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Our ref lm/cw

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Dear Ms Joannou

Pro forma financial information – Guidance for Directors.
Exposure Draft dated October 2013

We welcome the opportunity to comment on the Exposure Draft.

Although initially it had appeared that the update of the ESMA Q&A in November 2013 would have little impact on previous practice in the UK with regard to pro forma financial information, we see increasing indications that it may lead to a reanalysis by the UKLA of the wording contained in the PD Regulation, which may in turn lead to a new rationalisation of existing practice (cutting across certain underlying assumptions made in the drafting of TECH 18/98, and on into the current exposure draft), and to certain changes in practice, particularly with regard to pro forma income statements. It will clearly make sense for the revised guidance to take account of, and to reflect, the new paradigm.

Our responses to the questions raised are set out in the Appendix to this letter. We include in our responses an outline of assumptions that we consider may change, but the realignment is at an early stage, and the ICAEW should liaise so far as practicable with the UKLA in order to establish the appropriate analysis.

If you would like to discuss further any aspect of this response, please contact Linda Main on 020 7311 8574.

Yours sincerely

Linda Main

Linda Main
Partner, *KPMG LLP*

Appendix

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

As noted in the introduction to this response, we consider that there may be a need to reflect a somewhat different analysis of the underlying approach to preparing pro forma financial information under the PD Regulation, with regard to transactions to which the PD Regulation requirements are applicable and the need, or otherwise, for pro forma financial information.

2 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)?

Pro forma financial information is, in its nature, an illustration of an effect that by virtue of its sufficient resemblance to that effect is deemed suitable for publication. The limitations on its preparation are such that although the same approach may be taken in a range of cases, the resemblance to the effect of the resulting illustration in each case may vary between very close to almost entirely unlike. The point at which a pro forma statement becomes unsuitable for publication is therefore something that it is important to recognise, and linking this to the point at which the pro forma financial information becomes misleading seems to be a pragmatic approach. Making the judgment is inevitably somewhat subjective in marginal cases and entails certain assumptions about the interests of users and the significance of the effect of the accounting effect of the transaction to their assessment of it. Overall, we consider that the discussion in Section 2 provides a reasonable overview of the issues and approaches that may be adopted.

In paragraph 29, sixth line, we believe that the second 'preparation' should read 'preparer'.

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

The positioning of the description of nature of pro forma financial information in section 2 makes it somewhat difficult to identify it as a separate subject, but we assume that the key paragraph dealing with the nature of pro forma financial information is paragraph 29, with which we are broadly in agreement. There may be some merit in giving the material its own subheading and addressing it prior to introducing the 'not misleading' principle. Please see our comments on question 2 for our further thoughts on the nature of pro forma financial information.

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

As noted in the introduction to this letter, we believe that there may be a need in particular to revisit the assumptions underlying the use of the narrative descriptions.

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

In relation to paragraph 107, although the guidance is clear that a borrowing should not be presented as repaid if repayment is not stated as a commitment in the investment circular, the guidance does not go on to discuss the treatment that might be adopted in relation to the receipt of proceeds in such cases. Whilst treating the proceeds as an increase in cash would be one option, it is for consideration whether, in cases where the entity has an outstanding overdraft, it would be consistent with the guidance to illustrate the receipt of proceeds as an offset to the overdraft, and if so, whether this could be made clear.

We believe that if requests for inclusion in prospectuses of pro forma income statements for acquisitions are likely to become standard, section 4.2.9 may need to be expanded to include a more detailed discussion of if and when factual support for directors' estimates of fair values can be considered to have been obtained.

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

Please see comments in the introduction to this letter.

In connection with section 3.2.7, we have observed cases where financial information on a target in an acquisition which is drawn up to a non-conterminous date has been adjusted in a pro forma income statement, using information sourced from the management accounts of the target, so as to construct a coterminous period. Although this is not always a necessary step, we believe that it would be useful for the guidance to recognise it as a possible approach.

We have also observed cases where goodwill held at a group level in relation to an entity which is to be disposed of and which will be released on disposal, is reflected as an adjustment in a pro forma net asset statement. We believe that it may be useful to include a discussion of this issue in the guidance.

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

We have no comments on the proposed transitional arrangements.