KPMG

Analyzing prospective financial information

Relevant guidance to consider

When preparing prospective financial information (PFI), one must consider the various users of the PFI, including regulators. In recent years, scrutiny of PFI by regulators has been steadily increasing. As a result, preparers of PFI should understand the applicable standards. This document discusses some of the PFI guidance issued by the American Institute of Certified Public Accountants (AICPA), and Securities and Exchange Commission (SEC), and each is briefly described below.

The AICPA Guide on Prospective Financial Information[1]

Most recently published in 2021, the American Institute of Certified Public Accountants (AICPA) Guide on Prospective Financial Information was developed to assist management in the preparation of financial forecasts and projections. Further, the guide was intended to facilitate the completion of engagements by practitioners in accordance with Statements on Standards for Attestation Engagements and Statements on Standards for Accounting and Review Services. It is largely written from the perspective of audit or attestation services around the PFI (e.g., compilation, examination, agreed-upon procedures, etc.).

This guide also includes a number of important definitions pertaining to PFI. For example, it differentiates between *financial forecasts* (best guess under current conditions) and *financial projections* (uses one or more hypothetical[2] assumptions), but it confirms that both constitute PFI. PFI may be used in *prospective financial statements* (financial position, results of operations, and cash flows) or in a *partial presentation* (at least one missing key element[3]).

In addition, it provides the following guidance on developing PFI:

- PFI should be prepared:
  - In good faith;
  - With appropriate care by qualified personnel; and
  - Using appropriate accounting principles.
- The process used to develop PFI should:
  - Provide the means to determine the relative effect of variations on the major underlying assumptions;
  - Provide adequate documentation of both the PFI and the process used to develop it;
  - Use information that is consistent with the plans of the entity;
  - Identify key factors as a basis for assumptions;
  - Use assumptions that are appropriate;
  - Seek out the best information that is reasonably available at the time;
  - Include, where appropriate, the regular comparison of the PFI with the attained results; and
  - Include adequate review and approval by the responsible party at the appropriate levels of authority.

[1] https://future.aicpa.org/cpe-learning/publication/prospective-financial-information-guide

[2] An assumption used in a financial projection or in a partial presentation of projected information to present a condition or course of action that is not necessarily expected to occur, but is consistent with the purpose of the presentation.

[3] The required elements to be considered prospective financial information include the following: sales or gross revenues; gross profit or cost of sales; unusual or infrequently occurring items; provision for income taxes; income from continuing operations; discontinued operations or extraordinary items; net income; basic and diluted earnings per share; significant changes in financial position; a description of what the responsible party intends for the prospective financial statements to present, a statement that the assumptions are based on the responsible party's judgment at the time the prospective information was prepared, and a caveat that the prospective financial results may not be achieved; a summary of significant assumptions; and a summary of significant accounting policies.

SEC Division of Corporation Finance – Financial Reporting Manual[4]

Section 3520.2 of the Financial Reporting Manual states that all projections and forecasts must comply with the guidelines for projections in S-K 10, which requires that management have a reasonable basis for the assumptions underlying their prospective financial statements. Support for assumptions may include market surveys, general economic indicators, trends and patterns developed from the entity's operating history (e.g., historical sales trends), internal data and analyses (e.g., obligations under union contracts for labor rates), etc. An absence of adequate support may preclude a registrant's ability to include prospective financial statements in the filing. Additionally, a company with a limited operating history may not have a reasonable basis to present a financial forecast beyond one year.

Forecasts presented in lieu of pro forma financial statements must be presented in accordance with AICPA guidelines and the following guidance:

- Forecasts should cover a period of at least 12 months from the later of:
  - The latest historical balance sheet in the filing, or
  - The date of the event.
- Forecasts should include the same degree of detail as that required in pro forma data and should clearly set forth any assumptions used.
- Historical information of the registrant and business to be acquired (if applicable) should be presented for a recent 12-month period in parallel columns with the forecast.

Key observations

Given the increased scrutiny of PFI, it is more important than ever to have a robust and well-documented process for developing financial forecasts. In addition, to ensure the appropriate level of rigor is applied, one should be familiar with the PFI-related guidance discussed in this document. Companies with limited finance and FP&A resources available to test, modify, and document PFI may wish to involve an experienced valuation and business modeling specialist to help them through the process.

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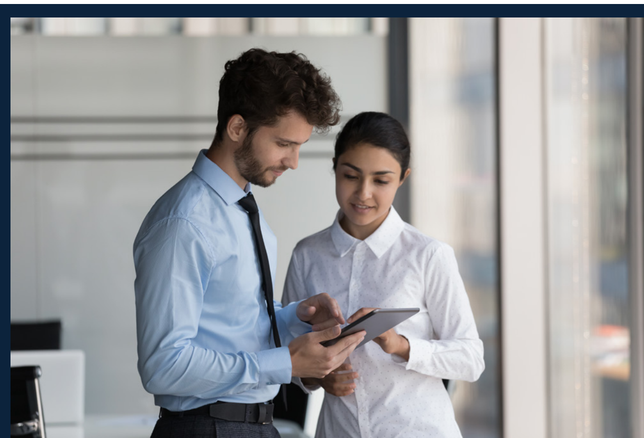

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[4] https://www.sec.gov/corpfin/cf-manual

Contact us

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