

Guidance on financial position and prospects

Given that IPOs are an increasingly popular means of generating capital, this article explores applicants' assessments of their financial position and prospects.

BY ANTHONY CONNOLLY

The use of the Initial Public Offering (IPO) vehicle is gaining momentum as a means of generating capital amongst Irish companies, particularly in the property development sector. Applications to the Main Market of the London Stock Exchange (LSE), (Premium and High Growth Segment listings), the Alternative Investment Market (AIM) of the LSE and the ISDX Growth Market of the LSE require the establishment of procedures that allow the directors to assess the financial position and prospects (FPP) of the applicant and its group on an ongoing basis. Irish companies wishing to pursue a dual listing on Euronext Dublin (formerly the Irish Stock Exchange) and the LSE are therefore subject to FPP requirements.

FPP impacts a number of stakeholders in the IPO process and is currently a hot topic with the UK regulator. The Financial Conduct Authority (FCA) issued a technical note in August 2017 (August 2017/UKLA/TN/708.3) setting out the sponsor's obligations in relation to FPP. Responsibility for the development and maintenance of FPP procedures rests with the applicant directors. This article will explore FPP from a company perspective, focusing in particular on directors' obligations with regard to FPP requirements, and highlight points for consideration in

order to carry out those obligations as efficiently and effectively as possible.

FPP roles and responsibilities

The Institute of Chartered Accountants in England and Wales (ICAEW) drafted a 'Guidance on Financial Position and Procedures' document (TECH 14/14CFF), which is aimed at:

- Applicant directors, to explain how they can demonstrate the establishment of FPP procedures to address relevant objectives; and
- Reporting accountants undertaking an assurance engagement and providing an assurance report in relation to the FPP procedures established by the applicant directors.

The directors are responsible for asserting that they have "established procedures that provide a reasonable basis for them to make proper judgements on an ongoing basis as to the FPP of the applicant and its group". The established procedures will typically be set out within a risk assessment document and the assertion on those procedures will typically be included within a board memorandum.

A reporting accountant is engaged by the applicant to provide an assurance opinion on the directors' assertion to the sponsor, and this

assurance opinion will typically be included within a report addressed to the applicant directors and the sponsor.

The sponsor's role is to assess the applicant's suitability to list. If the directors are unable to demonstrate the robustness of the FPP procedures in place, the reporting accountant may be unable to provide an unqualified opinion to the sponsor. The sponsor may therefore be unable to confirm that the applicant is fit to list.

FPP definition

Section 8 of Tech 14/14CFF states that "the directors must have established procedures that enable them to be informed on a regular basis as to:

- The financial position of the applicant and its group, including assets and liabilities, profits and losses;
- Projected profitability, cash flows and funding requirements based on realistic assumptions about the internal and external factors that might reasonably be expected to have a material impact on the business; and
- Any changes to the above."

Directors' responsibilities under FPP

Section 28 of Tech 14/14CFF sets out the following key components of the applicant directors' responsibility under FPP:

- Accepting responsibility for FPP procedures;
- Ascertaining whether appropriate FPP procedures have been established at the time of listing; and
- Obtaining sufficient evidence that the necessary FPP procedures are in place and documenting those procedures.

The FPP guidance recommends that the applicant directors carry out a risk assessment of factors that are likely to impact on FPP as a first step. This is an important document as it enables not only the documentation of FPP risks impacting the applicant, but also the FPP procedures (current and prospective) to address those risks. It can also be used to refer to the evidence supporting the documented procedures.

Including everything in one document makes it easier for the applicant directors to assess the FPP procedures in place and provides the basis for the development of the board memorandum, in which the applicant directors provide their assertion over the FPP procedures. It will also provide the reporting accountant and relevant advisors with one point of reference in order to carry out their work.

The risk assessment

The applicant directors, with the aid of the management team, need to identify the FPP procedure objectives to be adopted by the applicant and to document a risk assessment against the achievement of these objectives. Illustrative objectives are set out in Appendix 1 to TECH 14/14CFF under the following headings:

- Risk assessment of FPP;
- High-level reporting environment;
- Forecasting and budgeting;
- Management reporting framework;
- Significant transaction complexity, potential financial exposure or risk;
- Strategic projects and initiatives;
- Financial accounting and reporting; and
- IT environment.

The generic objectives should be assessed for their appropriateness to the particular applicant's business model and amended as appropriate. Once the objectives have been identified and documented, specific risks which threaten the achievement of these objectives need to be identified and documented.

Certain risks may be common to the vast majority of business models from an FPP perspective – for example, the risk that board members do not possess the necessary qualifications and experience to enable them to fulfil their roles to the required standard for a listed group. Other risks may be more industry-specific. For example, treasury risks are likely to be of greater significance to a bank than a construction company.

be documented. The FPP objectives, FPP risks, FPP mitigating activities and details of evidence supporting mitigating activities should all be included within the risk assessment.

The board memorandum

Upon completion of the risk assessment, directors must evaluate whether the FPP procedures developed meet the FPP objectives and provide a directors' assertion in relation to those procedures. Paragraph 31 of Tech 14/14 CFF states that "the results of the evaluation are documented in a company document, which may take the form of a board memorandum on FPP procedures, and directors are responsible for ensuring that FPP procedures and the results of their evaluation against FPP objectives are

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Once the risks have been identified and agreed, mitigating activities (controls) that reduce the probability and impact of an FPP risk occurring to an acceptable level need to be identified and documented by the applicant. Mitigating activities can be either current or prospective. Current mitigating activities are controls that are in place and operating at the listing date (day one). Prospective mitigating activities are controls that have been designed prior to listing but which will only become operational after day one. This type of mitigating activity may arise if the applicant is a completely new entity with no past history, or where the implementation of certain actions relies upon the completion of the listing process.

Following identification of the mitigating activities, supporting evidence must be pinpointed to demonstrate their operation. The location of this evidence should also

documented". It is important that the basis for the directors' assertion either describes the FPP procedures set out in the risk assessment or cross-references to the risk assessment. While there is no prescribed form for documenting the basis of the directors' assertion, Paragraph 50 of Tech 14/14CFF sets out the key elements that might typically be included as follows:

- A statement of the directors' responsibilities;
- Details of the nature of the company and the transaction that may be relevant to FPP procedures;
- A reference to the directors' risk assessment and the extent of FPP procedures necessary to respond to the identified risks;
- A reference to the use of TECH 14/14CFF;
- A directors' confirmation that the board memorandum describes fairly the FPP procedures that

- have been established on a specified date;
- A directors' confirmation that where FPP procedures have been planned by the directors but not yet brought into operation, those FPP procedures will be brought into operation and subsequently operated in accordance with the plans;
- A directors' assertion that they have established procedures to provide a reasonable basis for proper judgements on an ongoing basis as to the FPP of the company and its group;
- The name and signature of the director signing on behalf of the board; and
- The date of approval.

Appendix 2 to Tech 14/14CFF provides sample wording for FPP procedure board approval depending on the type of listing sought.

- (TECH 14/14CFF) in order to understand what is required to develop the risk assessment, the evidence supporting the FPP procedures and the board memorandum;
- Engage early with the reporting accountant with regards to the FPP deadlines within the overall listing timetable and communicate any changes in these timelines as soon as possible to the relevant parties;
- Assign appropriate responsibility for the initial FPP procedure development process. The board will typically delegate the development of the risk assessment, evidence supporting the FPP procedures and board memorandum to senior management. Senior management may in turn seek the support of outside advisors in their preparation;

- and agree this plan with the reporting accountant and key advisors;
- Approve the risk assessment, evidence supporting the FPP procedures and board memorandum prior to listing;
- Implement the prospective mitigating activity plan in accordance with the timelines agreed; and
- Assign responsibility for ongoing maintenance of the FPP process including the maintenance of the risk assessment and the evidence supporting the FPP procedures; liaising with senior management on at least an annual basis regarding any updates to FPP procedures; collation of updated FPP documentation; and submission to the board for their review and approval. Given their role in supporting the board, this responsibility would typically rest with the group secretary.

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Points for consideration

Given that the listing process is complex and time consuming, the applicant directors should ensure that the development and implementation of FPP procedures is given sufficient priority within the process. Senior management will typically support the directors in their obligations by developing the risk assessment, FPP evidence and board memorandum for board discussion and approval. To develop FPP procedures that are appropriate to the applicant and in accordance with the listing timetable agreed, the directors (with the support of senior management) should:

- Obtain an early understanding of the FPP procedures guidelines
- Provide the FPP risk assessment, evidence supporting the FPP procedures and the board memorandum to the reporting accountant in accordance with the timelines agreed;
- Process amendments to the FPP documentation based on comments provided by the reporting accountant and resubmit the documentation in accordance with the timelines agreed. Any wording updates and weaknesses in the design of mitigating activities will generally need to be addressed by day one, depending on the requirements of the reporting accountant and key advisors;
- Develop a plan to implement prospective mitigating activities

Conclusion

The development of FPP procedures is an important element of the listing process for companies. Failure to satisfy the reporting accountant and sponsor as to the robustness of these procedures may result in frustrating listing delays.

The risk assessment is critical to this process and its early development is essential in order to assess time and human resource requirements to address gaps. In particular, applicant directors need to assess at an early stage, in consultation with the reporting accountant, the prospective controls that must be in place and operational at the time of listing and those which must be operational shortly thereafter.

Applicant directors should therefore ensure that the development of FPP procedures is given sufficient priority within the listing process.



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