal to remove the requirement for profit forecasts in prospectuses to be reported on by accountants may, subject to the impact of BREXIT, result in more profit forecasts being included in UK prospectuses from 2019 without the "safeguard" of such a report. Our experience has been that in practice preparers of profit forecasts have frequently been unfamiliar with the Guidance and have to a significant extent been reliant upon reporting accountants to explain the application of the Guidance. If the requirement for a reporting accountant is removed it will be important that the updated guidance is readily understandable by directors who have little or no experience of preparing such published profit forecasts.

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?

Whilst we agree that the 2003 principles are appropriate the "understandability" principle was underdeveloped in the Guidance. The focus was very much on the clarity of the disclosure and whether a reader could understand the information presented but did not really address what a reader would understand is meant by the forecast. For example the guidance explained (paragraph 2.21) that where a range is presented for a forecast every point in that range should be "possible" or that a floor should not be "excessively cautious" but it did not attempt to explain how a reader should interpret a range – so should it be assumed that every point in the range is equally possible or that the mid-point is most likely outcome with reducing likelihood at the edges of the range? With a floor how should "excessive" caution be construed?

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?

This structure is appropriate. It is important that the general principles are clearly explained and that practical guidance is given on their application. This should address specific issues relevant to different types of PFI but we do not believe that there is a need to include the detailed guidance on regulatory requirements that is included in the Guidance, which is now out of date.

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?

The Guidance has four principles (“attributes”?) of useful PFI (paragraph 2.1 of Guidance) and also refers to the “principles of reasonable disclosure, business analysis and subsequent validation” (paragraph 3.3 of Guidance). This is unnecessarily confusing because the three principles are simply an explanation of the application of three of the “attributes”. The distinction between attributes and principles should be removed by stating that there are four attributes and clearly explaining what they are.

We do not see a need for either of the two additional proposed attributes if the existing ones are clearly explained. If the PFI is reliable, having been based on proper business analysis (which should involve “integrated and cohesive management thinking”) it will be aligned. Similarly, if PFI is reliable, comparable and properly understandable it will not be misleading. We therefore believe that the focus should be on clearly explaining the existing attributes rather than introducing new ones which would largely duplicate the existing ones as they are currently explained.

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?

Whilst the attributes may be helpful to preparers of PFI in the context of the private finance raising, for the reasons stated above we do not believe that this should be the focus of the guidance.

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 generally agree with this approach although it is not clear what is meant by “changes in expectations of performance” in the context of capital markets transactions. The Guidance currently has extensive reproduction of regulatory requirements. This should be removed and practical guidance included on the application to specific aspects of PFI – for example dealing with the fact the Takeover Code (Rule 28.3(b)(iii)) does not require comparability to apply to a quantified financial benefit statement and how ESMA’s reference (paragraph 126 of ESMA’s guidance on prospectus contents – ESMA/2013/319) to “reasonable worst case scenario” in the context of working capital statement sensitivity analysis should be interpreted.

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?

No comment

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?

The guidance would be helpful in those situations where users of PFI are not able to seek further information – for example a profit warning issued by a listed company. However, care will need to be taken in explaining the application of the understandability attribute. This is because whilst a profit forecast in prospectus or offer document can be viewed as an “event” in its own right, a profit warning will often be part of the ongoing communication by a company with the investment community. As a consequence there is frequently less disclosure concerning the PFI, itself but more explanation about the case of the profit warning. This means that when a company that has published PFI as part of its ongoing investor communication is subsequently required to include that PFI in a prospectus or offer document (and have it reported on) it often has to include additional information, not only to meet regulatory requirements on the disclosure on assumptions, but also to ensure that the PFI is understandable when viewed in isolation. This does not itself mean that then original PFI was deficient but does illustrate the the impact of context.