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By email to katerina.joannou@icaew.com

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Dear Katerina

Exposure Draft: Pro forma financial information – Guidance for Directors

We are pleased to respond to the Working Group's request for comments on the above Exposure Draft.

We have included our detailed response in Attachment 1 addressing the specific questions raised.

In summary, our main comments are as follows:

1. It might be helpful for this guidance to refer to all matters included in the ESMA Recommendations and ESMA Q&A (as at the date of its publication) so that preparers starting with this guidance are directed to areas of other appropriate guidance rather than having to read each of those pieces of guidance separately (to consider how they interact with or supplement this guidance). The detail in the ESMA Recommendations and ESMA Q&A would not necessarily need to be repeated; cross-references would be helpful and Attachment 2 indicates potential cross-references.
2. We agree with the principle that pro forma financial information must not be misleading. However, the lack of any reference to "inclusion of all appropriate adjustments" and "omission of potential adjustments that do not satisfy the PD Regulation 'factually supportable' criterion" (see paragraph 2.3.6 of Developing the Guidance) as part of the consideration of whether the information might be misleading seems like a significant omission from Section 2.
3. We recommend that this guidance is not finalised until the UKLA have provided input on their interpretation of the nature of a transaction for this purpose and the requirement for pro forma profit and loss information in light of the impact of ESMA FAQ 51.
4. Annex II, Item 4 – no mention is made for the potential of pro forma financial information to be prepared on the basis of the "accounting policies adopted by the issuer in its next financial statements".

5. Section 4 on making adjustments does not include guidance on how completion accounts and resulting price adjustments for acquisitions should be reflected in pro forma net assets statements.

Please contact Yvette Allen (Partner, Corporate Finance Quality and Risk Management, on 020 7303 0996) should you wish to discuss any of the points raised in the attached response.

Yours faithfully

Deloitte LLP

DELOITTE RESPONSES TO QUESTIONS IN EXPOSURE DRAFT OF GUIDANCE FOR DIRECTORS ON PRO FORMA FINANCIAL INFORMATION

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

- (a) Paragraph 1 could be deleted. Pro forma information in generic terms could be much wider than that definition and, according to paragraph 13, this guidance applies to pro forma financial information that complies with the requirements in the PD Regulation. Sections 1.4 and 1.5 could be moved up to form the introduction.
- (b) Paragraph 3 – consider adding a reference to Annex II regarding the presentation of such pro forma financial information.
- (c) Paragraph 4 – might be helpful to indicate that this definition comes from Recital 9.
- (d) Paragraph 5 – it should be noted that the UKLA does not regard a share issue as a transaction for the purpose of considering the need for pro forma financial information?
- (e) Paragraph 8 could be deleted as Annex I, Item 20.2 does not apply directly to such circulars (its application to such circulars is dealt with in paragraph 11).
- (f) Paragraphs 13 – “criteria in Annex II” seems incorrect; suggested redrafting as follows: “.... that complies with the requirements in the PD Regulation (and relevant ESMA Recommendations) including presentation in accordance with Annex II”.
- (g) Paragraph 15 – we suggest amending as follows: “This guidance does not address the work to be 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 to be reported in accordance with paragraph 7 of Annex II”.
- (h) Paragraph 16 – is it correct to refer to IFRSs rather than IFRS? Note – this is also in other paragraphs.
- (i) Terms used in the guidance – add reference to use of Annex being to an annex of the PD Regulation.

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)?*

- (a) We agree with the principle that pro forma financial information must not be misleading. However, the lack of any reference to “inclusion of all appropriate adjustments” and “omission of potential adjustments that do not satisfy the PD Regulation ‘factually supportable’ criterion” (see paragraph 2.3.6 of Developing the Guidance) as part of the consideration of whether the information might be misleading seems like a significant omission from this section. Any such reference to adjustments could be cross-referenced to Section 4.
- (b) Paragraph 29 – it is not particularly clear how this relates to the ‘not misleading’ principle. Possibly it should be moved down into the following section on “judging whether information is misleading” as it is primarily to do with disclosures to ensure that investors are not misled as to what pro forma financial information is.
- (c) When ‘judging whether information is misleading’ it would be helpful to begin with a general statement such as that from paragraph 12 of Tech 18/98 as follows: “The requirement that pro forma financial information is not misleading does not imply that it can give a true picture of the effect of the transaction”. This could act as an introduction to paragraph 29.
- (d) Paragraph 32 – this seems rather oddly placed between paragraphs 31 and 33; it would probably be better amalgamated with paragraph 35. The wording “differs from what would reasonably be expected” is rather unclear – consider replacing by “contrary to that which ought reasonably to be given if the illustration appropriately reflects the effect”.
- (e) Paragraph 33 – consider adding “the statements, formats and captions selected for presentation” (from para 12(b) of Tech 18/98) as that would still seem relevant.
- (f) Paragraph 34 would fit best as part of, or immediately following, paragraph 29 as that finishes with “should be read in light of the investment circular as a whole”.

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

- (a) Section 2.1 could begin by setting out that a 'significant gross change' is described in Recital 9 of the PD Regulation and/or including a cross-reference to paragraph 4.
- (b) Paragraph 25 – could add a cross-reference to paragraph 11.
- (c) Paragraph 27 could be deleted as sign-posted from Index. Its current drafting is inconsistent in referring to issuers and directors; also references to “the requirements” could be considered unclear.

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

- (a) Paragraph 37 – second sentence should perhaps be a separate paragraph; also it is rather vague as there may always be such uncertainty. Could either be more specific as to the nature of such uncertainties (e.g. fair value exercise to be completed – see paragraph 43) which could lead to that conclusion or perhaps delete from here and add as an explanation into paragraph 26 of why the narrative approach is commonly adopted in the UK to show the effect on earnings.
- (b) Paragraph 39 would be better separated into two paragraphs. In first sentence, rather than “principal accounting effects of the transaction” which is rather vague, could state “impact on consolidated net assets and potentially major categories of assets and liabilities”.
- (c) Paragraph 40 – in first sentence, replace “consolidated assets or liabilities” by “consolidated net assets”. In third sentence, delete “which will lead to an increaserecognised as goodwill.”
- (d) Paragraph 41 – is this the right way round? Starting point is likely to be overall effect – i.e. profit or loss on disposal impacting consolidated net assets. Might then drill down into effects of constituent elements – e.g. impact on consolidated assets and liabilities which will depend on whether proceeds are used to repay debt; impact on cash/borrowings or gearing.
- (e) Paragraph 44 should also refer to description of the transaction. Fourth bullet – consider changing “as a result” to “because” to be consistent with the PD Regulation.
- (f) Section 3.2.2 (Presentation of multiple significant gross changes) seems out of position here as section 3.2.3 would seem to follow better after paragraph 44. Section 3.2.2 would probably fit better after 3.2.3.
- (g) Paragraph 50 – reference to “more than the primary financial statements” may not be sufficiently clear.
- (h) Paragraph 52 – add “in the UK” in the second sentence.
- (i) Paragraph 57 – suggested mark up as follows: *An issuer may decide to include other pro forma financial information to show the impact of the identified transactions on unadjusted financial information other than its principal unadjusted financial information used in the principal pro forma financial information ~~presented to comply with the PD Regulation or the Listing Rules~~. This might be the case where an issuer routinely reports financial information externally under more than one basis, for example IFRS and local financial reporting standards. In these circumstances this additional set of pro forma financial information is presented on a standalone basis, distinct from the primary principal pro forma financial information and, therefore, should separately comply with Annex II. An example of such other pro forma financial information is embedded value pro forma financial information presented by issuers who undertake life assurance business and present supplemental embedded value financial statements as part of their routine external financial reporting.*
- (j) Paragraph 59 – suggested mark up as follows: *An issuer prepares pro forma financial information for inclusion in an investment circular relating to a transaction by:*
 - ~~presenting 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 ~~an earlier~~ the date to or period for which that financial information was prepared.
- (k) Paragraph 60 – suggested mark up as follows: *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 ~~or related to subsequent Class 1 transactions~~, the result is still described as pro forma financial information at the date or for the period covered by the unadjusted ~~source~~ financial information of the issuer.*

- (l) Paragraph 63 – make clear that this is “unadjusted financial information of the issuer”; how does this relate to the potential of pro forma financial information to be prepared on the basis of the “accounting policies adopted by the issuer in its next financial statements”?
- (m) Paragraph 65 – seems rather ‘wordy’. Could simplify sentences 2 to 4 to the following: *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.*
- (n) Paragraph 69 – consider adding “normally for a complete year”.
- (o) Paragraph 71 – rather than “interim”, better to describe as “pro forma financial information for a period other than a complete year”.
- (p) Section 3.2.8 (Subsequent events) – this section might fit better within Section 4 on Adjustments.

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

- (a) Paragraph 80 – insert “normally” before “involve” in the first sentence.
- (b) Section 4.1.5 (Materiality) – might fit better as part of the General Considerations (section 4.1.1) as it is not directly related to the various statements made in the PD Regulation.
- (c) Section 4.1.6 (Omitted adjustments) might be better as a sub-section of 4.1.4 (Factually supportable) as it is providing comments on how to approach adjustments which are not factually supportable.
- (d) Paragraph 90 1st sentence – consider changing “whether the proposed purpose of the pro forma financial information is realistic” to “whether the use of the pro forma financial information to achieve its stated purpose is realistic”. 2nd sentence – consider inserting “to illustrate the effects of a significant gross change” after “PD Regulation requirement”.
- (e) Section 4.2 (Issues encountered in making adjustments) – what about completion accounts and resulting price adjustments? That is frequently a cause of debate.
- (f) Paragraph 94 – consider changing “frequently form the basis for adjustments” to “are frequently considered for potential adjustments” as some of these do not frequently form actual adjustments.
- (g) Section 4.2.1 (Tax and similar effects) might fit better at the end of the section.
- (h) Paragraph 96 – might be helpful to include a cross reference to paragraph 93.
- (i) Paragraph 99 – cross reference to ESMA Recommendations paragraph 88 seems incorrect – that refers to a future ‘action’ which could be distinguished from a future ‘event’. ESMA Recommendations paragraph 89 refers specifically to contingent consideration and might suggest a different answer to that stated in paragraphs 99 and 100; it would be helpful if the guidance could make specific reference to this matter.
- (j) Paragraphs 101 and 102 – better to make into one paragraph. Consider adding reference to disclosing in the pro forma that adjustment for synergies has not been made.
- (k) Paragraph 104 – might be helpful to split this into two paragraphs to deal separately with net assets and P&L/cash flows. Last sentence – “on the basis used by the issuer” is unclear; could an example be given of what that would mean say for an acquirer with a December year end acquiring a target with a June year end.
- (l) Paragraph 112 second bullet – insert “/liabilities” after “pension surpluses”.
- (m) Section 4.2.10 (When the Issuer is a Newco) – this seems out of place within the section on adjustments. It would appear to fit better in either Section 2.1 or Section 3.2.
- (n) Section 4.2.11 (Reflecting other small transactions) – the drafting of this section is not very clear. Consider deleting “small” in sub-heading. First sentence of paragraph 119, change “not the subject of the pro forma financial information” to “not the subject of the investment circular” and add a rider with cross-reference to paragraph 45 in respect of potential previous significant gross changes since the date of the unadjusted financial information.

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

(a) No

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

(a) We have no comments on the transitional arrangements. We would not expect pro forma financial information presented under Tech 18/98 and the new guidance to differ.

POTENTIAL CROSS-REFERENCES TO ESMA RECOMMENDATIONS/Q&A

Potential cross-references to ESMA Recommendations

ESMA Recommendations paragraph(s)	Draft ICAEW Guidance paragraph/section
87	Included in Section 4.1.1
88	Included in Section 4.1.1 and paragraph 99
89	Paragraph 99
90 to 94	Paragraph 4 and/or Section 2.1

Potential cross-references to ESMA Q&A (20th version at October 2013)

ESMA Q&A question number	Draft ICAEW Guidance paragraph/section
50a	Section 2.1
50b	Section 3.2.5
50c	Section 3.2.7
51	Section 3.2.7
52	Section 3.2.2
53	Section 3.2.2
54	Paragraph 10
55	n/a