Dear Mr. Demarigny,

Re: CESR’s proposed recommendations for the consistent implementation of the European Commission’s Regulation on prospectuses no. 809/2004

We are writing to you in response to your request for comments on the proposed recommendations (“the Recommendations”) for the consistent implementation of the Prospectus Directive implementing Regulation (the “Regulation”). In considering our response, we have had regard to our letters of 14 April and 25 May concerning your earlier call for evidence on this matter.

We are pleased to respond to the proposals for recommendations on consistent implementation. As you are aware, we see this as an important element in ensuring the consistency and quality of prospectus disclosure under the new Prospectus Directive regime. We encourage all of your members to ensure that the final recommendations are adopted in their jurisdiction. It would be helpful if the recommendations could include a clear statement of your expectation that these will be followed by your members in supervising the application of the Regulation.

We commend the work accomplished by CESR in the short time available, particularly given the complexity of some of the issues addressed. However, we are concerned that there is not yet agreement on a number of important issues necessary for issuers across the European Union to prepare prospectuses to a consistent standard. These include providing examples of statements which CESR considers to be profit forecasts, examples of acceptable pro forma adjustments and of complex financial histories.

In our letter of 14 April in response to CESR’s call for evidence, we provided you with our views on the proposed Regulation on prospectuses. In this letter, we elaborate further on many of the issues that, in our view, merit the development of guidance in order to facilitate the consistent implementation of the Regulation across the European Union. In addition we have suggested possible solutions to the issues arising that CESR may wish to consider in drafting the final Recommendations.

As with our earlier letters, we have concentrated our comments on those areas where auditors or independent accountants are likely to have direct involvement, whether through meeting reporting obligations imposed on them by the Regulation or through providing due diligence in the areas concerned.

We have structured our letter to respond, firstly, in Appendix 1, to specific questions raised by CESR and secondly, where appropriate to the topics in question, to reiterate those points we made in our earlier letters that have not yet been addressed. In addition, in Appendix 2 we have included points from our earlier letters concerning subjects not addressed in the Recommendations.
It is also clearly important that guidance should be provided for auditors or independent accountants on the work they are expected to perform and the form of their reports. We believe that the appropriate auditing standards setters should issue such guidance. We encourage CESR to request those bodies to provide such guidance.

We continue to be concerned about the practical liability consequences for auditors or independent accountants of the requirements imposed on them by the Regulation. A solution for the liability problem should be found in order to achieve the full benefits of the single European prospectus.

We regret that CESR has to date apparently not yet reached a consensus on recommendations to be provided in respect of “complex financial histories”. We continue to believe that recommendations in this area are essential if issuers and their advisers are to be able to prepare prospectuses that achieve a consistent implementation of the Regulation on prospectuses. We reiterate in appendix 1 our views on historical financial information.

We would be pleased to discuss with you in detail any of our points.

Yours sincerely,

David Devlin
President

Encl.
Appendix 1

Responses to selected questions - Financial information issues

Selected financial information

30. Q: Do you agree with this proposal? Of not, please state your reasons.

1. FEE broadly agrees with the proposal.

2. However, it is unclear what is intended by the phrase “on a straight-forward basis” in paragraph 24. In FEE’s view it is superfluous to the objective of the recommendation.

Operating and financial review

37. Q: Do you consider that it is appropriate to include key performance indicators about past performance?

3. FEE believes that the reporting of non-financial key performance indicators about past performance can be of great value to investors in understanding a company’s overall performance.

4. FEE agrees with the high level, non-prescriptive, approach recommended in respect of the OFR.

Capital resources

42. Q: Do you agree with this proposal? If not, please state your reasons and please provide alternative information.

5. Whilst generally in agreement with the recommendations, FEE notes that there is an element of duplication in the recommendations with those of IAS/IFRS in relation to financial instruments, for example on hedging policy, which should be avoided.

Profit forecasts or estimates; Annex I Item 13

50. Q: Do you agree with the above approach in relation to profit forecasts and estimates? If not, please state which particular aspects you do not agree with and give your reasons.

6. Overall FEE agrees with the approach in relation to profit forecast and estimates. We make a number of specific comments below.

Framework for preparing profit forecasts

7. FEE’s position is that the inclusion of profit forecasts, together with auditors’ or independent accountants’ reports thereon, requires that there is an acceptable framework for preparers. Such a framework is necessary for clarity as to the respective responsibilities of the issuer and the auditor or independent accountant. As a result, FEE is pleased that you have provided some general principles for the preparation of profit forecasts in paragraphs 43 and 44.

8. FEE agrees with the assertion set out in paragraph 43 that “due care and diligence must be taken to ensure that profit forecasts or estimates are not misleading to investors.” FEE notes that the Recommendations provided in relation to the working capital statement provide guidance as to how the issuer and persons responsible should exercise due care and diligence. FEE strongly encourages CESR to include equivalent recommendations in relation to profit forecast and estimates.
9 FEE believes that it is not necessary in paragraph 44 to refer to “hypothetical” strategies, plans and risk analysis when defining what is meant by “reliable” in the context of profit forecasts.

10 In particular, FEE believes that the responsible persons or entity should establish processes to apply the principles of reasonable disclosure, business analysis and subsequent validation to the preparation of any published prospective financial information (“PFI”). In such processes the responsible issuer or persons should:

(a) Plan, organise and communicate internally the process of preparing and issuing PFI;

(b) Involve directors and other members of management with the necessary in-depth experience of the business and expertise across all its activities;

(c) Clearly allocate and co-ordinate responsibilities;

(d) Satisfy themselves that there are appropriate systems to generate the reports underpinning published PFI;

(e) Produce clear contemporaneous documentation to evidence key elements of the process;

and, in the preparation of a profit forecast or estimate, should

(f) Prepare a robust and up-to-date business analysis which ensures that the directors are highly confident that the forecast will be achieved;

(g) Consider the strategy and plans of the business and related implementation risks together with checks against external evidence and opinion;

(h) Have a comprehensive reporting systems and supporting forecast profit and loss accounts, cash flow statements and balance sheets; and

(i) Consider the neutrality of the captions and period selected for reporting and the simplicity and understandability of the numbers and assumptions that are presented.

11 FEE notes that in the case of a wholesale debt registration document, the minimum requirement, Annex IX item 8.2, is for the issuer to disclose: “Any profit forecast set out in the registration document shall be accompanied by a statement confirming that said forecast has been properly prepared on the basis stated and that the basis of accounting is consistent with the accounting policies of the issuer.”

12 In making this declaration, FEE believes that the directors of an applicable issuer should be expected to have followed the same principles as those for equity securities issuers and that CESR should make this clear in its Recommendations.

Outstanding forecasts

13 FEE is generally content with the analysis of "outstanding forecasts" in paragraphs 45, 46 and 47. However, FEE does not fully agree with the assertion in paragraph 46 that "outstanding forecasts by issuers made outside of prospectuses will inevitably be material information ... and should be disclosed in a prospectus". FEE’s belief is that the Regulation should contemplate the differing needs of investors in different classes of securities. FEE questions whether it should be a presumption that a profit forecast is material information for the issuers of debt securities.
Meaning of “correct” and “no longer valid”

14 FEE continues to believe that recommendations should be available on the interpretation of the terms “correct” and “no longer valid” within Article 13.4. FEE’s view is that the meaning of “correct” should be determined by whether the issuer would be prepared to repeat or stand by the previous profit forecast in the current prospectus and that it is the opposite of “no longer valid”.

51. Q: Do you consider that it is appropriate to provide examples of what may or may not constitute a profit forecast or estimate? If so, could you please provide some examples?

15 The lack of guidance on what constitutes a profit forecast and the fact that the Regulation refers to “or by implication” is likely to result in differing practice. FEE believes therefore that detailed guidance should be made available so as to clarify, including by means of illustrations and examples, the interpretation of what constitutes a profit forecast. Clarity is necessary so as to harmonise the application of this requirement across jurisdictions. By way of illustration, FEE considers a statement that “this year’s results will be better than last year’s” to be a profit forecast whereas a statement that “the current year is proceeding in line with management’s expectations” is not a profit forecast unless management’s expectations have previously been made available to the public. Similarly a dividend forecast would not generally be a profit forecast unless the issuer has made or makes a statement of its policy regarding dividend cover.

16 FEE notes that the Recommendations do not provide any guidance as to the meaning of a profit estimate. This is particularly important as it is market practice in some EU markets and a requirement in others for issuers to publish a “preliminary announcement” of their annual results. FEE believes that such a preliminary announcement should not be considered to be a profit estimate for the purposes of requiring auditors to report on its compilation when it is included in a prospectus. FEE considers that this would be best achieved by defining the expectation as to the quality of the information underlying the preliminary announcement.

Historical financial information

Restatements pursuant to paragraph 2 of item 20.1

75. Q: Do you agree with the conclusion stated in the previous paragraph? If not, please state your reasons.

17 Specifically, FEE agrees that it would be helpful in relation to the circumstances where an issuer is preparing a prospectus after its year end but before publishing its statutory accounts for that year for there to be disclosure of additional IAS/IFRS based financial information. FEE suggests that CESR applies its recommendations in respect of the current transition to IAS/IFRS. FEE also suggests that CESR makes it clear that, even where not required to do so, issuers may choose to restate all or part of their historical financial record on the basis of IAS/IFRS.

18 In addition, FEE agrees with the overall approach taken in the recommendation for assessment of the criterion in paragraph 2 of item 20.1 of Annex 1 to the Regulation regarding next year’s accounting policies, as set out in paragraphs 52 to 74. In particular, FEE supports the conclusion that the assessment should be at “macro” change in GAAP level rather than a “micro” level. FEE notes that the examples in the Recommendations do not acknowledge the transitional provisions within the Regulation permitting issuers not to present IAS/IFRS information for any period commencing before 1 January 2004. FEE believes that, for completeness the recommendations should make some reference to the transitional provisions.

19 In relation to the requirement that restated historical financial information should show a true and fair view for each of the years presented, FEE wishes to draw to the attention of CESR the requirements of IAS 1 that, in order for financial statements for a year to show a true and fair view, they must include comparatives.
FEE accepts that where two or more years are presented together each of the years can should be able to show a true and fair view, notwithstanding that IAS 1 would require comparatives for the immediately preceding period to be presented. We request that CESR liaise with the IASB to request an interpretation from IFRIC or a change to IAS 1 to make this clear. Alternatively, CESR should make it clear that it will accept that an auditor’s report on restated accounts in accordance with IAS/IFRS will not explicitly cover the first period presented.

However, where the Regulation requires only one year of historical financial information to be presented in accordance with an issuer’s next year’s accounting policies, FEE does not believe that one year of financial information presented on the basis of IAS/IFRS without comparatives can show a true and fair view. If a true and fair view opinion is to be required from an issuer’s auditors, then it will be necessary for the financial information to include comparatives for the immediately preceding period. As an alternative, CESR could consider following the recent guidance from IAASB in its document entitled “First time adoption of IFRSs – Guidance for Auditors on Reporting Issues”. In particular, this allows auditors to provide a “properly prepared” opinion where issuers present their opening year of IFRS without any comparatives. FEE notes that this would affect both equity issuers in the transitional period from 1 July 2005 until they have published their 31 December 2005 statutory accounts, and debt issuers in all circumstances.

Q: Do you agree with this proposal? If not, please state your reasons.

The proposal does not make it clear as to whether CESR is expecting issuers to prepare full restated financial statements when an additional “statement”, such as a cash flow statement, is required to be presented or whether it is CESR’s intention that only the additional statement itself needs to be presented. If CESR is expecting only the additional statement to be presented independently of the original financial statements, FEE believes that the Recommendations must address how CESR believes that such information can show a true and fair view. FEE’s view is that it is not possible for a single statement, for example a cash flow statement, to show a true and fair view in isolation from the financial statements of which it forms part. A reference to International Standard on Auditing (ISA) 800 “The Auditor’s Report on Special Purpose Audit Engagements” would be useful as it includes guidance related to the auditor’s report on a component of financial statements. An alternative would be for CESR to accept that the additional statement be properly prepared, independently of the original financial statements. Audit reporting requirements should reflect this approach rather than inappropriately requiring a true and fair opinion.

FEE also suggests that the Recommendations should address the inclusion of new disclosures such as segment reporting or earnings per share as well as new statements. In addition, FEE believes that the Recommendations should be extended to cover the situation where comparative information in one of the last two year’s statutory financial statements may have been restated for changes in GAAP, other changes in accounting policy or correction of errors.

Other matters to be addressed

Restatements of comparatives in underlying statutory financial statements

Where the historical financial information for the middle of the three required financial years has been restated in the comparative amounts in the most recent financial year’s statutory financial statements, following adoption of new accounting policies in the most recent period, FEE’s position is that issuers should be expected to adopt a “4 column” or “2+2” presentation approach, consistent with that required when restated accounts are prepared because of future changes in accounting policies as described below. That is, the middle period should be presented twice, both as originally stated in the statutory financial statements for that year and as restated in the subsequent period’s statutory financial statements, together with the relevant notes explaining the restatement.

If the historical financial information for the middle period has been restated in the comparative amounts in the most recent financial year’s statutory financial statements to correct an error or
errors, the issuer will need to determine whether the error or errors would have given rise to restatement of the opening periods amounts had they been presented in the issuer's statutory financial statements.

26 Where the opening financial year has been restated, FEE's position is that issuers should be expected to present only comparable information and therefore present the opening financial year as restated. Whilst FEE would not expect the opening year's amounts as originally presented to be shown, it may be the case that in order to include the audit report on the opening year it is necessary also to present the opening period as originally presented using a "1+3" tabular form of presentation.

Audit of the annual financial information

27 FEE is concerned that the requirement to include the audit report in respect of each year of historical financial information will give rise to some serious conceptual and practical difficulties.

28 These difficulties are most evident where the historical financial information is restated, which will occur frequently. Requiring the previous audit reports on the previously published financial statements to be reproduced would often be misleading for the investing public in that they are not related to the restated figures published in the prospectus.

29 Furthermore, to require the inclusion of the audit report for each year in effect requires that the previously published financial statements are also reproduced. This conclusion is supported by the Fourth and Seventh Company Law Directives which require that an audit report cannot be presented without the financial statements to which it relates. FEE believes that this regulatory conflict could be resolved by issuers incorporating, where appropriate, their last three year's statutory financial statements and the accompanying audit reports into a prospectus and by issuers presenting a comparative table of the three year's information extracted from those accounts in the body of the prospectus.

Issuers operating for less than one year

30 FEE notes that the Recommendations do not address the application of the requirements concerning an issuer that has been operating in its current sphere of economic activity for less than one year, as set out in paragraph 3 item 20.1.

31 Is it intended that this requirement address the historical financial information to be included in a prospectus when an issuer has not, at the time of issuing the prospectus, prepared statutory financial statements or is it tied to the commencement of "operations"? FEE's view is that the commencement of operations is more relevant to investors. Commencement of operations should mean the date of beginning specific economic activities and not later than the date of registration as a company. This provision should apply whenever an issuer has changed its sphere of operations. FEE's view is that "sphere of operations" should be defined. It would be helpful if CESR were to address this particular issue when formulating its final Recommendation.

32 FEE recommends that the balance sheet should be drawn up to a date not more than three months earlier than the prospectus is to be dated. This has the advantage of being consistent with the other time limit rules in the implementing measures set out in Annex 1, Appendix A, items 20.5.1 and 20.6.2 to the Regulation.
Complex financial histories

33 FEE believes that it is essential that recommendations be provided in respect of complex financial histories. This is particularly important given the interaction of the historical financial reporting disclosure requirements with those for pro forma financial information. We comment in detail below on the recommendations for start-up companies. We note that a new holding company imposed over a pre-existing group or business would be caught by the definition of a start-up company, whereas clearly it should be seen as, in substance, having a three year historical record.

34 In FEE’s view a complex financial history can arise when an issuer has not been required historically to prepare statutory financial statements presenting the totality of its operations, for example because it is a new holding company or it has been part of a larger consolidated group. This could occur when a business has been, or is being, separated from a larger group, for example at the time of demerger and separate listing or on acquisition by another listed group – a so-called “carve out”. It can also be the case that a number of businesses are grouped together for the first time at the time of a public offer or admission to trading.

35 Is it appropriate to present combined financial information rather than a disclosure based approach, highlighting those operations discontinued or presenting separate information for the component entities? FEE’s view is that there are many circumstances where it is appropriate to present a single combined set of financial information for a business offering its shares to the public or seeking admission to trading on a regulated market.

36 In deciding which route to adopt for entities with a complex financial history, FEE believes that the following criteria should be taken into account; however, it should be noted that each situation is unique and requires separate consideration:

(a) Whether the business or entities to be combined were under common ultimate ownership throughout the periods to be presented.

(b) The extent to which the businesses or entities to be combined can be said to have been separately managed and operated from the other businesses and operations from which they are being separated.

(c) The relative size of the businesses or entities to be combined when compared with the totality of the businesses and entities from which they are being separated.

(d) Whether it would be misleading in the context of the circumstances for which the information is to be presented to exclude the results and assets of those operations not the subject of the transaction concerned.

(e) The practicalities of whether it is possible to identify the historical financial information attributable to the businesses and entities to be combined. In particular, material allocations of revenues, cost, assets or liabilities should not be made on the basis of arbitrary assumptions but should be based on verifiable financial or non-financial metrics.

37 To the extent that the businesses or entities were not under common control, FEE’s view is that separate historical financial information for the material constituents should be presented for the required periods together with pro forma financial information prepared in accordance with the rules set out in Annex II to the Regulation. FEE believes that information should be provided to cover at least 75% of the whole group. The 75% is considered a useful threshold similar to the one used in IAS 14 for segment information.

38 If the businesses or entities to be reported on do not meet the criteria in (b) to (e) set out above, it will be necessary to present financial information on the totality of the businesses and entities, with separate disclosure of the operations either previously discontinued or not the subject of the transaction for which the prospectus is being issued.
If the existing historical financial information of the total operations has not separately identified the results and assets of the operations not being acquired, it may be necessary to prepare restated accounts in accordance with the restated accounts principles.

FEE believes that it would be helpful if there were guidance in this area and that it should provide some practical examples in order to assist issuers in the application of the criteria. FEE would be pleased to assist in identifying appropriate examples.

One question that does need to be addressed is whether combined financial information can be said to show a true and fair view. The concern is that IFRS does not permit consolidated accounts to be prepared in all circumstances, for example if there was no parent entity or the parent entity had no explicit control over the businesses and entities of which it is to become the parent at the time of separation.

FEE’s view is that it is appropriate to define the reporting entity specifically for the purposes of the prospectus and, save only in that regard, IFRS should be applied in full. This approach is consistent with that adopted in some Member States today as well as in the United States of America. In particular, combined historical financial information should present an allocation of what actually happened in the periods being reported on which is consistent with the financial and corporate structure taking effect at the time of separation. It should not, for example, make assumptions about business relationships that might exist going forward but that are not supported by appropriate corroboration.

FEE believes that not only should CESR provide recommendations covering this matter but that it should liaise with the IASB and IAASB so that they address the implications for accounting and auditing standards.

Pro forma financial information

Q: Do you agree with this proposal? If not, please state your reasons.

FEE supports the proposal to refer to the independence requirements of the 8th Directive on statutory audit in the definition of an “independent accountant”. FEE notes that this has wider application in the Regulation than just pro forma reporting and recommends that the topic is dealt in its own right.

FEE does not believe that accountants other than those qualified to be appointed as statutory auditor should be able to report as required by the Regulation. Accordingly, it is unnecessary to consider the equivalence of professional qualifications etc.

Q: Please provide examples of indicators of size which you consider appropriate.

FEE believes that it is necessary to consider what is meant by “significant gross change” and how such change is to be measured.

In FEE’s view, relevant transactions means those resulting in changes in corporate structure that meet at least one of the following criteria as defined as set out below:

(a) On the transaction date, the total assets of the subsidiary, group or part of an entity acquired or disposed of exceed 25% of the total assets stated in the most recent statements prepared by the issuer prior to the relevant transaction; or

(b) The revenues of the most recently completed fiscal year of the subsidiary, group or part of an entity acquired or disposed of are more than 25% of the revenues of the issuer for the most recently completed fiscal year; or
(c) The acquisition costs of the subsidiary, group or part of an entity or the sale proceeds from the disposition of the subsidiary, group or part of an entity are more than 25% of the total assets stated in the most recent financial statements prepared by the accounting entity prior to that transaction.

48 Other criteria that could be considered include comparing profits or shareholders equity. FEE also believes issuer’s should be encouraged to consider industry specific criteria where appropriate.

99. Q: CESR members had a discussion on appropriate definitions of indicators of size. Should they refer to IAS/IFRS figures, local GAAP figures, other definitions or not defined at all? If you provided indicators of size in response to the preceding question, please explain your preferences on definitions of the proposed indicators.

49 FEE believes that it would overcomplicate the recommendations were CESR to address all the possible issues such as differing GAAP which could arise when issuers apply relevant indicators of size. In FEE’s view it should be sufficient to allow issuers to address anomalies by agreement with the relevant competent authority.

Other matters to be addressed

IFRS 3

50 FEE draws CESR’s attention to the requirement of the recently published IFRS 3, paragraph 70, to disclose the impact on an acquirer’s turnover and profit or loss by way of combined figures as if a business combination had occurred at the beginning of the financial year. IFRS 3 does not provide any detailed rules concerning how this “proforma” information is to be calculated. Accordingly, Annex II to the Regulation and any guidance that CESR may issue will effectively set such rules. FEE encourages CESR to liaise with the IASB before finalising its guidance.

Defining transactions

51 Pro forma information is required when transactions result in a significant gross change. The Regulation however gives no guidance as to which transactions need to be considered for a description of their impact in a prospectus.

52 FEE’s view is that “transactions” should be defined to mean transactions that result in a change in corporate structure.

53 Pro forma financial information is normally expected to be prepared only when relevant transactions have been completed at the date at which a prospectus, or registration document, is prepared. In FEE’s view pro forma financial information should not be prepared where transactions are in contemplation unless they are the purpose for which the prospectus is being prepared, for example a proposed securities offering to raise cash or in connection with an offer to acquire, or fund the acquisition of, another company. However, we note that in the latter case, where an offer is contested all of the necessary information required to compile pro forma financial information may not necessarily be available.

Merger accounting exception

54 Recital 9 to the Regulation specifically refers to the fact that pro forma financial information may not be required when merger accounting is required. The availability of this exception needs to be understood.

55 It is FEE’s view that the Recommendations should indicate that the exception captures only those situations where merger accounting, where permitted by GAAP, has been applied to an acquisition
completed prior to the latest financial year end balance sheet date presented in the prospectus. FEE believes that the basis of accounting for a transaction completed after the last reported year end should not determine whether pro forma financial information ought to be presented but rather only the basis on which it is prepared.

What is meant by pro forma financial information?

It should be noted that the Regulation does not define the term “pro forma financial information”. From analysis of some of the existing rules and practices for pro forma financial information it is evident that there is no common understanding of “pro forma financial information”. It could be read from Annex II that pro forma information seems to include the primary financial statements (balance sheet, income statement, cash flow statement and changes in equity) adjusted for the effects of the transaction. More guidance as to what is expected and as to whether the issuer in all cases is required to give all the primary financial statements is needed.

FEE also notes that GAAP in some jurisdictions requires disclosure of so called “pro forma financial information” in an issuer’s statutory financial statements on a basis that may not be consistent with the requirements of Annex II. FEE encourages CESR to make it clear that, for the purpose of a prospectus “pro forma financial information” has a specific meaning and that, in effect, other non-GAAP information must be differently described.

Financial statements of acquired businesses

It is noted that, if applicable, the financial statements of the acquired businesses or entities must be included in the prospectus. In FEE’s view the requirements concerning these financial statements need to be determined:

- What form the financial statements should take;
- How many years information to present;
- What action is required if they have not been prepared on the same accounting policies as those of the issuer of the prospectus; and
- To what date should they be drawn up.

FEE’s position is that the financial statements of acquired businesses should be prepared on a basis consistent with the historical financial information requirements imposed on the issuer.

In order that pro forma financial information can be presented, as required, on consistent accounting bases it may be necessary to make adjustments to the underlying financial information of a business to be acquired.

In FEE’s opinion, there are two possible approaches, either to include the necessary adjustments as part of the explanatory notes to the pro forma financial information or to require the preparation of special purpose financial statements for the acquired business on the basis of the issuer’s accounting policies. FEE’s position is that in those circumstances where audited financial statements exist for the acquired business it is appropriate to include reconciling items as adjustments in the pro forma notes.
Presentation of information - New accounting policies

62 The reference to the accounting policies adopted by the issuer in its last or next financial statements requires clarification as to its intent.

63 For the issuing entity, the historical financial information should be that set out in the prospectus. Therefore, FEE's view is that this requirement should be clarified as meaning that the pro forma financial information is on the same basis as the historical financial information as required under Annex I Item 20.1.

Pro forma information in respect of the current financial period

64 The question of what is meant by the "current financial period" needs clarification.

65 In interpreting Annex II, item 5(a), the reference to the current financial period may permit a profit forecast to be used as the unadjusted basis of pro forma financial information. Whilst CESR allows pro forma financial information to be presented for the most recent interim period for which relevant unadjusted information has been or will be published in the same document, the presentation in respect of the current period is not expressly limited to profit forecasts already published or those that will be published in the same document.

66 FEE believes that for the sake of clarity there should be a clear distinction between pro forma financial information and profit forecasts.

Basis for adjustments

67 FEE welcomes the inclusion in the Recommendations of explanation of the terms "directly attributable" and "factually supportable" in paragraphs 93 and 94 as well as the clarification in paragraph 95. FEE believes it would be helpful if the application of these terms were to be illustrated by reference to examples of adjustments.

Financial data not extracted from the issuer's audited financial statements

103. Q: Do you agree with this proposal? If not, please state your reasons.

68 FEE agrees with the proposal that actual audited historical financial information should be given greater prominence than any forecast, estimated or pro forma figures.

69 Whilst agreeing with the point, FEE believes that the recommendation regarding a statement that investors should read the whole prospectus and not just rely on the key or summarised information properly belongs in the section dealing with "selected financial information".

Interim financial information

112. Q: Do you agree with this proposal? If not, please state your reasons.

70 FEE agrees with the proposals regarding the content of interim financial information for the application of item 20.6.2.

71 Whilst accepting that a pragmatic solution to the definition of "interim financial statements", for the purposes of Annex I Item 20.5, is to define them to be the same as the interim financial information required under item 20.6.1, FEE questions what the purpose is of item 20.5? FEE suggests that the Recommendations make it clear that under item 20.5 it is after 15 months have passed since the last year end that the interim financial information needs to be audited and that after 18 months the latest
financial year’s financial information needs to be audited. FEE also notes that by imposing an “audit” requirement the Recommendations imply that a true and fair view opinion is required. Accordingly, FEE considers that this has the effect of requiring full financial statements, since condensed financial statements such as allowed by IAS 34 cannot be said to show a true and fair view.

Where a new issuer seeking admission to trading will not be subject to Regulation (EC) 1606/2002, and whilst accepting that paragraph 109 reflects the minimum requirements for interim reporting by such companies under the Transparency Directive, FEE’s position is that such issuers should present their interim financial information in accordance with the implementation of the Transparency Directive in their Member State.

One area not specifically covered in the Recommendations is the situation where issuers not trading on a regulated market make a further issue of securities or where a new issuer is not seeking admission to trading on a regulated market. FEE believes paragraph 109 should apply in such cases.

FEE’s view is that CESR should make it clear that the requirements for condensed financial statements in accordance with IAS 34 should be observed where a new issuer is seeking admission to trading on a regulated market. Where the issuer is not seeking admission to trading national requirements or GAAP equivalent to IAS 34, where these exist, should be applied or otherwise the principles of IAS 34 should be applied to the issuer’s national GAAP.

Working capital statements

Q: Do you agree with this proposal? If not, please state your reasons.

FEE strongly supports the proposals in relation to working capital statements. FEE is pleased to see that CESR has included explanation of the terms “working capital” and “present requirements” and has set out some principles for preparing working capital statements.

Capitalization and indebtedness; Annex III Item 3.2

Q: Do you agree with this proposal? If not, please state your reasons.

FEE notes that CESR has adopted a form driven approach to the presentation of capitalization and indebtedness statements. FEE does not believe that such a prescriptive recommendation is consistent with the general approach to prospectus disclosure.

However, paragraph 135 does make it clear, albeit indirectly, that CESR defines capitalization to include reserves. Whilst the table includes “legal reserve” and “other reserves” it does not explicitly include “profit and loss reserve”. It should be made clear whether the profit and loss reserve is to be included or not. If the profit and loss account is to be included, FEE believes that CESR should permit issuers to use their last publicly reported amounts notwithstanding that these might have been drawn up to a date outside the 90 day time limit. If this is not to be accepted, the potential costs to issuers of drawing up accounts to support a profit and loss account balance could be significant.

In FEE’s view, the Recommendations need to take account of the relevant IFRS captions in relation to financial instruments.

Other matters which in FEE’s view should be addressed in the Recommendations are that that the balances included in indebtedness should be determined in accordance with the accounting policies of the issuer and that there should be disclosure in the prospectus or securities note of the date at which indebtedness is determined.
Mineral companies

167. Q: Do you agree with the proposed recommendations? If not, please state your reasons.

80 FEE expresses no opinion on the non-financial aspects of the recommended disclosure.

81 FEE notes that 162.2(b) requires disclosure by issuers that have not been mineral companies for three years of “an estimate of the funding requirements of the company for at least two years following publication of the prospectus”. In addition, it requires “confirmation by an independent accountant or auditor that the cash flow estimate has been properly prepared on the basis of the assumptions stated and that the basis of accounting used for the estimate is consistent with the accounting standards and policies of the issuer.”

82 FEE believes that it is essential that the Recommendations refer to the principles by which a cash flow estimate must be included as a prerequisite for those responsible being able to demonstrate that the estimate is properly prepared. For convenience a cross reference to the principles for preparing working capital statements could be made.

83 FEE does not agree that the issuer’s auditors should be required to confirm that the cash flow estimate has been properly prepared. Such a requirement goes beyond any existing requirements applied by CESR members. FEE considers that requiring the issuer to make the necessary confirmation should provide investors with sufficient confidence in the care with which the statement has been prepared.

Start-up companies

187. Q: Do you agree with the specific disclosure requirements set out for start-up companies? If not, please state your reasons and refer to the additional information you think should be required.

84 FEE agrees that disclosure of the key elements of an issuer’s business plan for a start-up company is of importance to investors. However, FEE believes that it is important for CESR to clarify in what circumstances the figures from an issuer’s business plan would not be considered to be profit forecasts for the purposes of the disclosure and auditor reporting requirements of Item 13 of Annex I to the Regulation.

85 FEE also believes that the inclusion of explicit sensitivity analysis could lead investors to imply an unmerited degree of confidence in the possible range of performance outcomes that an issuer could achieve. In FEE’s view better information is provided by describing the sensitivities and the extent to which they interact with each other.

86 FEE also questions the relative importance of the disclosure in paragraph 186.d of “mention of the assets necessary for production not owned by the issuer.”

188. Q: Do you agree with the proposed definition of start-up companies? Would you instead prefer that these companies are defined as those that have less than three years of existence? Please state your reasons.

87 FEE does not agree with the proposed definition of start-up companies. As proposed a new company incorporated to acquire a pre-existing business, whether operated through statutory entities or not, would be treated as a start-up company. This should clearly not be the case. The appropriate remedy to the short operating history, or indeed existence, of the company, is to require the presentation of the three year history of the underlying business. The definition should be expanded to exclude newly formed companies that have or are about to acquire a business with a three year trading record.
Expert's report

88 FEE expresses no view on the merits or otherwise of including expert’s reports in the prospectuses of start-up companies.

Compensation

229. Q: Do you agree with the usefulness of the proposed recommendations and with the level of detail provided for? If not, please state your reasons.

89 FEE agrees with the proposals for compensation disclosure.

230. Q: Do you think additional information is required? Which one?

90 FEE does not believe that any additional information is required.

231. Q: Do you think information in compensation could be presented in another way? If yes, please provide examples.

91 FEE is content with the presentation recommended.

Related party transactions

243. Q: Do you think recommendations are needed in this matter? If not, please state your reasons.

92 FEE believes that recommendations are needed in this area and that the proposals set out in paragraph 242 are appropriate.

244. Q: Do you agree with the proposed recommendations? If not, please provide examples of what other definitions of who can be considered related party to an issuer could be followed.

93 FEE agrees that the only practical solution is to define related parties as in IAS/IFRS.
APPENDIX 2

Other matters not addressed by CESR

Set out below are some matters FEE has identified as giving rise to uncertainty in their practical application. FEE believes that these should also be addressed in the Recommendations.

Age of latest financial information

1 The requirements of the Regulation in respect of the age of the latest financial information thereof are set out below:

"The last year of audited financial information may not be older than one of the following:
(a) 18 months from the date of the registration document if the issuer includes audited interim financial statements in the registration document;
(b) 15 months from the date of the registration document if the issuer includes unaudited interim financial statements in the registration document."

How do the time limits work?

2 Clarity as to the precise meaning of this requirement is needed, and in particular what is happening in each of the three periods: up to 15 months, 15 to 18 months; and after 18 months.

3 Our understanding is that between 15 and 18 months, there needs to be audited interim financial statements and that after 18 months audited full financial statements are needed. Before 15 months, unaudited interim financial statements should be included but it is not clear to us when the counting of this period starts and whether this provides any requirement in addition to item 20.6.

Accounting reference date

4 Another issue arising is as to whether it is necessary to indicate to which date the financial information should be drawn up other than a date later than the 15 or 18 month time limit would require.

5 FEE’s view is that technically the financial information could be drawn up to a date three months into its financial year but no earlier. In practice, FEE would expect issuers to choose a date coincident with their normal reporting dates.

Significant change in the issuer’s financial or trading position

6 The requirements of the Regulation regarding significant change in disclosure are set out below:

"A description of any significant change in the financial or trading position of the group which has occurred since the end of the last financial period for which either audited financial information or interim financial information have been published, or provide an appropriate negative statement."

Need for guidance

7 Whilst this disclosure has been required for many years under the Listing Particulars Directive (now part of the Combined Admission and Reporting Directive,) there has never been any guidance as to how this statement is to be interpreted, as to either the meaning of financial position and trading position or what constitutes a significant change.
8 It is FEE’s position that this disclosure should reflect the specific circumstances of each issuer and that therefore other than in very general terms it is not possible to provide guidance as to the significance of any changes. However, it would be helpful to issuers if there were guidance as to the meaning of financial position and of trading position.

9 FEE’s view is that financial position can only be determined against changes in the components of an issuer’s balance sheet.

10 FEE’s view is that the only practicable way of determining changes in an issuer’s trading position is against financial amounts as shown in its profit and loss account. In making the statement, whilst it runs from the last reporting date, it takes account of the corresponding period in the previous financial year.

Quarterly reporting

11 The question arises as to whether the significant change statement can be measured from an issuer’s quarterly reporting date.

12 FEE’s position is that where issuers are traded on a regulated market they should be permitted to consider significant change as being measured from their quarterly reporting date only if they have presented financial information at least to the standard that they are required to disclose in their half-yearly reports.

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