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# *Standards for Investment Reporting*

**3000**

**INVESTMENT REPORTING STANDARDS  
APPLICABLE TO PUBLIC REPORTING  
ENGAGEMENTS ON PROFIT FORECASTS**

The Auditing Practices  
Board

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# STANDARDS FOR INVESTMENT REPORTING

## 3000 – INVESTMENT REPORTING STANDARDS APPLICABLE TO PUBLIC REPORTING ENGAGEMENTS ON PROFIT FORECASTS

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## STANDARDS FOR INVESTMENT REPORTING

### **3000 – INVESTMENT REPORTING STANDARDS APPLICABLE TO PUBLIC REPORTING ENGAGEMENTS ON PROFIT FORECASTS**

*SIR 3000 contains basic principles and essential procedures (“Investment Reporting Standards”), indicated by paragraphs in bold type, with which a reporting accountant is required to comply in the conduct of an engagement to report on a profit forecast which is included within an investment circular prepared for issue in connection with a securities transaction governed wholly or in part by the law and regulations of the United Kingdom.*

*SIR 3000 also includes explanatory and other material, including appendices, in the context of which the basic principles and essential procedures are to be understood and applied. It is necessary to consider the whole text of the SIR to understand and apply the basic principles and essential procedures.*

*For the purposes of SIRs, an investment circular is defined as: “any document issued by an entity pursuant to statutory or regulatory requirements relating to listed or unlisted securities on which it is intended that a third party should make an investment decision, including a prospectus, listing particulars, circular to shareholders or similar document”.*

*SIR 1000 “Investment reporting standards applicable to all engagements involving an investment circular” contains basic principles and essential procedures that are applicable to all engagements involving an investment circular. The definitions in the Glossary of terms set out in Appendix 4 of SIR 1000 are to be applied in the interpretation of this and all other SIRs. Terms defined in the glossary are underlined the first time that they occur in the text.*

*To assist readers, SIRs contain references to, and extracts from, certain legislation and chapters of the Rules of the UK Listing Authority. Readers are cautioned that these references may change subsequent to publication.*

### **Introduction**

1. Standard for Investment Reporting (SIR) 1000 “Investment Reporting Standards applicable to all engagements in connection with an investment circular” establishes the Investment Reporting Standards applicable to all engagements involving investment circulars. The purpose of this SIR is to establish specific additional Investment Reporting Standards and provide guidance for a reporting accountant engaged to report publicly on profit forecasts to be included in an investment circular under the PD Regulation, other

regulations with similar requirements<sup>1</sup>, the City Code, or if required by the London Stock Exchange in respect of an AIM Admission Document.

2. An engagement to report publicly on the proper compilation of a profit forecast is a public reporting engagement as described in SIR 1000. The description of a public reporting engagement includes three generic terms having the following meanings in the context of an engagement to report on the proper compilation of a profit forecast:
  - (a) with respect to a profit forecast the “**subject matter**” is the directors’ expectation of the issuer’s profit for the period of the forecast;
  - (b) “**suitable criteria**” to be used by directors in the preparation of the profit forecast are provided by the requirements of the PD Regulation and the guidance<sup>2</sup> issued by CESR (CESR Recommendations). In forming its opinion as to whether the profit forecast has been properly compiled the reporting accountant considers whether certain of those criteria (“**reporting accountant’s criteria**”) have been properly applied. Reporting accountant’s criteria are set out in Appendix 2 of this SIR; and
  - (c) with respect to a profit forecast the “**outcome**”<sup>3</sup> is the directors’ profit forecast and related disclosures, that is included in the investment circular, and on which the reporting accountant expresses an opinion (in the “**reporting accountant’s report**”) as to whether that forecast is properly compiled on the basis stated and the basis of accounting used is consistent with the accounting policies of the issuer.
3. The PD Regulation defines a profit forecast as “a form of words which expressly states or by implication indicates a figure or a minimum or maximum figure for the likely level of profits or losses for the current financial period and/or financial periods subsequent to that period, or contains data from which a calculation of such a figure for future profits or losses may be made, even if no particular figure is mentioned and the word “profit” is not used”<sup>4</sup>. Where a profit forecast relates to an extended period and/or is subject to significant uncertainty it is sometimes referred to as a projection.
4. A profit forecast may include historical financial information relating to a past period. For example, a forecast made on 15 October 20xx for the profit for the year ended 31 December 20xx may include the profit for the six months ended 30 June 20xx included in the issuer’s half yearly report and amounts extracted from management accounts for July

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1 In the UK the Prospectus Directive is implemented into law through amendments to Part VI of FSMA and to certain secondary legislation. The Annexes to the PD Regulation have been incorporated into the Prospectus Rules issued by the FSA.

2 CESR issued “CESR’s Recommendations for the Consistent Implementation of the European Commission’s Regulation on Prospectuses No. 809/2004” in February 2005.

3 The “outcome” is sometimes described as “subject matter information”.

4 The definition of a profit forecast in the City Code is similar to that used by the PD Regulation.

and August. A profit estimate is historical financial information for a financial period which has expired but for which the results have not yet been published.

5. In this SIR requirements relating to “profit forecasts” also apply to statements typically referred to as “profit estimates” or “projections”. The Investment Circular Reporting Standards in this SIR are applied to the whole period of the profit forecast including historical financial information included therein.

### **The nature of profit forecasts**

6. A profit forecast is, by definition, uncertain because events and circumstances may not occur as expected or may not be predicted at all, or because the directors may take actions different to those previously intended. A profit forecast will usually include disclosures which provide information to assist the intended users understand the uncertainties involved.
7. A profit forecast is usually based on assumptions, relating to the expected outcome of future events and possible actions by the entity. As assumptions on which any forward-looking element of a profit forecast is based are a critical element of the profit forecast, the various regulations require, among other things, the disclosure of the principal assumptions which could have a material effect on the achievement of the profit forecast including those within the influence and control of the directors.
8. The extent to which a profit forecast will differ materially from the actual out-turn will depend on a profit forecast’s particular circumstances. The length of the period into the future to which the profit forecast relates is only one, and not necessarily the most significant, factor. For example, an established business may be able to predict with greater certainty its results for the following year, particularly if it operates in a very stable environment, than a start-up business or an established business entering a new field.
9. Profit forecasts are inherently uncertain and the probability that a profit forecast will correctly predict the actual out-turn is dependent upon the many factors which determine that uncertainty. The fact that a profit forecast does not correctly predict the actual out-turn does not mean that the profit forecast was not properly compiled.
10. The Institute of Chartered Accountants in England and Wales issued guidance entitled “Prospective Financial Information – Guidance for UK directors” in September 2003 (“ICAEW Guidance”) to assist directors in meeting the needs of the intended users of such information and of regulators and to promote the production of high quality prospective financial information, including profit forecasts.
11. As explained in Appendix 1 of this SIR the CESR Recommendations state that profit forecasts should be:
  - (a) reliable;

- (b) understandable;
- (c) comparable; and
- (d) relevant.

Directors are required to form a judgment as to whether the profit forecast is relevant to the purpose of the investment circular<sup>5</sup> and, therefore, whether or not it is appropriate for the profit forecast to be included in the investment circular. The directors' judgment in this regard will be influenced by the applicable regulatory requirements. The role of the reporting accountant is to report on whether a profit forecast, that the directors have decided to include in an investment circular, has been properly compiled. The role of the reporting accountant does not include questioning the directors' decision to include a profit forecast in an investment circular.

12. In order to provide an opinion on the proper compilation of a profit forecast the reporting accountant carries out the procedures required by this SIR and SIR 1000, and any others it considers necessary, to satisfy itself that the profit forecast is:
- (a) reliable<sup>6</sup>;
  - (b) understandable<sup>7</sup>; and
  - (c) comparable<sup>8</sup>.

Consequently, these three principles are considered to be suitable criteria for the evaluation of profit forecasts by the reporting accountant (see Appendix 2 of this SIR).

### **Reliability**

13. The ICAEW Guidance explains that to be **reliable** a profit forecast will possess the following attributes:
- (a) it can be depended upon by the intended users as a faithful representation of what it either purports to represent or could reasonably be expected to represent;
  - (b) it is neutral because it is free from deliberate or systematic bias intended to influence a decision or judgment to achieve a predetermined result;
  - (c) it is free from material error;

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5 The ICAEW Guidance considers that a profit forecast will only be "relevant" if it:  
(a) has the ability to influence economic decisions of investors;  
(b) is provided in time to influence the economic decisions of investors; and  
(c) has predictive value or, by helping to confirm or correct past evaluations or assessments, it has confirmatory value.

6 The business analysis principle in the ICAEW Guidance.

7 The reasonable disclosure principle in the ICAEW Guidance.

8 The subsequent validation principle in the ICAEW Guidance.

- (d) it is complete within the bounds of what is material; and
- (e) it is prudent in that a degree of caution is applied in making judgments under conditions of uncertainty.

The ICAEW Guidance explains that a profit forecast will be a faithful representation where it reflects an entity's strategies, plans and risk analysis in a way that is appropriate for the purpose for which the profit forecast is being prepared. The fact that a profit forecast does not correctly predict the actual out-turn once reported, does not necessarily mean that it was not reliable when made.

14. A profit forecast, including the assumptions used, is more likely to possess the above attributes when the issuer has undertaken an analysis of the underlying business and its strategies, plans and risks (the directors' business analysis) and when the forecast is prepared as a faithful representation of that business analysis, taking prudent account of the risk analysis. The reliability of a profit forecast is, therefore, a function of:
  - (a) the quality of the analysis undertaken; and
  - (b) the degree to which that analysis is reflected in the profit forecast.

### ***Understandability***

15. To be ***understandable*** a profit forecast contains the information necessary for intended users to appreciate the degree of uncertainty attaching to the information and how that uncertainty might impact it. This requires the disclosure of assumptions and other matters relevant to the basis of preparation of the profit forecast which are of importance in assisting the intended users' understanding of the profit forecast. The omission of important information may prevent a profit forecast from being understandable and equally, if the disclosure is too complex or too extensive the understandability of the profit forecast may be also impaired. What constitutes reasonable disclosure will therefore depend upon the particular circumstances of each profit forecast but will need to take into consideration:
  - (a) sources of uncertainty and the related assumptions made relating to uncertainties;
  - (b) the factors that will affect whether assumptions will be borne out in practice; and
  - (c) alternative outcomes, being the consequences of assumptions not being borne out.

### ***Comparability***

16. The usefulness of a profit forecast is derived partly from its ***comparability***, namely the expectation that it will be possible to compare it to the actual results and that it can be compared to equivalent information for other reporting periods. For this to be the case profit forecasts need to be prepared and presented on a basis comparable with the actual financial information for that period and will involve the application of the accounting policies used by the entity in preparing the historical financial information included in the investment circular.

### **Compilation process**

17. The compilation of a profit forecast is the gathering, classification and summarisation of relevant financial information. The process followed by the preparer would be expected to include:
- (a) an appropriate analysis of the business (what is appropriate will depend on a number of factors including the complexity and predictability of the business and the length of the period being forecast and accordingly the content, degree of detail and presentation of such analyses may vary significantly);
  - (b) identification of material uncertainties;
  - (c) selection of appropriate assumptions;
  - (d) where relevant, identification of and reference to, appropriate third party information (eg. market research reports);
  - (e) arithmetic computation of the profit forecast;
  - (f) appropriate sensitivity analysis;
  - (g) appropriate disclosures to enable the intended users to understand the profit forecast; and
  - (h) appropriate consideration of the profit forecast and approval of it by the directors of the entity.

### **Engagement acceptance and continuance**

18. SIR 1000.1 and SIR 1000.2 set out the basic principles and essential procedures, with respect to engagement acceptance and continuance, which are applicable to all engagements involving an investment circular.
19. When accepting or continuing an engagement to report publicly on a profit forecast, the reporting accountant ascertains whether the directors intend to comply with all relevant regulatory requirements, in particular those that are the basis of the reporting accountant's criteria set out in Appendix 2 of this SIR.

### **Agreeing the terms of the engagement**

20. SIR 1000.3 and SIR 1000.4 set out the basic principles and essential procedures with respect to agreeing the terms of the engagement. Examples of engagement letter clauses are set out in Appendix 4 of this SIR.

## Ethical requirements

21. SIR 1000.5 sets out the basic principles and essential procedures with respect to the ethical requirements that apply to a reporting accountant<sup>9</sup>.

## Legal and regulatory requirements

22. The PD Regulation requires any profit forecast or estimate included in a prospectus to be reported on by independent accountants or auditors (referred to in this SIR as “a reporting accountant”) and specifies the form of opinion to be given<sup>10</sup>. The City Code contains provisions in relation to profit forecasts included in offer documents and requires reports from the auditors or reporting accountants in certain circumstances.
23. SIR 1000.6 sets out the basic principles with respect to the legal and regulatory requirements applicable to a reporting accountant.
24. Appendices 1, 2 and 3 to this SIR set out those provisions of the PD Regulation, the CESR Recommendations relating to the implementation of the PD Regulation, and the City Code, that provide the suitable criteria for directors. Those provisions that are the basis of criteria for a reporting accountant expressing an opinion on whether the profit forecast has been properly compiled are set out in Appendix 2 of this SIR.

## Quality control

25. SIR 1000.7 and SIR 1000.8 set out the basic principles and essential procedures with respect to the quality control of engagements to report on profit forecasts.

## Planning and performing the engagement

26. SIR 1000.9 and SIR 1000.10 set out the basic principles and essential procedures with respect to the planning of all reporting engagements. Additional essential procedures and guidance are set out below.
27. **The reporting accountant should obtain an understanding of the key factors affecting the subject matter sufficient to identify and assess the risk of the profit forecast not being properly compiled and sufficient to design and perform evidence gathering procedures including:**
- (a) the background to and nature of the circumstances in which the profit forecast, which is included in the investment circular, was made;**
  - (b) the entity’s business; and**

<sup>9</sup> In January 2006 the APB issued an Exposure Draft of an Ethical Standard for Reporting Accountants (ESRA).

<sup>10</sup> The PD Regulation requirements are reproduced verbatim in the Prospectus Rules issued by the FSA.

**(c) the procedures adopted, or planned to be adopted, by the directors for the preparation of the profit forecast. (SIR 3000.1)**

28. The reporting accountant gains an understanding of the background to and nature of the circumstances in which the profit forecast is being prepared, by discussion with the directors or management of the issuer and by reading relevant supporting documentation. In particular, the reporting accountant ascertains whether the profit forecast is being made for the first time or whether it is a forecast that has previously been made by the issuer that may be required to be updated by the directors.
29. The reporting accountant uses professional judgment to determine the extent of the understanding required of the entity's business. In a start-up situation or where an established business is entering a new field the reporting accountant's understanding of the prospective business is necessarily limited to general knowledge of the field being entered and an understanding of the business analysis undertaken by the entity.
30. Reporting on the proper compilation of a profit forecast generally requires an understanding of the entity's management accounting, budgeting and forecasting systems and procedures beyond that normally considered necessary for an audit of historical financial statements.
31. Discussion with the preparers of a profit forecast will identify the process by which the profit forecast has been, or will be prepared, the extent to which the ICAEW guidance has been followed, the sources of information used, areas of significant uncertainty where assumptions have been made and the basis for those assumptions and how those assumptions have been documented. Specific matters for consideration include:
  - The organisational structure of the entity and the extent to which subsidiaries or local operating units have been involved in the preparation of the profit forecast.
  - Whether the profit forecast is prepared on a basis comparable with the most recent historical financial information in the investment circular.
  - The extent to which the period of the forecast includes historical financial information.
  - Whether the profit forecast will be capable of comparison to subsequently published historical financial information.
32. Where profit forecasts are regularly prepared by the entity either for internal management purposes or for publication, the reporting accountant considers the closeness to actual out-turns achieved in previous forecasts and the analysis of any variances. As well as helping to provide an understanding of the entity's business this may be helpful in identifying those aspects of the business which are subject to significant uncertainty.

33. **The reporting accountant should consider materiality and public reporting engagement risk in planning its work in accordance with its instructions and in determining the effect of its findings on the report to be issued. (SIR 3000.2)**

### **Materiality**

34. The ICAEW Guidance states that in order for a profit forecast to be **reliable** it will, amongst other things, be free of material error. An error in the context of the proper compilation of a profit forecast includes:
- Assumptions that are not consistent with the analysis of the business.
  - Mathematical or clerical mistakes in the compilation of the profit forecast.
  - Misapplication of accounting policies.
  - Misapplication of a stated assumption.
  - Known misstatements in historical financial information embodied in the forecast without adjustment.
35. Additionally, there may be deficiencies in the presentation of a profit forecast which may impair the understandability or comparability of the forecast in a way that is material. An error could, therefore, also include:
- (a) failure to disclose an assumption or other explanation which is necessary for an understanding of the forecast; or
  - (b) presenting the forecast in a way that it is not capable of being compared with subsequent published results.
36. Matters are material if their omission or misstatement could, individually or collectively, influence the economic decisions of the intended users of the profit forecast. Materiality depends on the size and nature of the omission or misstatement judged in light of the surrounding circumstances. The size or nature of the matter, or a combination of both, could be the determining factor.
37. Evaluating whether an omission or misstatement could influence economic decisions of the intended users of the profit forecast, and so be material, requires consideration of the characteristics of those intended users. The intended users are assumed to:
- (a) have a reasonable knowledge of business and economic activities and accounting and a willingness to study the profit forecast with reasonable diligence; and
  - (b) make reasonable economic decisions on the basis of the profit forecast.

The determination of materiality, therefore, takes into account how intended users with such characteristics could reasonably be expected to be influenced in making economic decisions.

38. The fact that the out-turn differs from the forecast does not necessarily mean that the forecast was not properly compiled as, for example, actual economic conditions may have differed from those reasonably assumed in the preparation of the profit forecast.

**Public reporting engagement risk**

39. “Public reporting engagement risk” is the risk that the reporting accountant expresses the positive and unmodified opinion required by the PD Regulation or the City Code when the profit forecast has not been properly compiled on the basis stated or the basis of accounting used for the profit forecast is not consistent with the accounting policies of the issuer.
40. SIR 1000.11 and SIR 1000.12 set out the basic principles and essential procedures, with respect to obtaining evidence, that are applicable to all engagements involving an investment circular. Additional basic principles, essential procedures and guidance relating to engagements to report on profit forecasts are set out below.
41. **To form an opinion that the profit forecast has been properly compiled, the reporting accountant should obtain sufficient appropriate evidence that the forecast is free from material error in its compilation by:**
- (a) obtaining evidence that the directors have applied the criteria set out in Appendix 2 of this SIR;**
  - (b) checking that the profit forecast has been accurately computed based upon the disclosed assumptions and the preparer’s accounting policies;**
  - (c) considering whether the assumptions used are consistent with the directors’ business analysis and the reporting accountant’s own knowledge of the business; and**
  - (d) where applicable, evaluating the basis on which any historical financial information included in the profit forecast has been prepared. (SIR 3000.3)**
42. The reporting accountant considers the business analysis carried out by the preparer of the profit forecast and whether there is prima facie evidence that it has been used by the directors in compiling the profit forecast. The extent and nature of the analysis that is necessary to support a forecast, and therefore the extent of the reporting accountant’s consideration of such analysis, will be dependent upon the specific circumstances in which the forecast is being prepared. The reporting accountant discusses the preparer’s plans, strategies and risk analysis with the preparer of the profit forecast, considers documentary support for them and assesses whether they are consistent with the analysis of the business. Where the outcome is dependent upon the intent of the directors and management the reporting accountant will ordinarily obtain representations from the directors concerning such matters.

43. The preparer can be expected to document the assumptions that have been made relating to matters significant to the profit forecast. The reporting accountant will, therefore, obtain from preparers of the profit forecast details of those assumptions identified as being relevant to the compilation of the profit forecast. It will usually be the case that not all of the assumptions made in support of the profit forecast will be published. This is because only those that are material to an understanding of the profit forecast are required to be disclosed.
44. There may be a range of appropriate assumptions which can be used as the basis for a profit forecast and the resulting forecast may differ significantly depending on which assumptions are adopted. The reporting accountant is not required to express an opinion on the appropriateness of the assumptions used or the achievability of the results reflected in a profit forecast. The reporting accountant does however:
- (a) consider if any of the assumptions adopted by the directors which, in the opinion of the reporting accountant are necessary for a proper understanding of the profit forecast, have not been adequately disclosed; and
  - (b) consider whether any material assumption made by the directors appears to be unrealistic.
45. When checking whether the profit forecast has been accurately computed the reporting accountant considers whether cash flow statements and balance sheets have been prepared to act as checks against omissions and inconsistencies. If cash flow statements and balance sheets have not been prepared, in circumstances where the reporting accountant considers this to be necessary, the reporting accountant discusses with the directors whether their preparation is necessary in order to properly compile the profit forecast.

### ***Historical financial information***

46. **When evaluating the basis on which any historical financial information included in the profit forecast has been prepared the reporting accountant should:**
- (a) consider whether any element of that historical financial information has been audited or reviewed by the auditors and, if so, the results of that audit or review;**
  - (b) evaluate the suitability of unaudited historical financial information included in the profit forecast;**
  - (c) evaluate how the historical financial information has been embodied into the profit forecast; and**
  - (d) if adjustments have been made to previously published historical financial information evaluate whether the adjustments appear appropriate in the circumstances. (SIR 3000.4)**

47. If historical financial information has been audited or reviewed the reporting accountant evaluates the scope of the audit or review procedures performed. In performing such an evaluation the reporting accountant ordinarily seeks access to the working papers of the auditor or reviewer and considers whether the results of those procedures indicate that the historical financial information may be unreliable or reveal uncertainties that ought to require the directors to make and disclose assumptions in the forecast.
48. In order to evaluate the suitability of unaudited historical financial information included in the profit forecast the reporting accountant<sup>11</sup>:
- (a) understands the internal control environment of the entity relevant to the historical financial information;
  - (b) discusses with the management of the issuer the accounting policies applied and any differences from the method of preparing the entity's published financial statements;
  - (c) enquires of management, including internal audit, whether there have been any changes in the financial reporting systems or internal controls, or any breakdowns in systems and controls, which might affect the reliability of the financial information;
  - (d) enquires about changes in the entity's procedures for recording, classifying and summarising transactions, accumulating information for disclosure, and preparing the financial information;
  - (e) considers the accuracy of unaudited historical financial information by comparing it to audited financial statements for the same period;
  - (f) compares the historical financial information to previous budgets or forecasts prepared by the entity in respect of the period covered by the historical financial information and gains an understanding of the reasons for any significant differences; and
  - (g) checks the historical financial information used in the profit forecast agrees to, or reconciles with, the underlying accounting records of the entity.
49. Where the reporting accountant determines that it is not able to obtain sufficient appropriate evidence from the above procedures to indicate that the financial information for the expired part of the forecast period forms a suitable basis for inclusion in the profit forecast the reporting accountant discusses the matter with the directors of the issuer and, if appropriate, the issuer's advisers.
50. In considering historical financial information included in a profit forecast, it is important that the reporting accountant understands the manner in which such information has

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11 Some of these procedures may already have been performed as part of a review.

been included in the profit forecast. Where different systems or processes have been used to produce prospective financial information and the historical information, there is a risk that there may be inconsistencies in the cut-off between these two sources of information which could lead to a material error in the compilation of the profit forecast.

### ***Consistent accounting policies***

51. **The reporting accountant should compare the accounting policies used in connection with the profit forecast with those used by the entity in preparing the most recent historical financial information in the investment circular, and evaluate whether they are consistent with each other and continue to be appropriate so far as concerns the profit forecast. (SIR 3000.5)**
52. Where the profit forecast relates to the expansion of an existing business the reporting accountant's primary consideration is the consistency of the accounting policies used. However, the reporting accountant also considers the ongoing appropriateness of the accounting policies in the light of the business plans underlying the profit forecast.
53. Where the profit forecast relates to a start-up situation the reporting accountant considers the appropriateness of the accounting policies chosen.

### ***Presentation of the profit forecast***

54. **The reporting accountant should consider whether it has become aware of anything to cause it to believe that:**
  - (a) **the profit forecast is presented in a way that is not understandable;**
  - (b) **a material assumption is unrealistic;**
  - (c) **an assumption or other information which appears to it to be material to a proper understanding of the profit forecast has not been disclosed; or**
  - (d) **the profit forecast is not capable of subsequently being compared with historical financial information.**

**If the reporting accountant is aware of such matters it should discuss them with the parties responsible for the profit forecast and with those persons to whom its report is to be addressed and consider whether it is able to issue its opinion. (SIR 3000.6)**

55. The ICAEW Guidance provides guidance to directors with regard to the matters that should be disclosed in connection with a profit forecast. This covers both the manner in which the profit forecast is presented and the use of disclosure to deal with uncertainty. It is 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.

56. When evaluating the presentation of a profit forecast the reporting accountant considers whether the components of the profit forecast are clearly described and whether the descriptions are adequate to allow an intended user to understand the profit forecast. For example, if a profit forecast is presented as a single figure for profit before tax, and this was to be achieved by the inclusion of a significant non-recurring profit from the sale of a fixed asset, consideration is given as to whether additional disclosure is necessary to make the profit forecast understandable.
57. When evaluating whether the disclosures made in respect of a profit forecast are sufficient to make it understandable, the reporting accountant considers whether the degree of uncertainty inherent in the information is clearly disclosed. Disclosure of an assumption may not make the profit forecast understandable if the significance of that assumption is not apparent from the disclosure made.
58. Where a profit forecast is subject to significant uncertainty it is common practice for the preparers to perform a sensitivity analysis in respect of those assumptions which are either believed to be subject to the greatest uncertainty and/or where the profit forecast is most sensitive to variations in such assumptions. The reporting accountant considers such sensitivity analysis, as it may assist in the identification of material assumptions or other aspects of the profit forecast where the uncertainty requires additional disclosure to enable it to be understood.
59. The manner in which the profit forecast is presented in the investment circular will also be considered in respect of whether the profit forecast is capable of being compared with subsequent historical financial information. The choice of captions and disclosure or emphasis of particular numbers or attributes may determine how the profit forecast will be interpreted and consideration is given as to whether this is consistent with the purpose for which the profit forecast has been prepared.

### ***Representation letter***

60. SIR 1000.13 sets out the basic principles and essential procedures, with respect to representation letters, that are applicable to all engagements involving an investment circular. Examples of representation letter clauses are set out in Appendix 5 of this SIR.
61. Some of the assumptions used in the compilation of a profit forecast will be dependent on the intent of the directors and management. Consequently the representations of directors and management as to their intent are a particularly important source of evidence for the reporting accountant.

### **Documentation**

62. SIR 1000.14 and SIR 1000.15 set out the basic principles and essential procedures with respect to the reporting accountant's working papers.

### **Professional scepticism**

63. SIR 1000.16 sets out the basic principle with respect to the attitude of professional scepticism adopted by the reporting accountant in planning and performing an engagement.

### **Reporting**

64. SIR 1000.17, SIR 1000.18 and SIR 1000.19 set out the basic principles and essential procedures, with respect to reporting, that are applicable to all engagements involving an investment circular. Additional basic principles and essential procedures relating to engagements to report on profit forecasts are set out below.

### **Responsibilities**

65. **In all reports on profit forecasts in investment circulars the reporting accountant should explain the extent of its responsibility in respect of the profit forecast by including in its report:**
- (a) **a statement that the reporting accountant's responsibility is to form an opinion (as required by the relevant regulatory requirement) on the compilation of the profit forecast and to report its opinion to the addressees of the report; and**
  - (b) **a statement that the profit forecast and the assumptions on which it is based are the responsibility of the directors. (SIR 3000.7)**

### **Basis of preparation of the profit forecast**

66. **The reporting accountant should include a basis of preparation section of its report that cross refers to disclosures that explain the basis of preparation of the profit forecast including:**
- (a) **assumptions made;**
  - (b) **the accounting policies applied; and**
  - (c) **where appropriate, the source of historical financial information embodied in the profit forecast. (SIR 3000.8)**
67. Where the entity is reporting on the expansion of an established business it is usual for it to report that the basis of accounting is consistent with the existing accounting policies. Where the accounting policies used in the profit forecast differ from those previously published a more detailed explanation of the accounting policies used in the preparation of the profit forecast will be appropriate.

### **Basis of opinion**

68. SIR 1000.18 sets out the basic principles and essential procedures, with respect to the basis of the reporting accountant's opinion, that are applicable to all engagements involving an investment circular. Additional basic principles and essential procedures relating to engagements to report on profit forecasts are set out below.

69. **The reporting accountant should explain the basis of its opinion by including in its report a statement that where the profit forecast and any assumptions on which it is based relate to the future and may, therefore, be affected by unforeseen events, the reporting accountant does not express any opinion as to whether the actual results achieved will correspond to those shown in the profit forecast. (SIR 3000.9)**
70. By its nature financial information relating to the future is inherently uncertain. For a profit forecast to be understandable sufficient information must be disclosed to allow an intended user to understand this uncertainty. As the reporting accountant is not required to form or express an opinion on the achievability of the result shown in the profit forecast, it is inappropriate for the reporting accountant to include in the basis of preparation section of its report cautionary language relating to uncertainty beyond that referred to above.

### ***Expression of opinion***

71. **The report should contain a clear expression of opinion that complies with applicable regulatory requirements. (SIR 3000.10)**
72. In forming its opinion the reporting accountant takes account of those events or information which the reporting accountant becomes aware of occurring up to the date on which the reporting accountant signs the report, that affect the opinion expressed in the report.
73. The investment circular in which the reporting accountant's report is included may be made available in other countries, such as the United States of America, which have their own standards for accountants when reporting on profit forecasts. In such circumstances, the reporting accountant considers whether to include a reference to the fact that a report issued in accordance with the SIRs should not be relied upon as if it had been issued in accordance with the standards applicable in that other country. An example of such a reference is included in the example reports set out in Appendices 6 and 7 of this SIR.

### **Modified opinions**

74. SIR 1000.20 sets out the basic principles and essential procedures, with respect to modified opinions, that are applicable to all engagements involving an investment circular. Additional basic principles and essential procedures relating to engagements to report on profit forecasts are set out below.
75. **The reporting accountant should not express an unmodified opinion when the directors have not applied the criteria set out in Appendix 2 of this SIR and in the reporting accountant's judgment the effect of not doing so is, or may be, material. (SIR 3000.11)**

76. The PD and other regulations, such as the City Code, usually require a positive and unmodified opinion. Consequently, in the event that the reporting accountant concludes that it is unable to report in the manner prescribed it invites those responsible for the profit forecast to consider whether the profit forecast can be amended to alleviate its concerns or whether the profit forecast should be omitted from the investment circular.
77. Examples of reports on a profit forecast and a profit estimate expressing such positive and unmodified opinions are set out in Appendices 6 and 7 of this SIR.

## Consent

78. SIR 1000.21 and SIR 1000.22 set out the basic principles and essential procedures with respect to the giving of consent by the reporting accountant.
79. The reporting accountant considers whether disclosures in the investment circular, such as those in the “Risk Factors” section, are consistent with the assumptions and other disclosures made in connection with the profit forecast before consent is given by the reporting accountant to its report on the profit forecast being included in the investment circular.

## Events occurring between the date of the reporting accountant’s report and the completion date of the transaction

80. SIR 1000.23 sets out the basic principles and essential procedures with respect to events occurring between the date of the reporting accountant’s report and the completion date of the transaction.
81. Under Sections 81 and 87G of the FSMA, Prospectus Rule 3.4, and Listing Rule 4.4.1, a supplementary investment circular must be prepared if, after the date the investment circular has been formally approved by a regulator and before dealings in the relevant securities commence, the issuer becomes aware that there has been a significant change affecting any matter contained in the document or a significant new matter has arisen, the inclusion of information in respect of which would have been required if it had arisen at the time of its preparation. A similar obligation arises under Article 16 of the Prospectus Directive in respect of the period following registration of the investment circular during which an agreement in respect of the securities can be entered into in pursuance of the offer contained in the investment circular.
82. If, as a result of discussion with those responsible for the investment circular concerning an event that occurred prior to the completion date of the transaction, the reporting accountant is either uncertain about or disagrees with the course of action proposed the reporting accountant may consider it necessary to take legal advice with respect to its responsibilities in the particular circumstances.
83. After the date of its report, the reporting accountant has no obligation to perform procedures or make enquiries regarding the investment circular.

## **Effective date**

84. A reporting accountant is required to comply with the Investment Reporting Standards contained in this SIR for reports signed after 31 March 2006. Earlier adoption is encouraged.

## THE REGULATORY BACKGROUND

### Prospectus Directive Requirements

The **Prospectus Directive** and **PD Regulation** determine the requirements for the content of a prospectus. In determining whether the PD Regulation has been complied with, the FSA will take into account whether a person has complied with the CESR Recommendations.

The PD Regulation requires that where an issuer chooses to include a profit forecast (including a profit estimate) in a prospectus it must:

- (a) be prepared on a basis comparable with the historical financial information in the prospectus;
- (b) include a statement setting out the principal assumptions upon which the issuer has based its forecast or estimate. There must be a clear distinction between assumptions about factors which the members of the administrative, management or supervisory bodies can influence and assumptions about factors which are exclusively outside the influence of the members of the administrative, management or supervisory bodies; the assumptions must be readily understandable by investors, be specific and precise and not relate to the general accuracy of the estimates underlying the forecast; and
- (c) other than for issuers of high denomination debt and derivative securities, include a report prepared by independent accountants or auditors stating that in their opinion the forecast or estimate has been properly compiled on the basis stated and that the basis of accounting used for the profit forecast or estimate is consistent with the accounting policies of the issuer.

The CESR Recommendations provide further guidance concerning the principles that should be applied in preparing a profit forecast in a prospectus. In addition to due care and diligence being taken to ensure that profit forecasts or estimates are not misleading to investors, the following principles should be taken into consideration when profit forecasts are being compiled. Profit forecasts and estimates should be:

- (a) **reliable** - they should be supported by a thorough analysis of the issuer's business and should represent factual and not hypothetical strategies, plans and risk analysis; (a criterion for a reporting accountant see Appendix 2 of this SIR)
- (b) **understandable** - they should contain disclosure that is not too complex or extensive for investors to understand; (a criterion for a reporting accountant see Appendix 2 of this SIR)

- (c) **comparable** - they should be capable of justification by comparison with outcomes in the form of historical financial information (a criterion for a reporting accountant see Appendix 2 of this SIR); and
- (d) **relevant** – they must have an ability to influence economic decisions of investors and provided on a timely basis so as to influence such decisions and assist in confirming or correcting past evaluations or assessments. (Not a criterion for a reporting accountant see paragraph 11 of this SIR).

## The City Code

The City Code requires that:

- (a) all communications to shareholders in an offer, including forecasts, must maintain the highest standard of accuracy and fair presentation;
- (b) assumptions should be drafted in a way that allows shareholders to understand their implications; and
- (c) the forecast is compiled with due care and consideration by the directors and the disclosure of assumptions should provide useful information to assist shareholders to help them to form a view as to the reasonableness and reliability of the forecast.

Notes 1(c) and (d) to Rule 28.2 of the City Code state:

*“The forecast and the assumptions on which it is based are the sole responsibility of the directors. However, a duty is placed on the financial advisers to discuss the assumptions with their client and to satisfy themselves that the forecast has been made with due care and consideration. Auditors or consultant accountants must satisfy themselves that the forecast, so far as the accounting policies and calculations are concerned, has been properly compiled on the basis of the assumptions made.*

*Although the accountants have no responsibility for the assumptions, they will as a result of their review be in a position to advise the company on what assumptions should be listed in the circular and the way in which they should be described. The financial advisers and accountants obviously have substantial influence on the information about assumptions to be given in the circular; neither should allow an assumption to be published which appears to be unrealistic, or one to be omitted which appears to be important, without commenting appropriately in its report”.*

Whilst the City Code does not explicitly identify the principles contained in the CESR Recommendations those principles are consistent with the requirement of the Code.

## APPENDIX 2

## REPORTING ACCOUNTANT'S CRITERIA

	PD Regulation	Annex 1 <sup>1</sup> of PD Regulation	CESR Recommendations
A statement setting out the principal assumptions upon which the issuer has based its forecast or estimate.		13.1	
There must be a clear distinction between assumptions about factors which the members of the administrative, management or supervisory bodies can influence and assumptions about factors which are exclusively outside the influence of the members of the administrative, management or supervisory bodies; the assumptions must be readily understandable by investors, be specific and precise and not relate to the general accuracy of the estimates underlying the forecast.		13.1	
The profit forecast or estimate must be prepared on a basis comparable with the historical financial information.		13.3	
The following principles should be taken into consideration when profit forecasts or estimates are being compiled. Profit forecasts or estimates should be <ul style="list-style-type: none"> <li>• <b>Understandable</b>, ie Profit forecasts or estimates should contain disclosure that is not too complex or extensive for investors to understand;</li> <li>• <b>Reliable</b>, ie Profit forecasts should be supported by a thorough analysis of the issuer's business and should represent factual and not hypothetical strategies, plans and risk analysis;</li> <li>• <b>Comparable</b>, ie Profit forecasts or estimates should be capable of justification by comparison with outcomes in the form of historical financial information;</li> </ul>			para 41

<sup>1</sup> The column illustrates Annex I as an example. Other annexes to the PD Regulation contain identical requirements with respect to profit forecasts. See Appendix 1 of SIR 1000.

## OTHER REGULATORY PROVISIONS RELEVANT TO THE PREPARERS OF PROFIT FORECASTS

	PD Regulation	Annex I of PD Regulation	CESR Recommendations
(8) Voluntary disclosure of profit forecasts in a share registration document should be presented in a consistent and comparable manner and accompanied by a statement prepared by independent accountants or auditors. This information should not be confused with the disclosure of known trends or other factual data with material impact on the issuer's prospects. Moreover, they should provide an explanation of any changes in disclosure policy relating to profit forecasts when supplementing a prospectus or drafting a new prospectus.	Recital 8		
Profit forecast means a form of words which expressly states or by implication indicates a figure or a minimum or maximum figure for the likely level of profits or losses for the current financial period and/or financial periods subsequent to that period, or contains data from which a calculation of such a figure for future profits or losses may be made, even if no particular figure is mentioned and the word "profit" is not used.	Article 2		
Profit estimate means a profit forecast for a financial period which has expired and for which results have not yet been published.	Article 2		
If an issuer chooses to include a profit forecast or profit estimate the registration document must contain the information set out in items 13.1 and 13.2.		13	
A report prepared by independent accountants or auditors stating that in the opinion of the independent accountants or auditors the forecast or estimate has been properly compiled on the basis stated and that the basis of accounting used for the profit forecast or estimate is consistent with the accounting policies of the issuer.		13.2	

	PD Regulation	Annex I of PD Regulation	CESR Recommendations
<p>If a profit forecast in a prospectus has been published which is still outstanding, then provide a statement setting out whether or not that forecast is still correct as at the time of the registration document, and an explanation of why such forecast is no longer valid if that is the case.</p>		13.4	
<p>The inclusion of a profit forecast or estimate in a prospectus is the responsibility of the issuer and persons responsible for the prospectus and due care and diligence must be taken to ensure that profit forecasts or estimates are not misleading to investors.</p>			para 40
<p>The following principles should be taken into consideration when profit forecasts or estimates are being compiled. Profit forecasts or estimates should be</p> <ul style="list-style-type: none"> <li>• <b>Relevant</b>, ie profit forecasts and estimates must have an ability to influence economic decisions of investors and provided on a timely basis so as to influence such decisions and assist in confirming or correcting past evaluations or assessments.</li> </ul>			para 41
<p>Where an issuer provides a profit forecast or estimate in a registration document, if the related schedules so requires, it must be reported on by independent accountants or auditors in the registration document (as described in item 13.2 of Annex I of the Regulation). Where the issuer does not produce a single prospectus, upon the issuance of the securities note and summary at a later time, the issuer should either:</p> <ul style="list-style-type: none"> <li>• Confirm the profit forecasts or estimates; or</li> <li>• State that the profit forecasts or estimates are no longer valid or correct; or</li> <li>• Make appropriate alteration of profit forecasts or estimates. In this case they must be reported upon as described in item 13.2 of Annex I of the Regulation.</li> </ul>			para 42
<p>If an issuer has made a statement other than in a previous prospectus that would constitute a profit forecast or estimate if made in a prospectus, for instance, in a regulatory announcement, and that statement is still outstanding at the time of publication of the prospectus, the issuer should consider whether the forecasts or estimates are still material and valid and choose whether or not to include them in the prospectus. CESR considers that there is a presumption that an outstanding forecast made other than in a previous prospectus will be material in the case of share issues (especially in the context of an IPO). This is not necessarily the presumption in case of non-equity securities.</p>			paras 43 & 44

	PD Regulation	Annex I of PD Regulation	CESR Recommendations
<p>When there is an outstanding profit forecast or estimate in relation to a material undertaking which the issuer has acquired, the issuer should consider whether it is appropriate to make a statement as to whether or not the profit forecast or estimate is still valid or correct. The issuer should also evaluate the effects of the acquisition and the profit forecast made by that undertaking on its own financial position and report on it as it would have done if the profit forecast or estimate had been made by the issuer.</p>			<p>paras 45 &amp; 46</p>
<p>The forecast or estimate should normally be of profit before tax (disclosing separately any non-recurrent items and tax charges if they are expected to be abnormally high or low). If the forecast or estimate is not of profit before tax, the reasons for presenting another figure from the profit and loss account must be disclosed and clearly explained. Furthermore the tax effect should be clearly explained. When the results are published relating to a period covered by a forecast or estimate, the published financial statements must disclose the relevant figure so as to enable the forecast and actual results to be directly compared.</p>			<p>paras 47 &amp; 48</p>
<p>CESR recognises that often in practice, there is a fine line between what constitutes a profit forecast and what constitutes trend information as detailed in item 12 of Annex I of the Regulation. A general discussion about the future or prospects of the issuer under trend information will not normally constitute a profit forecast or estimate as defined in Articles 2.10 and 2.11 of the Regulation. Whether or not a statement constitutes profit forecasts or estimates is a question of fact and will depend upon the circumstances of the particular issuer.</p>			<p>para 49</p>
<p>This is a non-exhaustive list of factors that an issuer is expected to take into consideration when preparing forecasts:</p> <ul style="list-style-type: none"> <li>• Past results, market analysis, strategic evolutions, market share and position of the issuer</li> <li>• Financial position and possible changes therein</li> <li>• Description of the impact of an acquisition or disposal, change in strategy or any major change in environmental matters and technology</li> <li>• Changes in legal and tax environment</li> <li>• Commitments towards third parties.</li> </ul>			<p>para 50</p>

## EXAMPLES OF ENGAGEMENT LETTER CLAUSES

*The examples of engagement letter clauses are intended for consideration in the context of a public reporting engagement on a profit forecast. They should be tailored to the specific circumstances and supplemented by such other clauses as are relevant and appropriate.*

### Financial information upon which the report is to be given

The [investment circular] will contain a profit [forecast] [estimate] for the company for the period [ending] [ended] [date] (the “PFI”) prepared and presented in accordance with [item 13 of Annex I of the PD Regulation] [the requirements of the City Code] [other applicable regulation]. We will prepare a report on the profit [forecast] [estimate] addressed to [...] expressing our opinion on the profit [forecast] [estimate], in the form described below, to be included in the [investment circular].

We will ask the Directors to make certain representations to us regarding the PFI. If the PFI is intended only to be a hypothetical illustration, or the Directors are unable to make such representations to us, we will not wish to be associated with the PFI and accordingly, will be unable to report publicly on it.

### Responsibilities

The preparation and presentation of the profit forecast will be the responsibility solely of the Directors. [This responsibility includes the identification and disclosure of the assumptions underlying the profit forecast. (omit if no assumptions)] The Directors are also responsible for ensuring that the PFI is prepared and presented in accordance with [item 13 of Annex I of the PD Regulation] [the requirements of the City Code] [other applicable regulation].

We will require the Directors to formally adopt the PFI before we report on it. We understand that the Directors will have regard to the guidance issued by The Institute of Chartered Accountants in England & Wales entitled “Prospective Financial Information – Guidance for UK directors” in preparing the PFI.

It is our responsibility to form an opinion as to whether the profit [forecast] [estimate] has been properly compiled on the basis stated and whether such basis is consistent with the accounting policies normally adopted by ABC plc.

If the results of our work are satisfactory, and having regard to the requirements of [item 13.2 of Annex I of the PD Regulation] [the City Code] [other applicable regulation], we shall prepare a report on the profit [forecast] [estimate] for inclusion in the [investment circular]. An illustration of the form of our report is attached.

## **Scope of work**

Our work will be undertaken in accordance with Standard for Investment Reporting (SIR) 3000 "Investment Reporting Standards Applicable to Public Reporting Engagements on Profit Forecasts" issued by the Auditing Practices Board and will be subject to the limitations described therein.

We draw your attention in particular to paragraph 75 of SIR 3000 which would preclude us from expressing any opinion if the Directors have not complied with the regulatory requirements set out in Appendix 2 of that SIR.

As the purpose of our engagement is restricted as described above and since the PFI and the assumptions on which it is based relate to the future and may be affected by unforeseen events, we will not provide any opinion as to how closely the actual result achieved will correspond to the profit [forecast] [estimate]. Accordingly we neither confirm nor otherwise accept responsibility for the ultimate accuracy and achievability of the PFI.

## **Assumptions**

We will discuss the assumptions with the persons responsible for preparing the PFI together with the evidence they have to support the assumptions, but we will not seek to independently verify or audit those assumptions. We are not responsible for identifying the assumptions.

In the event that anything comes to our attention to indicate that any of the assumptions adopted by the Directors which, in our opinion, are necessary for a proper understanding of the PFI have not been disclosed or if any material assumption made by the Directors appears to us to be unrealistic we will inform the directors so that steps can be taken to resolve the matter. However, we are required to comment in our report if an assumption is published which appears to us to be unrealistic or an assumption is omitted which appears to us to be important to an understanding of the PFI.

## EXAMPLES OF MANAGEMENT REPRESENTATION LETTER CLAUSES

*Similar clauses to those below could be amended to be used in connection with a report on a profit estimate.*

### Introduction

We refer to the forecast of [*insert description of items forecast*], profit for the financial year and earnings per share of ABC plc (“the Company”) and its subsidiaries together (“the ABC Group”) for the year ending [*date*] (“the profit forecast”) set out on page [●] of the [Prospectus]/[Circular]/[Offer Document] to be issued on [*date*]. We acknowledge that we are solely responsible for the profit forecast and the assumptions on which it is based as set out on page [●] and confirm on behalf of the Directors [and Proposed Directors] of the Company to the best of our knowledge and belief, having made appropriate enquiries of officials of the Company, the following representations made to you in the course of your work:

### Specific representations

- The profit forecast is based on our assessment of the financial position and results of operations and cash flow for the period and is presented on a basis consistent with the accounting policies [normally] [to be] adopted by the ABC Group and has been prepared in accordance with relevant legislative requirements.<sup>1</sup>
- We believe the forecast results are likely to be achieved although achievement of the forecast may be favourably or unfavourably affected by unforeseeable and uncontrollable events.
- We have made available to you all significant information relevant to the profit forecast of which we have knowledge.
- All significant assumptions have been disclosed and the assumptions underlying the profit forecast are reasonable and appropriate.
- The results shown in the [audited/unaudited] financial results for the six months ended [*date*] and the unaudited management accounts for the [●] months ended [*date*] which are included in the profit forecast have been prepared in accordance with the accounting policies [normally] [to be] adopted by the ABC Group and are free from material misstatement.

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<sup>1</sup> The reporting accountant may also wish to obtain a representation that the profit forecast has been prepared in accordance with ‘Prospective Financial Information - Guidance for UK directors’ published by the Institute of Chartered Accountants in England and Wales.

- There are no contingencies, (other than those which have been taken into account in making the forecast), that are material in the context of the profit forecast which should be disclosed or taken into account in the profit forecast.
- The profit forecast is presented in a manner which is balanced and fair and not misleading and contains all information necessary for a proper understanding of the profit forecast.
- The profit forecast together with the assumptions and the representations in this letter have been approved by the board of directors.

***Representations in respect of specific assumptions such as;***

- The assumed like for like increase in sales of 5% in the last quarter of 200X incorporates expected price increases of 2% based on preliminary discussions with three of our major customers.
- The assumed increase in gross margin of 2 percentage points from 1 July 200X is based on manufacturing cost savings as a result of the realisation of efficiencies resulting from the factory reorganisation which we expect to be completed by the end of May 200X.
- The assumed increase in sales prices by 2% more than the general level of inflation in 200Y is based upon the expectation that our major competitor will announce a price increase of at least that amount in November 200X. Our expectation takes account of similar timing of increases in previous years and information derived from conversations with mutual customers.
- The opening of two new sales outlets in the current financial year assumes that negotiations to agree a lease on one out of the three potential units in Guildford will be completed and that refitting and pre-opening will be completed within 10 weeks which is 25% longer than the historical average due to additional building works being required in one of the potential sites.
- The profit forecast assumes that a forward sale of \$x million will be designated as a hedge against expected US\$ income.

## EXAMPLE OF A REPORT ON A PROFIT FORECAST

Date

Reporting accountant's address

Addressees, as agreed between the parties in the engagement letter

Dear Sirs

**[ABC plc]**

We report on the profit forecast comprising *[insert description of items comprising the prospective financial information, e.g. [forecast of turnover, operating profit, profit before tax and earnings per share]/[projected profit and loss account]]* of ABC plc ("the Company") and its subsidiaries (together "the ABC Group") for the *[specify period]* ending *[date]* (the "Profit Forecast"). The Profit Forecast, and the material assumptions upon which it is based, are set out on pages *[•]* to *[•]* of the *[describe document]* ("the [Document]") issued by the Company dated *[date]*. This report is required by *[Relevant Regulation]* *[guidance issued by the London Stock Exchange with respect to the AIM market]* and is given for the purpose of complying with that *[Relevant Regulation]* *[guidance issued by the London Stock Exchange]* and for no other purpose.

*[Substitute the following text for the last sentence of the immediately preceding paragraph, where a profit forecast is made by an offeree in the context of a takeover. This report is required by Rule 28.3(b) of the City Code and is given for the purpose of complying with that rule and for no other purpose. Accordingly, we assume no responsibility in respect of this report to the Offeror or any person connected to, or acting in concert with, the Offeror or to any other person who is seeking or may in future seek to acquire control of the Company (an "Alternative Offeror") or to any other person connected to, or acting in concert with, an Alternative Offeror.]*

### Responsibilities

It is the responsibility of the Directors of ABC plc to prepare the Profit Forecast in accordance with the requirements of the *[PD Regulation]/[Listing Rules]/[City Code]* *[guidance issued by the London Stock Exchange]*.

It is our responsibility to form an opinion as required by the *[PD Regulation]/[Listing Rules]/[City Code]* *[guidance issued by the London Stock Exchange]* as to the proper compilation of the Profit Forecast and to report that opinion to you.

### **Basis of preparation of the Profit Forecast**

The Profit Forecast has been prepared on the basis stated on page [ ] of the [Document]<sup>1</sup> and is based on the [audited/unaudited] interim financial results for the [six] months ended [date], the unaudited management accounts for the [x] months ended [date] and a forecast to [date]. The Profit Forecast is required to be presented on a basis consistent with the accounting policies of the ABC Group.

### **Basis of opinion**

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included [evaluating the basis on which the historical financial information included in the Profit Forecast has been prepared and] considering whether the Profit Forecast has been accurately computed based upon the disclosed assumptions and the accounting policies of the ABC Group. Whilst the assumptions upon which the Profit Forecast are based are solely the responsibility of the Directors, we considered whether anything came to our attention to indicate that any of the assumptions adopted by the Directors which, in our opinion, are necessary for a proper understanding of the Profit Forecast have not been disclosed and whether any material assumption made by the Directors appears to us to be unrealistic.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Profit Forecast has been properly compiled on the basis stated.

Since the Profit Forecast and the assumptions on which it is based relate to the future and may therefore be affected by unforeseen events, we can express no opinion as to whether the actual results reported will correspond to those shown in the Profit Forecast and differences may be material.

*[This paragraph may be omitted if the document is not to be distributed outside the UK - Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America [or other jurisdictions] and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.]*

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1 The disclosures presented with the profit forecast should explain the basis on which the forecast has been prepared. This will include identification of the accounting policies used and the financial information used in compiling the forecast. Typically this may include reference to audited/unaudited financial statements of the entity for an interim period, unaudited management accounts and management's forecast for the period for which no management accounts are available.

## Opinion

In our opinion, the Profit Forecast has been properly compiled on the basis [stated] [of the assumptions made by the Directors/]<sup>2</sup> and the basis of accounting used is consistent with the accounting policies of the ABC Group<sup>3</sup>.

## Declaration<sup>4</sup>

For the purposes of [Prospectus Rule [5.5.3R(2)(f)] [5.5.4R(2)(f)] [guidance issued by the London Stock Exchange] we are responsible for [this report as part] [the following part(s) of the [prospectus] [registration document] [AIM admission document] and declare that we have taken all reasonable care to ensure that the information contained [in this report] [those parts] is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the [prospectus] [registration document] [AIM admission document] in compliance with [item 1.2 of annex I of the PD Regulation] [item 1.2 of annex III of the PD Regulation] [guidance issued by the London Stock Exchange].

Yours faithfully

*Reporting Accountant*

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- 2 The City Code requires 'on the basis of the assumptions made by the Directors' but the PD Regulation requires 'on the basis stated'.
  - 3 Where the accounting policies used in the profit forecast either differ from those used by the company in its latest published financial statements or where the company has never published financial statements reference should be made to the accounting policies which have been used.
  - 4 This declaration is a requirement of the PD Regulation and is appropriate for inclusion when the report is included in a Prospectus, see Appendix 2 of SIR 1000.

## EXAMPLE OF A REPORT ON A PROFIT ESTIMATE THAT IS NOT SUBJECT TO ASSUMPTIONS

Date

Reporting accountant's address

Addressees, as agreed between the parties in the engagement letter

Dear Sirs

**[ABC plc]**

We report on the profit estimate comprising *[insert description of items comprising the prospective financial information, e.g. [estimate of turnover, operating profit, profit before tax and earnings per share]/[estimated profit and loss account]]* of ABC plc ("the Company") and its subsidiaries (together "the ABC Group") for the *[specify period]* ended *[date]* (the "Profit Estimate"). The Profit Estimate and the basis on which it is prepared is set out on pages *[•]* to *[•]* of the *[describe document]* ("the *[Document]*") issued by the Company dated *[date]*. This report is required by *[Relevant Regulation]* *[guidance issued by the London Stock Exchange with respect to the AIM market]* and is given for the purpose of complying with that *[Relevant Regulation]* *[guidance issued by the London Stock Exchange]* and for no other purpose.

*[Substitute the following text for the last sentence of the immediately preceding paragraph, where a profit estimate is made by an offeree in the context of a takeover. This report is required by Rule 28.3(b) of the City Code and is given for the purpose of complying with that rule and for no other purpose. Accordingly, we assume no responsibility in respect of this report to the Offeror or any person connected to, or acting in concert with, the Offeror or to any other person who is seeking or may in future seek to acquire control of the Company (an "Alternative Offeror") or to any other person connected to, or acting in concert with, an Alternative Offeror.]*

### Responsibilities

It is the responsibility of the directors of ABC plc to prepare the Profit Estimate in accordance with the requirements of the *[PD Regulation]/[Listing Rules]/[City Code]*. In preparing the Profit Estimate the directors of ABC plc are responsible for correcting errors that they have identified which may have arisen in unaudited financial results and unaudited management accounts used as the basis of preparation for the Profit Estimate.

It is our responsibility to form an opinion as required by the *[PD Regulation]/[Listing Rules]/[City Code]* as to the proper compilation of the Profit Estimate and to report that opinion to you.

### **Basis of preparation of the Profit Estimate**

The Profit Estimate has been prepared on the basis stated on page [ ] of the [Document]<sup>1</sup> and is based on the [audited/unaudited] interim financial results for the [six] months ended [date], the unaudited management accounts for the [x] months ended [date] and an estimate for the [month] to [date]. The Profit Estimate is required to be presented on a basis consistent with the accounting policies of the ABC Group.

### **Basis of opinion**

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included evaluating the basis on which the historical financial information for the [x] months to [date] included in the Profit Estimate has been prepared and considering whether the Profit Estimate has been accurately computed using that information and whether the basis of accounting used is consistent with the accounting policies of the ABC Group.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Profit Estimate has been properly compiled on the basis stated.

However, the Profit Estimate has not been audited. The actual results reported, therefore, may be affected by revisions required to accounting estimates due to changes in circumstances, the impact of unforeseen events and the correction of errors in the [interim financial results] [management accounts]. Consequently we can express no opinion as to whether the actual results achieved will correspond to those shown in the Profit Estimate and the difference may be material.

*[This paragraph may be omitted if the document is not to be distributed outside the UK Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America [or other jurisdictions] and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.]*

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1 The disclosures presented with the profit estimate should explain the basis on which the estimate has been prepared. This will include identification of the accounting policies used and the financial information used in compiling the estimate. Typically this may include reference to audited/unaudited financial statements of the entity for an interim period, unaudited management accounts and management's estimate (which may itself be based on other forms of management information for the period for which no management accounts are available).

## Opinion

In our opinion, the Profit Estimate has been properly compiled on the basis stated and the basis of accounting used is consistent with the accounting policies of the ABC Group<sup>2</sup>.

## Declaration<sup>3</sup>

For the purposes of [Prospectus Rule [5.5.3R(2)(f)] [5.5.4R(2)(f)] [guidance issued by the London Stock Exchange] we are responsible for [this report as part] [the following part(s) of the [prospectus] [registration document] [AIM admission document] and declare that we have taken all reasonable care to ensure that the information contained [in this report] [those parts] is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the [prospectus] [registration document] [AIM admission document] in compliance with [item 1.2 of annex I of the PD Regulation] [item 1.2 of annex III of the PD Regulation] [guidance issued by the London Stock Exchange].

Yours faithfully

*Reporting Accountant*

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- 2 Where the accounting policies used in the profit estimate either differ from those used by the company in its latest published financial statements or where the company has never published financial statements reference should be made to the accounting policies which have been used.
- 3 This declaration is a requirement of the PD Regulation and is appropriate for inclusion when the report is included in a Prospectus, see Appendix 2 of SIR 1000.

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