

Private and Confidential

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Dear Ms Joannou

Pro forma financial information, guidance for directors

We are writing in response to your request for comments on the exposure draft dated October 2013 of the proposed new guidance for directors on preparing pro forma information.

Q1 Do you have any comments of the background material or the scope of the guidance set out in the Introduction?

The Introduction is a useful summary of the circumstances in which pro forma information may be required and the various sources of rules, guidance and market practice. We recommend it is updated for the latest version of ESMA's Q&A's on prospectuses and the resulting views of the UKLA regarding pro forma income statements.

We consider it would be useful to clarify that "transaction" and "significant gross change" refer (as set out in ESMA's Q&A), to any significant gross change which has occurred since the latest published financial information and not just to the proposed event for which the investment circular is being prepared. It is very common in the CF community to use "transaction" to mean the event for which the investment circular is being prepared, whereas the pro forma requirements use the term in a broader sense.

The examples given in paragraphs 5 and 6 (section 1.2) both relate to situations when the transaction/significant gross change giving rise to the requirement to prepare pro forma information is also the event requiring the investment circular. Whilst Premium Listed companies may have had to prepare a Class 1 circular for certain acquisitions, companies with, for example, a Standard Listing or admitted to trading on AIM do not have equivalent obligations. Therefore such a company may be preparing a prospectus having undertaken a transaction giving rise to a significant gross change but which is not the reason for the prospectus. It may be useful to provide an example under this scenario.

We note that paragraph 14 (section 1.4) states that the guidance may also be useful in situations where there are no regulatory requirements governing the preparation of pro forma information. While the guidance will be of use to, for example, directors of companies seeking a listing on AIM, we consider that too prescriptive an application might restrict the more flexible regime which is one of AIM's strengths and that the ICAEW should keep this under review.

Q2 Do you have any comments on the way the principle of ‘not misleading’ has been applied in the context of pro forma financial information (Section 2)?

We welcome the emphasis in paragraph 32 and 35 that pro forma information can be prepared in accordance with regulatory requirements and still be misleading and the importance of considering the information as a whole and in context.

Q3 Do you have any comments on the specific guidance on the nature of pro forma financial information (Section 2)?

We question whether section 2 should be titled “Nature of information”. Section 2.1 does not seem to be a definition of pro forma information but rather a repetition of part of the background material already set out in section 1.2 and 1.3. Section 2.2 covers the principle of “not misleading” referred to in the previous question. Section 1.1 seems to be the clearest definition of pro forma information in the exposure draft.

Paragraph 26 within section 2.1 states that the typical approach in the UK is for a narrative description of how the transaction giving rise to the significant gross change might have affected the issuers earning. Recent changes to ESMA’s Q&As on prospectuses has led to the UKLA stating that issuers will now be required to provide a pro forma profit and loss account where there has been a significant gross change, where previously the UKLA would have accepted a narrative description to address the impact on earnings.

We would recommend that this change in ESMA Q&A and therefore UKLA approach should be reflected in the ICAEW guidance both in paragraph 26 and elsewhere, particularly as the change is very recent.

Q4 Do you have any comments on the specific guidance on the presentation of pro forma financial information (Section 3)?**Section 3.1.3**

In our experience the use of a narrative description to describe the impact on net assets is more limited than suggested in these paragraphs and a pro forma statement of net assets is invariably recommended by the Sponsor for any acquisition/disposal if that is the reason for the circular.

Section 3.2.8

As drafted Paragraph 74 (Section 3.2.8) could be read to contradict paragraph 73.

Paragraph 74 suggests that adjustments could be made to the pro forma information (as distinct from additional notes) for significant non-adjusting events to prevent the pro forma information being misleading. However paragraph 73 says that subsequent events should only be reflected if they qualify as adjustments under the PD Regulation. It is perhaps unfortunate that IAS10 refers to adjusting and non-adjusting events after the reporting period and the PD Regulation refers to adjustments in the context of pro forma information. We would suggest that the language in Paragraph 74 is amended to clarify which type of adjustment is being referred to and have set out a suggestion below:

“73. Other than where a subsequent event qualifies as an adjusting event under International Accounting Standard (IAS) 10 *Events After the Reporting Period* and is reflected in the unadjusted financial information of the issuer or an acquisition target, it should not be reflected in pro forma financial information unless it qualifies to be reflected as an adjustment in accordance with the PD Regulation.

74. If an issuer believes that pro forma financial information would be misleading if it does not reflect subsequent events which are significant non-adjusting events after the end of the reporting period (as defined in IAS10) which are relevant to an understanding of the matters addressed in the pro forma financial information given the purpose for which the pro forma financial information is being presented, it should consider whether ~~these events qualify as adjustments to the pro forma in accordance with the PD Regulation~~ or disclosure of the events in the notes to the pro forma financial information could be made which would prevent the pro forma financial information from being misleading.”

It may also be helpful to provide examples of the type of non-adjusting events after the end of the reporting period (as defined in IAS10). We refer again to the example of a company with a Standard Listing or admitted to trading on AIM which has undertaken the equivalent of a Class 1 acquisition and is then preparing a prospectus at a later date (but before the acquisition is reflected in the company’s reported financial information). This acquisition would be a non-adjusting event after the end of the reporting period (as defined in IAS10) but, prima facie, would appear to qualify for inclusion as an adjustment to pro forma information as it represents a significant gross change.

Q5 Do you have any comments on the specific guidance on adjustments (Section 4)?

We welcome the inclusion of specific guidance on a number of situations which have historically been matters of debate between preparers of pro forma financial information and reporting accountants but believe some matters require further clarification.

Transaction costs

Section 4.2.2/paragraph 96 states that “Written estimates [of transaction costs] from advisers that are disclosed in total elsewhere in an investment circular will normally provide sufficient factual support”. In our experience the investment circular may disclose total costs but it may be necessary to split these costs between say those attributable to an acquisition and a related fundraising for purposes of the pro forma information. Whilst this split may not be disclosed in the investment circular, and the factual support may come from other supporting documentation, we do not believe that this should preclude the different elements being disclosed in the investment circular.

Cost and revenue eliminations

We consider that the guidance in section 4.2.6/paragraph 103 on disclosing past costs or revenues which will not occur in future on the face of the pro forma statement of profit or loss and other comprehensive income or as a footnote should be improved. The distinction between past costs which will not recur in future periods *under the terms of the transaction* (our emphasis) and synergy benefits (as referred to in section 4.2.5) should be refined and emphasised particularly as there may be off-setting additional costs (as is acknowledged).

We also believe that clarification is needed as to the circumstances when issuers should disclose past costs or revenues which will not occur in future on the face of the pro forma statement of profit or loss and other comprehensive income. We presume that it is intended that any disclosure is within the *unadjusted* statement of profit or loss and other comprehensive income. If so we consider that the drafting should be amended to include “unadjusted”.

A similar situation is envisaged in paragraph 20 of the Annexure to SIR2000 which recommends changes in presentation or additional disclosure or explanation. We consider that it would be normally be appropriate to include this information as a footnote rather than on the face of the statement of profit or loss and other comprehensive income.

Other small transactions

Section 4.2.11/paragraph 120 appears to suggest that issuers may include as adjustments small transactions which are not attributable to the proposed event for which the investment circular is being prepared or were not significant gross changes individually. The drafting of this paragraph appears more permissive than ESMA's Q&A (question 52).

Our reading of ESMA's Q&A is that small transactions would not be adjusted for and, in our experience, this is also UKLA practice. While ESMA's Q&A acknowledges the need to consider small transactions on a case by case basis to ensure that the pro forma information is not misleading, the tone of its guidance suggests it would be very unusual to include such transactions. We suggest that paragraph 120 of the proposed ICAEW guidance should include wording similar to ESMA's question 52 to set a presumption that small transactions should not be included as adjustments.

Q6 Are there any other matters that should be taken into account when finalising the new guidance in Part 3?

Save for amendments needed to reflect the recent change in the approach to pro forma profit and loss accounts discussed against Q3 above we do not believe that there are any other matters which should be taken into account when finalising the new guidance.

Q7 Do you have any comments on the transitional arrangements discussed in Part 2 of this document?

As the new guidance largely codifies existing market practice and the previous guidance dates from 1998 we consider that two months is an appropriate time between the publication of the new guidance and its mandatory implementation.

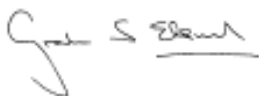
Contact details

We hope these comments are of assistance. If you would like to discuss them further please contact either:

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Yours sincerely



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For and on behalf of BDO LLP