ICAEW KNOW-HOW
CORPORATE FINANCE FACULTY

GUIDANCE FOR PREPARERS OF PROSPECTIVE FINANCIAL INFORMATION

TECHNICAL RELEASE 04/20CFF

ISSUED JUNE 2020

The Corporate Finance Faculty is the ICAEW's centre of professional excellence in corporate finance. It contributes to policy development and many consultations by international organisations, governments, regulators and other professional bodies. The faculty also provides a wide range of services, events and media to its members, including its highly regarded magazine Corporate Financier and its popular series of best-practice guidelines. The faculty's network includes more than 80 member organisations. Members are drawn from major professional services groups, specialist advisory firms, companies, banks and alternative lenders, private equity, venture capital, law firms, brokers, consultants, policy-makers and academic experts. More than 40 per cent of the faculty's membership is from beyond ICAEW. The faculty also provides technical expertise for the ICAEW's Diploma in Corporate Finance.

ICAEW connects over 150,000 chartered accountants worldwide, providing this community of professionals with the power to build and sustain strong economies. Our profession is right at the heart of the decisions that will define the future, and insight and we contribute by sharing our knowledge, insight and capabilities with others. That way, we can be sure that we are building robust, accountable and fair economies across the globe.

Contents

Foreword

The guidance in this Technical Release 04/20 CFF will help the preparation of prospective financial information (PFI) for which there is a prescribed form, for example, in the UK, in connection with regulated capital markets transactions, and in situations where there are no regulatory requirements, for example, in connection with the private raising of debt or equity, or in connection with the private sale of a business.

The guidance sets a high standard for PFI that inspires the confidence of users of such information.

Structure of the guidance and how to use it

The Technical Release includes general guidance, specific guidance for certain types of PFI and detailed illustrative procedures. The guidance accommodates the preparation of any PFI and application is intended to be modular and proportionate.

Modular application: The general guidance is set out in Parts I and II and should be applied when preparing any prospective financial information. Specific guidance, set out in discrete application notes in Part III, should be applied in addition to the general guidance in Parts I and II when preparing the information to which the application note relates.

Proportionate application: The general guidance should be applied on a proportionate basis, taking into account such factors as the circumstances in which the information is being prepared, the intended use, and the size and complexity of the business.

Status of the guidance

The guidance in this Technical Release is not prescriptive or mandatory for ICAEW members to follow and does not bind regulatory authorities. However, the courts and regulators may take it into account in relation to the work of ICAEW members.

Effective date

The effective date of this guidance is 15 October 2020. Early adoption of the guidance is encouraged.

This Technical Release both updates and is wider in scope than ICAEW's 2003 guidance, Prospective Financial Information, Guidance for UK Directors, which focused mainly on specific types of PFI published by listed companies. The 2003 guidance will be withdrawn on 15 October 2020.

Glossary

AIM Rules	AIM Rules for Companies, published by the London Stock Exchange
APM	Alternative Performance Measure
City Code	The City Code on Takeovers and Mergers, published by the Panel on Takeovers and Mergers (as applicable to the companies, transactions and persons as detailed under pages A3-A7 of the City Code)
Class 1 transaction	A transaction classified as such under the Listing Rules
Delegated Regulation	Commission Delegated Regulation (EU) 2019/980 supplementing the Prospectus Regulation
DTR	Disclosure Guidance and Transparency Rules, published by the FCA
EBITDA	Earnings before interest, taxation, depreciation and amortisation
ESMA	European Securities and Markets Authority
ESMA Guidance	ESMA Update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive (CESR Recommendations). In July 2019 ESMA published Draft Guidelines on disclosure requirements under the Prospectus Regulation which, when finalised, will replace the CESR Recommendations. The Draft Guidelines include changes in terminology but are similar with the substance of the CESR Recommendations. Accordingly, this guidance includes the essence of the Draft Guidelines but the references in the Annex will be updated when they come into force.
ESMA Q&A	ESMA Questions and Answers – Prospectuses
EU	European Union
FCA	Financial Conduct Authority
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Practice
IESBA	International Ethics Standards Board for Accountants
IPO	Initial Public Offering
KPI	Key Performance Indicator
LR	Listing Rules, published by the FCA

MAR	Market Abuse Regulation (EU) No 596/2014
NEX Exchange Growth Market Rules	NEX Exchange Growth Market Rules for Issuers
Panel	The UK's Panel on Takeovers and Mergers
Prospectus Regulation	Regulation (EU) 2017/1129
PFI	Prospective Financial Information
PRR	Prospectus Regulation Rules, published by the FCA; these implement and incorporate the Prospectus Regulation and the Delegated Regulation
QFBS	Quantified Financial Benefits Statement
SIR	Standard for Investment Reporting, published by the FRC
2003 guidance	Prospective Financial Information, Guidance for UK Directors, published by ICAEW in 2003

Part I: Principles for preparing prospective financial information

Part I defines PFI for the purpose of the guidance.

This Part also introduces and provides general commentary on the preparation principles.

Part I: Principles for preparing prospective financial information

1. INTRODUCTION

Definition of PFI

1. Businesses and other organisations prepare prospective financial information (PFI) in differing formats and for varying purposes, and refer to it using different terms including, but not limited to: forecasts, projections, budgets and business, revenue, profit, cost-saving, or synergy plans.

2. For the purpose of the guidance in this Technical Release (the guidance), PFI comprises either quantitative or qualitative statements that reflect the future financial performance and prospects of a business and may be issued in the form of:

   - primary financial statements;
   - elements, extracts and summaries of such statements (such summaries may be narrative in nature, and may reflect financial conclusions that the preparer has drawn); and
   - related financial disclosures and/or supporting calculations.

   This definition of PFI is broad and includes the forward-looking equivalent of any information that might subsequently be prepared to support, or to summarise, historical financial information (such as financial statements or internal management accounts). It is not limited to any specific reports or formats.

3. For the purpose of the guidance, PFI does not include forward-looking financial information that is aspirational in nature where that aspirational nature is made clear. This is because a reasonable user of clearly identified aspirational forward-looking information will understand its nature and limitations and, accordingly, will not place a high degree of confidence in it. Terms such as 'goal', 'target', 'estimate[1]' and 'illustration' are commonly used to identify forward-looking financial information which is aspirational in nature.

4. PFI may be prepared solely for the internal use of an organisation (internal PFI) or PFI may be prepared in the expectation that the organisation will make it available to external parties for their use (external PFI). External PFI may be published or unpublished. External PFI is typically published in the context of the regulatory requirements of an applicable capital market. Unpublished external PFI, although private and confidential in nature, is made available to certain external parties for their use (eg, in connection with the private raising of debt or equity, or in connection with the private sale of a business).

5. For reasons of investor protection and the general promotion of the efficiency of capital markets, the relevant regulatory regime for a given form of published external PFI may indicate the level of confidence that users can expect to place in that published external PFI in light of the regulatory requirements that apply to its preparation.

6. ICAEW considers that the act of publishing PFI, or otherwise making PFI available to external parties, creates high expectations regarding that external PFI which are above and beyond those placed on internal PFI. In particular, in the absence of an explicit indication to the contrary by the external PFI user, a preparer of external PFI should reasonably assume that there is an expectation on the part of the external PFI user that the external PFI, including related disclosures, the supporting calculations and assumptions, has been subject to a rigorous process of preparation and that they can have confidence in it. Having confidence in PFI does not mean that the future outcome(s) set out in the PFI will be achieved, since PFI will necessarily remain subject to inherent uncertainties including external factors, the nature of the business and the period covered by the PFI. Rather, the user of the PFI may be confident that it reflects a forward-looking analysis of the business based on facts known, or that ought reasonably to have been known, to the preparer at the time of preparation and that it is free from material error or omission.

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

The approach to preparing PFI

7. The guidance sets out a principles-based approach, and provides practical guidance and procedures for the application of those principles in the preparation of all PFI. A modular approach has been adopted to provide further guidance for specific types of PFI in specific situations. The areas for which application notes have been published are set out in paragraph 9. Application notes for further types of PFI prepared in other situations and for which there is demand will be published in the future.

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

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

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

10. Where modular application notes have been published separately, these do not comprise stand-alone guidance. Rather Parts I and II of the guidance are the essential building blocks on which the material in the application notes is based and they should be read and applied with the relevant application notes.

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

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

Scope of the guidance

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

14. Parts I and II of the guidance are intended to apply to all PFI. Accordingly, Parts I and II will aid in the preparation of high-quality internal PFI. ICAEW strongly encourages application on a proportionate basis to internal PFI and external unpublished PFI (unless subject to any agreement to the contrary with the external user). In all circumstances, the guidance should be applied with regard to materiality considerations.

15. The application notes in Part III address specific requirements of published external PFI required by capital markets regulation in a transactions context.

16. The guidance is intended to apply to businesses (whatever the legal form) and other organisations such as public bodies, charities and not-for-profit entities. Where this guidance uses the term ‘business’, this should be interpreted to include all types of organisation. Where this guidance uses the term ‘preparer’, this means the person or persons with ultimate responsibility for the PFI, as well as such other persons or parties who they have directed or instructed to assist with the preparation of the PFI. For corporate entities, the directors would typically be expected (or required by regulation) to have ultimate responsibility for any PFI that is published or otherwise made available to an external party.

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

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

19. Directors of certain publicly traded companies in the UK are required to have established procedures that enable them to be informed as to the financial position and prospects (FPP) of the company from the date of its admission to trading. They must also maintain such FPP procedures subsequent to admission to trading. ICAEW has published guidance[2] to support the establishment of FPP procedures and typical FPP procedures will be relevant to the preparation of PFI by applicable publicly traded companies in the UK.

20. Publicly traded companies in the UK typically publish a wide range of external PFI including profit warnings or updates, working capital statements, profit forecasts, synergy and stand-alone cost-saving statements and announcements made under the general obligation of disclosure for companies under relevant capital markets regulations (eg, the LR, PRR, AIM Rules, NEX Exchange Growth Market Rules, City Code, DTR and MAR). The capital markets regimes of other jurisdictions may have similar requirements for published external PFI, and it is envisioned that the guidance may be of assistance to preparers of published external PFI in such jurisdictions.

21. Publicly traded companies may also issue pro forma financial information that involves presenting historical financial information to indicate the effects of a planned transaction or other future event. This pro forma financial information is not PFI because it consists entirely of restated historical financial information and is not drawn up to a date, or for a period, in the future. The guidance therefore does not apply to such pro forma financial information, for which ICAEW has published specific guidance[3].

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

[2] ICAEW’s Guidance on financial position and prospects procedures (TECH 14/14 CFF)

[3] ICAEW’s Guidance for preparers of pro forma financial information (TECH 06/15CFF)

2. ATTRIBUTES AND PRINCIPLES

23. To be useful, PFI is prepared according to four principles – taking into account cost-benefit and materiality considerations – so that it demonstrates four attributes. The attributes and preparation principles are as follows.

Principle of preparation	Attribute
User needs: PFI has the ability, in a timely manner, to influence its users' economic decisions and has predictive value or confirmatory value for its users	Relevant
Business analysis: PFI is supportable or based on sound business analysis	Reliable
Reasonable disclosure: PFI contains reasonable disclosure about what it relates to, its risks, uncertainties and mitigating actions	Understandable
Subsequent validation: PFI is capable of subsequent validation by comparison with historical financial information	Comparable

24. If the above four principles are applied to the preparation of PFI, and the resultant PFI possesses the above four attributes, the PFI would also be expected to be:

- aligned ie, the PFI is reflective of integrated and cohesive management thinking with, for most businesses, a link between the PFI and management's determination of the strategy, performance and risks of the business;
- not misleading ie, the PFI does not give its users a view contrary to that which ought to be given;
- 'fair, balanced and understandable'[4].

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

26. For PFI that will be unpublished, and which has not been prepared to support published PFI, typically there will be an opportunity for the user of the PFI to interact with the preparer of the PFI before, and/or during, and/or after the preparation of that unpublished PFI. To be useful, such unpublished PFI (whether external PFI or internal PFI) should address the needs and requirements of its known users as articulated by them. However, it should be recognised that some users of unpublished PFI will be less sophisticated than others and so less able to articulate their requirements for the unpublished PFI. In some situations the actual user of the unpublished PFI will not be known at the time of preparation. Application of the guidance should, however, help to ensure that less sophisticated or unidentified users are provided with unpublished PFI that is useful to them.

27. That PFI, whether internal PFI or external PFI (and whether published or unpublished), should not be misleading is congruent with a PFI preparer's responsibilities under ICAEW's Code of Ethics[5] (and the Code of Ethics of the IESBA, on which ICAEW's Code of Ethics is based).

[4] These are the principles for communication promoted by the FRC in Guidance on the Strategic Report

[5] ICAEW Code of Ethics (2020)

28. Compliance with the fundamental principle of integrity in the ICAEW Code of Ethics requires that:

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

(a) Contains a materially false or misleading statement;

(b) Contains statements or information provided recklessly; or

(c) Omits or obscures required information where such omission or obscurity would be misleading.'[6]

29. Moreover, in relation to professional accountants in business:

'When preparing or presenting information, a professional accountant shall:

(a) Prepare or present the information in accordance with a relevant reporting framework, where applicable;

(b) Prepare or present the information in a manner that is intended neither to mislead nor to influence contractual or regulatory outcomes inappropriately;

(c) Exercise professional judgement to:

(i) Represent the facts accurately and completely in all material respects;

(ii) Describe clearly the true nature of business transactions or activities; and

(iii) Classify and record information in a timely and proper manner; and

(d) Not omit anything with the intention of rendering the information misleading or of influencing contractual or regulatory outcomes inappropriately.'[7]

2.1 'Relevant' attribute and 'user needs' principle

30. PFI should be relevant by addressing the known or anticipated needs and requirements of the user(s) of the PFI. Generally, in the absence of any contrary instruction from a known user for whom unpublished PFI (whether external or internal) is being specifically prepared, PFI will only be relevant if it:

- relates to and has the ability to influence economic decisions of PFI users;
- is provided in time to influence economic decisions of PFI users; and
- has predictive value for PFI users or, by helping to confirm or correct past evaluations or assessments, it has confirmatory value for PFI users.

31. The relevance of information is also affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance. In relation to materiality, the guidance considers an item of information to be material if its omission or misstatement could influence the economic decisions of users taken on the basis of that information. Materiality depends on the size and qualitative nature of the item, judged in the particular circumstances in which it is presented.

32. The materiality considerations that apply to historical financial information will also generally apply to PFI. However, because PFI is inherently uncertain, there are additional considerations. Disclosure of uncertainties and related assumptions is ordinarily required for PFI to be relevant to, and understandable by, users for decision-making purposes, and it may also be necessary to disclose the sensitivities involved and alternative outcomes. Where, for certain types of published external PFI, disclosure of uncertainties, assumptions, sensitivities and/or alternative outcomes is prohibited

[6] ICAEW Code of Ethics (2020) Part 1 'Complying with the Code, Fundamental Principles and Conceptual Framework' paragraph 111.2

[7] ICAEW Code of Ethics Part 2 'Professional Accountants in Business' paragraph 220.4

by the relevant regulatory regime, the underpinning unpublished PFI would be expected to contain such disclosures for consideration by the parties responsible for approving or authorising the published external PFI.

33. Information is relevant only in as much as it comprises material items. Immaterial assumptions and risk factors that will not influence the decisions made by users of the PFI should not be disclosed to external users. This will require judgements to be made in practice, because what is material will always depend on the size of the amounts involved, the nature of the information and the circumstances in which it is presented.

34. Choices about the form and content of PFI should, as with historical financial information, reflect judgements as to:

    - how relevant and useful the chosen form and content will be for the users of the PFI in the exercise of their economic decisions; and
    - whether the benefit to users exceeds the cost of preparing it.

35. For unpublished external PFI, the private external user for whom it is prepared may provide instructions or explicit requirements for the form and content of the PFI, but this will not always be the case and any such instructions or requirements may not be comprehensive. The form and content of published external PFI may be set by regulation, but this will not always be the case and, where any such regulations do exist, the requirements may not be set out in any great detail.

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

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

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

2.2 'Reliable' attribute and 'business analysis' principle

38. 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.

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

40. PFI is reliable if it:

- can be depended upon by users as a faithful representation of what it either purports to represent or could reasonably be expected to represent;
- is neutral because it is free from deliberate or systematic bias intended to influence a decision or judgement to achieve a predetermined result;
- is free from material error in its preparation;
- 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.

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

- it reflects a forward-looking analysis of the business based on facts and circumstances known, or that reasonably ought to have been known, at that time;
- it only reflects future actions that are envisaged in the entity's current strategies and plans;
- it only reflects future actions, events and circumstances for which the related risks have been analysed;
- it offers a faithful representation of the entity's strategies, plans and risk analysis or elements of them;
- it reflects the entity's business analysis in a way that is free from material error and is materially complete; and
- it is consistent with planned courses of action published or disclosed elsewhere by the entity.

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

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

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

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

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

2.3 'Understandable' attribute and 'reasonable disclosure' principle

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

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

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

49. To be understandable, PFI should contain disclosure that is reasonable, and PFI should not be presented in situations of such uncertainty that the disclosure becomes too complex or extensive to be understood or used by the expected users of the PFI.

50. PFI should be structured in such a way that users encounter the more significant information first including, where appropriate, information relating to the uncertainty attaching to the PFI.

51. For PFI to be understandable, users need sufficient information to be able to make judgements about the uncertainties attached to it. Thus, disclosure will need to deal with:

    - material sources of **uncertainty**;
    - **assumptions** made relating to uncertainties;
    - **determining factors** that will affect whether assumptions will be borne out in practice; and
    - **alternative outcomes**, being the consequences of assumptions not being borne out.

52. For example, an increase in revenue next year might depend on obtaining regulatory approval for a new product. Disclosure could cover the following matters.

    - **Uncertainty**: whether or not regulatory approval will be obtained.
    - **Assumption**: that regulatory approval will be obtained by the end of the current financial year.
    - **Determining factors**: these could include:
      - meeting technical requirements;
      - passing relevant tests; and
      - obtaining expert support.

      These factors should be described and explained.
    - **Alternative outcomes:** no sales of the new product. In this example, the failure of an assumption to be fulfilled will have a simple consequence. However, in some cases, the preparer of the PFI may need to provide sensitivity analysis to explain the consequences of failed assumptions in terms of alternative outcomes.

53. As uncertainties become more significant, there will be a greater need to describe the assumptions that have been adopted to deal with them, the nature of the related determining factors and the impact of alternative outcomes. A point will be reached at which the interaction of multiple significant uncertainties relating to, for example, market demand, competitor actions, product

acceptance or labour and raw material supplies may become too complex for the user to understand. The user's ability to understand places limits on the degree of uncertainty that can be accommodated by PFI, and may require preparers to be less ambitious in terms of the implied precision of the PFI presented.

54. For example, the implied precision may be reduced if the PFI is expressed in terms of:

- a range (between x and y);
- a floor (not less than, or at least, x); or
- a ceiling (not more than, or at most, y).

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

55. Preparers also need to consider whether PFI is presented in a way that makes it understandable, and how it will be understood. To be 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 to the user first. Less important supporting detail is disclosed in supporting analyses or in notes that supplement users' understanding of the high-level information.

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

2.4 'Comparable' attribute and 'subsequent validation' principle

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

58. For financial information to be comparable it usually:

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

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

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

61. References to being capable of subsequent validation reflect the fact that, at the time when PFI is published or otherwise made available, it is not possible to state with certainty that comparable historical financial information will be drawn up in the future. What enhances the usefulness of PFI at the time it is prepared is the expectation that there could be appropriate future reporting, with the expectation for published external PFI being that there could be appropriate future public reporting. If users of PFI know from the outset that they will never be able to compare PFI to what actually happens, then the PFI will be less useful. It is therefore important that PFI is perceived by users as being capable of validation.

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

63. 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. Such comparisons are likely to have beneficial effects on the behaviour of preparers, and help users perceive PFI as being more useful. For example, preparers will not wish to make available to external parties PFI that reflects events that they do not believe will happen, if they will subsequently be held to account. Preparers are also likely to be more diligent in monitoring PFI against actual performance and updating it promptly if they know that users of the PFI will themselves expect to have actual performance compared against PFI in due course.

Part II: General application guidance

Part II includes illustrative procedures for preparing PFI, and any supporting PFI, in accordance with the PFI principles.

Part II: General application guidance

1. INTRODUCTION

1. This part identifies procedures that will assist in the preparation of PFI that is relevant, reliable, understandable and comparable, and therefore will be useful to the user of the PFI.

2. PFI is prepared for a variety of purposes and in a number of contexts, including to support merger and acquisition (M&A) activity and the raising of equity and debt finance.

3. The term 'preparer' means the person or persons with ultimate responsibility for the PFI, as well as such other persons or parties who they have directed or instructed to assist with the preparation of the PFI. For corporate entities, the directors would typically be expected (or required by regulation) to have ultimate responsibility for any PFI that is published or otherwise made available to an external party. Also, the term PFI means prospective financial information prepared for internal purposes and that for publication or for disclosure to external users, as well as any underlying/ supporting financial forecasts, projections or financial forecast model (referred to in this Part as 'supporting PFI').

4. When preparing a financial forecast model, consideration might also be given to relevant elements of:

   - the ICAEW Spreadsheet Competency Framework, which provides a framework for assessing a person or party's modelling skills[8];
   - the ICAEW Corporate Finance Faculty's best-practice guideline, Financial Modelling[9];
   - the ICAEW Tech Faculty's Financial Modelling Code, and Twenty principles for good spreadsheet practice[10]; and
   - ICAEW resources on technology and finance[11].

2. ILLUSTRATIVE PROCEDURES FOR PREPARING PFI

5. The preparation of PFI should be carefully planned, executed and documented. The practical considerations set out in the table below are categorised under these stages.

6. While the purpose and context of the PFI may differ, the preparation of PFI generally requires a wide range of business skills and commercial judgement as well as accounting expertise, and certain core processes and procedures are typically appropriate.

2.1 Illustrative practical considerations and techniques for preparing PFI and supporting PFI

7. The list below is not exhaustive or prescriptive; other considerations and techniques may be applicable. The preparer should assess those that are likely to be relevant having regard to the purpose and context of the PFI, the size, complexity and circumstances of the entity or group, the industry, and the general economic environment.

[8] icaew.com/technical/technology/excel/spreadsheet-competency-framework
[9] icaew.com/technical/corporate-finance/corporate-finance-faculty/guidelines
[10] icaew.com/technical/thought-leadership/tech-faculty/thought-leadership-excel
[11] icaew.com/technical/technology

PLANNING

Purpose of PFI

a. The preparer should identify the purpose for which the PFI is being prepared and the appropriate period to be covered to ensure the form and content of the PFI meets the known or anticipated needs of its users.

Applicable regulation

b. The preparer should understand any applicable legal and regulatory requirements of the proposed PFI and its use, issue or publication. Consideration should also be given to industry-specific regulatory requirements that may impact plans and performance and, hence, the PFI, for example regulatory capital requirements that apply to certain financial institutions.

Business analysis and strategic plan

c. The preparer should identify whether appropriate up-to-date business analysis and a strategic plan exist upon which the PFI should be based.

d. If business analysis and a strategic plan need to be updated or developed, the preparer should determine who needs to be involved in this process.

e. Financial constraints such as banking agreements and covenants that may impact the plans and performance (and hence need to be reflected within the PFI) should be identified and the implications considered.

Financial forecast model and level of detail

f. The preparer should establish whether the business already has a suitable financial forecast model to generate the PFI. If no suitable model exists, the preparer should determine who will be responsible for developing a model and whether that person or party has appropriate financial modelling skills.

g. The preparer should determine the level of detail required in the PFI and ensure that the financial forecast model has the functionality to deliver the required level of detail. For example, integrated income statements, cash flows and balance sheets on a monthly basis are normally required – but depending on purpose, circumstances, materiality, seasonality and the nature of the businesses, different interval periods may be appropriate.

h. The preparer should determine what quality assurance procedures should be applied to the financial forecast model, which may include independent testing procedures on the model. The extent and form of testing to be undertaken should be considered in the context of the complexity of the model and the ultimate purpose of the PFI.

Involvement of directors and managers

i. Directors (or equivalents in unincorporated businesses) and other appropriate senior members of financial and operational management with the necessary in-depth knowledge and experience of the business, its activities and the market, should be briefed on their required involvement in the preparation of the PFI. Subsidiary, divisional, and business unit management should also be briefed on their involvement, as appropriate, and where practical from a confidentiality perspective.

j. Appropriate processes should be planned for obtaining input from all relevant areas of the business, which, in addition to finance, may include some or all of: treasury, tax, operational, commercial and legal functions. Where such functions do not exist in-house, consideration should be given as to whether it is appropriate to obtain input from external service providers to the business. These processes should be implemented, organised and communicated internally, as appropriate, taking into account any confidentiality issues.

Information relating to a target

k. If relevant, appropriate processes should be planned for obtaining PFI input from an acquisition target business.

Relevant accounting policies

l. When planning the PFI, the preparer should identify the accounting policies to be applied in preparing the PFI. In this regard, PFI should usually be prepared in accordance with the entity's key accounting policies and have regard to disclosures of KPIs and APMs insofar as they are material to the PFI and its purpose. Consideration should also be given to whether there are any required or proposed accounting policy or accounting standard changes that should be reflected and, if so, how any changes would impact financial covenant compliance calculations in the PFI.

Format of the PFI and comparison with historical financial information

m. The preparer should consider whether the planned format of the PFI will be capable of being compared with subsequent historical financial information prepared for the period covered by the PFI so that differences and similarities can be evaluated, explained and assessed. The preparer should consider what level of detail and disclosures will be required to address factors that might cause comparability issues such as the impact of a major acquisition or disposal, major strategic change in the business or accounting policy changes.

Responsibilities and timetable for preparation

n. Responsibilities should be clearly planned. Roles should be allocated and co-ordinated, including responsibility for the ultimate internal review and approval of the PFI.

o. A timetable for the preparation of the PFI should be drawn up and communicated to relevant parties. It should include sufficient time for the review and the formal approval process of the PFI by the persons responsible for its preparation/issue, and for any necessary amendments to be made before it is approved.

EXECUTION

Business analysis, key assumptions and inputs

a. PFI should be supported by up-to-date business analysis that is properly grounded in reality, known facts and circumstances. The preparer should identify and collate the appropriate sources of reliable information (business analysis, business plans, strategies and risk analysis) to be used as the basis for the assumptions and inputs used to prepare the PFI.

b. Support for key assumptions and inputs may include:

- the actual balance sheet in the latest available management accounts (which will form the opening balance sheet in the financial forecast model used to generate the PFI), the basis of which will be updated to reflect any further management accounts that become available during the preparation/review period;
- historical performance/ precedents (but it should be recognised that basing forecast assumptions on historical precedent may not always be reasonable, for example, it may not be reasonable for the business in question to both grow market share and maintain its historical pricing);
- current run rate data;
- the pipeline of work recorded in a customer relationship management system or similar;
- future planned actions/investments that are supported by research and third-party analysis; and
- third-party documentary evidence such as the commercial terms of key customer/supplier contracts, market/economic studies, commercial due diligence, experts' reports etc.

c. In developing the assumptions to be applied in the PFI, the preparer should consider the possible range of values for each assumption and the level of uncertainty underpinning the assumption.

d. In addition, consideration should be given to the inter-relationship between key assumptions in the PFI – even if each assumption may appear reasonable in isolation, they may not be reasonable in aggregate.

Other relevant factors

e. The preparer should consider information about the key aspects of the economic and market environment within which the business operates and assess whether there are any economic, market, regulatory, legal, political or other factors which may cause the market to change and impact trading and cash flows, and so should be reflected in the PFI.

f. Consideration should be given to any potential capacity constraints, for example those relating to supply chains, staffing levels, production facilities and distribution channels that may impact the ability to deliver projected results, unless investment or other actions are planned to address these.

Accounting policies

g. In preparing the PFI the appropriate accounting policies identified in the planning phase should be applied. Where relevant, the preparer should take account of the impact of known changes in accounting standards that will apply to the business in future financial periods beyond the current financial year and, if relevant, their impact on any covenant compliance calculations.

Financial forecast model

h. To the extent not already available, a financial forecast model should be built which:

- is integrated, covering the income statement, cash flow and balance sheet, to ensure that all assumptions are consistently and appropriately reflected in each statement, thereby avoiding errors in the model. If, exceptionally, the model is not fully integrated, steps should be taken to ensure all assumptions are appropriately and consistently reflected in all elements of the PFI;
- has the functionality to enable the entity's accounting policies to be applied;

- to the extent appropriate (ie, where this is the objective of the PFI), has the functionality to present financial information in a consistent format with the financial information presented in internal management accounts or statutory accounts;
- allows the preparer to input an opening balance sheet consistent with the actual balance sheet in the latest available management accounts;
- is driven by key assumptions and allows these key assumptions to be flexed to enable modelling of changes in key assumptions and the impact of business risks (sensitivity analysis);
- has the functionality to enable financial covenant compliance to be modelled; and
- uses robust formulae and variable inputs and avoids hard coding of numbers within the financial forecast model which would reduce functionality and could result in errors.

i. Quality assurance procedures should be applied to the financial forecast model which may include:
   - undertaking appropriate integrity and validation checks within the model, for example to confirm that the projected income statement, cash flow and balance sheet reconcile with each other;
   - performing test procedures on the calculations within the model. This may include testing the logical integrity and arithmetical accuracy of calculations; and
   - analytical review and testing of model outputs, tracing back through to inputs.

Sense check of the PFI

j. A 'top-down' sense check of the PFI should also be undertaken. Typically, this will be achieved through analytical review of KPIs and by comparing the PFI with recent actual performance to identify unusual/unexpected trends that indicate possible inconsistencies and, potentially, a need for amendments to the key assumptions and/or the workings of the financial forecast model.

Sensitivity analysis and mitigating actions

k. The preparer should apply sensitivities to the PFI (sensitivity analysis) to determine the impact on the PFI of risks and uncertainties and of changing relevant material assumptions, in order to gain an understanding of the impact on the PFI of such changes.

l. The ability of the entity to undertake mitigating actions that may reduce the impact of risks should be considered and, where appropriate, modelled in the sensitivity analysis. These should reflect only those actions within management's control in terms of quantum, timing and impact and should be realistic and justifiable. The cost of implementing such actions should also be reflected.

Consistency with the business model

m. The preparer should be able to articulate whether and how any PFI they prepare is consistent with their business model and strategy. Such questions might include:
   - Is the PFI consistent with the objectives of the business?
   - Is the PFI consistent with the key drivers of success?
   - Is the PFI consistent with how the business model is working currently?
   - Is the PFI consistent with how the business is and might be impacted by external events?
   - Is the PFI consistent with how risks that affect key processes and information are being managed?

EVIDENCE AND DOCUMENTATION

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

b. Sufficient documentary support should be prepared or obtained, including for:

- the business plans, strategies, risk analysis and business analysis used as the basis of the assumptions underlying the PFI;
- key assumptions and inputs; and
- the accounting policies applied.

c. Approval of the PFI (including all relevant disclosures) by appropriate individuals should be documented. For external PFI this is likely to entail approval by the directors (or equivalents in unincorporated businesses), which should be evidenced in board meeting minutes or their equivalent.

Part III: Application notes

Part III includes the following discrete application notes, each of which relates to specific PFI:

A. Statements of sufficiency of working capital in capital markets transactions

B. Profit forecasts in capital markets transactions and other profit guidance

C. Synergy and stand-alone cost-saving statements in capital markets transactions

These application notes are intended to be considered in addition to the guidance in Parts I and II.

Part III, A: Statements of sufficiency of working capital in capital markets transactions

CONTENTS

Part III, A: Statements of sufficiency of working capital in capital markets transactions

1. INTRODUCTION

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

2. REGULATORY REQUIREMENTS

2.1 Overview of regulation

2. Capital markets regulation in many regimes requires that the investment circular issued in connection with a transaction contains a statement by the issuer, or in some regimes the directors of the issuer, that working capital is sufficient for the present requirements of the issuer (and its group where the issuer has subsidiaries) or, if not (where the regulation applicable to the transaction permits), how it is proposed to provide the additional working capital needed. Many regulators permit only two forms of working capital statement – either the issuer states that it has sufficient working capital (a clean statement) or that it does not (a qualified statement). The form and content of the statement is typically set by regulation.

3. Examples of such regimes and regulatory requirements, which include the UK and the member countries of the European Union, are set out in Annex A.

2.2 Definition of working capital and present requirements

4. For the purpose of working capital statements, working capital is considered to be an issuer's ability to access cash and other available liquid resources to meet its liabilities as they fall due. Present requirements are generally considered to be a minimum of 12 months from the date of the investment circular, although some regulation requires a minimum of 12 months from the date of admission of shares to trading. The term used for the purpose of this application note is 'present requirement period'.

2.3 PFI in relation to working capital statements

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

2.4 ESMA Guidance

6. ESMA Guidance (as defined in the Glossary) provides guidance on the requirements for working capital statements in EU prospectuses, which may also be pertinent for other regimes. In particular, the ESMA Guidance:

- requires that the working capital statement is based on robust procedures to limit the risk that the statement is called into question;
- requires the statement to be unambiguous;
- clarifies that where an issuer can state without qualifying wording that it has sufficient working capital to meet its present requirements, then a clean statement should be made. If an issuer cannot make such statement without qualifying wording, it should provide a qualified statement;

- requires that where a qualified statement is made, matters relating to the relative timing, shortfall, action plan and implications be disclosed to ensure that investors are fully informed.

7. These guidelines are in substance consistent with the guidance of other regulators, including, for example, those set out in Annex A.

2.5 Directors' accountability, including satisfying regulatory obligations

8. The directors make and are responsible for the working capital statement and should be fully engaged in the preparation process. This includes approving the working capital statement, the supporting working capital projections and considering and making decisions in relation to the need for sufficient debt facilities or other external funding. Capital markets regulation imposes overall requirements on the content of information included in investment circulars, and on the standards of care to be adopted by the directors in preparing such information. Such UK and EU regulatory obligations that apply to working capital statements are set out in Annex A.

9. While the obligations in the various regulations are articulated differently, the spirit of the obligations and standards of care are broadly aligned. They require that the process and procedures adopted by the directors are robust and appropriate such that there is very little risk that the basis of the working capital statement is subsequently called into question. They should also ensure that information included in the investment circular, as a whole, is consistent and not misleading.

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

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

3. APPLYING ATTRIBUTES AND PRINCIPLES TO WORKING CAPITAL STATEMENTS

3.1 'Relevant' attribute and 'user needs' principle

12. The working capital statement should address the purpose for which it is being prepared, and be prepared in accordance with the applicable regulation and guidance. For example:
    - for an issuer that has subsidiary undertakings and is making a statement that relates to the company and its group, the working capital statement should be prepared on a consolidated basis covering the entire group;
    - certain regulation requires that the working capital statement is prepared on the basis that the transaction that is the subject of the investment circular (eg, acquisition, disposal, refinancing/reconstruction, purchase of own shares, rights issue, placing etc.) has been completed.

3.2 'Reliable' attribute and 'business analysis' principle

13. If there were significant uncertainties attached to a clean working capital statement, then the principles established in Part I would require that there be appropriate disclosure of assumptions, explanation of the underlying uncertainties and analysis of the consequences of the assumptions not being borne out in practice. However, since many regulatory regimes (including the FCA and ESMA Guidance) do not permit disclosure of assumptions in relation to a clean working capital

statement, then when a clean statement is made there should not be any significant uncertainties that would affect the validity of the statement.

3.2.1 Sensitivity analysis – reasonable worst-case scenario

14. To help limit the risk that the basis of the working capital statement is subsequently called into question, the directors should undertake sensitivity analysis to consider what they believe to be the reasonable worst-case scenario. Although reasonable worst-case scenario is a term used by regulators such as ESMA, it has not been defined or prescribed. What constitutes a reasonable worst-case scenario is a matter of judgement based on the specific circumstances: it represents what the directors judge to be reasonably possible downside sensitivities and may include mitigating actions within the directors' control. The analysis should focus on those assumptions believed by the directors to be subject to the greatest uncertainty (and where the range of possible assumed values is wide) and those assumptions that, if changed by a relatively small amount, can have a large impact on the forecast outcome. The sensitivity analysis can also be used to assess the extent to which working capital is sensitive to other assumptions. See the illustrative practical considerations and techniques in section 4.1.
15. Where, in considering the reasonable worst-case scenario, the directors conclude that there is insufficient margin or 'headroom' between required and available funding to cover such a scenario (or that a breach of covenants is projected), it will not be possible to make a clean working capital statement. In these circumstances, the directors will either need to reconsider their business plans, arrange additional financing or consider whether they should issue a qualified working capital statement – see section 3.3 on understandability.

3.2.2 Other aspects of reliability

16. The concept of neutrality is relevant to working capital statements in that directors should consider any statement required by the applicable regulation in a wider context. For example, if the statement was valid for the present requirement period but difficulties were foreseen in the subsequent period, the information might be seen as biased and the lack of disclosure misleading. In these circumstances, the directors should consider if supplementary disclosures in other parts of the investment circular would be appropriate to describe the difficulties foreseen in periods beyond the present requirement period. In considering this issue, the directors should consider the unpublished PFI that supports the working capital statement beyond the present requirement period covered by the statement.
17. The directors should also consider the availability of committed financing facilities and compliance with any covenants or material adverse change clauses. Where required by regulation or local market practice, liquidity headroom should only take into account facilities for the forecast period to the extent that they are committed. In assessing whether a facility is committed, any clauses in the facility agreements that are within the issuer's control but are forecast to be breached (whether under the base case and/or the reasonable worst case), including those, for example, relating to a change of control or covenants, should be considered.

3.3 'Understandable' attribute and 'reasonable disclosure' principle

18. When making a working capital statement (the form of which is typically set by regulation), issuers should ensure that the statement or explanation is understandable; ie, the working capital statement should be clear and unambiguous leaving no doubt in the user's mind as to whether, in the issuer's opinion, there is, or is not, sufficient working capital. The working capital statement

also needs to be understandable in the context of the overall investment circular so care should be taken to ensure that there is alignment of information within the investment circular.

3.3.1 Form of the working capital statement

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

3.3.2 Risk factors

20. The typical contents of an investment circular have evolved to include greater disclosure of risk factors affecting the issuer. While the ESMA Guidance and the FCA require that these risk factors should not constitute qualifications to the working capital statement, these expanded disclosures provide useful context for the basis upon which the rest of the investment circular, including the working capital statement, is prepared. It is therefore important that the PFI underpinning the working capital statement includes sufficient consideration of the potential impact of the issuer's principal risk factors and that the working capital statement is consistent with this and other parts of the investment circular.

3.3.3 Qualified working capital statements

21. Where the directors consider that the issuer does not have sufficient working capital and it is not possible to arrange additional financing before the issue of the relevant investment circular, then (provided a clean statement is not an eligibility requirement for listing or admission) a qualified working capital statement must be made. Regulation or guidance issued by regulators typically specifies the additional matters that need to be disclosed in such cases.

22. The plans to address the working capital shortfall should be specific – not just a high-level statement of intention.

3.3.4 Alignment and interaction with disclosures elsewhere in the investment circular

23. Disclosures elsewhere in the investment circular should be aligned and consistent with the working capital statement (and vice versa). If they are not, then this would raise questions about the reliability of the working capital statement. There is particular potential for overlap between the business analysis, reason for offer, use of proceeds, and risk factor sections of an investment circular, and the working capital statement. For example:

   - if the business analysis section refers to expansion plans then the working capital assessment undertaken by the directors should show that working capital is sufficient over the present requirement period for such expansion opportunities;

- if the use of proceeds section of the investment circular states that the proceeds will be used for capital projects, then the working capital projections underlying the working capital statement need to be consistent with this;
- a risk factor such as a risk that scheduled debt repayments within the present requirement period may be missed if the business is not generating sufficient cash, is fundamentally inconsistent with a statement that working capital is sufficient;
- a risk factor that covenants attaching to facilities may limit expansion or acquisition opportunities is not necessarily inconsistent with an unqualified working capital statement. However, in the instance of a fundraising where the use of proceeds states that the fundraising is for capital projects, it would be inconsistent if an unqualified working capital statement can only be made if capital projects are not undertaken, as this would not be aligned with the use of proceeds section; and
- risk factors that are generically and broadly drafted to seek to cover all conceivable risks irrespective of materiality can start to stray into areas that potentially conflict with the working capital statement.

24. Notably, the ESMA Guidance and the guidance issued by the FCA (see Annex A) recognise this potential for overlap. The FCA has consequently stated that where a clean working capital statement is made it will pay close attention to risk factors that suggest that the issuer will or may run out of working capital in the present requirement period.

3.4 'Comparable' attribute and 'subsequent validation' principle

25. For PFI to be comparable it should be capable of subsequent validation by comparison with the outcomes in the form of historical financial information and, hence, the PFI supporting the working capital statement should be prepared on a consistent basis with historical financial information.

26. The principle of subsequent validation should not be interpreted too literally or narrowly in the context of working capital statements. Under this guidance a working capital statement is an example of PFI that satisfies the subsequent validation principle and is clearly capable of being reported against. A clean statement is that the working capital available to an entity is sufficient for its present requirements. While companies do not explicitly report actual performance against a working capital statement, it will be apparent if a company has run out of working capital. Even before a company runs out of working capital, if it is in imminent danger of exceeding its working capital facilities, this will need to be considered for disclosure in the context of the general regulatory disclosure obligations that apply to the issuer (see Annex A).

4. PREPARING PFI IN CONNECTION WITH WORKING CAPITAL STATEMENTS (AND THE SUPPORTING UNPUBLISHED PFI)

27. Part II identifies core procedures for the preparation of PFI, in the form of illustrative practical considerations and techniques, which are applicable to the preparation of all PFI. These should be applied as appropriate, in the context of a working capital statement along with those in section 4.1, which are specific to working capital statements.

28. Directors should assess those procedures that are likely to be relevant having regard to the size, complexity, predictability, and particular circumstances of the group, the industry, the general economic environment and the transaction that is the subject of the investment circular. For example, the level of detail and analysis needed for a debt-free investment entity with no committed capital or investment expenditure undertaking a fundraising will be less than that required for a complex or highly leveraged trading group facing its most important trading period.

The procedures are not exhaustive or prescriptive: other considerations and techniques may be applicable.

4.1 Illustrative practical considerations and techniques specifically applicable to working capital statements

29. The applicable practical procedures and considerations set out in Part II should be undertaken in addition to the following, which are specific to working capital statements and the supporting unpublished PFI (referred to in this note as working capital projections).

PLANNING

Board input and involvement

a. The directors are responsible for the working capital statement and should be involved and provide oversight throughout the preparation process including: planning, approving the working capital statement, the supporting working capital projections and the accompanying board memorandum or paper, and considering and making decisions in relation to the need for sufficient debt facilities, other external funding or working capital facilities.

Timely planning

b. The process should be planned in detail at the outset to ensure that sufficient time and resources are built into the project plan. In the case of an acquisition, for example, this will entail consideration of the practical issues involved in obtaining access to target information.

Applicable regulation

c. The applicable regulation and guidance should be reviewed at the outset and then followed. The directors should ensure that the working capital statement and supporting unpublished PFI that forms the basis for the statement are prepared in accordance with the applicable regulatory requirements and guidance.

Engagement with advisers

d. Where a public report or confirmation to a regulator is required from a third party (such as a sponsor/nominated adviser or reporting accountant), then such advisers should be engaged early in the process to enable appropriate involvement and for this to be factored into the directors' planning process for the preparation of the PFI.

Level of detail required in the working capital projections

e. The level of detail within the working capital projections may vary depending on the circumstances of their preparation and the level of bank balances, liquid assets, credit facilities and headroom available to the issuer.

f. Where headroom is significant and projected working capital requirements are not volatile, the level of detail required in the working capital projections may be less than in circumstances where headroom is limited and the projected working capital requirements are highly sensitive to small changes in key assumptions.

Period covered by the working capital projections

g. Notwithstanding the 12-month present requirement period of the working capital statement, it will be necessary for the directors to consider any foreseeable working capital difficulties beyond the 12-month period of the required statement and they should consequently prepare their working capital projections to cover at least the next 18 months (although it may be appropriate for the period to terminate at the issuer's next reporting date following that date).

h. If, however, the issuer's normal business cycle is greater than 18 months or the cash flow figures show an adverse trend at the end of the period which is projected to continue, then it will be necessary for the directors to address any factors likely to pose a significant threat to the sufficiency of working capital thereafter (for example, substantial repayments of borrowings, deadlines for repayment of significant loans, continuing trading losses or other factors of which the directors are aware).

i. Where relevant, the financial adviser may also have a view in relation to the period to be covered.

Frequency of balance sheets in the working capital projections

j. The frequency of balance sheets in the working capital projections will depend on the impact of seasonality, the profile and nature of trading cash flows, and covenants set by lenders, but a monthly basis is considered best practice.

k. Where cash requirements fluctuate considerably, for example due to the seasonal nature of the business, the balances may need to be considered more frequently including on an intra-month basis as set out below.

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

l. The preparation of working capital projections for a group proposing a major acquisition may entail practical difficulties.

m. While the directors of the acquiring company will be able to assess the working capital needs of their own group, they will need to factor information relating to the potential working capital requirements of the target business into their enlarged group working capital projections. Unless the target business is already well known to the acquirer, the latter is likely to need to obtain some of this information from target management.

n. While target management can be expected to have a detailed understanding of the existing requirements of the target business, they will not be in a position to take into account the consequences of the change of ownership (for example, on the availability of funding, the extent of intra-group trading, and the trading strategy) which will be matters that the acquirer will need to address in preparing the enlarged group working capital projections.

Working capital for credit institutions and insurance companies

o. Regulatory capital or 'solvency' requirements will be an aspect of, but not identical to, sufficiency of working capital and will need to be considered.

p. Specific regulatory guidance applicable to credit institutions and insurance companies, such as that provided by ESMA, should be followed.

Qualified working capital statement – action plans and disclosure

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

EXECUTION

Working capital projections should be prepared on a consistent basis

a. The working capital projections should be prepared on a consistent basis with the issuer's historical financial information and in accordance with stated accounting policies insofar as they are material to the working capital statement and its purpose.

Working capital projections should be prepared on a consolidated basis

b. Where the issuer has subsidiary and other undertakings, the working capital projections should be prepared on a consolidated basis covering the entire group throughout the working capital period and taking into account the financing arrangements in place across the group.

c. Restrictions on the ability to remit funds between subsidiaries (due, for example, to exchange control restrictions or the terms imposed by lenders) need to be taken into account in preparing the consolidated working capital projections.

d. Material cash flows with associated undertakings and any off-balance sheet financing vehicles should also form part of the information that the directors should analyse and appraise.

e. The applicable regulation may require that the working capital projections cover both the consolidated position of the existing group and the group as enlarged by a proposed acquisition – see below.

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

f. Certain regulation requires that the working capital statement and the underlying working capital projections be prepared on the basis that the transaction (eg, acquisition, disposal, refinancing/reconstruction, purchase of own shares, rights issues, placings) has taken place (provided, in the case of a fundraising, that the proceeds are fully underwritten – ie, an underwriter has agreed to purchase the remaining securities that are not taken up by investors). In the case of an EU prospectus, the working capital statement needs to address all outcomes (ie, if the transaction or fundraising happens or not).

g. In relation to a reverse takeover, the statement will need to take into consideration the enlarged group, and if the transaction also involves a fundraising that would proceed even if the reverse acquisition did not take place or involves a share issue, a statement covering the existing group is also required to ensure that information on all possible scenarios is provided to users.

h. Where permitted by regulation, account is taken of offer proceeds (but only to the extent underwritten), placing proceeds (but only to the extent firmly committed) and disposal proceeds. Their treatment in the working capital projections should be consistent with references to the use of such proceeds elsewhere in the investment circular.

i. All relevant costs including transaction costs should also be factored into the working capital projections.

Consistency with historical financial information and accounting policies

j. The working capital projections should be prepared on a consistent basis with the issuer's historical financial information and in accordance with stated accounting policies to the extent that they are material to the working capital statement and its purpose.

Opening cash and loan balances

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

Other forecast information/regulatory requirements

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

Borrowing facilities

m. The directors should prepare an analysis of the sources of borrowings which they believe will be available over the working capital period, the amounts involved and the periods of availability (borrowing facilities).

n. The directors should undertake an analysis of the terms and conditions relating to borrowing facilities so that risks relating to continued availability of the borrowing facilities can be assessed and addressed including, for example, determining if borrowings are linked to specific projects or purposes such that, even if committed, they cannot be used for general working capital requirements.

o. The availability of borrowing facilities may be dependent upon the issuer's compliance with specific terms and conditions (covenants) and may also depend on the lender's assessment of the transaction and risks impacting security and repayment of borrowing.

p. The working capital projections should appropriately reflect these analyses, the key financial terms of the banking/loan facilities and where required by regulation or local market practice should reflect only committed funding facilities. Where required by regulation or local market practice, liquidity headroom should only take into account facilities for the period to the extent that they are committed. In assessing whether a facility is committed, any clauses in the facility agreements that may be breached, including those relating to covenants and change of control clauses, should be considered.

q. UK market practice is that 'committed' facilities are those that are in place in the present requirement period, which cannot be withdrawn or reduced (subject to normal explicit conditions such as covenant compliance) and do not need to be renewed. An overdraft facility, if it can be withdrawn at the lender's discretion, is not considered to be a committed facility.

Other sources of finance

r. The directors should prepare an analysis of other sources of funding (for example, the proceeds of a share offering).

s. The level of confidence in other sources of finance should be considered. The proceeds of an offering should only be included in the working capital projections if the offering is underwritten on a firm commitment basis or if irrevocable undertakings have been given for placings.

t. Where the transaction that is the subject of the investment circular is conditional upon the issuer achieving a specified amount of net proceeds from an offer of securities, then consideration should also be given to any minimum level of net proceeds stated in the investment circular.

Borrowing limits and covenants

u. The working capital projections should demonstrate that borrowing limits and covenants as defined under the Articles of Association, Debenture Trusts Deed, or borrowing facilities etc. will not be breached with regard to:

- projected borrowings;
- maximum utilisation of facilities; and
- covenant tests.

v. Consideration should be given to any cross default provisions in borrowing facilities which could result in a default on one bank facility triggering an automatic default on all other facilities held by the same lender.

w. In calculating projected financial covenant positions, the directors should ensure that all requirements of the facility agreements are met – eg, calculating the covenants using the exact definitions included in the agreements and taking into account related clauses such as the application of frozen GAAP or different foreign exchange rates compared to the underlying working capital projections.

Intra-month cash flows

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

Risk factors

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

Reasonable worst-case scenario

z. In order for the working capital statement to be made with a high degree of confidence, the directors should assess whether there is sufficient margin or headroom to cover a reasonable worst-case scenario (ie, applying sensitivity analysis) to be confident that, in the event that such a reasonable worst-case scenario unfolds in the working capital projections period, the working capital statement will still hold true. The 'base case' working capital projections should, therefore, be sensitised to reflect a reasonable worst-case scenario and to determine the impact on working capital. Although reasonable worst-case scenario is a term used by regulators such as ESMA, it has not been defined or prescribed. What constitutes a reasonable worst-case scenario is a matter of judgement based on the specific circumstances. It represents what the directors judge to be reasonably possible sensitivities. It is not a stress test (in the sense used by the financial services industry to establish an organisation's resilience to shock events), nor is it intended to be a disaster scenario. However it should be a downside analysis of the factors (singular or multiple) which have more than a remote possibility of occurring.

This will require:

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

aa. The resulting reasonable worst-case scenario will constitute separate PFI, which will also be relied upon by the directors in making their working capital statement. It will reflect the directors' view of a reasonable worst case, rather than the most likely outcome, and should otherwise adopt the same principles of preparation as the base case working capital projections.

bb. As with the base case working capital projections, the extent of the analysis should be proportionate to the size, complexity, particular circumstances of the issuer and the risks it faces.

cc. It may, depending upon the facts and circumstances, be appropriate to test the impact of changes such as the following:

- revenue shortfall (volume and/or price);
- reliance on key customers or suppliers;
- a customer or supplier failing;
- higher than expected bad debts;
- decrease in margin/increase in raw material or labour costs;
- increase in various categories of overheads;
- changes in debtor or creditor payment profiles;
- delays in cash inflows;
- changes in regulation;
- taxation rates;
- interest rates;
- exchange rates; and
- a planned acquisition or disposal not taking place.

dd. Typically, it will only be appropriate to take account of mitigating factors or corresponding upsides to offset the downside sensitivity analysis, where the mitigation/'upside' is reasonably certain and within the directors' control.

ee. Any expected time lag between the crystallisation of the vulnerability and the implementation of the mitigating action should be addressed. It should also be recognised that certain mitigating factors/upsides may result in a short-term cash flow drain.

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

ff. Consideration should be given to the disclosures elsewhere in the investment circular and their impact on the working capital projections and working capital statement. There should be consistency between the disclosures elsewhere in the investment circular (risk factors, business analysis, reason for the offer, use of proceeds sections and dividend policy disclosures etc.)

and the working capital statement and the working capital projections. For example, capital investment and expansion plans or opportunities referred to in the investment circular should be appropriately reflected in the working capital projections. If such opportunities are constrained by a lack of available working capital, then this should be stated in the business analysis section of the investment circular.

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

gg. The funding of longer-term commitments of a significant or potentially significant nature such as taxation liabilities, special pension scheme contributions, capital expenditure, potential damages or costs in legal disputes, and other commitments should be considered.

hh. If there is substantial doubt as to the ability of the issuer to fund such commitments that fall due after the period covered by the working capital statement, the investment circular will need to report this clearly.

Working capital difficulties in the subsequent period

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

Qualified working capital statement

jj. Where the directors have determined that the business does not have sufficient working capital for its present requirements then (where permitted by the regulation governing the transaction/investment circular) a plan to address the shortfall should be prepared covering:

- the estimated quantum of the shortfall;
- the relative timing of the working capital insufficiency;
- an action plan to address the shortfall (including degree of confidence and timing); and
- the implications of the proposed actions being unsuccessful.

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

EVIDENCE AND DOCUMENTATION

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

b. Sufficient documentary support should be obtained, including for the business analysis and plans, working capital projections, key assumptions, risk analysis, committed facilities and reasonable worst-case scenario.

c. The directors should formally document and approve the working capital statement and underlying PFI in the form of a board memorandum/paper (or in board minutes) covering the form of the published working capital statement, the basis for the statement, a summary of the working capital projections, key assumptions, headroom, sensitivities and conclusions reached by the directors.

Part III, B: Profit forecasts in capital markets transactions and other profit guidance

CONTENTS

Part III, B: Profit forecasts in capital markets transactions and other profit guidance

1. INTRODUCTION

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

2. REGULATORY REQUIREMENTS

2.1 Overview of regulation

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

2.2 Definition of a profit forecast and scope of application note

8. In capital markets regulation the definition of a profit forecast typically includes any disclosure from which a profit (or loss) figure can be derived, and can be for all or part of a business. This includes statements such as 'We expect this year's profit before taxes to be between £30 million and £50 million' as well as purely narrative statements such as 'The profit/loss is expected to be higher than/lower than/in line with the previous year'.

9. The interpretation of the definition of a profit forecast can often involve some debate, and may require case-by-case discussion with the relevant regulatory authority. To assist directors in the context of an EU prospectus, ESMA has released detailed guidance in relation to the definition of profit forecasts (see Annex B).

10. 'Profit estimate' is a term used by certain regulators. A profit estimate is typically for a financial period that has expired but for which the results have not yet been published. This guidance remains applicable to a profit estimate to the extent it is supported by unpublished PFI, ie, after the financial period has expired but before actual results are available for the full period.

2.3 PFI in relation to profit forecasts

11. The profit forecast statement published in an investment circular is itself PFI. The profit forecast statement is also, however, supported by underlying PFI, including unpublished financial projections that form the basis for the statement; these are referred to in this Part as the supporting unpublished PFI. While the focus for a profit forecast will inevitably be on the income statement, it is expected that the supporting unpublished PFI will also include a forecast balance sheet and cash flow statement.

2.4 ESMA Guidance

12. The ESMA Guidance (as defined in the Glossary) on the requirements for profit forecasts included within EU prospectuses may also be pertinent to other regimes. In particular, the ESMA Guidance states that:

    - A profit forecast should follow the core principles of PFI, that is, it should be understandable, reliable, comparable and relevant. The application of these core principles to profit forecasts is discussed further in section 3.
    - Additional comparative financial information or narrative disclosure may be necessary to facilitate comparability of profit forecasts or estimates, for example, if a significant transaction affects the historical or forecast period or if a change in accounting policies might impact the comparability of financial information.

13. These themes are also reflected in the guidance of regulators, including, for example, in FCA Technical Notes (see Annex B).

2.5 Directors' accountability, including satisfying regulatory obligations

14. In most regulatory regimes the directors are responsible for the profit forecast statement and, accordingly, should be fully engaged in the preparation process. This includes considering and approving the profit forecast statement (including the assumptions upon which it is based), the supporting unpublished PFI and the assessment of the risks to achieving the profit forecast.

15. Capital markets regulation imposes standards on the content of information included in investment circulars, and on the processes and procedures adopted by the directors in preparing such information. Such UK and EU regulatory obligations that apply to profit forecast statements are set out in Annex B.

16. While the obligations in various regulations are articulated differently, the spirit of the obligations and standards of care are broadly aligned, and require that the process adopted by the directors is sufficiently robust. Typically:

- there should be clear disclosure of assumptions upon which the profit forecast has been based;
- the basis of accounting should be consistent with the accounting policies of the issuer; and
- the profit forecast should be prepared on a basis comparable with the historical financial information that will be subsequently reported.

17. Regulation may require that the profit forecast be publicly reported on by a reporting accountant, stating for example that, in its opinion, the profit forecast or estimate has been properly compiled on the basis stated and that the basis of accounting is consistent with the accounting policies of the issuer. Regulation may also require other statements to be made by one or more of the reporting accountant, the financial adviser and the directors regarding the preparation of the profit forecast. Where the directors are required to make a statement, this is typically required to confirm that the forecast has been properly compiled on the basis stated.

18. One of the principal issues that will concern directors is ensuring that they are highly confident that a forecast will be achieved and that there is very little risk that it will not. Accordingly, this guidance requires that directors should undertake appropriate and robust procedures to ensure that the PFI is free from material error or omission and reflects a forward-looking analysis of the business based on facts known (or that ought reasonably to have been known) to the preparer at the time of preparation, and consider carefully the form of the profit forecast statement to limit the risk that the profit forecast is subsequently called into question. This guidance sets out principles and processes for the preparation of profit forecasts and the supporting unpublished PFI which help the directors to satisfy their obligations and meet user expectations. Notwithstanding this, users should recognise the inherent uncertainties of PFI set out in paragraph 6 of Part I.

19. The guidance does not address legal obligations and directors should obtain legal and professional advice as appropriate.

3. APPLYING ATTRIBUTES AND PRINCIPLES TO PROFIT FORECASTS

3.1 'Relevant' attribute and 'user needs' principle

20. Broadly, a profit forecast should be relevant to users and have predictive value if it:

- has an ability to influence economic decisions of investors and is provided on a timely basis so as to influence such decisions and assist in confirming or correcting past evaluations or assessments;
- is drawn up on a relevant and appropriate basis that enables the user to assess the prospects of the issuer. If preparation of the forecast on the most relevant and appropriate basis is not practicable, then this should be made clear through disclosure; and
- is for an appropriate profit measure.

3.2 'Reliable' attribute and 'business analysis' principle

21. Users of profit forecasts expect that an issuer will achieve a profit forecast that it publishes. If it fails to do so, and the difference is material, then, depending on applicable regulation, the directors may be required to disclose in the next annual report the relevant figure and explain any material variance so as to enable the forecast and actual results to be directly compared. Following this guidance will help the directors to demonstrate that, notwithstanding the inherent uncertainties of PFI, they are acting responsibly by only making a profit forecast that they are highly confident will be achieved.

22. To the extent that a profit forecast relates to a financial period that has begun but not ended at the date of issue, it will include financial information relating to the expired part of the period. Normal considerations applicable to the integrity of published historical financial information will apply to any historical financial information incorporated into a profit forecast.

3.2.1 Sensitivity analysis, risks and opportunities

23. Where, in considering the sensitivity analysis, the directors conclude there is insufficient certainty of achieving the profit forecast, then the directors should consider whether it is appropriate and not misleading to publish that forecast. In these circumstances, if a profit forecast has already been published then the directors will need to consider whether to update the profit forecast to reflect the latest available information, or to state that the profit forecast is no longer valid and withdraw it. In both cases, it is expected that the directors will give a clear explanation of the reasons for the amendment or withdrawal of a profit forecast.

3.2.2 Other aspects of reliability

24. The concept of neutrality is relevant to profit forecasts because of the scope for providing forecast information for particular captions from a profit and loss account so as to convey a particular message. Selection of the most appropriate profit measure should be driven by consideration of what is most useful to the investor and take into account applicable regulation.

25. The concept of neutrality is also pertinent because of the risk that the forecast period introduces potential bias. For example, if the level of profits in the forecast period were not sustainable or if losses were expected in the subsequent period, supplementary disclosures should be considered.

26. Ranges can be used to indicate a level of uncertainty in relation to a forecast but they can be hard to interpret. Care should be taken to ensure the disclosure of a range does not undermine the reliability of the profit forecast, for example by presenting a range when the directors' best estimate is at one end of that range.

3.3 'Understandable' attribute and 'reasonable disclosure' principle

3.3.1 Form of the profit forecast

27. The wording of the profit forecast itself is central to its understandability. There is significant variation in the phraseology used in published earnings guidance of what may or may not subsequently be deemed a profit forecast. This is partly driven by the lack of regulation governing the release of earnings guidance in the ordinary course of business (that is, prior to the publication of an investment circular) in many regulatory regimes.

28. The directors should pay particular attention to the form of profit forecast issued, and consider the interpretation of the forecast by investors and/or potential investors. A particular difficulty arises with unspecific or ambiguous profit forecasts. For example:

    - if it is stated that 'profits will be less than those of last year', and the relative figures are £100 million and £10 million respectively, there would be concern that without amplifying the statement to give a meaningful indication of the scale of the drop in profit the statement would not be understandable and may be considered misleading;
    - if reference is made to 'a substantial improvement in profit this year' the increase should be by an amount that is sufficient to ensure that the statement remains understandable and not misleading;
    - disclosing a minimum or a floor may imply that the most likely outcome is close to that number;

- in cases of relatively high uncertainty that are subject to a broad range of likely outcomes, the use of a maximum or minimum might be misleading. In such circumstances, a carefully considered range may be more appropriate and provide more understandable and useful information for investors.

29. Disclosure of an exact profit figure is rare, given the uncertainty associated with the exact figure that will be achieved. This is particularly relevant when the profit forecast is published in an investment circular, given the rigorous expectations applicable to such profit forecasts.

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

3.3.2 Disclosure of assumptions upon which the profit forecast is based

31. Disclosure of the principal assumptions upon which the issuer has based its profit forecast is often required, including, for example, by the ESMA Guidance, the FCA and the City Code. In particular, the assumptions should:
    - be clearly segregated between assumptions relating to factors which the directors/issuer can influence and assumptions relating to factors which are exclusively outside the influence of the directors/issuer;
    - be readily understandable by investors;
    - be specific and precise; and
    - not relate to the general accuracy of the estimates underlying the profit forecast.

32. Care should be taken when disclosing assumptions. While appropriate disclosure will improve the understandability of the profit forecast, disclosure of a large number of insignificant assumptions is likely to compromise that understandability. The directors should ensure the disclosure draws attention to those assumptions that could materially change the outcome of the forecast.

33. A further aspect of understandability is the disclosure relating to the degree of uncertainty inherent in the information. For example, the disclosure of an assumption may not make the profit forecast understandable if the significance of that assumption is not apparent from the disclosure made.

34. Accordingly, the segregation of assumptions in relation to factors which the directors can influence from assumptions which are exclusively outside of their influence also aids understandability.

35. What constitutes reasonable disclosure will therefore depend upon the particular circumstances of each profit forecast but will need to take into consideration:
    - sources of uncertainty and the assumptions made in relation to these uncertainties;
    - the factors that will affect whether assumptions will be borne out in practice; and
    - alternative outcomes, being the consequences of assumptions not being borne out.

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

36. Disclosures elsewhere in the investment circular should be aligned and consistent with the profit forecast (and vice versa). There is particular potential for overlap between the business analysis and risk factors sections of an investment circular and the profit forecast.

37. While disclosure of risk factors elsewhere in the investment circular provides useful context, it is not a substitute for the explicit disclosure of the principal assumptions upon which the profit forecast is based or the uncertainties that it is exposed to. It is important that the supporting unpublished PFI underpinning the profit forecast includes sufficient consideration of the potential impact of the issuer's principal risk factors and, where these may materially affect the published result, the directors should consider additional disclosure to the profit forecast.

3.4 'Comparable' attribute and 'subsequent validation' principle

38. For PFI to be comparable, it should be capable of subsequent validation by comparison with the outcomes in the form of historical financial information and, hence, the profit forecast should be prepared on a consistent basis with historical financial information, and this is often prescribed by regulation.

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

40. 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.

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

4. PREPARING PFI IN CONNECTION WITH PROFIT FORECASTS AND OTHER PROFIT GUIDANCE (AND THE SUPPORTING UNPUBLISHED PFI)

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

43. In preparing the profit forecast itself, as well as the supporting unpublished PFI on which it is based, the techniques and considerations in section 4.1 which are specific to profit forecasts should also be considered and applied where appropriate.

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

4.1 Illustrative practical considerations and techniques specifically applicable to profit forecasts

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

PLANNING

Applicable regulation

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

Engagement with advisers

b. Where a report is required from one or more external advisers, especially a public report on the profit forecast, the advisers should be engaged early in the process to enable appropriate involvement and input into the directors' planning process for the preparation of the profit forecast and the supporting unpublished PFI.

Board input and involvement

c. The directors are responsible for the profit forecast and should be involved and provide oversight throughout the preparation process, including approving the form and content of the published profit forecast and supporting disclosures of bases of preparation and principal assumptions (as well as the supporting unpublished PFI).

d. The process should be appropriately planned on a timely basis. In the case of an acquisition where the target's forecast is relevant to the profit forecast, for example, this will entail consideration of the practical issues involved in obtaining access to target information, if applicable.

Period covered by the supporting unpublished PFI

e. Supporting unpublished PFI should be prepared to cover the exact period(s) for which the profit forecast has been made.

f. Depending on the unpredictability and variability of the business and/or the industry in which it operates, it may also be appropriate to prepare supporting unpublished PFI for subsequent period(s), in order to assess whether further disclosure regarding the profitability of the business after the profit forecast period should be made.

Level of detail required in the supporting unpublished PFI

g. The level of detail required within the supporting unpublished PFI may vary depending on the circumstances of its preparation, the form of the profit forecast itself, the level of contingency available (see Execution, Contingency), and the time between publication of the profit forecast and the end of the relevant financial period.

h. Where the results of the business are predictable and the result is not sensitive to changes in circumstances, the level of detail required in the supporting unpublished PFI may be less than in circumstances where the margin for error is small and the trading results are subject to large fluctuations.

i. Similarly, where the profit forecast is published close to the end of the relevant financial period, the level of detail required in the supporting unpublished PFI may be less than in circumstances where the financial period has just begun or the profit forecast relates to a financial period entirely in the future. However, significant rigour will also need to be applied to the determination of any actual results for past periods forming part of the overall profit forecast period.

j. It is expected that a forecast balance sheet and/or cash flow statement should be prepared as part of the supporting unpublished PFI to assess, for example, the unwinding of provisions/ accruals and their impact on profit.

EXECUTION

Supporting unpublished PFI should be prepared on the appropriate basis

a. The basis of preparation (which should be disclosed in the profit forecast) should be applied consistently across the supporting unpublished PFI, including all relevant subsidiary and other undertakings that comprise the group or business that is the subject of the profit forecast.

b. Regulation may not require the profit forecast to be prepared on the basis that the transaction (eg, acquisition, disposal, refinancing/reconstruction, purchase of own shares, rights issue, placing) has been completed, since the statement has often been made prior to contemplation of the transaction.

Basis of preparation

c. The profit forecast should be prepared:

- using accounting policies consistent with the accounting policies of the issuer; and
- on a basis comparable with the historical financial information.

d. Where the issuer changes its accounting policies (whether due to adoption of a new standard or amending its existing accounting policies), sufficient disclosure should be made to enable comparability and subsequent validation upon release of the actual results.

Historical information included in the forecast

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

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

Other forecast information/regulatory requirements

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

Adjusted profit measures

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

i. Where the profit forecast relates to a profit measure other than profit before tax (for example, EBITDA), the directors should consider profit and loss items recognised outside of the relevant profit measure, for example expenses recognised outside of an adjusted profit measure, to ensure that these have been appropriately recognised outside of that profit measure.

j. The treatment of all profit and loss items recognised outside of the relevant profit measure should be consistent with the historical financial information and the group's accounting policies to ensure comparability.

Risks and opportunities

k. The process of preparing the supporting unpublished PFI should include an assessment of all risks and opportunities to achieving the profit forecast.

l. Directors and other senior members of financial and operational management with the necessary in-depth knowledge and experience of the business, its activities and the market, should be actively involved in the identification and ongoing monitoring of risks and opportunities to achieving the profit forecast.

m. The ongoing monitoring of the risks and opportunities should continue up to the date of approval and publication of the profit forecast, to ensure the latest available information is being taken into account.

Mitigating actions

n. In preparing the supporting unpublished PFI and considering whether this gives the required confidence to issue the profit forecast, the directors may take into account actions and discretionary items within their control that could be initiated in the forecast period in the event that the actual result starts to deviate from the forecast.

o. Examples of such mitigating actions include, but are not limited to, the following:

- bonus and other discretionary pay-outs (and therefore the associated income statement expense) where contractual commitments allow variation;
- delaying the introduction of new products or initiatives that will require front-loaded investment in operating costs; and
- delaying other operating expense items, such as non-essential events, travel, etc.

p. Mitigating actions should only be taken into consideration where management has a high degree of confidence that it would be able to effect those actions in the profit forecast period.

q. As with risks and opportunities, directors and other senior members of financial and operational management with the necessary in-depth knowledge and experience of the business, its activities and the market should be actively involved in the identification and ongoing monitoring of potential mitigating actions.

Contingency

r. To achieve a high degree of confidence in the PFI, the directors may consider it appropriate to maintain a contingency between the published profit forecast and the supporting unpublished PFI.

s. The level of contingency required will depend on a number of factors (for example, the sensitivity to key assumptions, the period of the forecast that is outstanding, and the wording of the profit forecast itself) and is a matter of judgement. Directors should take care to ensure that any contingency is not so large that it may cause the profit forecast to be misleading.

Sensitivity analysis

t. The directors should undertake sensitivity analysis to determine the impact on the forecast result in the event that the identified risks and opportunities crystallise during the relevant financial period.

u. Such sensitivity analysis involves measuring the impact on the forecast result of risks, opportunities and uncertainties and of changing relevant assumptions to provide the directors with an understanding of the critical assumptions that underpin the profit forecasts and their impact.

v. The extent of the analysis should be proportionate to the particular circumstances of the issuer and the risks it faces.

w. Typically, when assessing the overall net impact of sensitivities, it will only be appropriate to take account of upsides (ie, potential profit beneficial events which have not been accounted for in the base case forecast results), where the associated upside is a direct result of the downside sensitivity.

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

x. There is no single measure that itself confirms a high degree of confidence has been achieved.

y. The directors should take into account a variety of different factors and indicators and other relevant information when considering whether they have sufficient certainty to issue the profit forecast. Examples of the key indicators in assessing the level of evidence obtained are as follows:

- the level of uncertainty associated with the trading forecasts of the business and the industry in which it operates;
- the timing of publication of the profit forecast compared with the time to expiry of the relevant financial period;
- the sensitivity of the forecast result to the key assumptions upon which it is based;
- the risks and opportunities to achieving the profit forecast, including the likelihood and magnitude of those risks and opportunities crystallising;
- the level of contingency maintained within the supporting unpublished PFI; and
- the actions available to management to influence the final result if risks or opportunities outside the control of the directors materialise.

Form of the profit forecast statement

z. The profit forecast should include disclosure of the following:

- the basis of preparation, including:
  - confirmation that the accounting policies used in preparing the profit forecast are consistent with the accounting policies of the issuer;
  - confirmation that the basis of preparation is consistent with the issuer's historical financial information; and

  - the underlying audited or unaudited actual and/or forecast data upon which the profit forecast has been based.
- the principal assumptions upon which the profit forecast is based (see below):
  - the treatment of any one-off or transaction-specific items that the directors consider to be relevant, material and to contribute to the understandability of the profit forecast; and
  - if applicable, confirmation that the profit forecast has been compiled or properly compiled on the basis of the assumptions stated and the basis of accounting used is consistent with the issuer's accounting policies.

aa. If the forecast or estimate is of any profit measure other than profit before tax (eg, an adjusted profit measure), the reasons for presenting another figure from the profit and loss account should be disclosed and clearly explained.

Disclosure of principal assumptions

bb. The principal assumptions disclosed in the profit forecast should:

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

EVIDENCE AND DOCUMENTATION

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

Part III, C: Synergy and stand-alone cost-saving statements in capital markets transactions

CONTENTS

Part III, C: Synergy and stand-alone cost-saving statements in capital markets transactions

1. INTRODUCTION

1. This application note applies when making statements of anticipated synergies published in a merger and acquisition-related UK investment circular. It also applies to stand-alone cost-saving statements published in a bid defence document under the City Code. The application note should also be used by those assisting with the preparation of such statements and the supporting unpublished information. Elements of the guidance and practical steps may also be applicable to the preparation of synergy statements in other regulatory regimes and in other circumstances.
2. There is no regulatory requirement for any such statement of anticipated synergies or stand-alone cost savings to be made. However, if the transaction is subject to UK capital markets regulation there may be specific regulatory requirements governing such statements, if they are made publicly.
3. The proposed acquisition of a UK public company is governed by the City Code. A statement of synergies or stand-alone cost savings made in relation to the proposed transaction is defined within the City Code as a Quantified Financial Benefits Statement (QFBS). As the specific City Code requirements in connection with a QFBS do not apply to a statement published by an all-cash offeror, they are not included in the term QFBS used in this application note.
4. When a Class 1 circular issued under the LR includes a statement of synergy benefits (Synergy Benefits Statement), such a statement must include certain disclosures.
5. The respective regulatory requirements that apply under the City Code and LR, including the specific disclosure requirements, are set out in Annex C.
6. It is possible that both the City Code and the LR obligations may apply to the same statement. While the disclosure requirements are broadly similar, there is more regulation in the City Code. In addition, there is a City Code requirement for a QFBS to be reported on by the financial adviser(s) and reporting accountant.
7. This application note is predominately focused on a QFBS made in the context of a transaction subject to the City Code and, unless stated to the contrary, can also be applied to a Synergy Benefits Statement made in the context of a transaction subject to the LR.
8. This application note should be used proportionately when preparing a public statement of anticipated synergies not captured by the City Code or LR. However, the level of rigour applied to the internal processes adopted in the preparation of the PFI supporting the statement of anticipated synergies would be expected to be similar.
9. This application note should be considered and read together with Parts I and II of the guidance.

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

10. Any Synergy Benefits Statement or QFBS (either of which is considered a Statement for the purpose of this application note) published in an investment circular is itself PFI. There will be further PFI (which is unpublished) specifically prepared to directly support the Statement which may include:

- the underlying detailed plan developed by the company making the announcement, including the development of the synergy case, the documentation of assumptions underpinning the planned financial benefits and the high-level integration/implementation plans for realising the benefits in practice (in the context of a synergy announcement, this is often known as the Synergy Plan); and

- where the Synergy Plan does not form part of the papers presented to the board, a separate summary board document that summarises the Synergy Plan (or cost-savings plan for cost-saving statements).

2. REGULATORY REQUIREMENTS

2.1 City Code definition of QFBS

11. A QFBS is defined in the City Code as either:
    - a statement by a securities exchange offeror or the offeree company quantifying any financial benefits expected to accrue to the enlarged group if the offer is successful; or
    - a statement by the offeree company quantifying any financial benefits expected to accrue to the offeree company from cost-saving or other measures and/or a transaction proposed to be implemented by the offeree company if the offer is withdrawn or lapses.

2.2 Overview of City Code regulation

12. There is a general standard of care under the City Code that states each document, announcement or other information published, or statement made, during the course of an offer must be prepared with the highest standards of care and accuracy. The language used must clearly and concisely reflect the position being described and the information given must be adequately and fairly presented. These requirements apply whether the document, announcement or other information is issued by the party concerned or by an adviser on its behalf.
13. The City Code sets out specific regulatory requirements (including required disclosures) that apply to any QFBS made in connection with a proposed takeover, in any document or announcement published during an offer period (or in an announcement which commences an offer period). These are set out in detail in Annex C and the table below highlights the key areas covered by the disclosure requirements:

QFBS
• Analysis, explanation and quantification of the constituent elements of the QFBS. • Base figure where a comparison is made with the historical costs or existing cost base. • Details of any dis-benefits expected to arise. • Statement that the financial benefits are directly attributable to the offer and could not be achieved independently (applies to QFBS made by offeror only). • An indication of the timing for achievement of the financial benefit. • An indication of recurring vs non-recurring financial benefits and clear identification of those which are non-recurring. • Costs of realising financial benefits. • Bases of belief supporting the QFBS, identifying principal assumptions and sources of information.

14. The Panel will not normally permit an offeree company to publish a statement quantifying the financial benefits expected to accrue from an offer by a particular offeror unless that statement is published with the consent of the offeror.

15. When a QFBS is first published, the City Code requires a reporting accountant and financial adviser(s) to each issue public reports containing the relevant opinion (see Annex C for form of opinion required).

16. Any further documents or announcements published in connection with the offer must, unless superseded by information included in the new document or announcement, include a statement by:

- the directors confirming that the QFBS remains valid; and
- the directors confirming that the reporting accountant and financial adviser(s) have confirmed that their reports continue to apply.

2.3 LR definition of Synergy Benefit

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

2.4 Overview of LR regulation

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

SYNERGY BENEFITS STATEMENT

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

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

2.5 Directors' accountability, including satisfying regulatory obligations

20. The directors are responsible for the Statement and, accordingly, should be fully engaged in the preparation process, including approving the Statement. Publication of a Statement in an investment circular sets a strong expectation that the Statement will be met.

21. Prior to deciding to make such Statements, the directors should consider the risks associated with making such a public statement and the fact that the directors are responsible for the Statement and associated disclosure requirements.

22. While the obligations under the City Code and LR are articulated differently, the spirit of the obligations and standards of care are broadly aligned and require that the process adopted by the directors is sufficiently robust. The directors should, therefore, undertake appropriate procedures to ensure a Statement has been properly compiled on the basis stated and prepared with due care and consideration.

23. In order for the directors to satisfy themselves that the Statement made under the City Code or LR has been properly compiled on the basis stated and prepared with due care and consideration, they should ensure the Statement meets the relevant regulatory disclosure requirements and be able to demonstrate that they have applied the general attributes and principles set out, or cross referred to, in this application guidance.

24. The guidance does not address legal obligations and directors should obtain legal and professional advice as appropriate.

3. APPLYING ATTRIBUTES AND PRINCIPLES TO SYNERGY AND STAND-ALONE COST-SAVING STATEMENTS

25. The attributes and, where relevant, the way in which the associated principles apply to a Statement are set out below. Where application is specific to either a QFBS (under the City Code) or a Synergy Benefit Statement (under the LR) this is highlighted, though in most instances they are equally applicable to both.

3.1 'Relevant' attribute and 'user needs' principle

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

3.2 'Reliable' attribute and 'business analysis' principle

27. The City Code specifically requires that a QFBS:

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

3.2.1 Business analysis

28. Specific post-transaction integration/implementation plans (or, for bid defence scenarios, stand-alone implementation plans) should be developed to help enable benefits to be quantified and delivered. This application guidance promotes the preparation of a Statement based on an analysis of the strategic purpose of a transaction, specific post-transaction integration plans and

an understanding of the risks involved in implementing those plans. Such plans are likely to be developed, initially, at a relatively high level due to limitations on access and information, and may be further developed post deal.

29. There may be significant challenges around the supporting business analysis for a Statement when the directors:
    - are keeping different strategic options open;
    - have limited information about one or other party (for example, if no access to the target is available, or their own access is limited due to wishing to preserve confidentiality and involving only a small group of people) or the financial consequences of alternative plans (for example, cost-savings plans being planned or implemented by the offeree); or
    - have limited opportunity to validate its plans by reference to external evidence and opinion.

30. Where access and information are limited, benefits may only be able to be quantified under an 'outside-in' approach ie, where information is limited to publicly available sources. As there will be inherent uncertainties in the source information under such an approach, the process adopted should build in sufficient allowances (eg, risk-weighted adjustments and contingencies) when estimating the relevant cost saving. For example, a potential acquirer might have an adequate basis for stating that it plans to eliminate certain duplicate costs that are disclosed in sufficient detail in the financial statements or other publicly available information, but will require a higher contingency to be able to quantify and publish other cost savings (such as procurement) where there is no access to detailed information or commercially sensitive information. In situations where the level of uncertainty is so great that the cost saving cannot be enumerated, a qualitative disclosure may be appropriate.

31. When considering the attribute of reliability, the directors should consider in relation to the constituent parts:
    - how straightforward the calculation of the benefit is (for example, duplicated board costs and central overheads);
    - the degree of access and information available to support the benefit; and
    - whether they will have control over the achievement.

3.2.2 Other aspects of reliability

32. The concept of neutrality is reflected by the requirement to disclose dis-benefits expected to arise in addition to the recurring and non-recurring costs of implementing post-acquisition plans. For example, where there are synergy savings in salary costs from planned redundancies then the associated redundancy costs should be included within the announced quantum of non-recurring costs.

3.3 'Understandable' attribute and 'reasonable disclosure' principle

33. The attribute of understandability and the principle of reasonable disclosure are reflected in the City Code, which requires that the QFBS:

    'must not be so complex or include such extensive disclosures that it cannot be readily understood'.

3.3.1 Form of the Statement

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

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

36. It is appropriate for the Statement to not only distinguish between cost synergies and revenue synergies (if any), but to also set out the main constituent elements of the respective cost or revenue synergies.

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

38. There is a strong expectation that the Statement will be met and there should therefore be very little risk that the quantum of synergies announced is not achieved. Consequently, the directors may adopt a prudent approach in making a Statement and, in doing so, may opt to disclose the quantum as the minimum level they expect to achieve.

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

40. Where the bases of belief are included as part of the Statement they should set out the principal assumptions and sources of information in connection with the Statement and in a manner that is also readily understandable, specific and precise.

3.3.2 Alignment with disclosures elsewhere in the investment circular

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

3.4 'Comparable' attribute and 'subsequent validation' principle

42. The supporting Synergy Plan for a Statement should be in a format that facilitates the ongoing monitoring of synergies achieved so that the company maintains the ability to update the market in respect of overall delivery of the synergies or cost savings. To assist ongoing monitoring, the synergy case may be revised post deal to reflect the passage of time and increased access to management and information.

4. PREPARING PFI IN CONNECTION WITH SYNERGY AND STAND-ALONE COST-SAVING STATEMENTS (AND THE SUPPORTING UNPUBLISHED PFI)

43. Part II identifies core procedures for the preparation of all PFI, in the form of illustrative practical considerations and techniques. Some form of underlying PFI (including, for example, a Synergy Plan) will be required to support a Statement, but the form of Statement may not necessitate the preparation of full financial projections. Accordingly, the guidance in Part II should be applied on a proportionate basis where relevant to the Statement being made and the supporting unpublished PFI. This application note identifies a number of additional specific matters requiring consideration in connection with making a Statement and preparing supporting unpublished PFI.

4.1 Illustrative practical considerations and techniques specifically applicable to the Statement

44. The practical considerations and techniques below are not exhaustive or prescriptive: other considerations and techniques may be applicable. In the Execution section, bullets in italics relate to specific City Code requirements and are largely consistent with the LR requirement as set out in Annex C.

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

PLANNING

a. Obtain and review the relevant market rules and regulation (taking into account the circumstances).

Appointment of advisers

b. The directors should ensure that the Statement, Synergy Plan and other supporting unpublished PFI, which forms a basis for the Statement, are prepared in accordance with the relevant regulatory requirements and guidance (as set out in Annex C) and having regard to this application guidance.

c. Where public opinions/reports are required from financial advisers and reporting accountants in connection with a QFBS under the City Code, the directors should appoint them early on in the process.

d. Consider whether any third party professional adviser should be commissioned to advise and assist in the development of the Synergy Plan.

Board input and involvement

e. The directors are responsible for the Statement and should be involved and provide oversight throughout the preparation process, including approving the form and content of the published Statement and supporting disclosures of bases of belief (as well as the supporting unpublished PFI).

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

f. The directors are likely to benefit from ensuring the appropriate involvement of senior operational and financial management in the development of the detailed Synergy Plan and its underlying assumptions.

Level of or access to management and information (target and acquirer) in contemplation of a Statement

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

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

Key messages in the context of the rationale for the acquisition/takeover or stand-alone cost savings and any intention statements or post-offer undertakings

i. Intention statements and post-offer undertakings have specific meanings if the transaction is subject to the City Code (as set out in the City Code).

j. The directors should familiarise themselves with those rules to ensure the Statement complies with the requirements.

Monitoring the Statement

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

EXECUTION

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

Board memorandum

a. Preparation of the board memorandum (to be approved prior to making the Statement) may include, for example, a summary of the relevant regulation, any directors' confirmations, and an outline of the relevance of the Statement to the transaction, its context and its audience.

b. The purpose of the board memorandum is to formally record the directors' bases for the Statement and their responsibilities in relation to it. The directors should prepare and adopt a formal record of the evidence that has been compiled to support the information to be published (eg, in the board memorandum or Synergy Plan) and formally adopt the synergy case to be publicly announced.

c. The directors need to consider whether all factors that could have a material bearing on the Statement have been addressed.

Directly attributable

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

Preparation of detailed Synergy Plan

e. The Statement should be supported by, and consistent with, the preparation of an underlying Synergy Plan and individual synergy initiatives and analysis that support the Synergy Plan, which may form part of the board memorandum or be prepared separately.

f. When developing the Synergy Plan, the directors or senior operational and financial management may consider:

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

Existing cost bases of each business

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

- Cost base detail, at the greatest level of detail readily available, which may include:
  - overall profit and loss schedule; and
  - detailed analysis by business unit/function/location, as applicable, including a split of personnel versus non-personnel costs.
- Headcount detail, at the greatest level of detail readily available, which may include:
  - headcount and full-time employee by function by business unit/location (ideally this should take the form of anonymised payroll data);
  - determining the assumptions that need to be used – eg, target based on public information, disaggregated into greater granularity using acquirer cost-base ratios and other known factors; and
  - considering differences in financial periods and age/basis of data – eg, average for the year or headcount as at a specific date.

- Principal operating KPIs – eg, those used in monthly management reporting.
- Recent and projected capital expenditure, analysed into maintenance and expansionary expenditure.
- Information technology spend (including operational expenditure, capital expenditure and people costs).
- Material cost-saving programmes planned, in progress or recently completed, including benefits targeted, current status, and implementation costs.

Identification and specification of cost saving and other financial benefits (and associated costs) within the combined business

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

Targeted benefits and contingencies

i. The directors should consider whether a contingency should be built into the Synergy Plan and Statement. The level of any contingency provision will depend on a range of factors, which may include the profile of the businesses, the nature of the quantified financial benefits identified, the plan to achieve them and the quality of the information/evidence available.

j. The directors should assess the level of access in respect of their own and the target's information which will help inform the level of contingency to be applied to the Statement.

k. The contingency should take into consideration operational management's previous experience of achieving relevant cost savings/synergy initiatives.

l. Each element contributing to the total quantified financial benefit should be considered separately in determining the level of the contingency required.

m. In the circumstances of a hostile offer (and sometimes in the case of a recommended offer), where access to information relating to the target is limited to that which is publicly available, it is likely that the Statement will necessarily be more limited than if greater access had been available. The directors should establish that the published information is sufficiently detailed and specific to enable them to justify their quantification of financial benefits. Since significant assumptions may have to be made in such situations, the degree of confidence in the level of synergies which may be achieved may be reduced.

Compilation process

n. The Statement and the Synergy Plan should be subject to checks by the preparer to ensure that:

- there are no mathematical or clerical errors in the compilation;
- the Statement has been accurately computed based on the disclosed bases of belief;
- the bases of belief (or principal assumptions) are consistent with the directors' analysis of the business; and
- assumptions have not been misapplied.

Compilation process in development of Synergy Plan

o. The directors should ensure that detailed and specific plans have been developed to support and deliver the benefits.

p. The directors should be able to demonstrate that the business analysis carried out has been used by them in compiling the Statement and supporting unpublished PFI. The extent and nature of the analysis that is required to support the Statement will be dependent upon the specific circumstances in which the Statement is being prepared.

q. If required, the supporting detailed Synergy Plan and underlying assumptions should be based on:

- supportable assumptions based on rigorous business analysis;
- consideration of the integration strategy and plans of the business and related implementation risks; and
- assessment of the neutrality of the Statement and, in particular, whether all costs of realising the expected benefits have been identified.

r. The directors should prepare their supporting unpublished Synergy Plan and individual synergy initiatives to cover the period for the synergies in the Statement to be realised.

s. The directors should be able to demonstrate:

- appropriate levels of review and challenge within the organisation and involvement of senior operational and financial management; and
- the agreement of senior operational and financial management to the assumptions on which the quantified financial benefits/synergies are based.

Compliance of Statement with bases of belief

t. The bases of belief are the principal assumptions upon which the Statement is based and should be supported by robust analysis and, where applicable, demonstrate consistency with management's past experience.

u. The bases of belief should demonstrate a credible strategy for preparing the Statement. This strategy should be supported by the appropriate operational people within the acquirer and/or target as appropriate and be fully costed.

v. In relation to the bases of belief (principal assumptions):

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

- *the bases of belief should provide useful information as to the reasonableness and reliability of the QFBS.*
- *The bases of belief should:*
  - *be readily understandable;*
  - *be specific and precise; and*
  - *not relate to the general accuracy of estimates underlying the QFBS.*

w. *There must be a clear distinction between bases of belief about factors which the directors (or other members of the company's management) can influence and those which they cannot influence.*

x. Specific costs that will be impacted should be identified and evaluated.

y. The bases of belief should set out whether the synergy assumptions have had a contingency applied.

z. The benefits identified relating to cost savings are more likely to be readily supportable and within the control of management to deliver, than revenue enhancements.

aa. The approach adopted by the directors to compiling a Statement relating to a group will need to include measures to ensure that (particularly with regard to an assessment of dis-benefits) all subsidiaries and, where relevant, all material associated undertakings are considered.

Compliance with applicable disclosure requirements

bb. Where applicable, an indication should be provided of constituent elements, potential benefits should be balanced with dis-benefits and costs to achieve, timing clarified, and recurring vs non-recurring specified.

Constituent elements

cc. *The analysis, explanation and quantification of the constituent elements of the Statement should be sufficient to enable the context and relative importance of these elements to be understood.*

dd. The cost savings should be presented net of ongoing costs required to deliver them.

Base figure

ee. *A base figure is required where any comparison is made with historical financial performance or with existing cost bases and structures.*

ff. A base figure should also be provided where comparison is made with future anticipated cost bases and structures.

gg. Compelling evidence is required where the base figure is predicated on a future anticipated cost structure.

hh. Base figures provide context for interpreting the Statement. They should be readily understandable, and calculated and presented on a consistent basis.

ii. Unless clearly disclosed and explained base figures should not include any one-time or exceptional items (including those arising from a change in accounting policy).

jj. In the calculation of a financial benefit, the treatment adopted should be consistent with the entity's accounting policies.

Dis-benefits

kk. Details of any dis-benefits expected to arise must be disclosed in the QFBS.

ll. Dis-benefits should be calculated and disclosed – these may include any likely inefficiencies or consequences of increased scale within the entity's markets.

Directly attributable to the transaction

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

Timing for achievement of Statement

nn. The QFBS must set out the preparers' expectation of when the financial benefits are expected to arise.

oo. A Statement may specify the timing of benefits as either in-year benefits or exit run-rate benefits. It is important that the Statement makes clear the basis of the phasing statement.

Recurring vs non-recurring financial benefits

pp. The QFBS must include an indication as to whether the expected financial benefits will be recurring, clearly identifying any non-recurring benefit(s).

qq. The directors should prepare analysis to support the relevant categorisation of the expected financial benefits between recurring and non-recurring.

Costs of realising expected financial benefits

rr. The recurring and non-recurring costs of realising the expected financial benefits.

ss. Analysis to support the recurring and non-recurring anticipated costs of realising the expected financial benefits.

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

Consistency of Statement with other disclosures in the investment circular

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

Monitoring of synergies

uu. Consider how the synergies will be monitored post transaction and how the market will be updated on this, such as in trading updates, interim financial information and the annual report

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

ww. The company should maintain the ability to update the market in respect of overall delivery of the synergies.

EVIDENCE AND DOCUMENTATION

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

b. Board review and approval are required of the board memorandum, Statement and Synergy Plan.

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

- There should be documentary support for the plans, strategies and risk analysis, consistent with the analysis of the business. Support should also include information generated from within the organisation and from external sources, such as detailed and specialist benchmarking information.
- The bases of belief (assumptions) should be documented.
- The wording of the Statement should be compiled by the company's management team from financial and operational records with input from the board and having regard to advice from any external advisers that have been appointed.
- The directors should confirm in the documentation that the minimum disclosures required by the relevant regulation, as set out in Annex C, have been made (for example, for a QFBS the amount of the quantified financial benefits and the assumptions relating to them).
- The Statement, Synergy Plan and business analysis should be in a format that facilitates the ongoing monitoring of synergies achieved.

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

Annex A: Statements of sufficiency of working capital in capital markets transactions

1. UK

1.1 Summary of UK regulation relating to working capital statements

PRR (which implement and incorporate the Prospectus Regulation and the Delegated Regulation), LR, AIM Rules and NEX Exchange Growth Market Rules require that in certain circumstances, an investment circular (prospectus, circular, admission document, etc.) contains a working capital statement.

Investment circulars requiring a working capital statement	Regulation Reference
For a prospectus containing a securities note for equity securities or units issued by collective investment undertakings of the closed-end type	Delegated Regulation Annex 11 Item 3.1
For a prospectus containing a securities note for secondary issuance of equity securities or of units issued by collective investment undertakings of the closed-end type	Delegated Regulation Annex 12 Item 3.3
For a prospectus containing a securities note for depository receipts issued over shares	Delegated Regulation Annex 13 Item 1.1
For a prospectus containing an EU Growth securities note for equity securities	Delegated Regulation Annex 26 Item 2.1
Premium listing of equity shares: Application by a commercial company (Note: LR6.1.1R contains exceptions such that this only applies to new applicants)	LR 6.7.1R (must be a clean statement)
Premium listing of equity shares: Class 1 disposal by companies in severe financial difficulty	LR 10.8.4 R (8)
Premium listing of equity shares: Class 1 transaction	LR 13 Annex 1R (as applied by LR 13.4.1R)
Premium listing of equity shares: Circular for reconstruction or refinancing	LR 9.5.12 R (3)
Premium listing of equity shares: Circular for purchase of >25% of own equity shares	LR 13.7.1 R (2) (f)
AIM Admission Document	AIM Rules paragraph (c) of Schedule Two (must be an unqualified statement)
NEX Exchange Admission Document	NEX Exchange Growth Market Rules - Admission of shares, Appendix 1 Table A Section 3 - Admission of debt securities, Appendix 1 Table B Item 3.1 NEX Exchange Growth Market: Practice Note on Working capital for issuers seeking admission
Migration to a premium listing	LR 5.4A
NOTE: LR 16.2.1R contains a dispensation for Premium Listing: Open-ended investment funds (there are no equivalent derogations in the Delegated Regulation, therefore working capital statements are required to be included in a document that is a prospectus subject to the Delegated Regulation).	

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

1.2 Summary of regulatory guidance applicable to directors and/or advisers

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

FCA Technical Notes and Procedural Notes	
FCA / TN / 320.1	Working capital statements - Basis of preparation
FCA / TN / 321.1	Working capital statements and risk factors
FCA / PN / 904.3	Public offer prospectus – Drafting and approval

1.3 Summary of other relevant regulation and guidance

Role of Sponsor: Premium Listing – LR	LR 8.4.2 R (5) – Application for admission LR 8.4.8 R (3) – Application for admission: further issues LR 8.4.12 R (3) – Class 1 circulars, refinancing and purchase of own equity shares LR 8.4.15 R (5) – Applying for a transfer between listing categories
Sponsor – FCA Technical Notes	FCA / TN / 704.3 – The sponsor's role on working capital confirmation FCA / TN / 705.2 – Sponsors: uncertain market conditions
Role of Nominated Advisers	AIM Rules for Nominated Advisers – Schedule Three (Nominated Adviser Responsibilities) – AR 3 Due Diligence

Reporting accountants	Standard for Investment Reporting 1000 – Investment reporting standards applicable to all engagements in connection with an investment circular (SIR 1000)
Competent Authorities	PRR Section 3.1.1 Article 38

1.4 Regulatory obligation – standards of care required

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

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

1.5 Example wording of clean working capital statement

1.5.1 Prospectus

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

1.5.2 AIM Admission Document

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

2. EU

2.1 Summary of EU regulation relating to working capital statements

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

The Delegated Regulation specifies the contents of a prospectus:

Investment circulars requiring a working capital statement	Regulation Reference
For a prospectus containing a securities note for:	
Equity securities	Annex 11 Item 3.1
Units in a closed-end collective investment undertaking	Annex 12 Item 3.3
Depository receipts over shares	Annex 13 Item 1.1
Equity securities (EU Growth prospectus)	Annex 26 Item 2.1

2.2 Summary of regulatory guidance applicable to directors

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

2.3 Summary of other relevant regulation and guidance

Competent Authorities	Delegated Regulation Article 38

2.4 Regulatory obligation – standards of care required

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

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

Annex B: Profit forecasts in capital markets transactions and other profit guidance

1. UK

1.1 Summary of UK regulation relating to profit forecasts

PRR (which implement and incorporate the Prospectus Regulation and the Delegated Regulation), LR, AIM Rules, NEX Exchange Growth Market Rules and the City Code require that in certain circumstances an investment circular (prospectus, circular, admission document, offering document, etc.) contains a profit forecast.

Investment circulars, documents and announcements that may include a profit forecast	Regulation Reference
For a prospectus containing a registration document for equity securities	Delegated Regulation Annex 1 Section 11
For a prospectus containing a registration document for secondary issuance of equity securities	Delegated Regulation Annex 3 Section 7
For a prospectus containing a registration document for retail non-equity securities	Delegated Regulation Annex 6 Section 8
For a prospectus containing a registration document for wholesale non-equity securities	Delegated Regulation Annex 7 Section 8
For a prospectus containing a registration document for secondary issuance of non-equity securities	Delegated Regulation Annex 8 Section 7
For a prospectus containing an EU Growth registration document for equity securities	Delegated Regulation Annex 24 Item 2.7
For a prospectus containing an EU Growth registration document for non-equity securities	Delegated Regulation Annex 25 Item 2.5
Class 1 circular	LR 13.5.32 R LR 13.5.33 R
All documents regulated by the PRR or the LR	Delegated Regulation Article 1 'Definitions' Item (d)
AIM Admission Document	AIM Rules – Schedule Two paragraph (d) AIM Rule 17
NEX Exchange Admission	NEX Exchange Growth Market: Rules - Admission of shares, Appendix 1 Table A Item 2.7 - Admission of debt securities, Appendix 1 Table B Item 2.6
Document or Announcement covered by the City Code	The City Code, Section K, Rule 28 and definitions

1.2 Summary of regulatory guidance applicable to directors

ESMA Update of the CESR Recommendations on the Consistent Implementation of Commission Regulation (EC) No. 809/2004 Implementing the Prospectus Directive (ESMA Guidance)	
Para 38-50	Profit forecasts or estimates

ESMA Questions and Answers – Prospectuses (ESMA Q&A)	
Question 20	Supplement to prospectuses: profit forecast
Question 25	Profit forecasts or estimates
Question 102	Definition of profit forecasts
FCA Technical Notes	
FCA / TN / 340.2	Profit forecasts and estimates
Premium listing of equity shares: Continuing obligations	
LR 9.2.18 R (2)	Reproduction and explanation of a profit forecast in the next annual report and accounts: LR 9.2.18 R (2)(a) – publication of unaudited financial information LR 9.2.18 R (2)(b) – produce and disclose the actual figures for the same period LR 9.2.18 R (2)(c) – where there is a difference of 10% or more, provide an explanation of the difference
AIM Rules: Disclosure of miscellaneous information	
AIM Rules for Companies; Rule 17	Notification of any material change between actual trading performance or financial condition and any profit forecast, estimate or projection made public
Disclosure Guidance and Transparency Rules	
DTR 2.2	Disclosure of inside information via Regulatory Information Service DTR 2.2.3 – Identifying inside information DTR 2.2.6 – Information which is likely to be considered relevant to a reasonable investor's decision
Market Abuse Regulation	
MAR Article 17	Article 17(1) – Informing the public of inside information

1.3 Summary of other relevant regulation and guidance

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

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

1.4 Regulatory obligation – standards of care required

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

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

2. EU

2.1 Summary of EU regulation relating to profit forecasts

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

The Delegated Regulation specifies the contents of a prospectus:

Investment circulars that may include a profit forecast	Regulation Reference
For a prospectus containing a registration document for equity securities	Annex 1 Section 11
For a prospectus containing a registration document for secondary issuances of equity securities	Annex 3 Section 7
For a prospectus containing a registration document for retail non-equity securities	Annex 6 Section 8
For a prospectus containing a registration document for wholesale non-equity securities	Annex 7 Section 8
For a prospectus containing a registration document for secondary issuances of non-equity securities	Annex 8 Section 7

For a prospectus containing a registration document for equity securities (EU Growth prospectus)	Annex 24 Item 2.7
For a prospectus containing a registration document for non-equity securities (EU Growth prospectus)	Annex 25 Item 2.5

2.2 Summary of regulatory guidance applicable to directors

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

2.3 Regulatory obligation – standards of care required

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

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

Annex C: Synergy and stand-alone cost-saving statements in capital markets transactions

1. UK

1.1 Summary of UK regulation relevant to Statements

UK regulations do not require synergy and cost-saving statements (Statements) to be made. They may, however, be made voluntarily by companies during the course of a transaction.

If a company chooses to make a Statement, the relevant applicable UK regulation is set out below.

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

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

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

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

Reporting accountants	Standard for Investment Reporting 1000 – Investment reporting standards applicable to all engagements in connection with an investment circular (SIR 1000) Standard for Investment Reporting 6000 - Investment reporting standards applicable to public reporting engagements on quantified financial benefits statements (SIR 6000)
FCA Technical Notes FCA / TN / 315.1	Quantified Financial Benefits Statements – Reports on Quantified Financial Benefits Statements and Confirmatory Statements included in prospectuses

1.3 Other regulatory obligations including standards of care required

Capital markets regulation in the UK imposes standards on the content of information (including Statements) included in investment circulars (including offer and bid documents as appropriate), and on the processes and procedures adopted by the directors in preparing such information including the following.

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

Chartered accountants are talented, ethical and committed professionals. There are more than 1.8m chartered accountants and students around the world, and more than 184,500 of them are members and students of ICAEW.

We believe that chartered accountancy can be a force for positive change. So we attract the brightest and best people and give them the skills and values they need to ensure businesses are successful, societies prosper and our planet's resources are managed sustainably.

Founded in 1880, we have a long history of contribution to the public interest and we continue to nurture collaborative global connections with governments, regulators and business leaders. By sharing our insight, expertise and understanding we can create a world of strong economies and a sustainable future.

www.charteredaccountantsworldwide.com
www.globalaccountingalliance.com

ICAEW
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA
UK

T +44 (0)20 7920 8100
E generalenquiries@icaew.com
icaew.com

Chartered Accountants Worldwide
Member

GAA
Global Accounting Alliance