

# Financial Reporting Bulletin

## The Walker Report

### Recommended disclosures for private equity firms and their portfolio companies

#### Background

At the end of February 2007, Sir David Walker was asked by the British Venture Capital Association (the BVCA) and a group of major private equity firms to undertake an independent review of the adequacy of disclosure and transparency in private equity with a view to recommending a set of guidelines for conformity by the industry on a voluntary basis. The report was commissioned in the wake of the recent growth in large-scale private equity buyout activity which typically features the introduction of substantial leverage into the balance sheet of acquired portfolio companies coupled with, where listed companies are taken private, a diminution in reporting and governance obligations. The introduction of a degree of accountability was seen as imperative for the perceived social legitimacy of private equity particularly where acquisitions include major UK companies that, in some cases, are seen to have iconic significance.

A consultative document was published in July 2007 and following a process drawing input from, and involving discussion with, a wide range of interested parties, the Walker Report (the Report) was published in November 2007.

The Report sets out guidelines on enhanced disclosure for certain private equity firms and their portfolio companies (as defined), and makes recommendations for adoption by the BVCA in respect of data gathering, processing and reporting on an industry-wide basis, and for the establishment of a review group to keep the guidelines under review and to monitor conformity with them.

This Financial Reporting Bulletin (FRB) summarises the recommendations made in the Report in respect of public disclosures made by private equity firms and portfolio companies covered by the enhanced reporting guidelines. It also sets out our view of what might be considered to be best practice regarding the application of the recommendations to private equity firms and portfolio companies that fall outside of the scope of the enhanced reporting guidelines.

The Report also includes a number of recommendations covering guidelines for the BVCA, data that might be provided to the BVCA by portfolio companies and private equity firms, and guidelines on how private equity firms report to limited partners. These are not covered in this FRB as its focus is the publicly available information published by portfolio companies and private equity firms, and in particular their financial statements.

The full text of both the consultation document and the final report can be found at the following link: <http://www.walkerworkinggroup.com>.



## Definitions

The definition of a private equity firm for the purpose of the guidelines is:

A firm authorised by the FSA that is managing or advising funds that either own or control one or more UK companies or have a designated capability to engage in such investment activity in the future where the company or companies are covered by the enhanced reporting guidelines for portfolio companies.

The definition of a portfolio company to be covered by enhanced reporting guidelines is:

A UK company

- a) Acquired by one or more private equity firms in a public to private transaction where the market capitalisation together with the premium for acquisition of control was in excess of £300m, more than 50 per cent of revenues were generated in the UK and UK employees totalled in excess of 1,000 full-time equivalents.
- b) Acquired by one or more private equity firms in a secondary or other non-market transaction where enterprise value at the time of the transaction is in excess of £500m, more than 50 per cent of revenues were generated in the UK and UK employees totalled in excess of 1,000 full-time equivalents.

For the purposes of this FRB, private equity firms and portfolio companies falling within the scope of the recommendations are referred to as 'larger private equity firms' and 'larger portfolio companies' and those that fall outside of the scope of the recommendations as 'smaller private equity firms' and 'smaller portfolio companies'.

## The Walker Report recommendations

The Report makes the following recommendations which it suggests should be followed on a 'comply or explain' basis (ie where an entity does not comply with the guidelines, an explanation for the non-compliance should be included alongside other guidance called for under the guidelines):

### Larger portfolio companies – Disclosure

The guidelines recommend that a larger portfolio company should include as part of its audited annual report and accounts the following enhanced disclosures, which should throughout focus on substance rather than form and on the economic reality of a company or group rather than its legal structure:

- 1 The report should identify the private equity fund or funds that own the company and the senior executives or advisers of the private equity firm in the UK who have oversight of the company on behalf of the fund or funds.
- 2 The report should give detail on the composition of the board, identifying separately executives of the company, directors who are executives or representatives of the private equity firm, and directors brought in from outside to add relevant industry or other experience.

**The Walker Report  
recommendations  
Continued**

- 3 The report should include, in its business review, information that substantially conforms to the provisions of Section 417, sub-section 5 of the Companies Act 2006 which is ordinarily applicable only to quoted companies. Namely that:

“...the business review must, to the extent necessary for an understanding of the development, performance or position of the company’s business, include:

- a) the main trends and factors likely to affect the future development, performance and position of the company’s business; and
- b) information about –
  - i) environmental matters (including the company’s impact on the environment),
  - ii) the company’s employees, and
  - iii) social and community issues, such as policies and their effectiveness; and
- c) subject to subsection (11), information about persons with whom the company has contractual or other arrangements which are essential to the business of the company.

If the review does not contain information of each kind mentioned in paragraphs (b)(i), (ii) and (iii) and (c), it must state which of those kinds of information it does not contain.”

- 4 The financial review should cover risk management objectives and policies in the light of the principal financial risks and uncertainties facing the company, including those relating to leverage, with links to appropriate detail in the footnotes to the balance sheet and cash flow section of the financial statements.
- 5 To the extent that the guidelines at (2) and (3) above are met by existing market disclosures in respect of debt or equity issuance on public markets, this should be explained with the relevant material made accessible on the company’s website; and where compliance with these guidelines, in particular in respect of any forward-looking statement, might involve conflict with other regulatory obligations, the reason for non-compliance should similarly be explained on the company website.

## **The Walker Report recommendations Continued**

### **Larger portfolio companies – form and timing of public reporting**

In addition to the disclosure guidelines, the Walker Report recommends that:

- 1 The audited report and accounts should be readily accessible on the company website.
- 2 The report and accounts should be made available no more than six months after the company year-end.
- 3 A summary mid-year update giving a brief account of major developments in the company (but not requiring updated financial statements) should be placed on the website no more than three months after mid-year.

### **Larger private equity firms – communications**

A larger private equity firm should publish an annual review accessible on its website or ensure regular updating of its website to communicate:

- 1 A description of the way in which the FSA-authorized entity fits into the firm of which it is a part with an indication of the firm's history and investment approach, including investment holding periods, where possible illustrated with case studies.
- 2 A commitment to conform to the guidelines on a comply or explain basis and to promote conformity on the part of the portfolio companies owned by its fund or funds.
- 3 An indication of the leadership of the UK element of the firm, identifying the most senior members of the management or advisory team and confirmation that arrangements are in place to deal appropriately with conflicts of interest, in particular where it has a corporate advisory capability alongside its fiduciary responsibility for management of the fund or funds.
- 4 A description of UK portfolio companies in the private equity firm's portfolio.
- 5 A categorisation of the limited partners in the funds or funds that invest or have a designated capability to invest in companies that would be UK portfolio companies for the purposes of these guidelines, indicating separately a geographic breakdown between UK and overseas sources and a breakdown by type of investor, typically including pension funds, insurance companies, corporate investors, funds of funds, banks, government agencies, endowments of academic and other institutions, private individuals, and others.

**Best practice for smaller portfolio companies and smaller private equity firms**

As noted above, the guidelines in the Walker Report are aimed primarily at larger portfolio companies and the private equity firms that invest in them. In practice, this makes the Report relatively narrow in scope; it is estimated that only six to 12 private equity firms (including Apex and Alchemy Partners) and 65 portfolio companies (including the retailer New Look, and the supermarket chain Sommerfield) would be directly affected.

The Report, however, does indicate that the thresholds it specifies particularly in terms of employee numbers (1,000 full time equivalents), immediately below the current threshold. It goes on to say that it expects that the boards of all companies owned by private equity should be closely attentive to other stakeholder interests, in particular those of employees. It is clear, therefore, that the Walker Report envisages that portfolio companies and private equity firms that fall outside the scope of its guidelines are still expected to consider how they might comply with the recommendations although it is difficult to predict the extent to which this will colour in practice because:

- The Companies Act 2006, section 417, sub-section 5 and the provisions of International Financial Reporting Standard 7 'Financial Instruments: Disclosures' (from which the financial risk management objectives and policies disclosures are drawn) are new and still being interpreted even by the quoted companies for which they are mandatory.
- The extension of these guidelines to smaller portfolio companies and private equity firms is being resisted by certain industry groups such as the European Venture Capital Association.

**Best practice for smaller  
portfolio companies and  
smaller private equity firms  
Continued**

- The Companies Act 2006, section 417, sub-section 5 and the provisions of International Financial Reporting Standard 7 'Financial Instruments: Disclosures' (from which the financial risk management objectives and policies disclosures are drawn) are new and still being interpreted even by the quoted companies for which they are mandatory.

Nonetheless, in the light of the concerns which gave rise to the commissioning of the Report, it is our view that smaller portfolio companies and private equity firms should be advised to consider the recommendations and apply the elements of the guidelines which are appropriate to their own circumstances and stakeholder groups.

**Portfolio companies – Disclosure**

The disclosures recommended by the Report are drawn from the disclosures that quoted companies are required to make in accordance with company law, listing regulations or accounting standards. This approach has been adopted because of the perceived similarities between larger private equity funded companies and their quoted counterparts, the policies and performance of which a number of stakeholder groups such as employees, suppliers and customers, and the public more widely, have a legitimate interest.

It would seem appropriate for smaller portfolio companies also to draw on the disclosure requirements placed on equivalent public companies, whether they are smaller quoted companies or those listed on unregulated markets such as the Alternative Investment Market (AIM). In respect of AIM companies:

- They would not be required to give the disclosures described in section 417(5) of the Companies Act 2006 and thus would not generally provide detailed information on environmental issues, the company's employees or social and community issues, or future trends and factors likely to affect the future development of the company's business, unless that information amounted to a principal risk or uncertainty (which all companies required to present a business review must describe). Note that the Companies Act states that, for any company, the business review should be balanced and comprehensive but consistent with its size and complexity.

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### **Continued** Portfolio companies – Disclosure (continued)

- Many would, by virtue of the fact that they are required to prepare their consolidated financial statements in accordance with EU adopted IFRSs, be required to present information on financial risk management objectives and policies due to the requirements of IFRS 7.
- Whilst they are not required to do so, many AIM companies choose to make voluntary corporate governance disclosures that would include detail on the composition of the board and other influences over the policies of the company.

### **Portfolio companies – form and timing of public reporting**

The form and timing of public reporting guidelines for larger portfolio companies is based on the requirements of AIM companies, which are required to publish their annual accounts no later than six months after the end of the financial year to which they relate and to publish half-yearly financial information no later than three months after the end of the relevant period.

In our view, although many companies will elect to publish their financial statements on the company website, it will not generally be considered necessary for a smaller portfolio company to adopt the other form and timing recommendations.

### **Private equity firms – communications**

In our view it would be beneficial for a smaller private equity company to communicate its commitment or otherwise to conform to the guidelines set out in the Walker Report as well as to provide a description of the UK portfolio companies that it holds an interest in. It would not currently seem necessary for smaller private equity firms to adopt the other communication recommendations.

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