

This AG 3.341 is applicable for engagements where the investment circular is dated before 1 July 2014. For engagements where the investment circular is dated on or after 1 July 2014, HKSIR 500 "Reporting on Profit Forecasts, Statements of Sufficiency of Working Capital and Statements of Indebtedness" is applicable, with early adoption permissible.

Statement 3.341 (April 2014)

STATEMENT 3.341
AUDITING GUIDELINE
ACCOUNTANTS' REPORT ON PROFIT FORECASTS

(Issued May 1988; revised September 2004 (name change) and April 2014)

Introduction

1. This guideline is for the guidance of members required to report on profit forecasts in connection with a prospectus for the public issue of shares to be listed by The Stock Exchange of Hong Kong Limited or to report on profit forecasts as required under Rule 19 of the Hong Kong Code on Takeovers and Mergers. This guideline is not necessarily applicable to banking, shipping and insurance companies which claim exemption from the disclosure requirements under Part III of the Tenth Schedule to the Companies Ordinance Cap. 32. However, where applicable this guideline should be followed for those companies.
2. This guideline may also assist accountants when making arrangements to issue reports on profit forecasts other than under the above. However, the guideline is not directly concerned with such reports. All instructions from clients beyond the scope of the regulations referred to above should be in writing, for it will be those instructions which will determine the accountants' wider responsibilities, if any.
3. The guideline is issued after discussion with the Registrar General, the Commissioner for Securities, and The Stock Exchange of Hong Kong Limited.

Regulations relating to profit forecasts

4. There is no specific regulation or requirement that prospectuses or offer documents should incorporate a profit forecast. However it is generally accepted that prospectuses and offer documents include a profit forecast which should be reported upon by independent accountants.

The main regulation in relation to profit forecasts when they are issued is contained in Rule 19 of the Hong Kong Code on Takeovers and Mergers which provides that profit forecasts must be compiled with the greatest possible care by directors, whose sole responsibility they are, and that the assumptions upon which the directors have based their forecasts are clearly stated. Rule 19 requirements relating to auditors or reporting accountants (hereinafter referred to as "reporting accountants") are that they should examine and report on the accounting policies and calculations used in the profit forecast and whether the accounting policies differ from the policies adopted in the company's financial statements.

In addition:

- (a) Paragraph 3 of Part I of the Third Schedule to the Companies Ordinance provides for a prospectus to include "sufficient particulars and information to enable a reasonable person to form as a result thereof a valid and justifiable opinion of the shares or debentures and the financial condition and profitability of the company at the time of the issue of the prospectus"; and
 - (b) the Registrar General has indicated that if a profit forecast is contained therein, a prospectus must contain a report by the reporting accountants stating that they are satisfied that the profit forecast, so far as the accounting policies and calculations are concerned, has been properly compiled on the basis of the assumptions made by the directors.
5. The Companies Ordinance and the Hong Kong Code on Takeovers and Mergers require a statement that the reporting accountants have given and have not withdrawn their consent to publication of their letter in a prospectus.

Definitions

6. *Profit forecast* is an estimate of financial results made in advance of completion of financial statements up to publication standard:
 - (a) for any expired accounting period;
 - (b) for a current (or unexpired) accounting period; or
 - (c) the current and the immediately succeeding accounting period, provided that a sufficiently significant part of the current period has already elapsed.
7. *The Takeover Code* refers to the Hong Kong Code on Takeovers and Mergers approved by the Securities Commission on 1 October 1981 and as amended in March 1983.
8. *The regulations* are Rule 19 of The Takeover Code and specific directions by the Registrar General on a case by case basis.
9. *Reporting accountants* are independent accountants reporting under the regulations, whether or not they also act as auditors of the company issuing the document.
10. *Document* is any circular, prospectus or advertisement issued under the regulations.
11. *Assumptions* are the assumptions disclosed in the document relating the general economic, commercial, marketing, financial and other conditions under which the company expects to operate and the assumed position of the company in relation thereto.
12. *Publication standard* is defined as that applying to figures that have received the same degree of examination and carry the same degree of authority as normally apply to published but unaudited interim or preliminary final results of the company in question.
13. *Adviser* is a merchant bank, issuing house or stockbroker appointed by a company to assist in preparing a document.
14. *Accounting bases* are the methods developed for applying fundamental accounting concepts to financial transactions and items, for the purpose of financial statements, and in particular (a) for determining the accounting periods in which revenue and costs should be recognised in the profit and loss account and (b) for determining the amounts at which material items should be stated in the balance sheet. (SSAP 1 Disclosure of accounting policies, paragraph 3)
15. *Accounting policies* are the specific accounting bases selected and consistently followed by a business enterprise as being, in the opinion of the management, appropriate to its circumstances and best suited to present fairly its results and financial position. (SSAP 1, paragraph 4)

Principles

16. It is not the reporting accountants' responsibility to report upon the assumptions or to report on the prospect of the company achieving the profit forecast. Nevertheless, reporting accountants should not allow any assumption to be published which appears to them to be unrealistic (or one to be omitted which appears to them to be important), without commenting on it in their report.

17. It is emphasised that profit forecasts necessarily depend on subjective judgements. They are, to a greater or lesser extent according to the nature of the business and period the profit forecast covers, subject to numerous and substantial inherent uncertainties. In consequence, profit forecasts are not capable of being substantiated by reporting accountants in the same way as financial statements which present the results of completed accounting periods. Due to the uncertainties mentioned above, reporting accountants should normally restrict their reporting on profit forecasts to those for one year or less from the date to which the last audited financial statements were made up. Only in exceptional circumstances should they report on profit forecasts for a future accounting period which should in any case be limited to the immediately succeeding period and then only if a significant part of the current period has already elapsed.

In practice, it is unusual to provide a forecast for a succeeding period unless:

- (a) at least 10 months of the current period has elapsed; and
 - (b) the company's operations lend themselves to reasonably accurate forecasting such as in the case of a property investment company.
18. It is, therefore, important that reporting accountants should make the reporting period clear when they accept instructions to examine the accounting policies and calculations for profit forecasts, and in the wording of their report they should take care to avoid giving any impression that they are in any way confirming, underwriting, guaranteeing or otherwise accepting responsibility for the ultimate accuracy and realisation of forecasts. Moreover, bearing in mind their special status and authority, reporting accountants should do or say nothing to encourage directors, third parties or the public to place a mistaken degree of reliance on statements as to future profits, the achievement of which must always be subject to uncertainty.

Procedures

19. The reporting accountants' work to fulfil the requirements above falls into three main sections:
- (a) preliminary considerations;
 - (b) review of profit forecasts; and
 - (c) the accountants' report.

Preliminary considerations

20. Reporting accountants should agree with the directors the following fundamental points before accepting instructions to report:
- (a) the purpose for which the profit forecast has been prepared and the accountants' report is required;
 - (b)
 - (i) that the reporting accountants' instructions and responsibilities for reporting are limited to the requirements under the regulations and do not constitute an audit;
 - (ii) that the directors assume full responsibility for the profit forecast under review; and
 - (iii) that the directors will signify their responsibility for formal adoption by the board;
 - (c) that the profit forecast is for:
 - (i) an expired accounting period;

- (ii) the current (or unexpired) accounting period; or
 - (iii) the current and the immediately succeeding accounting period, provided that a sufficiently significant part of the current period has already elapsed;
 - (d) no material restrictions on the scope of the reporting accountants' work (for example, by restricting visits to overseas companies or material factory units) can normally be accepted unless the matter is dealt with in the reporting accountants' report and in the published documents; and
 - (e) that the time within which the accountants' report is required is not so severely restricted that, having regard to the company's circumstances and forecasting experience, and notwithstanding their best endeavours, it would be plainly impossible for the reporting accountants to obtain sufficient information to enable them properly to exercise their professional judgement.
21. In the case of a profit forecast in a prospectus, the Registrar General has indicated that the issuing house or sponsoring brokers should report whether or not they have satisfied themselves that the forecast has been stated by the directors after due and careful enquiry. In the case of a profit forecast in a document connected with an offer, the Takeover Code requires that any adviser mentioned in the document should also report on the forecast. The responsibilities of such persons are distinct from those of the reporting accountants. From the outset, liaison should be established with such other advisers to ensure that there is no doubt or misunderstanding on either side as to the respective responsibilities or as to the work which will be carried out by each party to enable it to fulfil its reporting function.

Review of profit forecasts

22. In carrying out their review, the main matters to which the reporting accountants will direct their attention are as follows:
- (a) the nature and background of the company's business;
 - (b) the accounting policies normally followed by the company;
 - (c) the assumptions upon which the profit forecast is based; and
 - (d) the procedures followed by the company in preparing the profit forecast.

The nature and background of the company's business

23. The reporting accountants will wish to review the company's recent history, with reference to such matters as the general nature of its activities and its main products, markets, customers, suppliers, divisions, locations, management, labour force and trend of results.

The accounting policies normally followed by the company

24. The reporting accountants will wish to establish which accounting policies have been adopted by the company in published financial statements so as to ensure that they are acceptable and have been consistently applied in the preparation of interim accounts and the profit forecast.

The assumptions upon which the profit forecast is based

25. It is the responsibility of the reporting accountants to determine that the profit forecast is consistent with and has been properly compiled on the basis of the assumptions made by the directors.

26. Accordingly the reporting accountants have no specific responsibilities for and are not required by the regulations or otherwise to report on the assumptions. However, in the course of their work on the accounting policies and calculations, they will need to consider the assumptions on which the profit forecast has been based. The reporting accountants should not comment on any assumption beyond his area of expertise.

The procedures followed by the company for preparing the profit forecast

27. In carrying out their review of the accounting policies and calculations for the profit forecast, and of the procedures followed by the company for its preparation, the main points which the reporting accountants will wish to consider include the following:
- (a) whether the profit forecast under review is based on forecasts regularly prepared for the purpose of management, or whether it has been separately and specifically prepared for the immediate purpose;
 - (b) where profit forecasts are regularly prepared for management purposes, the degree of accuracy and reliability previously achieved, and the frequency and thoroughness with which estimates are revised;
 - (c) whether the profit forecast under review represents the management's best estimate of results which they reasonably believe can and will be achieved as distinct from targets which the management have set as desirable;
 - (d) the extent to which profit forecast results for expired periods are supported by reliable interim accounts;
 - (e) the details of the procedures followed to generate the profit forecast and the extent to which it is built up from detailed profit forecasts of activity and cash flow;
 - (f) the extent to which profits are derived from activities having a proven and consistent trend and those of a more irregular, volatile or unproven nature;
 - (g) how the profit forecast takes account of any material extraordinary items and prior year adjustments, their nature, and how they are presented;
 - (h) whether adequate provision is made for foreseeable losses and contingencies and how the profit forecast takes account of factors which may cause it to be subject to a high degree of risk, or which may invalidate the assumptions;
 - (i) whether working capital appears adequate for requirements; normally this would require the availability of properly prepared cash-flow forecasts; and where short-term or long-term finance is to be relied on, whether the necessary arrangements have been made and confirmed;
 - (j) whether the forecasts have been prepared and presented on acceptable bases consistent with the accounting principles and practices adopted by the company in previous years, and if not, whether the fact and effects of any material change of basis are made clear; and
 - (k) the arithmetical accuracy of the profit forecast and the supporting information and whether forecast balance sheets and statements of changes in financial position have been prepared - these help to highlight arithmetical inaccuracies and inconsistent assumptions.

The accountants' report

28. The accountants' report will be addressed to the directors and will normally include statements dealing with the following matters, so far as appropriate:

Statement 3.341 (May 88)

- (a) specific identification of the profit forecast and documents to which the report refers;
 - (b) the fact that the directors are solely responsible for the profit forecast;
 - (c) the fact that the reporting accountants have reviewed the accounting policies and calculations used in arriving at the profit forecast;
 - (d) if, as will frequently be the case, the reporting accountants have not carried out an audit of results for expired periods, a statement to that effect; and
 - (e) whether in the opinion of the reporting accountants the profit forecast, so far as the accounting policies and calculations are concerned, has been properly compiled on the footing of the assumptions made by the board of directors, as set out in the document, and is presented on a basis consistent with the accounting policies normally adopted by the company.
29. The report should be qualified if, inter alia, the reporting accountants:
- (a) have reason for material reservation about the accounting policies or calculations for the profit forecast;
 - (b) have reason to consider the accounting policies and calculations to be inconsistent with the stated assumptions; or
 - (c) have not obtained all the information they consider necessary (for example, the fact that they were unable to review the profit forecasts of material subsidiary or associated companies or because of unduly restrictive time limits).
30. If any of the assumptions which are to be published appear to them to be unrealistic, or if any assumption is to be omitted which appears to them to be important, they should include an appropriate comment in their report.
31. An appropriate form of accountants' report is attached as Appendix 1.

Letter of consent

32. The regulations require that an accountants' report contained in a document must be accompanied by a statement that the reporting accountants have given in writing, and not withdrawn, their consent to its publication.
33. Most of the documents containing profit forecasts are also prospectuses for Companies Ordinance purposes, in which case there is a statutory requirement that the consent specifically refers to the statement being included, in the form and context in which it is included, and that the statement that the consent has been given and has not been withdrawn should appear in the prospectus.
34. An appropriate form of letter of consent to the directors of the company is attached as Appendix 2.

Re-issuance of forecast

35. In the event of a forecast being re-issued by the company, that forecast must contain a statement by the directors that the forecast remains valid for its intended purpose, and that the financial advisers and accountants who reported on the forecasts have consented to the re-issuance of their reports.
36. Before giving their consent to publication or re-publication of their report, the reporting accountants should require to see the whole text of the document and satisfy themselves that the inclusion of their report in the form and context of the document would not be inappropriate or misleading.

Appendix 1

SPECIMEN ACCOUNTANTS' REPORT

An accountants' report might in appropriate circumstances, where there are no grounds for qualification, read as follows:

Audit & Co.,
Hong Kong.
1 April 19X8

The Directors,
X Limited.

Dear Sirs,

We have reviewed the accounting policies and calculations for the forecast of the profit after taxation but before extraordinary items of X Limited (for which you as directors are solely responsible) for the periods set out on pages of the document dated

We have not conducted an audit of the results for the year ended on 31 March 19X8.

In our opinion, so far as the accounting policies and calculations are concerned, the forecast has been properly compiled in accordance with the assumptions made by the directors as set out in Appendix Y of the document and is presented on a basis consistent in all material respects with the accounting policies normally adopted by X Limited.

Yours faithfully,

Audit & Co.,
Certified Public Accountants (Practising) [or Certified Public Accountants]

Appendix 2

SPECIMEN LETTER OF CONSENT

A reporting accountants' letter of consent to the inclusion of their report on the accounting bases and calculations for profit forecasts addressed to the directors would, in appropriate circumstances, read as follows:

Audit & Co.,
Hong Kong.
4 April 19X8

The Directors,
X Limited.

Dear Sirs,

We hereby consent to the issue of the document dated issued in connection with , with the inclusion therein of a copy, of our report dated 1 April 19X8 and the references thereto, and references to our name, in the form and context in which they appear. We attach a copy/final proof of the document initialled by us for purposes of identification.

Yours faithfully,

Audit & Co.,
Certified Public Accountants (Practising) [or Certified Public Accountants]