Technical
Release

Guidance for preparers of pro forma financial information

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Foreword

This Technical Release, TECH 01/15CFF *Guidance for preparers of pro forma financial information*, is issued in the context of the Prospectus Directive (Directive 2003/71/EC) which was implemented in the UK from 1 July 2005 in the Prospectus Rules and in Part VI of the Financial Services and Markets Act 2000. Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing the Prospectus Directive (the PD Regulation) sets out the form and content of prospectuses. The PD Regulation is directly applicable in the UK and does not need implementing legislation.

Under the PD Regulation, a company which issues a prospectus in connection with a share issue must, in the case of a 'significant gross change', include a description of how the transaction might have affected the assets and liabilities and earnings of the issuer, had the transaction been undertaken at the commencement of the period being reported on or at the date reported.

The PD Regulation indicates that this requirement will normally be satisfied by the inclusion of pro forma financial information and, where this is the case, stipulates the presentation of that information.

TECH 01/15CFF provides practical help for applying the preparation and presentation requirements of the PD Regulation. The PD Regulation includes criteria for preparers of pro forma financial information and the guidance in this Technical Release reflects practice in the market relating to the application of those criteria.

This Technical Release takes account of the following material published by the European Securities and Markets Authority (ESMA).

- Update of the CESR recommendations on the consistent implementation of Commission Regulation No 809/2004/EC implementing the Prospectus Directive (version dated 23 March 2011) (ESMA Recommendations).
- *Questions and Answers, Prospectuses* (22nd updated version dated October 2014).

This Technical Release also reflects the guidance in proposed UKLA Technical Note *Pro forma financial information* (UKLA/TN/633), published for consultation by the Financial Conduct Authority (FCA) in August 2014.

Technical Release TECH 01/15CFF *Guidance for preparers of pro forma financial information* replaces Technical Release TECH 18/98 *Pro Forma Financial Information, Guidance for Preparers under the Listing Rules*. TECH 18/98 was based on the Listing Rules extant when it was published in 1998.

TECH 01/15CFF does not deal with the obligations under the PD Regulation of reporting accountants.

1. Introduction

1.1 What pro forma financial information represents

1. Pro forma financial information represents a hypothetical illustration of the impact of a transaction or transactions on an issuer's assets and liabilities and earnings. Pro forma financial information does not purport to represent what the issuer's actual financial position or results would have been had the transaction occurred at the date assumed for the purpose of its preparation.

1.2 Pro forma financial information under the PD Regulation

2. A prospectus relating to an offer, or a request for admission to trading, of shares[1] must, in the case of a 'significant gross change', include a description of how the transaction might have affected the assets and liabilities and earnings of the issuer, had the transaction been undertaken at the commencement of the period being reported on or at the date reported. This requirement is set out in Annex I, Item 20.2 of Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing the Prospectus Directive (the PD Regulation).

3. The PD Regulation states that the requirement set out in Annex I, Item 20.2 will normally be satisfied by the inclusion of pro forma financial information. The PD Regulation stipulates:
   - what information is to be presented and how; and
   - the scope of the report prepared by independent accountants (in the UK, reporting accountants) or auditors that must accompany the pro forma financial information.

4. Section 2.1 of this Technical Release includes a more detailed explanation of what constitutes a 'significant gross change'.

5. Pro forma financial information may also be considered useful in the case of transactions other than significant gross changes. An example might be an issue of capital on an initial public offering or a subsequent rights issue, open offer or placing when the purpose of pro forma financial information may be to illustrate the reduction in gearing that results from the application of the proceeds of the issue in repaying debt. Such pro forma financial information is, by its nature, included in a prospectus on a voluntary basis, and it is a matter for the issuer's judgement as to whether to include any such pro forma information at all, and if so, whether it should cover assets and liabilities, or earnings, or both. The pro forma financial information must nevertheless, when it is prepared, be prepared in accordance with the requirements of Annex II of the PD Regulation.

6. The requirement in Annex I, Item 20.2 is also repeated under:
   - Annex XXIII Proportionate Schedule for Minimum Disclosure Requirements for the Share Registration Document for Rights Issues, Item 15.2; and
   - Annex XXV Proportionate Schedule for Minimum Disclosure Requirements for the Share Registration Document for SMEs and companies with reduced market capitalisation, Item 20.2.

1.3 Other rules

7. Listing Rule 13.4.1R (5) requires in the case of a Class 1 transaction, a statement of the effect of the acquisition or disposal on the group's earnings and assets and liabilities. This rule, although similar to the requirement in Annex I, Item 20.2, does not mandate the use of pro forma financial information. If, however, a listed company includes pro forma financial information in a Class 1 circular (or a related party circular or a circular relating to the purchase by the company of 25% or more of its issued equity shares (excluding treasury shares)), Listing Rule 13.3.3R requires it to comply with the requirements for pro forma financial information set out in Annex II of the PD Regulation. Such voluntary pro forma financial information is frequently limited to the impact on the group's assets and liabilities, with the impact on earnings being dealt with by way of a narrative statement, as described in appendix 1 to this Technical Release. If the issuer is also required, in the context of a Class 1 transaction, to produce a prospectus, the requirements in Annex I, Item 20.2 will take precedence and the impact on earnings will need to be included in the prospectus.

1 Article 4, Prospectus Directive.

8. Pro forma financial information may be included in admission documents by applicants to the Alternative Investment Market (AIM) and the ICAP Securities and Derivatives Exchange (ISDX) Growth Market. There are no specific requirements for inclusion of pro forma financial information in admission documents. Unless the admission document is also a prospectus, the PD Regulation requirements concerning pro forma financial information do not apply.

1.4 Scope and application of the guidance

9. This guidance provides commentary and practical help for preparing pro forma financial information that complies with the requirements in the PD Regulation, including the criteria for pro forma financial information in Annex II, and relevant ESMA Recommendations. This guidance is underpinned by the principle that pro forma financial information should not be misleading in the context of the investment circular in which it is presented. Section 2.2 discusses this principle.

10. This guidance may also be useful in situations where there are no regulatory requirements governing preparation of pro forma financial information.

11. This guidance does not address the work performed by the reporting accountant, although the reporting accountant has regard to the criteria for pro forma financial information in Annex II in the process of reaching an opinion required by Annex II.

1.5 Terms used in the guidance

12. For ease of explanation, reference has been made to International Financial Reporting Standards (IFRS) throughout this guidance. However, it is recognised that other financial reporting standards may be applicable to the preparation of the financial information that forms the basis for the pro forma financial information to which this guidance applies. It is therefore necessary to consider any explanation that refers to IFRS in the light of the relevant financial reporting standards employed in preparing the unadjusted financial information and to be aware that the guidance given may not be directly applicable where those standards are different.

13. The guidance uses the names of financial statements as they are referred to in IFRS. Hereafter the guidance refers to 'statement of financial position' instead of 'balance sheet' and to 'statement of profit or loss and other comprehensive income' or 'statement of profit or loss' instead of 'profit and loss account'. However, where the guidance refers to disclosure requirements or guidance from other sources such as the PD Regulation or other guidance, the terminology used is consistent with the underlying material.

14. The term investment circular, when used in the guidance, refers to a prospectus where the PD Regulation is applied by European legislation or to a circular to which the PD Regulation provisions relating to pro forma financial information are applied by the Listing Rules.

15. The party responsible for the investment circular and the preparation and presentation of pro forma financial information contained within it, is referred to in the guidance as the issuer.

16. The term Annex, when used in the guidance, refers to an annex of the PD Regulation.

1.6 Structure of the guidance

17. Each of the sections that follow addresses a specific theme relating to pro forma financial information.

- Section 2 focuses on the requirement for information.
- Section 3 includes guidance on the presentation of information.
- Section 4 provides commentary and guidance on adjustments made to historical information to illustrate the effect of the transaction.

18. The guidance reproduces regulatory provisions related to pro forma financial information and sets out commentary and/or analysis of market practice for each of these themes.

19. Appendix 1 contains guidance on narrative descriptions of the effect of the transaction on the assets and liabilities and earnings of the company where pro forma financial information is not feasible or may not be a fair way to describe the effect of a transaction that is a significant gross change.

2. Requirement for information

2.1 Definition, guidance and market practice

PD Regulation

Annex I Minimum Disclosure Requirements for the Share Registration Document (schedule)

Item 20. Financial Information Concerning The Issuer's Assets And Liabilities, Financial Position And Profits And Losses

Item 20.2. Pro forma financial information

In the case of a significant gross change, a description of how the transaction might have affected the assets and liabilities and earnings of the issuer, had the transaction been undertaken at the commencement of the period being reported on or at the date reported.

This requirement will normally be satisfied by the inclusion of pro forma financial information.

This pro forma financial information is to be presented as set out in Annex II and must include the information indicated therein.

Pro forma financial information must be accompanied by a report prepared by independent accountants or auditors.

20. Recital 9 of the PD Regulation defines a 'significant gross change' as a variation of more than 25% relative to one or more indicators of the size of the issuer's business, in the situation of an issuer due to a particular transaction, with the exception of those situations where merger accounting is required.

21. ESMA has guidance on pro forma financial information in the ESMA Recommendations, which will be taken into account by the FCA in determining whether an issuer has complied with the PD Regulation.

22. Common supervisory approaches and practices towards the preparation of pro forma financial information are included in the ESMA publication, *Questions and Answers, Prospectuses* (ESMA Q&A). This publication includes confirmation that an issuer can voluntarily include pro forma financial information in a prospectus and that such voluntary pro forma financial information must be prepared according to Annex II.

23. The term 'transaction' covers both a transaction which has already occurred and a proposed transaction which has not yet taken place but where the issuer has made a significant commitment, such as a significant financial commitment.[2] A transaction which has already occurred will include one which has occurred since the beginning of the most recently completed financial period for which historical financial information has been published.

24. For the purposes of interpreting Annex I, Item 20.2, the FCA has clarified that a transaction is restricted to an acquisition or disposal. Other events, such as equity or debt raisings, are not in themselves significant gross changes. The UKLA Technical Note 633.1 *Pro forma financial information*, published for consultation by the FCA in August 2014, provides further guidance on what constitutes a significant gross change and on when pro forma financial information is required and when it is voluntary. Where pro forma information is required in a prospectus because a significant gross change has occurred, it must deal with the effect on assets and liabilities and earnings, which would generally mean that a net asset statement and statement of profit or loss would be presented. If there is no significant gross change and pro forma financial information is presented voluntarily in a prospectus or circular, it may only deal with assets and liabilities but is still required to comply with Annex II of the PD Regulation.

2 ESMA Q&A question 50.

ESMA Recommendations

ESMA Recommendations clarify and expand on certain terms used in Annex II Pro forma financial information building block. Relevant clarifications are reproduced together with the paragraph references in ESMA Recommendations.

In order to assess whether the variation to an issuer's business as a result of a transaction is more than 25%, the size of the transaction should be assessed relative to the size of the issuer by using appropriate indicators of size prior to the relevant transaction. A transaction will constitute a significant gross change where at least one of the indicators of size is more than 25% (paragraph 91).

A non-exhaustive list of indicators of size is provided below (paragraph 92):

- total assets
- revenue
- profit or loss

Other indicators of size can be applied by the issuer especially where the stated indicators of size produce an anomalous result or are inappropriate to the specific industry of the issuer, in these cases the issuers should address these anomalies by agreement of the competent authority (paragraph 93).

The appropriate indicators of size should refer to figures from the issuer's last or next published annual financial statements (paragraph 94).

25. The PD Regulation states that the requirement to describe the effects of a significant gross change will normally be satisfied by the inclusion of pro forma financial information. In cases where the inclusion of pro forma financial information in the prospectus is not feasible or might not be a fair way to describe the effect of the transaction, issuers will still have to comply with the requirement under Annex I, Item 20.2 (ie, by providing a narrative description) but would not have to follow Annex II. This is confirmed in question 50 of ESMA Q&A.

26. Listing Rule 13.4.1(5) requires that a Class 1 circular includes a statement of the effect of the transaction on the issuer's earnings and assets and liabilities. If there is no requirement to produce a prospectus in the context of the transaction (in which event the requirements of Annex I, Item 20.2 will take precedence) pro forma net asset information is often presented in a Class 1 circular as a means to comply with requirement of Listing Rule 13.4.1(5) so far as it relates to assets and liabilities. The description of how the transaction might have affected the earnings of the issuer is usually satisfied by a narrative description.

27. Appendix 1 includes guidance for issuers who are not able to present pro forma financial information and are instead required to satisfy the requirements by providing a narrative description.

2.2 Characteristics of pro forma financial information

28. Because pro forma financial information is a hypothetical illustration of the impact of a transaction (or transactions) on the issuer's assets and liabilities or earnings, it does not represent a company's actual financial position or results. Furthermore, pro forma financial information does not purport to represent what the issuer's actual financial position or results would have been had the transaction occurred at the date assumed for the purpose of its preparation.

29. The preparer of pro forma financial information makes use of information that is already available to the issuer and which has been prepared for other purposes. Such information may come from different sources and relate to different dates or periods, and may not, therefore, be consistent or directly matched. The resultant illustration needs to be read in the context of the general limitations on its preparation and its necessarily limited objective, as well as in the light of any specific limitations disclosed within the pro forma financial information. These limitations may include the omission of relevant adjustments because they do not meet one or more of the regulatory criteria. The illustration should also be read in the light of the investment circular as a whole.

2.2.1 'Not misleading' principle

30. The principle that information should not be misleading, while not explicit in the PD Regulation, can be traced across legal and regulatory requirements and is evident, for example, in section 90(1) of the Financial Services and Markets Act 2000 which establishes the liability of a person responsible for a prospectus to any person who suffers loss as a result of, inter alia, a misleading statement.

31. The 'not misleading' principle is also important to the reporting accountant engaged under the PD Regulation to report on pro forma financial information as it is found in:

   - paragraph 46 of Standard for Investment Reporting (SIR) 4000, *Investment Reporting Standards Applicable to Public Reporting Engagements on Pro Forma Financial Information*, published by the Financial Reporting Council; and

- paragraph 26(b) of International Standard for Assurance Engagements (ISAE) 3420, *Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus*, published by the International Auditing and Assurance Standards Board.

2.2.2 Judging whether information is misleading

32. The requirement that pro forma financial information is not misleading does not imply that it reflects the actual effect of the transaction. To enable issuers to judge whether pro forma information is misleading, they need to identify the purpose of that information. Historical and forecast financial information is part of a range of information that investors use to decide what assessment to make and what action to take, if any, in response to the investment circular. Pro forma financial information provides investors with illustrative information about the impact of proposed transactions on historical information and so may provide some assistance in their assessment. In judging whether pro forma financial information is misleading, an issuer should consider, among other things, the relevance of the information to any assessment being made and the actions to be taken on the basis of the investment circular.

33. In making their judgement, issuers consider the pro forma financial information as a whole having regard to each of the components of the information set out below, within the context of the transaction or transactions that the pro forma financial information is illustrating.

    - The introductory narrative explaining the purpose and nature of the pro forma financial information.
    - The statements, formats and captions selected for presentation.
    - The historical unadjusted information, the pro forma adjustments and the resulting pro forma financial information.
    - The notes explaining, inter alia, the sources of information and basis for the adjustments.

34. Even where pro forma financial information satisfies the regulatory conditions relating to its preparation, it could still be misleading if it gives users of the investment circular a view of the effect of the transaction on the unadjusted information contrary to that which ought reasonably to be given if the illustration appropriately reflects the effect and, thereby materially affects users' assessment of the transaction. The action of 'standing back' and considering pro forma financial information having regard to the matters referred to in the preceding paragraphs can safeguard against this risk.

3. Presentation of information

3.1 Introductory text

PD Regulation

Article 5 (extract)

Pro forma financial information should be preceded by an introductory explanatory paragraph that states in clear terms the purpose of including this information in the prospectus.

ANNEX II Pro forma financial information building block

Item 1

The pro forma information must include a description of the transaction, the businesses or entities involved and the period to which it refers, and must clearly state the following:

a) the purpose to which it has been prepared;

b) the fact that it has been prepared for illustrative purposes only;

c) the fact that because of its nature, the pro forma financial information addresses a hypothetical situation and, therefore, does not represent the company's actual financial position or results.

35. The introductory text to pro forma financial information typically contains statements describing the transaction and explaining:

- that the pro forma financial information has been prepared for illustrative purposes only, and in accordance with Annex II of the PD Regulation;
- that the pro forma statement of profit or loss has been prepared to illustrate the effect on the issuer for the stated period as if the proposed transaction had taken place on the first day of the period;
- that the pro forma net assets statement or pro forma statement of financial position has been prepared to illustrate the effect on the net assets or financial position of the issuer as if the proposed transaction had taken place on the date of the issuer's statement of financial position;
- that, because of its nature, the pro forma financial information addresses a hypothetical situation and therefore does not represent the actual financial position or results following the transaction; and
- the source of the unadjusted financial information from which the pro forma financial information has been prepared.

3.2 Identifying the purpose of pro forma financial information

36. Disclosure of the purpose for which pro forma financial information is prepared is fundamental to its presentation. The purpose of pro forma financial information is to illustrate the effects of one or more transactions on certain unadjusted financial information or aspects of that information. It should therefore clearly identify the specific transactions and unadjusted financial information involved.

37. Where the purpose is to illustrate the effect on assets and liabilities, the unadjusted financial information involved is usually a net assets statement or, sometimes, a statement of financial position. Where the purpose is to illustrate the effect on earnings, the unadjusted financial information involved is usually a statement of profit or loss.

PD Regulation

ANNEX II Pro forma financial information building block

Item 2

In order to present pro forma financial information, a balance sheet and profit and loss account, and accompanying explanatory notes, depending on the circumstances may be included.

38. Where financial information that gives a true and fair view is available for an issuer, the issuer could choose to illustrate the effect of a transaction on all that information. However, it would be highly unusual for an issuer to prepare pro forma information comprising a complete set of financial statements. The provision of more than the primary financial statements could actually frustrate the purpose of the information and give a false impression of its reliability. Issuers should nonetheless consider whether the provision of additional pro forma financial information would serve a useful purpose and whether the selection of specific items for presentation could itself be misleading.

39. Annex I, Item 20.2 refers to the effect on assets and liabilities and it is practice to present a pro forma net assets statement. While Annex II, Item 2 refers to a balance sheet being presented, it is usually the case that the impact of adjustments on the equity balances of the issuer is not significant to the purpose of the pro forma financial information or to an understanding of it.

40. Pro forma financial information must give effect to a transaction as if the issuer had undertaken the transaction, in the case of a statement of profit or loss, at the commencement of the earliest period being reported on (first day of the period) or, in the case of a pro forma statement of financial position or net assets statement, at the date of the unadjusted financial information.

41. A consequence of the requirement in the paragraph above is that a pro forma statement of financial position or net assets statement does not reflect the cumulative impact of pro forma statement of profit or loss adjustments. By way of example, it is appropriate to assume for the purposes of a pro forma statement of profit or loss that adjustments will be made on the basis that the proceeds of a share issue or a disposal are received at the beginning of the period. The proceeds might then be applied to the repayment of debt so that interest costs are reduced. However, a pro forma statement of financial position at the end of the period will not reflect the benefits of reduced interest costs since, in preparing the pro forma statement of financial position, the issuer assumes that it only receives the proceeds at the statement of financial position date.

3.3 Presentation of multiple significant gross changes

42. The purpose of pro forma financial information is to illustrate the effect of a specific transaction which is a significant gross change on the assets and liabilities or earnings of an issuer. Where there has been another significant gross change which would also give rise to a requirement for pro forma financial information, it will be necessary to consider how to deal with that additional transaction.

43. The clearest way to illustrate the transactions may vary from case to case. Depending on the number of transactions and their nature, it may be appropriate to illustrate by way of:

- separate tables for each transaction;
- separate tables for each transaction and then a combined table; or
- one combined table.

44. The approach adopted may differ depending on whether the transactions are completed transactions or proposed transactions. Where the transactions have all completed, the pro forma financial information would generally illustrate the combined impact of the transactions. Where transactions are proposed transactions, and where these transactions are not independent of each other (that is, where either all of the transactions will proceed or none of them will), the pro forma financial information would also generally illustrate the combined impact of the transactions. Where the proposed transactions are independent of each other, the pro forma financial information might illustrate separately the adjustments and impact on the issuer relating to each transaction on an individual basis, and additionally illustrate the impact on a combined basis.

3.4 Dealing with fundraisings

45. As noted in paragraph 24, a fundraising is not of itself a significant gross change for the purposes of the PD Regulation. Nevertheless, where an issuer is preparing pro forma financial information to reflect a significant gross change and has, since the date assumed for the purposes of the pro forma financial information undertaken a major fundraising, it may be necessary for that fundraising to be reflected so that the pro forma financial information is not misleading. For example, where a proposed acquisition is to be funded in part from the proceeds of an equity issue made subsequent to the last year end, but prior to the proposed acquisition, it would be appropriate to present as an adjustment in a pro forma net asset statement the receipt of the proceeds from the equity issue.

3.5 Presenting supplemental information

Pro forma ratios and other measures

46. An issuer may include as part of its pro forma financial information specific measures such as financial key performance indicators (KPIs) and regulatory ratios such as ones that it includes in its annual financial statements.

47. When illustrating the impact of pro forma adjustments on ratios and KPIs, the issuer should clearly explain those ratios and indicators and consider whether their presentation serves a useful purpose and is not misleading. The issuer should present the unadjusted financial ratios and KPIs and the pro forma financial ratios and KPIs on a consistent basis with the rest of the pro forma financial information. The source of information used for the unadjusted financial ratios and KPIs should be the same as is used for the unadjusted financial information shown in the principal pro forma financial information. The same considerations would apply to regulatory ratios such as those presented by financial services issuers.

Pro forma financial information based on supplemental historical financial information

48. An issuer may decide on a voluntary basis to include, in addition to the pro forma financial information required to be presented in order to comply with Annex I, Item 20.2, other pro forma information to show the impact of the identified transactions on supplemental unadjusted historical financial information. This might be the case where an issuer routinely reports financial information externally under more than one basis, for example where it reports both under IFRS and under local financial reporting standards. In these circumstances this additional set of pro forma financial information is presented on a standalone basis, distinct from the regulatory pro forma financial information and in compliance with Annex II. An example of other pro forma financial information is embedded value pro forma information presented by issuers who undertake life assurance business and present supplemental embedded value financial statements as part of their routine external financial reporting.

49. Pro forma financial information based on supplemental historical financial information would be expected to be presented on a basis consistent with the presentation and policies adopted in presenting the supplemental unadjusted historical financial information. If the presentation of such pro forma information is more summarised than that of the principal pro forma financial information, the description of the adjustments would still be expected to be sufficient to explain the constituent elements of each adjustment made.

3.6 Format of pro forma financial information

PD Regulation

ANNEX II Pro forma financial information building block

Item 3

Pro forma financial information must normally be presented in columnar format, composed of:

a) the historical unadjusted information;

b) the pro forma adjustments; and

c) the resulting pro forma financial information in the final column.

The sources of the pro forma financial information have to be stated and, if applicable, the financial statements of the acquired businesses or entities must be included in the prospectus.

50. An issuer prepares pro forma financial information for inclusion in an investment circular relating to a transaction by:

    - starting from its unadjusted financial information that is included elsewhere in the investment circular or that has been previously published; and
    - making adjustments to that financial information to illustrate how it might have been affected had the transaction occurred at the date at which, or the beginning of the period for which, that financial information was prepared.

51. Annex I, Item 20.2 makes it clear that pro forma financial information is the result of adjusting the issuer's financial information at a specific date or for a particular period. Even though adjustments can be based on information related to a transaction at a different date or for a different period, the result is still described as pro forma financial information at the date or for the period covered by the unadjusted financial information of the issuer.

52. As required by Annex II, Item 3, pro forma financial information must normally be presented in columnar format where:

    - the first column shows unadjusted financial information for the issuer on which the effect of one or more transactions is illustrated;

- subsequent columns reflect adjustments for the effect of the transaction or transactions. The issuer may aggregate adjustments to simplify the presentation so long as there is sufficient disclosure by way of note to explain clearly the components of each column and, where more than one transaction is involved, the separate effects of each transaction; and
- the final column displays the resultant adjusted amounts.

53. Annex II, Item 3 also includes the requirement to state the sources of the pro forma financial information. Accordingly, the source of the unadjusted financial information must be identified.

3.7 Accounting policies

PD Regulation

ANNEX II Pro forma financial information building block

Item 4

The pro forma information must be prepared in a manner consistent with the accounting policies adopted by the issuer in its last or next financial statements and shall identify the following:

a) the basis upon which it is prepared;

b) the source of each item of information and adjustment.

54. The policies adopted for pro forma financial information will be those in the unadjusted information of the issuer.

55. The requirement to prepare the pro forma financial information in a manner consistent with the accounting policies adopted by the issuer in its financial statements does not preclude simplification of the presentation where such simplification assists in a clear reading of the pro forma financial information and is consistent with the specific purpose of the pro forma information. Furthermore, the format and purpose of the pro forma financial information mean that disclosures required by the issuer's applicable financial reporting framework which are supplementary to those contained in the primary financial statements do not normally form part of an issuer's pro forma financial information.

Application of acquirer's policies on an acquisition

56. The requirement to apply the issuer's accounting policies in preparing pro forma financial information applies to adjustments made concerning an acquisition target. Unless Listing Rule 13.5.27R applies (broadly applicable where the target is a publicly traded company), the historical financial information for a Class 1 acquisition target will be prepared under Listing Rule 13.5.4R(1) in a form that is consistent with the accounting policies adopted by the issuer in its latest annual consolidated accounts. If Listing Rule 13.5.27R applies, the target's historical financial information will be presented under its own accounting policies together, if necessary, with a reconciliation of such financial information to reflect the policies of the acquirer. Although the Listing Rules do not prescribe the format of a reconciliation, the issuer will generally ensure that it includes any amounts that are relevant to the presentation of pro forma financial information.

57. Difficulties in presenting pro forma financial information are more likely to arise in contested bids when the directors of a proposed acquisition target choose not to recommend the issuer's offer to its shareholders and, in doing so, refuse or severely limit access to information relevant to the target.

58. In the UKLA Technical Note 305.1[3], the FCA notes that 'We would not normally expect to see pro forma financial information included in a circular where an offeror does not have access to the relevant offeree information. This is because it is not normally possible for the reporting accountants to confirm … that the information is compiled on a consistent basis with the accounting policies of the issuer.'

59. The requirement to prepare pro forma financial information on a consistent basis with the accounting policies of the issuer is exclusively the responsibility of the issuer, and it is the issuer's inability to obtain the evidence needed to prepare the pro forma financial information on the required basis that precludes its preparation. The UKLA Technical Note 305.1 goes on to explain that, in these cases, the UKLA would expect the disclosure obligation to be addressed via a narrative description covering the expected effect of the takeover or merger on the earnings or assets and liabilities of the group rather than through the use of pro forma financial information. Appendix 1 to this Technical Release contains guidance on such narrative descriptions.

3 The FCA published UKLA Technical Note 305.2 *Hostile Takeovers* for consultation in November 2014.

3.8 Accounting periods

PD Regulation

ANNEX II Pro forma financial information building block

Item 5

Pro forma information may only be published in respect of

a) the current financial period;

b) the most recently completed financial period; and/or

c) the most recent interim period for which relevant unadjusted information has been or will be published or is being published in the same document.

60. Where a pro forma statement of profit or loss is presented for an acquisition, the unadjusted information about the issuer and the adjustments in respect of the acquired entity should cover periods of the same length.

61. While desirable, it is not normally necessary to use coterminous accounting periods when preparing a pro forma statement of profit or loss to illustrate the effect on an acquisition. For example, an issuer may be preparing a pro forma statement of profit or loss based on its latest 31 December year-end results for inclusion in a circular for a Class 1 acquisition. If a 12-month statement of profit or loss and other comprehensive income for the business to be acquired is only available up to 30 June prior to the latest 31 December year end, that information could generally be used for the purpose of making an adjustment to derive a pro forma statement of profit or loss.

62. Even where businesses are seasonal, the use of non-coterminous accounting periods would not usually distort a pro forma statement of profit or loss as long as all the information covers a complete year. Nevertheless, where pro forma financial information is presented for an interim period and seasonal factors are significant, coterminous accounting periods may be required to prevent the pro forma financial information from being misleading.

63. In cases where coterminous financial information for a target is not available to an issuer, but the issuer nevertheless wishes to present its pro forma financial information using coterminous financial information, it may be possible for the non-coterminous financial information of the target to be re-presented on a coterminous basis by the addition and subtraction of relevant period financial information derived from interim or quarterly financial information, or in some cases, management accounts information. Disclosure of the relevant adjustments will usually be included in the notes to the pro forma financial information.

64. Non-coterminous accounting periods may also be of concern when preparing pro forma net assets statements or statements of financial position. An issuer needs to consider any significant seasonal variations, or transactions between the respective balance sheet dates, that would cause the pro forma financial information to be misleading. In the situation of an acquisition it might not be appropriate to make adjustments to an acquirer's 31 December information using information relating to the preceding 30 June for the acquired business if it is known that seasonal factors would make the financial position of the acquired business significantly different at 31 December. The issuer should consider whether additional explanatory information would prevent the pro forma financial information from being misleading.

4. Adjustments

4.1 The nature of adjustments

4.1.1 General considerations

65. Issuers will need to determine which adjustments are necessary in order to illustrate the effect of the transaction for the purposes of the pro forma financial information. Annex II, Item 6 sets out the criteria for adjustments (reproduced below). Issuers should ensure that the adjustments that are considered to be necessary do not create an impression that is materially biased or one-sided.

66. In considering adjustments to illustrate the effect of a transaction, issuers should give consideration to the full effect of that transaction in the context of the illustration. For example, where the purpose of pro forma information is to show the potential effect of an acquisition on asset backing and profitability, it would be inconsistent and incomplete to include property, plant and equipment in a net assets statement at their fair values without reflecting depreciation charges based on those values in any pro forma statement of profit or loss.

67. Similarly, it would be inconsistent and incomplete to illustrate an identified cost reduction without reflecting a consequential cost increase or revenue reduction. For example, where the proceeds of a disposal will be used to fund a debt repayment and this leads to a pro forma adjustment to reduce interest expense, the issuer should also reflect any related increase in its tax charge. Adjustments will not include items such as synergies which relate to future actions. The treatment of synergy benefits is discussed in section 4.2.5 of this Technical Release.

68. In considering which adjustments to make, issuers take into account the concept of materiality and focus on those adjustments which are material to the purpose of the illustration. By making adjustments for immaterial items, directors may give a false impression of the precision and reliability of the resulting pro forma information and detract from disclosures they make under Annex II, Item 1 about the nature and limitations of the information. Nevertheless, issuers should bear in mind that the materiality of an item is determined not only by its size but also by the qualitative factors of its nature and circumstances.

PD Regulation

ANNEX II Pro forma financial information building block

Item 4 (extract)

The pro forma information … shall identify … the source of each … adjustment.

Item 6

Pro forma adjustments related to the pro forma financial information must be:

a) clearly shown and explained;

b) directly attributable to the transaction;

c) factually supportable.

In addition, in respect of a pro forma profit and loss or cash flow statement, they must be clearly identified as to those expected to have a continuing impact on the issuer and those which are not.

ESMA Recommendations

ESMA Recommendations clarify and expand on certain terms used in Annex II Pro forma financial information building block. Relevant clarifications are reproduced together with the paragraph references in ESMA Recommendations.

'Factually supportable': the nature of the facts supporting an adjustment will vary according to the circumstances. Nevertheless, facts are expected to be capable of some reasonable degree of objective determination. Support might typically be provided by published accounts, management accounts, other financial information and valuations contained in the document, purchase and sale agreements and other agreements to the transaction covered by the prospectus. For instance, in relation to management accounts, the interim figures for an undertaking being acquired may be derived from the consolidation schedules underlying that undertaking's interim statements (paragraph 87).

'Directly attributable to transactions': pro forma information should only reflect matters that are an integral part of the transactions which are described in the prospectus. In particular, pro forma financial information should not include adjustments which are dependent on actions to be taken once the current transactions have been completed, even where such actions are central to the issuer's purpose in entering into the transactions (paragraph 88).

4.1.2 Clearly shown and explained

69. It is important that issuers clearly show and explain adjustments so that investors can understand those adjustments. It is also a requirement to identify the source of the adjustment.

70. Disclosure of the adjustments will involve a combination of the columnar presentation and information presented in the notes. While having a separate column for each adjustment may be desirable in the interest of greatest transparency, there are practical constraints on the number of columns that can be presented in a conventional document format. As a consequence, where there are more than a few potential individual adjustments, it is normal for the adjustment columns to contain information, with varying degrees of aggregation, reflecting more than one adjustment. In such cases more detail of the basis for the aggregated numbers will be presented in the notes.

71. When presenting the adjustments, the column headings and/or the notes to the pro forma financial information will be designed to achieve a number of objectives, including:

- reference to the purposes of the adjustment;
- details of the sources of the amounts concerned (in some cases this may be achieved by referring to information set out elsewhere in the investment circular);
- where relevant, how adjustments have been aggregated or allocated to financial statement captions; and
- where alternative outcomes are possible, explanation of the basis adopted for the purposes of the pro forma financial information.

72. The level of detail provided in relation to an adjustment may vary. In some cases, such as where the adjustment reflects the addition or subtraction of the net assets of the business to be acquired or disposed of, the purpose will be clear from the context and no further explanation will typically be given. In other cases, for example where the deal structure involves the retention of certain assets or liabilities, more detailed disclosure may be required concerning what the adjustment relates to.

73. The sources of the adjustment may be specifically identified by cross reference, such as in the case of the financial information relating to a business to be acquired or disposed of. Alternatively, information that is contained elsewhere in the investment circular may be repeated, for example details of the expected consideration for the transaction.

74. In some cases adjustments presented may comprise the aggregate or net result of a number of adjustments. An example might be an adjustment to reflect the net proceeds of a fundraising or disposal, which is made up of the gross proceeds after deducting the costs of the fundraising or disposal. Disclosure of the two elements of the net figure would be made in the notes. Where proceeds are stated to be used in part to repay borrowings and in part for general corporate purposes, the notes may explain how the apportionment between borrowings and cash has been determined.

75. Where the form and/or amount of consideration is uncertain, for example whether to receive consideration in the form of cash or shares, the notes will describe how the existence of the choice uncertainty has been dealt with for the purposes of the pro forma financial information (see paragraphs 85–88).

4.1.3 Directly attributable to the transaction

76. The purpose of the requirement that adjustments are directly attributable to the transaction concerned is to prevent pro forma financial information reflecting matters relating to the transaction that are not an integral part of the transaction. In particular, pro forma financial information should not include adjustments which are dependent on actions to be taken once the transaction has been completed, even where such actions are central to the issuer's purpose in entering into the transaction, for example eliminating duplicate facilities after an acquisition.

4.1.4 Factually supportable

77. In order to provide assurance as to the reliability of pro forma financial information, adjustments must be supported by facts. The nature of the facts supporting an adjustment will vary according to the circumstances. Nevertheless, facts are expected to be capable of some reasonable degree of objective determination. Support might typically be provided by published accounts, other financial information and valuations contained in the investment circular, purchase and sale agreements and other agreements integral to the transaction covered by the investment circular.

78. Issuers may be aware of the need to make an adjustment while lacking the appropriate factual support to satisfy Annex II, Item 6. In these circumstances, they should bear in mind the stated purpose of the pro forma financial information and consider whether disclosing the omission of the adjustment will be sufficient to prevent the pro forma financial information from being misleading.

79. Where disclosure will not suffice, issuers should either make further efforts to obtain appropriate support or reconsider whether the use of the pro forma financial information to achieve its stated purpose is realistic. Preparers of pro forma financial information should not lose sight of the fact that where the pro forma financial information is included on a voluntary basis, there may be alternative ways of providing information to users of the investment circular, which may include presenting a narrative description. This is particularly important where pro forma financial information may be misleading for reasons that are beyond the control of the preparer. As in other areas of financial reporting, there is sometimes a trade-off between the relevance and reliability of financial information. This may mean that an issuer does not report information that may be relevant because it is not sufficiently reliable. Where Annex I, Item 20.2 applies, the issuer will need to discuss with the UKLA whether the circumstances are such that a dispensation from presenting pro forma financial information will be permitted.

4.1.5 Continuing effects

80. For a pro forma statement of profit or loss, Annex II, Item 6 requires issuers to identify clearly those adjustments which are expected to have a continuing effect on the issuer and those which are not.

81. Ultimately it is the responsibility of investors to make their own individual assessments of future earnings and cash flows. Consequently it is recommended that an issuer interprets the requirement of Annex II, Item 6 in line with the requirements of International Accounting Standard (IAS) 1 *Presentation of Financial Statements,* IAS 7 *Statement of Cash Flows* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which cover appropriate disclosure of the results of continuing and discontinued operations and items of income or expense which are material. Adjustments related to discontinued operations will not have a continuing effect and should be disclosed as such. Other items should be considered on a case-by-case basis.

82. For the purposes of a pro forma statement of profit or loss, the relevant transaction is assumed to have been undertaken at the commencement of the period being reported on. As a consequence it is normally necessary to regard costs attributable to the transaction as falling to be accounted for in the period to which the pro forma statement of profit or loss relates. Where such items affect the statement of profit or loss, it would be normal to identify them as items which will not have a continuing effect.

4.2 Issues encountered in making adjustments

83. The paragraphs in section 4.2 describe the application of Annex II, Item 6 to a number of matters that may need to be addressed when considering adjustments in pro forma financial information.

4.2.1 Transaction costs

84. An adjustment should be made for costs directly attributable to a transaction that do not relate to future events or decisions and are factually supportable. Sufficient factual support can normally be given by written estimates from advisers which are provided to support estimated transaction costs that are disclosed in total elsewhere in an investment circular.

4.2.2 Consideration in cash or shares

85. It may be necessary to make an assumption where there is choice as to the form in which consideration is received or paid. For example, in a public takeover it may not be possible to determine in advance the extent to which a mixed cash and shares offer would be taken up in cash or shares. Consequently an issuer will need to make an assumption about the mix and state that assumption clearly. Any assumption that is made would be determined by the issuer in conjunction

with its financial advisers and would need to represent an appropriate basis given the stated purpose of the pro forma financial information. Where the actual outcome could differ materially from that reflected in the pro forma financial information, this should be explained in the notes and, where possible, a quantitative indication of the possible impact on the pro forma financial information given.

86. Where the consideration for an acquisition will be settled by the issue of a specified number of shares, it is necessary to determine which share price should be used to calculate the adjustment. In the subsequent financial statements it is most likely that the issue of shares will be recorded by reference to their value at the date of their issue. This value will not be known when the pro forma financial information is prepared. The most appropriate value to use is therefore the value at the most recently practicable date as this is likely to be the best indication of the effect of the transaction.

4.2.3 Contingent consideration

87. To the extent that consideration is payable or receivable in the future and is dependent on the outcome of future events, the issuer needs to make an appropriate assumption concerning the most likely amount to be paid. This does not violate ESMA Recommendations (paragraph 89) on not making adjustments relating to future events provided it is consistent with the accounting policies of the acquiring entity. The need to make a best estimate of the amount of contingent consideration that is payable or receivable is a direct consequence of an acquisition or disposal. It would be appropriate to explain, by way of a footnote, that any difference between the estimate and the amount paid will result in a change to the pro forma net assets. The relevant future events determine how accurate such an accounting estimate turns out to be but do not determine whether an estimate needs to be made. Where initial estimates are subject to potentially significant subsequent changes, issuers will need to ensure that appropriate disclosure is made in the notes to the pro forma financial information.

88. It may appear prudent to assume that the maximum amount payable under an acquisition agreement will be paid or that the minimum amount receivable under a sale agreement will be received. However, the overriding requirement is to apply the accounting policies of the acquiring entity, which is likely to require that an appropriate estimate is made given the stated purpose of the pro forma financial information. In circumstances where the impact of paying or receiving additional consideration could be significant, a similar approach to that described in section 4.2.2 should be adopted in dealing with such uncertainty.

4.2.4 Price adjustments

89. There may be occasions where the purchase price will be determined by adjusting a base figure for changes in certain balance sheet measures, such as net assets or net debt, that occur between an agreed reference date and a completion balance sheet date. Such adjustments to the purchase price may include dividend payments or the settlement of inter-company balances where the intention is to impact the final transaction price and/or the value that the vendor will realise from the transaction.

90. The base figure for the purchase price used as a basis for the adjustment will normally reflect a reasonable indication of the current expectation of the eventual price and would not ordinarily reflect any anticipated price adjustment. However, where an event that would give rise to a price adjustment has occurred at the time that the pro forma information is prepared, consideration should be given as to whether adjusting for that event is necessary to illustrate the financial impact of the acquisition/disposal and, if it is, an appropriate adjustment should be made.

4.2.5 Synergy benefits

91. It is often the case that acquisitions are justified in terms of the synergies to be obtained from bringing two businesses together, either through savings in costs or through enhanced cross-selling of products and services. Synergies are normally dependent on the future actions of the management of the enlarged group after completion of the transaction.

92. Consequently, synergies should not be the subject of adjustments made in preparing pro forma financial information, although it may be appropriate to indicate opportunities for synergy benefits elsewhere in the investment circular.

4.2.6 Cost and revenue eliminations and intercompany balances and trading

93. When considering the bringing together of two or more businesses on an acquisition, it is sometimes possible to identify past costs or revenues that will not occur in future financial periods under the terms of the transaction. For example, levels of remuneration paid prior to an acquisition can be inconsistent with agreements entered into at the time of such transactions. While it may be reasonable to consider eliminating such costs as an adjustment in a pro forma statement of profit or loss, they will often need to be offset against increases in other costs which the issuer will incur that are not capable of being factually supported. In such circumstances issuers should disclose past costs or revenues which will not occur in future by way of a footnote to the pro forma financial information or by highlighting them within the unadjusted financial information on the face of the pro forma statement of profit or loss instead of eliminating them through pro forma adjustments.

94. Where there are significant balances between the issuer and the target, or there has been significant trading between the issuer and the target, issuers should consider their impact on the pro forma financial information. To the extent that such balances or trading are readily identifiable, adjustments may be needed to the unadjusted financial information or other appropriate disclosure made as a footnote so that the pro forma financial information is not misleading.

4.2.7 Foreign currency translation

95. It may be necessary to translate adjustments into the reporting currency of the issuer. For a pro forma net assets statement or statement of financial position, the rate applied would usually be the rate ruling at the date of the issuer's unadjusted statement of financial position, even if the target statement of financial position has been drawn up to a different date. In these circumstances consideration should be given as to whether using the exchange rate at the date of the acquirer's statement of financial position could give rise to an anomalous result because, for example, significant assets and/or liabilities of the target were denominated in the reporting currency used by the acquirer and there had been significant movements in the relevant exchange rate between the respective statement of financial position dates.

96. For a pro forma statement of profit or loss, the issuer would adopt its normal translation policy for subsidiaries. If the issuer uses an average rate, the rate applied for the purposes of making an adjustment would normally be calculated on the basis used by the issuer in preparing its unadjusted information for the relevant period.

97. Where the consideration for a transaction is denominated in a foreign currency, it would be usual to translate the adjustment relating to the consideration using the exchange rate at the most recently practicable date. Alternatively, if the consideration for the transaction has been fixed due to hedging arrangements, it would be appropriate to apply this rate and disclose the basis for the rate applied.

4.2.8 Transaction proceeds

98. The transaction that is the subject of the investment circular may be a disposal, the effect of which is to provide proceeds that will be used to repay debt. An issuer may also issue securities for that purpose and may wish in that context to include pro forma financial information on a voluntary basis. Questions that commonly arise in determining the relevant adjustments are:

- how to allocate the proceeds of the disposal or issue to the repayment of different debt instruments when insufficient funds will be raised to repay all debt; and, conversely
- how to treat any excess of the amount to be received over the debt shown in the unadjusted financial information of the issuer; and
- how to determine the amount of the adjustment where the actual repayment is to be calculated by reference to an amount of debt at a particular date or is a fixed amount and this amount differs significantly from the amount of debt included in the unadjusted financial information that is used in preparing the pro forma financial information. Similar considerations arise where an amount of debt is being capitalised rather than being repaid.

99. Transaction proceeds should be allocated to the repayment of debt instruments on the basis of commitments stated in the document or legally binding obligations existing at the date of the document. A management intention to use the proceeds for one or more possible purposes would relate instead to future events or decisions and no consequential adjustment would be made to reduce debt balances or interest costs in the pro forma financial information. Cash which is intended to be used for general corporate purposes is generally included as an increase in cash balances. However, where the proceeds will offset short term overdrafts, the cash received may alternatively be presented as a reduction in such overdrafts. Issuers do not generally discount the proceeds to reflect them being received at the beginning of the period concerned.

100. Where the transaction proceeds result in an increase in cash balances, it is normally inappropriate to make an adjustment to reflect interest or other income which those cash balances might generate. This is because management has discretion over how to use those cash balances. Exceptions would only arise where an issuer states an intention to invest funds in a particular way which meant that it could demonstrate that income would be earned and could quantify it. Issuers should draw investors' attention to the treatment of transaction proceeds where they consider it to be of particular significance in helping investors understand the issuer's prospects.

101. A transaction may be undertaken in order to reduce a debt balance to zero. For the purposes of pro forma financial information, the amount of existing debt included in the unadjusted financial information may differ significantly from the actual amount that will be repaid or capitalised as a result of the transaction. This may occur due to other transactions, including normal trading, that have taken place since the unadjusted financial information date and are therefore not reflected in the pro forma financial information. In the case of a pro forma net assets statement, this may result in the pro forma financial information containing a residual debt balance or an excess cash balance according to whether the balance in the unadjusted financial information is greater than or less than the actual outstanding debt balance as at the date of the transaction.

102. It is not appropriate for the pro forma financial information to seek to introduce adjustments that are not directly attributable to the transaction, such as subsequent movements in balances shown in the unadjusted financial information, but the issuer may consider that in a particular situation it would be misleading not to do so (see paragraph 112 for further detail). It is also not appropriate for the pro forma financial information to introduce hypothetical transactions, such as additional payments. The objective of the pro forma financial information is not to illustrate the resultant financial position of the company, but to illustrate the effect of the actual transaction on a hypothetical basis ie, as if it had occurred at an earlier date. The issuer should consider including additional disclosure – for example, to explain that the resultant debt balance will not be indicative of the balance that would be reported immediately subsequent to the transaction taking place. As in all cases, consideration needs to be given to whether, notwithstanding the disclosures made, the pro forma financial information may be misleading.

4.2.9 Fair values

103. An issuer using IFRS that enters into a business combination will need, as a direct consequence of the transaction, to ascertain the fair values of the underlying assets and liabilities of the business that is treated as the acquired entity in accordance with IFRS 3 *Business Combinations* and IFRS 13 *Fair Value Measurement*. However, the extent of factual support for potential fair value adjustments will often be a key issue in determining whether an issuer can reflect them in pro forma financial information. Factual support may be provided through formal valuations which the issuer commissions or carries out either for commercial purposes or to satisfy other regulatory requirements in respect of the investment circular. In calculating fair values, issuers use the actual price paid or expected to be paid, determined as set out in sections 4.2.2 to 4.2.4 of this Technical Release.

104. In proposed UKLA Technical Note 633.1 *Pro forma financial information*, the FCA acknowledges that the exercise undertaken to arrive at the fair value of intangible fixed assets and the subsequent amortisation and impairment of these intangible fixed assets very often requires a degree of judgement and the use of assumptions. The FCA has indicated that purchase price allocations may be deemed to be 'factually supportable' for the purposes of adjustments in arriving at pro forma financial information ie, on a basis consistent with that which the issuer would use in its financial statements, if the issuer:

- sets out in the explanatory notes as transparently as possible the basis adopted in making the purchase price allocations;
- specifies any assumptions used;
- quotes the relevant supporting evidence, such as the sale and purchase agreement; and
- indicates, where relevant, that the purchase price allocation is preliminary and discloses what events are expected to occur to complete the exercise and the potential impact of any reallocation.

105. To ensure that pro forma financial information is not misleading, issuers should weigh the following factors when considering whether they need to record fair value adjustments.

- The nature of the acquisition and its commercial justification (eg, there is an expectation that asset-based deals would be more likely to require fair value adjustments than those involving significant amounts of goodwill).
- The extent to which uncertainties regarding fair values are commercially addressed through warranties, indemnities or adjustments to the purchase consideration (eg, the fair valuation of environmental liabilities or pension surpluses/liabilities might not be significant for a pro forma net assets statement if any fair value adjustments are compensated by changes in the consideration paid by the issuer).
- The stated purpose of the pro forma financial information and the consequential significance of any misallocation of the purchase consideration between, on the one hand, assets and liabilities that would be subject to a fair valuation exercise and subsequent amortisation and, on the other hand, goodwill. This might be significant if a pro forma statement of profit or loss were being presented.
- The likely materiality of fair value adjustments based upon the issuer's investment appraisal and acquisition due diligence.
- Any other matters described elsewhere in the investment circular that have been brought to the attention of investors and which indicate that a fair value adjustment might be material.

106. Where it has been decided that adjustments will be made to reflect fair values, consideration needs to be given as to how to obtain relevant information on which to base the adjustments. For the purpose of preparing future financial statements reflecting the actual transaction, fair values will be determined initially at the effective date of the acquisition and may then be subject to further revision. For the purposes of pro forma financial information, the issuer will need to consider whether, having regard to proposed UKLA Technical Note 633.1, there is factually supportable information relating to fair values that will be suitable as a basis for an adjustment.

107. Where such factually supportable information is available for more than one date, it will generally be appropriate to use the most recently available information on the basis that this is likely to be most indicative of the actual fair value adjustments that will be made. Where such information is only available at an earlier date (for example where an independent property valuation had been carried out at the target's balance sheet date), it may be acceptable to make adjustments based upon that information, provided that there is no evidence to suggest that there had been a change subsequent to that date such that its use would cause the pro forma financial information to be misleading.

108. A potential consequence of using valuations as at dates subsequent to the target's balance sheet date is that they may relate to assets and liabilities that are different from those reflected in that balance sheet. For example, assets may have been acquired or disposed of since the balance sheet date. Where such acquisitions or disposals are not directly attributable to the transaction, they will not have been reflected as adjustments in the pro forma financial information. As the objective of the pro forma financial information is to illustrate the effects of a specific transaction, in such circumstances consideration should be given as to whether the proposed adjustment is likely to be indicative of the actual fair value adjustment that will subsequently be made. If it is concluded that it is not, or that it is unlikely to be the case, consideration should be given as to whether a further adjustment can be made and/or disclosure included to rectify this if it is material to an understanding of the pro forma financial information.

109. Where issuers judge that fair value adjustments are unlikely to be material in the context of the stated purpose of pro forma financial information, such adjustments are not necessary. For example, where a pro forma net assets statement is intended to illustrate the impact of an acquisition on gearing, as opposed to tangible net assets per share, then any misallocation of the purchase consideration between goodwill and a fair value adjustment on properties is unlikely to be significant. In such a case issuers should make appropriate disclosure in the notes to the pro forma financial information. In other circumstances issuers may need to record fair value adjustments, supported, as appropriate, by note disclosure of their provisional nature and any related uncertainties and contingencies.

4.2.10 When the issuer is a Newco

110. In some instances a transaction may involve an issuer which is a newly incorporated holding company (Newco), created as the new parent company of an existing trading company or group (Oldco). As a consequence, in accordance with Article 4a of the PD Regulation, the investment circular will usually be required to include relevant financial information relating to Oldco. The PD Regulation notes that such information shall be deemed to relate to the issuer. Where the Newco has not traded or entered into any transactions since incorporation, issuers may be permitted not to present any financial information for Newco for inclusion in an investment circular. Instead the investment circular will usually include a statement that Newco has not traded or entered into any transactions since incorporation. Issuers may also include a statement that no financial information for Newco has been audited.

111. In the context of such a transaction, issuers may be required to include pro forma financial information in the investment circular to illustrate the effect of an acquisition. In presenting unadjusted information they may present Oldco's financial information where Newco has not traded or entered into any transactions since incorporation.

4.2.11 Reflecting other transactions

112. Issuers may wish to make adjustments to reflect other transactions which have taken place since the latest statement of financial position date but which would not be classified independently as a significant gross change or did not require a document such as a prospectus or a Class 1 circular. Issuers should consider the purpose of the information and the need for the information not to be misleading in deciding whether to make adjustments for other transactions.

113. The requirement that the resulting information is not misleading precludes cherry-picking transactions for which adjustments are made.

4.2.12 Tax and similar effects

114. Issuers should consider the tax effects of adjustments directly attributable to a transaction, along with other non-discretionary effects such as any material impact on profit-related bonuses. In quantifying tax effects, issuers should look at the incremental impact on tax liabilities and assets using their accounting policies for taxation rather than simply applying their overall effective tax rate.

4.2.13 Subsequent events

115. Other than where a subsequent event qualifies as an adjusting event under 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.

116. 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 IAS 10) 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 whether 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.

117. It is practice to draw attention to the approach taken concerning subsequent events by making a disclosure in the notes to pro forma financial information to the effect that it does not take account of any trading or transactions (other than those specified) subsequent to the date of the unadjusted information included in the pro forma information.

Appendix 1: Guidance on narrative descriptions of the effects of a significant gross change

Presentation of a narrative description

1. In certain circumstances an issuer may not be able to present pro forma financial information and, instead, may need to satisfy the requirement to describe the effects of a significant gross change by providing a narrative description of the effect of the transaction on the assets and liabilities or, as applicable, earnings of the issuer.

2. An example of where an issuer may not be able to present pro forma financial information is in the case of a contested acquisition where the issuer's access to information relevant to the target is limited and the issuer may not be able to present pro forma financial information on the basis of its own accounting policies.

Narrative description relating to the effect on assets and liabilities

3. A narrative description of the effect of a transaction on assets and liabilities will generally describe the impact on consolidated net assets and potentially major categories of assets and liabilities. For an acquisition, the description may contain a general description of the accounting effect of the transaction on assets and liabilities and the overview that, if funded from cash or borrowings, there is expected to be no impact on consolidated net assets. If the acquisition is funded by a new issue of shares, the description might state that consolidated net assets will increase by the fair value of the shares to be issued. The description may then explain that, following completion of the acquisition, the acquirer will undertake an exercise to identify the fair value of the assets and liabilities acquired.

Narrative description relating to the effect on earnings

4. A narrative description of the effect of a transaction on earnings will generally be expressed in the form of a directional indicator.

5. For an acquisition the description may be presented in the form of a general description of the accounting effects of the transaction on earnings, or on profit before tax, tax and interest individually. In the case of an acquisition where a fair value exercise has not been performed, the impact on earnings may be uncertain, particularly if the fair value exercise is likely to impact the value of the assets that might be depreciated or amortised. In such circumstances this uncertainty should be explained.

Appendix 2: List of abbreviations

Annex	Annex to the PD Regulation
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority
IAS	International Accounting Standard
ICAEW	Institute of Chartered Accountants in England and Wales
IFRS	International Financial Reporting Standards
PD Regulation	Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing the Prospectus Directive
UKLA	The United Kingdom Listing Authority, the securities regulator, part of the FCA

ICAEW is a world leading professional membership organisation that promotes, develops and supports over 144,000 chartered accountants worldwide. We provide qualifications and professional development, share our knowledge, insight and technical expertise, and protect the quality and integrity of the accountancy and finance profession.

As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.

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