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Dear Ms Joannou

Consultation paper on guidance for preparers of prospective financial information – December 2018

We welcome the opportunity to comment on the consultation paper.

Our responses to the questions raised are set out in the Appendix to this letter.

Yours faithfully

KPMG LLP

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1. *Do you think that the guidance in Parts I and II of the Exposure Draft will be readily understood and capable of application by a wider business audience that is not experienced in capital markets transactions?*

   Although we do not have any doubt that a wider business audience would be able to understand the guidance in Parts I and II of the Exposure Draft, we have concerns that even for those that are experienced in capital markets transactions the guidance is overly conceptual, and that the practical guidance contained within it frequently becomes lost in the jargon employed and the document's apparent need to treat its 'principles' separately.

2. *Do you agree with the categories of PFI that are included in the scope of the guidance, as set out in section 3 of this consultation paper and in Part I of the Exposure Draft?*

   It is a little unclear what 'categories' of PFI are being referred to in section 3 of the consultation paper and in Part I of the Exposure Draft.

3. *Are there any impending changes, including in regulation, that should be taken into account in finalising the guidance in the Exposure Draft?*

   Securities law and regulation is in a continuous state of revision and updating, particularly now as the EU is updating prospectus law and the UK continues to grapple with the consequences of the Brexit vote. However, it is not apparent at present whether this will have a substantive impact on the guidance in the Exposure Draft.

4. *Do you have any comments on the context or on the attributes and preparation principles of PFI set out in Part I of the Exposure Draft?*

   Although we can understand the original attraction of having 'principles' which recall the principles for preparation of historical financial information, the fact that the terms need to be explained in terms of attributes which are somewhat removed from the principles calls into question the value of having both principles and attributes. In particular, the term 'reliability' is a fundamentally troublesome concept when talking about statements regarding the future, and runs a significant risk of creating an expectation gap. At the same time, 'business analysis', whilst a useful term for some purposes, rather overlooks the compilation element of the forecasting process. We would consider it more helpful to collapse the four principles and the four attributes down into no more than four aspects, perhaps using the terms 'relevance', 'business analysis and compilation', 'reasonable disclosure' and 'comparability'. As the original PFI document acknowledged, 'relevance' is not a topic that needs to be over analysed for PFI – reasonable disclosure and the closely related topic comparability largely cover the issues in any event. Adding the term 'user

needs' does not alter this position. The notion of 'subsequent validation' continues to be a difficult one, both practically and conceptually, and comparability is a more understandable and useful term. It is noteworthy that even where regulators have clearly drawn on the ICAEW Principles (CESR/ESMA and the Takeover Panel) for the concept of comparability, they have avoided employing the term 'subsequent validation'.

In paragraph 37 (and wherever else it is used), 'free from material error' should be clarified, perhaps by adding 'in its compilation'. In a plain English sense, a statement about the future will be either 'right' or 'wrong' (usually the latter); 'right' and 'free from material error' are such similar concepts that the use of the phrase can lead to confusion and updating the wording will avoid this.

5. *Do you have any comments on the general principles and procedures for the preparation of PFI set out in Part II of the Exposure Draft?*

We find the structure and content of the guidance in Part II, which breaks up the guidance under the headings Planning, Execution and Evidence and Documentation into separate sections dealing with the principles/attributes somewhat unhelpful and over lengthy. What was two pages in the previous guidance now takes up six pages. In addition, whilst there may be some merit in distinguishing the three phases, the principles/attributes do not drive the sequence of activities, and it is sometimes difficult to follow the basis for the split. For most purposes, for example, disclosure and comparability are overlapping topics, and the point at which they become particularly relevant is towards the end of the preparation process, when consideration is being given to how to package up the material that has been compiled for presentation to users. Although the original guidance in the PFI guide needed refreshing, we are not convinced that the proposed version has dealt with the difficulties of that version, and in attempting to do so, it has introduced some major difficulties of its own. A sentence in 'planning' like: "The preparer should identify the purpose for which the PFI is being prepared and the appropriate period to be covered to ensure the form and content presented has the ability to influence economic decisions of users of the PFI" illustrates the problem. 'The preparer should identify the purpose for which the PFI is being prepared and the appropriate period to be covered' – this rather implies that there are 'preparers' of PFI who are doing so without knowing why and need to be reminded to find out why they are doing so. '… ensure that the form and content presented has the ability to influence economic decisions of users' – the implication here is that there are forms of PFI that does not have the ability to influence economic decisions, and/or that there is only one form and only one length of period that does. In practice, a user need is always going to be a pre-condition to any decision to prepare PFI. Whether users are influenced by PFI is ultimately a disclosure matter rather than a preparation matter. If there is a planning issue to be considered, it is perhaps that preparer should determine the nature of the

underlying PFI that they need to prepare given the PFI that they are proposing to disclose. The immediately following statement "The preparer should ensure that the PFI is being provided on a timely basis to influence the economic decisions and/or to assist in confirming or correcting past evaluations or assessments" again appears to say no more than "Do not prepare PFI after it is useful to do so". Again, it is hard to see this as a helpful 'procedure'. It merely contributes to the length of the document.

It would be more helpful to have guidance which attempts to describe the steps in a compilation process from a practical perspective, leaving the principles and attributes element implicit. If necessary, paragraphs describing relevant processes can be annotated to indicate which principles are being applied/exemplified, perhaps using a key (eg 1,2,3,4) at the ends of sentences/paragraphs, or in a margin.

6. *Do you have any comments on the application note for statements of sufficiency of working capital in capital markets transactions in Part III of the Exposure Draft?*

   As noted above in relation to Part II, the decision to draft the section using the four principles as the framework does not work well and leads to lack of clarity, repetition and redundancy.

   Paragraph 1 refers to 'directors and preparers'. In Part II, paragraph 3, 'preparer' is defined to include parties ultimately responsible for PFI. It may be useful to clarify the use of the term 'preparer' in Part III.

   The sentence at the end of paragraph 9 appears to be a somewhat garbled version of the responsibility statement requirements for EU prospectuses. As such, it is not directly applicable to circulars. If the purpose of the wording is to state that the information relating to the issuer's financial position presented in the investment circular as a whole should be consistent across the working capital, risk factors and business strategy sections (as per TN 321.1) the sentence should be redrafted to make this clearer.

   In paragraph 10, the wording "be of the opinion that they are confident that .." reads oddly. This should say 'be of the opinion that …".

   Paragraph 14 is a good illustration of how attempting to hook a paragraph to the principles turns some useful observations on what is required by certain regulations into something unnatural and difficult to follow.

   Paragraph 23 states that "The directors should make their statement with a high degree of confidence". Care is needed when using terms like 'confidence' when referring to statements about the future. Whilst the directors may have

confidence that the basis for the statement can be defended, it is better to avoid the misunderstandings inherent in the assertion that they make the statement with a high degree of confidence. The sentence goes on to say that 'hence, the working capital statement must be brief'. Whilst regulation envisages a brief statement, it is not as a result of anyone's confidence when making it. We suggest that the paragraph is rewritten to focus on the issues of disclosure which are at the core of the paragraph.

The discussion in paragraph 32 is laboured and difficult to follow. Is the paragraph actually necessary?

If the guidance in 4.1 and 4.2 is required to be read with the guidance in Part II, it is important (i) that the guidance in Part II is thoroughly reworked to ensure that it works well with any Part III guidance (and Parts IV and V) and (ii) that what is contained in Part III guidance is genuinely incremental. For this reason, having 4.1 and 4.2 is unnecessary and unhelpful. The summary version of 4.2 in 4.1 does not add anything to 4.2 and is simply additional reading matter to be worked through alongside what is in Part II. When looking at what is in 4.2, much merely repeats what is or should be in Part II, e.g. timeliness, board engagement, prepared on a consolidated basis, sensitivity analysis. There is useful material, but arguably there is too much detail, for example on questions of levels or detail, frequency of balance sheets, and periods to be covered. There is also repetition of information that is already set out in the first 36 paragraphs of Part III. The focus in section III should be on matters that are specific and genuinely additional. This might include issues surrounding acquisitions/disposals (although there is scope for this to be covered in Part II); borrowing facilities and borrowing limits and covenants. Ideally, the incremental topics should be covered only once in section III, and each topic dealt with in one place and (not split between phases and principles).

7. *Do you have any comments on the application note for profit forecasts in capital markets transactions in Part IV of the Exposure Draft, including the application of relevant aspects of the guidance in other circumstances such as where a listed company gives profit guidance to public investors in a less prescribed form (including guidance known as 'profit warnings'), and where profit guidance or forecasts are prepared for users other than public investors?*

   The comments on structure and organisation of material discussed in relation to question 6 above apply equally to Part IV.

   Additionally, we note a significant emphasis in Part IV on the 'confidence' that forecasters are envisaged to have that their forecasts will be 'achieved'. (e.g., paragraphs 18, 19, 23, 27, 29, 32 and 36). We do not consider this degree of emphasis to be appropriate. Whilst it is true, as stated in paragraph 23, that the

FCA requires an issuer to explain a difference of 10% or more, this is not the same as saying that there is an expectation that the forecast will be achieved. In fact, it is an indication that forecasts may not be achieved. The reasons for this are well understood but appear to have been forgotten for the purposes of Part IV. As reporting accountant's state in reports on profit forecasts: "Since the profit forecast and the assumptions on which it is based relate to the future and may therefore be affected by unforeseen events, we can express no opinion as to whether the actual results reported will correspond to those shown in the Profit Forecast and differences may be material." It may be appropriate to state that preparers should be confident that the basis for the forecast reflects the information that is available to them, they are not in a position to be 'confident' about things that will happen in the future. And whilst preparers' inability to be confident about the future is generally dealt with by the often cautious way in which public profit forecasts are expressed, the 'underlying PFI', to which Part IV also claims to be addressed, is not susceptible to the same treatment. We consider that Part IV should be updated to removed references to preparers' confidence and user expectations about achievement of forecasts, and that more emphasis should be given to the fact that all statements relating to the future involve predictions and are based on numerous assumptions about the future which may or may not turn out as anticipated, and the differences between actual results and those forecast may be material.

Other comments:
Paragraph 5. It is not clear what is meant by 'regulation is likely to apply to that statement'. Clearly 'regulation' applies to all statements made in a capital markets context, but regulation relating specifically to profit forecasts exists only with respect to profit forecasts contained in investment circulars.
Paragraph 17. It is not clear what the basis is for the statement "Other regulation requires a similar statement to be made by one or more of the reporting accountant, the financial adviser and the directors". We are not aware of any situation where a financial adviser makes such a statement, or of any where a reporting accountant makes such a statement outside the context of a public report.
Paragraph 22. It is somewhat overstating matters to refer to the bullets as 'criteria'. The first repeats the language of the definition of user needs principle (the value of which has been questioned above). The second appears to state the same thing – the basis must be relevant and appropriate' – before introducing the topic of a less relevant or appropriate basis. The discussion of this situation seems to demand rather more analysis. Whilst the example given of a suboptimal basis (an acquisition or disposal) may not render the basis for the forecast 'inappropriate', there presumably will be cases when this will not be the case. In cases where disclosure of the unusual basis is needed, it would expected that such disclosure would be in the basis of preparation rather than in the 'principal assumptions' as stated here. The third bullet refers to an 'appropriate profit measure', which again begs more questions than it answers.

Paragraph 32. See general comment about achievement of forecasts above. In addition, it does not seem to be appropriate to be considering the 'disappointment' of investors in technical guidance.

8. *Do you have any comments on the application note for synergy and stand-alone cost saving statements in capital markets transactions in Part V of the Exposure Draft?*

The comments on structure and organisation of material discussed in relation to question 6 above apply equally to Part V.

Paragraph 9. The paragraph introduces the concepts of a 'Synergy Plan' and a summary board document. It is not entirely clear why the Synergy Plan should not also be a board document, why the separate document is required, or what in more detail the Synergy Plan might comprise. Two strands that it might be useful to draw out are (i) the development of the synergy case (ie the identification of 'in principle' synergy benefits arising from the transaction); and (ii) the plans for realising the benefits in practice.

Paragraph 22. The drafting problems highlighted above in relation to paragraph 9 of section III also apply to this paragraph. The issue of alignment, which is incorrectly stated in paragraph 22, is dealt with more appropriately and correctly in paragraph 48 of section V.

Paragraph 23 is not needed (it merely repeats in different words what is already stated in paragraph 21).

Paragraph 29. As with a number of other paragraphs which appear to be included simply to reflect the principles, this paragraph labours a point which does not need to be made.

Paragraphs 30 and 32 essentially repeat what is covered in paragraph 10. Paragraph 31, if it is needed, should appear in the regulatory requirements section, as it merely states what is contained in note 2 to Rule 28.6 of the Code.

Paragraph 36. 'may' in the second sentence should probably by 'will'.

Paragraph 37. 'obvious' seems an odd choice of terms. Perhaps 'how straightforward the calculation of' might be better.

Paragraph 38. It is odd to state that disclosure is an aspect of reliability (particularly as it is expressly as aspect of understandability). Paragraph 38 rightly addresses the issues of inherent uncertainty and consideration of contingencies. It would seem to be sensible though rather than to hook it onto disclosure, to expand the paragraph into one that places these matters in the

context of 'risk analysis' (as this is not otherwise referred to in the business analysis section, but is an element of support specifically envisaged by the Code). This is an aspect which is relevant not just for disclosures, but also for assessing the nature and quantum of the synergies.

Paragraph 39. The first sentence needs to be updated in the light of current Code requirements. Whether for the purposes of neutrality or not, disclosure is required of 'disbenefits expected to arise' as well as the 'recurring and non-recurring costs of realising the expected benefits'. In the second sentence, 'one-off' should perhaps be replaced with 'non-recurring'.

Paragraphs 42 and 43. Care should be taken when introducing the term 'should' in these paragraphs. The Code is not prescriptive about how its requirement to include sufficient analysis, explanation and quantification should be met, so examples should be examples of what 'may be appropriate' only and not statements of what 'should' be included.

Paragraph 44. The first sentence should be removed (for the reasons outlined in relation to similar statements in other sections). The second and third sentences (modified to remove 'consequently') are sufficient and balanced statements of the position.

Paragraph 49 and 50. It should be noted that the City Code, Rule 28.3, specifically excludes the concept of comparability in relation to QFBSs. Paragraph 49 retains considerable elements of the guidance relating to subsequent validation contained in the 2003 ICAEW Guidance, but what is stated there, and consequently in the current draft, does not reflect practice or regulation as it has emerged in relation to QFBSs. References to cost bases, for example, have not become practice for QFBSs. We would suggest that the paragraph is removed (particularly the discussion of subsequent validation and the example of 'failing' statements, although there may be merit in retaining the guidance in relation to internal monitoring of progress under the Synergy Plan. It should however be emphasised that if it is to be used for this purpose, the Plan developed for the purposes of the QFBS would be expected to be refined and updated after the deal has completed, as inevitably more detailed and up-to-date information will become available at that time. The objectives of the group post deal should include the identification and realisation of all synergies that might benefit the business and not just those that are identified pre-deal. (As an aside, whilst it is true that, as stated in the first sentence, there is no regulation that requires the achievement of benefits reported in the QFBS statement to be monitored, Rule 19.5 does include an obligation in relation to the monitoring of statements of intention (why may relate to synergies) in certain cases.)

Sections 4.1 and 4.2. Without prejudice to our general comments that 4.1 and 4.2 need to be rethought and re-presented, the comments are restricted to 4.2, but apply equally to 4.1.

Execution, user needs (page 70). Reference to board memorandum including "a summary of relevant regulation, outline of the relevance of the statement to the transaction, its context and its audience and directors' confirmations'. See comments above concerning the board memorandum and the Synergy Plan. If a separate board memorandum is required, we question whether all this needs to be included, and if so, why. Perhaps the wording should be, 'which may include for example'.

Execution, business analysis principle (page 71). The concept of 'individual synergy initiatives' is mentioned only here, but may merit greater emphasis.
Rather than 'the directors and senior operational and financial management *should* consider …' the notion should be that the guidance presents matters that they *may* consider.
Reference to 'contingency' should pick up paragraph 38 (as revised). Note that 'risk adjustment' (page 72) is one approach, but not the only one, so the term should be avoided.
Page 72. Why is it stated that 'all cost data should be for a full year'?
'Identification and specification of cost savings and other financial benefits (and associated costs) within each business' – this should say 'within the combined business'. Cost savings that might be achieved in one of the businesses are not 'synergies'.
The directors and senior operational and financial management *should* consider. As above, this should be indicative not required.
'There should be clarity on which cost base (ie acquirer or target) the cost or saving is expected to come from'. This is a questionable statement. In a pre-deal environment, limitations on the information available may make it impossible to conclude on precisely how the synergies will be realised. In some cases it may be unlawful to commit to post deal decisions. The key is that within the combined business there is an established synergy case. Actual savings may come from one of the pre-deal entities, the other or both.
'The level of any contingency provision will depend on …'. As this is not an exhaustive list, it would be preferable to add before 'the profile of the businesses' 'on a range of factors, which may include …'.
Page 73 Compilation process. It is not clear how computational checks can 'ensure that' 'historical financial information which forms part of the analysis does not contain misstatements which have not been corrected'. What is intended here?
Compilation process in development of Synergy Plan. This section reflects a somewhat idealised situation and needs to be updated to recognise the practical realities referred to elsewhere (eg in paragraph 36), where details are often limited to public sources and access is restricted. Involvement of

operational management whilst desirable, may also be constrained in practice by the heightened levels of confidentiality surrounding the existence of the possible transaction.
Page 74 Basis of belief and other disclosures. It is not clear what the basis is for the list of bullets that go beyond what is in the Code, and why the guidance appears to be making them mandatory ('should' / 'must'). There is no basis for example for stating that the bases of belief should set out whether the synergy assumptions have been risk adjusted. Others of the bullets seem to relate more to preparation principles than to disclosures.

Base figure. See comments above (paragraph 49 and 50) on this topic.

Timing. It is not clear what is intended by the assertion 'a length timeframe or excessively short timeframe for delivery of expected benefits may raise concern over inclusion of these benefits'. If such timings are in fact legitimate, the existence of this statement in guidance appears to create unnecessary and unjustified doubt about them. It may be that this topic is more suited to a discussion within the compilation section where it can be explained why there is an issue and what might be done about it.

Subsequent validation/ongoing monitoring. See points above with regard to subsequent validation and the need to avoid the impression that the basis for the published statement is set is stone and that plans to identify and realise synergies should not be reviewed and updated on an ongoing basis.

9. *What, if any, transition arrangements are needed for applying the principles when the final guidance is published?*

   We have no observations on this.

10. *Are there any other matters that should be taken into account when finalising the guidance in the Exposure Draft?*

    Our observations are as set out above.