Guidelines Monitoring GROUP

Private Equity Monitoring Group on Transparency and Disclosure

SEVENTH REPORT – DECEMBER 2014

GUIDELINES MONITORING GROUP

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GUIDELINES MONITORING GROUP

EXECUTIVE SUMMARY

1

This is the seventh annual report of the Guidelines Monitoring Group (the "Group") and provides a summary of the private equity industry's conformity with the Guidelines for Disclosure and Transparency in Private Equity (the "Guidelines") following their introduction in November 2007.

The Group was established in March 2008 to monitor conformity with the Guidelines recommended by Sir David Walker in 2007 and make periodic recommendations to the British Private Equity and Venture Capital Association (the "BVCA") for changes to the Guidelines if required.

Highlights of the 2014 review

- Compliance levels by portfolio companies covered by the current Guidelines further improved this year with full compliance on the reporting requirements by the 25 companies reviewed. All companies achieved either a good or excellent level of disclosure overall with the proportion in the latter category increasing by 9% to 16%. The benchmark against which compliance is measured – the FTSE 350 – has also seen standards of disclosure improve and in this context, the results support the industry's commitment to transparency. However, whilst overall compliance levels were good, there continued to be variability in the quality of disclosures on individual requirements and not all the companies reviewed met the publication and data provision requirements.
- The Group continues to review the Guidelines to ensure they evolve over time and remain relevant. 2014 saw the first amendments to the content requirements in the Guidelines to incorporate new narrative reporting requirements in the UK and a statement of conformity for portfolio companies. Therefore in the upcoming reporting season, a higher level of thought and preparation will be needed if portfolio companies are to achieve a good or excellent level of compliance with the Guidelines next year.
- The number of portfolio companies required to comply with the Guidelines decreased by one to 71, following a record year of transaction activity since the Guidelines were implemented in 2008. This includes five portfolio companies that exited and re-entered the population following a change in ownership.
- The number of private equity firms managing or advising funds which owned the portfolio companies within scope increased by two to 55. The Guidelines extend to firms that conduct their business in a manner that would be perceived by external stakeholders to be similar to that of other participants in the private equity industry and the new entrants were all 'private equity-like' firms. Following a further review this year, the Group amended the definition of private equity firms covered by the Guidelines to include these firms.
- The Group is committed to working with private equity firms, 'private equity-like' firms and portfolio companies to improve their disclosures and strongly encourages standards above the minimum requirements within the Guidelines, being those observed in the FTSE 350. Detailed feedback will be provided to all parties involved to help achieve this objective. This is particularly important in the forthcoming reporting season as the Guidelines were amended in 2014, following a consultation, to incorporate new narrative reporting requirements in the UK.

- Disappointingly, only 20 of the portfolio companies reviewed made the audited report and accounts available on the company's website and a further two published a Walker Guidelines-compliant report that was not the full audited accounts. The Group continues to reinforce the message that accounts should be readily accessible on the company's website and will be monitoring this in more depth next year, including the requirement to publish within the six month period.
- Portfolio companies markedly improved the level of disclosure covering strategy, the market environment and principal risks and uncertainties. However, disclosures covering environmental matters and social and community issues were weaker.
- The Guidelines operate on a 'comply or explain' basis and none of the portfolio companies reviewed adopted an 'explain' approach within their annual report. One 'private equity-like' owner provided an explanation for non-compliance separately.
- The Financial Reporting Council's Clear & Concise initiative is aimed at ensuring that annual reports provide relevant information and is regarded as a key step towards higher quality corporate reporting. This, coupled with new narrative reporting and corporate governance requirements in the UK, is leading to higher standards in the FTSE 350. Accordingly, portfolio companies need to embrace these developments to continue to meet the Group's benchmark. Preparing annual reports underpinned by strategic priorities which clearly link different elements of reporting together will help in achieving this objective.
- The Group reviewed the websites and/or annual reports of all private equity firms covered by the Guidelines to assess compliance with applicable disclosure obligations relating to their own activities. Members of the BVCA met the requirements or were in the process of updating them at the time of the publication of this report.

1.1 The Guidelines

In February 2007, the BVCA asked Sir David Walker 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. This review resulted in the publication of the Guidelines in November 2007 and these are summarised in Section 2.

The Guidelines require additional disclosure and communication by private equity firms and their portfolio companies where the private equity firms and portfolio companies meet the Guidelines criteria. The criteria together with details of the full requirements under the Guidelines are set out in Appendix 3.

In addition to the enhanced disclosure requirements, the Guidelines include requirements on data provision by private equity firms and portfolio companies to the BVCA, adoption of certain valuation guidelines and reporting to limited partners. During periods of significant strategic change, private equity firms are responsible for ensuring timely and effective communication with employees.

1.2 Guidelines Monitoring Group

The members of the Group are:

Nick Land	Chairman & independent member
Baroness Jeannie Drake	Independent member
Glyn Parry	Independent member
Gerry Murphy	Industry representative (Blackstone)
Ralf Gruss	Industry representative (Apax)

At the start of 2014, Robert Easton stepped down as an industry representative and Ralf Gruss was appointed to the Group. The Group and BVCA would like to thank Robert for his significant contribution and dedication to the Group over the years.

Meetings of the Group are attended by Tim Hames, BVCA Director General, Gurpreet Manku, BVCA Director of Technical & Regulatory Affairs, PwC and EY (both advisors to the Group) by invitation.

1.3 Private equity firms and portfolio companies covered by the Guidelines

Details of the private equity firms and portfolio companies that fall within the scope of the Guidelines are set out in Appendices 1 and 2.

1.3.1 Private equity firms

The number of firms covered by the Guidelines has increased this year from 53 to 55 due to movements in the underlying population of portfolio companies within scope. The Guidelines extend to firms that conduct their business in a manner that would be perceived by external stakeholders to be similar to that of other participants in the private equity industry and include infrastructure funds, sovereign wealth funds, pension funds and – increasingly – firms operating in the debt and credit opportunities space. Following a detailed review this year, the Group amended the definition of private equity firms covered by the Guidelines to include 'private equity-like' firms. The full definition is set out in Appendix 3 and Appendix 1 explains how minority and other shareholders are monitored.

Table 1: Number of private equity firms covered by the Guidelines

	2013 report	2014 report
Private equity firm	30	28
Private equity-like firm	23	27
Total	**53**	**55**

Onex Partners, which has a majority stake in Tomkins (the minority being held by The Canadian Pension Plan Investment Board), has provided an explanation for not complying fully with the Guidelines (as detailed in the Group's 2013 report). The Group notes that Tomkins was reviewed in the sample this year and it did comply with the disclosure requirements.

The Group continues to believe that 'private equity-like' entities with investments in significant UK businesses should comply with the Guidelines, and the Group will continue to encourage and work with these entities. For example, Global Infrastructure Partners, Infracapital Partners and Macquarie Infrastructure and Real Assets Europe have engaged with the BVCA.

1.3.2 Portfolio companies

A total of 76 portfolio companies were covered by the Guidelines this year (2013: 89). Of this number, 71 were included as required companies (2013: 72) and the rest complied voluntarily. Further details on the portfolio companies are included in Appendix 2.

Table 2: Number of portfolio companies covered by the Guidelines

	2013 report	2014 report
Required	72	71
Voluntary	17	5
Total	**89**	**76**

1.4 Review of compliance

PricewaterhouseCoopers LLP ("PwC") was reappointed as an independent advisory firm to assist the Group in carrying out this year's review of the disclosures made by a sample of portfolio companies. The sample included companies with accounting years ending up to and including 30 April 2014. This report summarises the findings of that exercise along with the Group's own review of the other requirements of the Guidelines.

1.4.1 Portfolio companies

PwC reviewed a total sample of 25 portfolio companies including 19 companies reviewed previously, 5 reviewed for the first time and one reviewed previously that had only achieved a basic level of compliance. Through annual sampling, the Group aims to ensure that all portfolio companies are reviewed at least once every three years, and will continue with its policy of re-reviewing companies whose reporting is regarded as not compliant with the Guidelines.

All portfolio companies reviewed by the Group this year met the enhanced disclosure requirements. The findings of this year's review continued to show a higher level of overall compliance with the Guidelines than in previous years with the proportion of companies providing excellent disclosure increasing from 7% to 16%. This is in part due to fewer new entrants in the population and also early engagement by portfolio companies new to the population. These were all owned by private equity firms with experience of complying with Guidelines and this was a contributing factor to the overall result. Within the sample reviewed for a second or third time, not all portfolio companies continued to improve disclosures in line with the benchmark (see further below) and the quality of compliance with individual requirements did vary in some of the companies reviewed.

The Group will continue to provide feedback to firms and portfolio companies to raise the levels of disclosure and adherence to the Guidelines, and to promote these as standard industry practice. Each private equity firm and portfolio company reviewed will receive a letter setting out the detailed findings of this year's review and recommendations for improvements. This is particularly important in the forthcoming reporting season as the Guidelines were amended in 2014, following consultation with the industry. The Guidelines have been updated to incorporate amendments to implement the Department of Business, Innovation and Skills' new narrative reporting regulations that came into effect in October last year for quoted companies. The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (the "Strategic Report Regulations") necessitated amendments to the Guidelines as they removed the requirement for a business review in the directors' report – which was the foundation for the enhanced disclosure requirements for portfolio companies – and moved this content, with a few additions, to a new report called the Strategic Report. The revisions to the Guidelines are therefore focused solely on the requirements for portfolio companies and the enhanced disclosures required to be comparable to quoted companies. This include requirements for further detail on the business model of the company, gender diversity and human rights issues.

The Group commissioned PwC to publish an update to its good practice guide in 2014, based on their findings and amended Guidelines. This incorporated the need for greater quality and clarity of disclosure to track the trends in both the FTSE 350 and the FTSE 100. This also sets out expectations for compliance with both the existing and new requirements.

The Group has continued to raise the required standard of overall disclosure to achieve compliance with the Guidelines as it benchmarks compliance against the standard of disclosure seen in the FTSE 350, with an emphasis on the better performers in this group, typically the FTSE 100. An excellent level of disclosure for portfolio companies is broadly comparable to those better performers. The FTSE 350 is a benchmark with a significant range and the expectation would be for portfolio companies to aspire to be near the top end of that range, albeit recognising the higher standards of the FTSE 100. The Group is assessing whether the FTSE 350 remains an appropriate benchmark given the variability identified and its own expectations.

The quality and level of disclosure by the FTSE 350 has increased in the last year due to new narrative reporting and corporate governance requirements in the UK. Against this backdrop, the results this year are encouraging, although not all requirements were complied with to the same degree. Portfolio companies markedly improved the level of disclosure covering strategy, the market environment and principal risks and uncertainties. However, disclosures covering environmental matters, and social and community issues were weaker. Portfolio companies are encouraged to review feedback received as the updated Guidelines include new requirements in these areas. Furthermore, a consistent theme seen across the sample reviewed, the FTSE 350 and the FTSE 100, is that there needs to be better linkage between the different elements of the annual report such as using strategic priorities to drive the narrative and linking this to KPIs and the discussion on market trends. When compared to the FTSE 100, further attention is required on the clarity of the disclosure around the business model (a new requirement for portfolio companies next year) and insights into the risk profile of the company.

The Guidelines require that conformity with each of the requirements is on a 'comply or explain' basis and explanations for non-compliance should be posted on the website. Within the population reviewed, none of the portfolio companies adopted an 'explain' approach.

In assessing conformity, the requirements under the Guidelines are separated into four areas: publication of reports; Guidelines specific; business review required by the Companies Act; and enhanced business review. The Group's key findings are summarised below along with comments on the quality of narrative reporting compared to trends seen across the FTSE 350.

1.4.1.1 Publication of portfolio companies reports

Disappointingly, only 20 of the portfolio companies reviewed made the full audited report and accounts available on the company's website and a further two published a Walker Guidelines-compliant report that was not the full audited accounts. The Group continues to reinforce the message that accounts should be readily accessible on the company's website and will be monitoring this in more depth next year, including the requirement to publish within the six month period.

1.4.1.2 Guidelines specific

All the portfolio companies in the sample reviewed identified the private equity fund(s) that were its owners and provided details on the private equity firms that had oversight of the company. The requirement to detail composition of the board was also met with directors from the private equity firm identified. The Group expects portfolio companies to aim for best practice when providing these disclosures as they are central to efforts to provide transparency on ownership. This includes presenting CVs of board members to demonstrate why their experience is relevant. The Group was therefore pleased to see improvements in compliance levels with these requirements in the current year as the overall quality had fallen in its 2013 review.

The Guidelines require a financial review which explains the financial position of the portfolio company at the year end and identifies financial risks facing it and the policies in place to manage and mitigate these. The level of excellent or good disclosure in these areas remained high at 92% and 84% respectively. Notwithstanding the overall results achieved on these requirements, the quality and level of disclosure on financial risks across the sample reviewed did vary considerably. The remainder only met the basic compliance expectations and these companies should take greater steps to provide improved disclosure. Given their generally higher indebtedness compared to quoted companies, this is a sensitive area for private equity owned businesses and companies should redouble their efforts to ensure clear and relevant disclosure. The expectations placed on FTSE companies with respect to disclosure on going concern, risk and viability have also been raised this year and therefore, the financial review disclosures for portfolio companies require continued focus.

1.4.1.3 Business Review (required by UK Companies Act)

Portfolio companies should set out a fair review of their business that covers strategy and the market environment in which they operate. Changes in narrative reporting in the UK in 2013 meant a number of companies were preparing strategic reports and had started to consider what would be required under the updated Guidelines. This in turn facilitated much improved disclosures on strategy and the market environment with nearly a third of the sample achieving excellent disclosure.

Principal risks and uncertainties were disclosed by all the portfolio companies reviewed and the better disclosures in this area also set out how the portfolio company sought to mitigate these risks. 36% of the sample reviewed provided an excellent level of disclosure, another improvement on the prior year's review (13%).

Portfolio companies are expected to set out financial and non-financial key performance indicators ("KPIs") used by the company to assess their position and performance. This level of excellent disclosure seen on financial KPIs did fall and the opposite was the case for non-financial KPIs. However, the high proportion of companies providing only basic disclosures in this area has continued and leads to variability in disclosure across the sample.

A continued theme is that disclosure in the areas above could be improved by **better linkage** to one another and other parts of the annual report and financial statements. This is also an area of weakness across the FTSE 350 although there have been improvements within the FTSE 100. Over the past year, quoted companies have sought to refresh their annual reports to ensure they are "fair, balanced and understandable" – a new requirement for companies complying with the UK Corporate Governance Code. This requirement, coupled with the Strategic Report Regulations, is expected to continue to facilitate improvements in the quality of reporting across the FTSE 350. The Group therefore believes a significant improvement is needed in this area.

1.4.1.4 Enhanced Business Review

The quality of disclosures in respect of trends and factors likely to affect future development, performance or the position of the company's business was mixed. The majority of portfolio companies provided some information but in many cases this information was historical and discussion lacked a forward-looking orientation supported by qualitative or quantitative information.

Disclosures on environmental matters and social and community issues were provided, however the level of good or excellent disclosure in this area was relatively weaker, compared to the FTSE 350, than in prior years. This is partly a consequence of higher standards seen in the FTSE 350 due to new narrative reporting requirements in the UK. Portfolio companies will need to take steps over the course of this year to ensure their disclosures are comparable in future years. Levels of good or excellent disclosures on employees remained high.

The level of good or excellent disclosure on essential contracts improved this year though this has continued to be an area where most portfolio companies reviewed could improve significantly, with clearer references to contracts important to the business. This disclosure will not be explicitly required in the updated Guidelines; however compliance will need to be carefully judged as there is an expectation that this should form part of the business risks assessment.

The areas discussed in this section should also link through to other elements of the annual report, especially when discussing strategy and the impact on risks and KPIs.

1.4.2 Private equity firm disclosures

This year, the Group reviewed the websites and/or annual reports of all private equity firms covered by the Guidelines to assess if they met the disclosure requirements relating to the publication of information including details on their investment approach, UK portfolio companies, and leadership of the firm. The information published varied with some firms opting for succinct statements and others providing extended information on strategy and detailed case studies.

Members of the BVCA met the requirements or were in the process of updating them at the time of the publication of this report. The BVCA and Group is monitoring how best to assess compliance with the disclosure requirements for private equity firms and this will be an area of focus in 2015.

Members of the BVCA also signed a statement of conformity with the Guidelines with respect to their own disclosure and data provision requirements and those of their portfolio companies. This is an annual commitment for private equity firms covered by the Guidelines.

1.5 Performance of portfolio companies

The Guidelines recommend that the BVCA should commission research into the trading performance of companies and attribution analysis in respect of exits and publish the findings. EY LLP was commissioned again in 2014 to undertake the research and this will be published alongside this report at www.bvca.co.uk/Research. Disappointingly, there were two owners of two portfolio companies that did not provide the information requested or an explanation for non-compliance: Camelot (Ontario Teachers' Pension Plan) and Viridian Group (Arcapita). Onex (the owner of Tomkins alongside Canadian Pension Plan) provided an explanation for non-compliance with this requirement. The compliance rate for the provision of data is 96% which has improved slightly from 92% last year.

1.6 Activities of the Group

When the Guidelines were introduced it was recognised that they would need to evolve over time to remain relevant. 2014 was a very active year for the Group which culminated in the first significant change to the contents requirements for the Guidelines and key projects have been summarised below.

1.6.1 A strategic report for portfolio companies

Following a consultation with the industry the Guidelines were updated to incorporate the Strategic Report Regulations. These necessitated amendments to the Guidelines as they removed the requirement for a business review in the directors' report – which was the foundation for the enhanced disclosure requirements for portfolio companies – and moved this content, with a few additions, to a new report called the Strategic Report. The revisions to the Guidelines are therefore focused solely on the requirements for portfolio companies and the enhanced disclosures required to be comparable to quoted companies. This includes requirements for further detail on the business model of the company, gender diversity and human rights issues. The Guidelines now also require portfolio companies to confirm compliance or provide explanations for areas of non-compliance within their annual reports. Further detail on these changes is available at www.walker-gmg.co.uk and the amended Guidelines have been reproduced in Appendix 3.

1.6.2 The impact of regulation

The Group decided not to amend the Guidelines for any of the applicable additional disclosure requirements included within the transparency provisions in the Alternative Investment Fund Managers Directive ("AIFMD"). A table setting out the interaction between the two sets of requirements is included in the Guidelines as set out in Appendix 3. Firms that are covered by the AIFMD may find the Guidelines and examples of good practice reporting by portfolio companies a useful source of guidance but are responsible for taking appropriate advice to ensure they are fully compliant with their AIFMD obligations.

1.6.3 The definition of a private equity firm

As highlighted above, the Group amended the definition of a private equity firm for the purposes of the Guidelines to incorporate 'private equity-like' firms. This is reproduced in Appendix 3 and was considered necessary given the changing nature of the owners of the portfolio companies covered by the Guidelines, and to provide clarity to firms in the industry to help them determine whether they are in scope.

1.6.4 2015 work plan

The Group's plan for 2015 includes:

- Supporting the industry when implementing the amended Guidelines that incorporate the Strategic Report. The Financial Reporting Council's ("FRC") Clear & Concise initiative[1], along with the Financial Reporting Lab's bulletins[2], is a programme of activities aimed at ensuring that annual reports provide relevant information and this initiative is regarded as a key step towards higher quality corporate reporting. This, coupled with new narrative reporting and corporate governance requirements in the UK, is leading to increased standards in the FTSE 350. Portfolio companies need to embrace these initiatives to continue to meet the Group's benchmark. Preparing annual reports underpinned by strategic priorities which clearly link different elements of reporting together will help in achieving this objective.
- Monitoring changes in narrative reporting, such as the FRC's statements implementing the recommendations arising from the Sharman Panel of Inquiry into going concern and liquidity risks. These are likely to impact the expectations for disclosures on the financial review.
- Continuing to review the enterprise value thresholds in accordance with developing European legislation and regulation.
- Reviewing the quality of disclosures published by private equity firms about their own activities.
- Monitoring whether portfolio companies are publishing their annual reports on a timely basis and within the six month timeframe. This includes the expectation that the full audited annual reports and accounts should be available on the company's website.

Over the next year, the private equity industry will implement the first set of substantial changes to the disclosure requirements in the Guidelines since their inception. We expect firms to rise to this challenge and would encourage them to use it as a catalyst to refresh their approach to reporting. This includes embracing the growing emphasis on clear and concise reporting which brings together the different elements of an annual review such as strategy, the assessment of risks and measures of performance in a fair, balanced and understandable manner. Acceptable transparency encompasses the timely publication of this information, as well its quality, and this will be an area of focus for the Group in coming year.

1 https://www.frc.org.uk/Our-Work/Headline-projects/Clear-Concise.aspx
2 https://www.frc.org.uk/Our-Work/Codes-Standards/Our-Work-Codes-Standards-Financial-Reporting-Lab.aspx

OVERVIEW OF THE GUIDELINES

2

The Guidelines set out recommendations and enhanced disclosure requirements for private equity firms, their UK portfolio companies and the BVCA. These are reproduced in Appendices 3 to 5 and summarised below. This summary does not include the amendments to the requirements on enhanced reporting for portfolio companies that will be applicable for certain portfolio companies next year.

2.1 Definition of private equity firms and portfolio companies covered by the Guidelines

The Guidelines apply exclusively to private equity firms and their UK portfolio companies as defined below.

Private equity firms for the purposes of the Guidelines include private equity and 'private equity-like' firms (together "PE firms"). PE firms include those that manage or advise funds that either own or control one or more companies operating in the UK and the company or companies are covered by the enhanced reporting guidelines for companies. PE firms include those that acquire portfolio companies: i) with funds provided by one or more investors; ii) an exit/disposal of the company is envisaged and iii) may play an active management role in the company. This would therefore include, but is not limited to, other types of investment funds including infrastructure funds, pension funds, sovereign wealth funds and credit/debt funds. It also applies to firms that may be headquartered outside of the UK. Banks and credit institutions, other than their asset management operations, are specifically excluded.

A private equity firm is a firm authorised by the FCA 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 companies.

A portfolio company 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 £210 million and more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full-time equivalents; or

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 was in excess of £350 million and more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full-time equivalents.

2.2 Summary of the content and timing of disclosure required by portfolio companies

A portfolio company should publish its annual report and accounts on its website within six months of the year end; and

- The report should identify the private equity fund or funds that own the company and provide details of the composition of the board;
- The financial review should cover risk management objectives and policies in light of the principal financial risks and uncertainties facing the company with links to the appropriate detail in the footnotes to the accounts; and
- The report should include a business review that substantially conforms to the provisions of Section 417 of the Companies Act 2006 including the Enhanced Business Review requirements that are ordinarily applicable only to quoted companies.

A summary of the detailed requirements for portfolio company disclosure can be found in Appendix 3.

2.3 Disclosure and communication required by private equity firms

A private equity firm should publish either in the form of an annual review or through regular updating of its website:

- A description of the way the FCA-authorised entity fits into the firm as a whole with an indication of its investment approach including investment holding periods along with an indication of the leadership of the firm and confirmation that it has appropriate arrangements to deal with conflicts of interest; and
- A commitment to conform to the Guidelines, a description of the companies in the private equity firm's portfolio and a categorisation of the limited partners in the fund or funds including a geographic categorisation and a breakdown by type of investor.

Additionally, private equity firms should, in their reporting to limited partners, follow established guidelines, such as those published by the International Private Equity and Venture Capital Valuation Board, follow established guidelines in the valuation of their assets, and should provide data to the BVCA in support of its enhanced role in data collection, processing and analysis.

Private equity firms should also commit to ensure timely and effective communication with employees, either directly or through their portfolio company, as soon as confidentiality constraints are no longer applicable.

2.4 Recommendations for initiatives to be undertaken by the BVCA

The Guidelines recommended that the BVCA should:

- Enlarge and strengthen its data gathering, analytical and reporting capabilities and should apply those capabilities to increased research activities including performance and attribution analysis for portfolio companies;
- Initiate discussions with "private equity-like" groups with the purpose of enlisting their voluntary undertaking to conform to the Guidelines; and
- Participate proactively with overseas private equity trade associations to develop a methodology for the content and presentation of fund performance information.

REVIEW OF CONFORMITY WITH THE GUIDELINES

3

3.1 Introduction

This section summarises the findings of the Group's review of conformity with the Guidelines and considers conformity in three areas:

Disclosure by a portfolio company	Communication by a private equity firm	Other requirements and recommendations
The requirements to make accounts and mid-year updates available, and for the accounts to meet enhanced disclosure requirements. This covered portfolio companies with accounting years ending up to and including 30 April 2014.	The requirement to make information about the firm available in an annual report on, or through regular updating of, the firm's website.	The requirements for firms and companies to provide data to the industry association, to follow established reporting and valuation guidelines and to ensure timely and effective communication as well as the recommendations for the BVCA relating to research, "private equity-like" entities and fund performance measurement.

A snapshot of the reporting requirements for portfolio companies is below.

Guidelines–specific disclosures	
■ Identity of private equity firm ■ Details on board composition ■ Financial review	
Business review disclosures	
Applicable to all companies[3]	**Enhanced disclosures normally applicable to quoted companies that are required by the Guidelines**
■ Fair review of the business ■ Principal risks and uncertainties facing the company ■ Key performance indicators	■ Trends and factors affecting future development, performance or position ■ Environmental matters ■ Employees ■ Social and community issues ■ Essential contractual or other arrangements

3 This is applicable to all companies (including private companies) except those eligible for the small companies' exemption. Medium-sized companies are also eligible for an exemption to provide non-financial information.

3.2 Overview of findings

The sample of portfolio companies selected for review in 2014 all achieved either a good or excellent level of disclosure overall with the proportion in the latter category increasing by 10% to 17%. This in part was due to a greater proportion of sample being portfolio companies that had been reviewed previously and proactive engagement by new entrants. The Group's objective is to ensure that all companies covered by the Guidelines report to a level at least equivalent to, or in advance of, FTSE 350 companies. Therefore the quality and level of disclosure is benchmarked against disclosures by FTSE 350 companies, with an emphasis on the better performers in that cohort, typically the FTSE 100. An excellent level of disclosure for portfolio companies is broadly comparable to those better performers. There has been a steady increase in the quality of disclosure seen in the FTSE 350 which in turn means that the portfolio companies reviewed this year have continued to improve in line with this benchmark.

Some portfolio companies that are UK companies were required to prepare a Strategic Report for the time. The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 have necessitated amendments to the Guidelines as they removed the requirement for a business review in the directors' report – which was the foundation for the enhanced disclosure requirements for portfolio companies – and moved this content, with a few additions, to a new report called the Strategic Report. The Group consulted on the updated Guidelines during 2014 and they will apply to companies reviewed in next year's report with years ending on or after 30 September 2014. The Group's approach included a year's grace to implement the extended requirements although legally, UK companies have still had to prepare a Strategic Report this year. As a number of the portfolio companies reviewed this year have prepared a Strategic Report, there has been a **marked increase** in the quality of disclosures seen on the following criteria compared to previous years:

- strategy;
- market environment; and
- principal risks and uncertainties facing the company

Portfolio companies also **improved** the quality and level of disclosure in respect of the following areas compared to last year's review:

- identity of the private equity firm;
- details on board composition; and
- essential contracts.

Whilst in general, there was an improvement in the overall quality of disclosures, this was not consistent across individual requirements. The performance against the following criteria was **weaker** this year against a backdrop of increasing standards seen in the FTSE 350:

- environmental matters; and
- social and community issues.

The Group will explain where improvements can be made in feedback letters sent to private equity firms and portfolio companies. To promote good practice, these will highlight areas where disclosures could be improved beyond the basic requirements and examples are available in the in a good practice guide published by PwC in July 2014.

Overall, there remains the need to better link elements of the annual report together to highlight relationships and interdependencies. A forward-looking orientation is recommended that uses strategic objectives to underpin the disclosures in the annual report and these should be clearly structured to ensure consistency of messaging. This includes aligning strategy to management actions, risks, key performance indicators and employee compensation.

3.3 Private equity firms and portfolio companies covered by the Guidelines

The Group has established a policy that all portfolio companies within the population will be reviewed at least once within a three-year cycle and will continue with its policy of re-reviewing more frequently companies whose reporting has been found to not comply with, or only just meet, the requirements. All new entrants in the period covered are reviewed each year. Details of the private equity firms and portfolio companies that fall within the scope of the Guidelines are set out in Appendices 1 and 2.

When assessed in overall terms all the companies reviewed by the Group this year met the Guidelines' enhanced disclosure requirements for reporting. This population included 19 companies reviewed previously, five reviewed for the first time and one that had only achieved a basic level of compliance. The proportion achieving excellent disclosure overall compared to the prior year also increased. Whilst overall compliance levels were good, there continued to be variability in the quality of disclosures on individual requirements and not all the companies reviewed met the publication and data provision requirements (see further below).

	Quality of disclosures 2014			***Quality of disclosures 2013***		
	Excellent	**Good**	**Basic**	***Excellent***	***Good***	***Basic***[4]
Overall quality of disclosures	**16%**	**84%**	**0%**	***7%***	***87%***	***6%***

The 100% compliance rate (up from 97% in 2013) can be in part attributed to early engagement with the Group and the BVCA by private equity firms and portfolio companies, particularly those that were new in the population covered by the Guidelines.

In line with prior years, only a small number of companies included a specific statement of conformity with the Guidelines in the annual report and financial statements. This statement is not currently a requirement, however it will be under the updated Guidelines consulted on this year. Such a statement would be in line with the requirement for certain statements in the UK Corporate Governance Code for listed companies, such as the new requirement to confirm the financial statements are "fair, balanced and understandable". The Group has seen this contribute to higher standards of disclosure by FTSE 350 companies this year and expects this will continue. To ensure compliance levels remain high and follow this progression next year, portfolio companies will need to prepare in advance and review the format and content of the annual report as a whole, rather than just the new requirements.

3.4 Disclosure by a portfolio company – detailed findings

The Guidelines require that the portfolio company's audited report and accounts should be readily accessible on the company website no more than six months after the company year end and that a summary mid-year update giving a brief account of major developments in the company (but not requiring updated accounts) should be placed on the website no more than three months after mid-year.

Only 20 of the portfolio companies reviewed made the audited report and accounts available on the company's website and a further two published a Walker Guidelines-compliant report that was not the full audited accounts. The Group continues to reinforce the message that accounts should be readily accessible on the company's website and will be monitoring this in more depth next year, including the requirement to publish within the six month period.

4 This column includes one company that failed to comply overall and one company that achieved basic compliance with the requirements overall. The individual exceptions are not presented on a disaggregated basis by the Group unless more than one company is named in the report as non-compliant.

The table below sets out how the sample of portfolio companies reviewed performed against the individual requirements assessed for compliance and whether the quality of disclosure provided was excellent, good or basic (i.e. the minimum level expected).

	Quality of disclosures 2014			*Quality of disclosures 2013*		
Criteria reviewed	**Excellent**	**Good**	**Basic**	***Excellent***	***Good***	***Basic*[5]**
Identity of the private equity firm	20%	48%	32%	*13%*	*47%*	*40%*
Details on board composition	36%	40%	24%	*27%*	*27%*	*46%*
Financial review:						
- *Financial position*	12%	80%	8%	*17%*	*57%*	*26%*
- *Financial risks*	32%	52%	16%	*23%*	*63%*	*14%*
Fair review of the business:						
- *Strategy*	28%	52%	20%	*10%*	*53%*	*37%*
- *Market environment*	32%	44%	24%	*13%*	*53%*	*34%*
Principal risks and uncertainties facing the company	36%	48%	16%	*13%*	*67%*	*20%*
Financial key performance indicators	8%	76%	16%	*13%*	*67%*	*20%*
Non-financial key performance indicators	24%	44%	32%	*10%*	*67%*	*23%*
Trends and factors affecting future development, performance or position	20%	48%	32%	*7%*	*53%*	*40%*
Environmental factors	12%	52%	36%	*20%*	*57%*	*23%*
Employees	12%	68%	20%	*13%*	*63%*	*24%*
Social and community issues	16%	40%	44%	*13%*	*70%*	*17%*
Essential contracts	16%	52%	32%	*0%*	*57%*	*43%*

The basic requirements are set out below along with what is required to achieve good practice, comparable to the standard seen in the FTSE 350. The Group has continued to raise the required standard of overall disclosure to achieve compliance with the Guidelines as it benchmarks compliance against the standard of disclosure seen in the FTSE 350, with an emphasis on the better performers in this group, typically the FTSE 100. An excellent level of disclosure for portfolio companies is broadly comparable to those better performers. The quality and level of disclosure by the FTSE 350 has increased in the last year due to new narrative reporting and corporate governance requirements in the UK.

5 This column includes one company that failed to comply overall and one company that achieved basic compliance with the requirements overall. The individual exceptions are not presented on a disaggregated basis by the Group unless more than one company is named in the report as non-compliant.

3.4.1 Guidelines specific disclosures

Identity of the private equity firm	Expectations for compliance
"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."	To comply with this requirement, the identity of the private equity firm should be disclosed within the annual report. To achieve **good practice** in this area, disclosures should include the name of the fund as well as the name of the private equity firm and put the role of the private equity firm into context. Additional information on the background of the private equity firm is also recommended.

The basic requirement to disclose the name of the private equity firm was met in the entire sample. 17 companies went further than the basic requirement and also disclosed additional information such as the name of the fund managed by the private equity firm as well as that of the private equity firm itself or the history of ownership.

Examples of excellent disclosure ensured the role of the private equity firm was clearly identified, with specific examples of how they are involved in the running of the portfolio company. Further excellent examples discussed how the private equity firm has worked historically with the company, in terms of financial support and other interaction.

This requirement is straightforward to comply with and, as would be expected, it was met by the majority of the sample reviewed to at least a good standard. The Group was also pleased to see an improvement in the area on the prior year with 68% of the sample reviewed providing good or excellent disclosure (up from 60%). This is an area where the Group expects companies to aim for excellent disclosure above the minimum requirements and would encourage companies to consider this in the next reporting season.

Details on board composition	Expectations for compliance
"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 report should go beyond the Companies Act requirements relating to directors and should include additional disclosure to highlight which of the directors were also directors of, or had been appointed by, the private equity firm. For **good practice** additional explanations of the industry and other experience that external directors bring to the organisation should be included.

This requirement was met by the sample reviewed, although this was achieved in different ways. Good examples included biographies of each director, including areas of expertise, similar to the reporting format adopted by public companies. The best examples included the governance structure in place, the various committees the directors are involved in and the role of these committees in the organisation. These examples went further than the minimum requirements of the Guidelines.

Other companies provided a table of directors stating whether they were appointed by the private equity firm or not. Another method used was to include a list of directors with a footnote explaining who is from the private equity firm.

This requirement is again relatively straightforward to comply with and was met in the majority of the sample reviewed to at least a good standard (76% of the sample and up from 53%). There has been an improvement in the quality of disclosure on this criteria compared to last year when there had been notable deterioration. This occurred as the Group has aligned expectations with the FTSE 350 standard, which itself has improved in recent years. As with the first criteria, this is one where the Group expects firms to company to a high standard as it is a Guidelines-specific requirement.

Financial review	**Expectations for compliance**
"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."	The report should include an explanation of the year end debt and capital structure of the company, its funding requirements and discussion of the overall risk management objectives and policies of the company, including those in relation to the company's leverage. Attributes of **good practice** for disclosures on **financial position** include: ■ An analysis of the components of debt and the repayment schedule; ■ Discussion and quantification of the debt covenants in place; ■ A reconciliation of the year end net debt position to the prior year (or to free cash flow); and ■ Where non-GAAP measures (for example, net debt and free cash flow) are used to support the discussion in the financial review, these are appropriately reconciled to the numbers within the financial statements. Attributes of **good practice** for disclosures on **financial risks** include: ■ More detailed discussion in the financial statements of the overall risk management objectives and policies; ■ Discussion focused on the key financial risks identified, for example liquidity and cash flow, credit, interest rate, and how the risk management policies aim to address these risks; and ■ Quantitative information is included to support the discussion on risks.

Compliance with this requirement was measured by reference to two areas: the financial position of the company at the year end and the identification and analysis of financial risks.

Financial position at year end

Excellent examples did not need to provide an exhaustive narrative in this area, but did provide a clear summary of the company's financial position at the year end to ensure the users of the accounts could easily understand this. Examples of ways this could be achieved included diagrams of the timing of debt repayments or summaries of the key elements of multiple debt arrangements (such as interest rates, covenants, and timing of repayment) which could be presented in a table for comparability. Where this requirement was less well met was where there was a general discussion over the financial position that lacked clarity and transparency. Not all companies defined or reconciled the non-GAAP measures they had used in addition to the numbers included within the financial statements.

This requirement was generally well met by the portfolio companies reviewed, with 23 companies or 92% of the sample having achieved a good or excellent level of disclosure in this area. This represents an improvement from prior year when this figure was 73%. Given the level of attention the industry draws in respect of financing arrangements, good, and more importantly clear, disclosure is encouraged in this area.

Financial risks

Discussions were often at a high level and not always company specific. The majority of companies included disclosure on the company's exposure to price risk, credit risk, liquidity risk and cash flow risk as required by the accounting standards and the Companies Act 2006 (the "Companies Act"). The best examples included a good narrative on the year-end financial position, and also included a forward looking consideration over future cash requirements and debt settlement. Examples of good compliance ensured the financial risk was well explained and the mitigation employed by the portfolio company was equally well described.

Examples that went further to achieve an excellent standard quantified the potential risk exposure for the portfolio company. This requirement was successfully met by the majority of portfolio companies reviewed, with 21 companies (84%) having excellent or good disclosure in this area. This is consistent with the prior year's review but the level of excellent disclosure increased from 23% to 32%.

Notwithstanding the overall results achieved on this criteria, the quality and level of disclosure across the sample reviewed did vary considerably. The remainder only met the basic compliance and these should take greater steps to provide improved disclosure for the user of the accounts. Given their generally higher indebtedness compared to quoted companies, this is a sensitive area for private equity owned businesses. Portfolio companies should redouble their efforts to ensure clear and relevant disclosure.

3.4.2 Business Review (required by UK Companies Act)

Fair review of the business	Expectations for compliance
"The business review must contain a fair review of the company's business."	To comply with these requirements the annual report and accounts should include: ■ A statement of company strategy setting out what the company is trying to achieve and the priorities for how it plans to achieve those objectives; and ■ A description of the market in which the company operates should be given as well as how the competitive, regulatory and macro-economic forces impact on the business. Attributes of **good practice** for disclosures on **strategy** include: ■ Clear prominent statement of strategy; ■ Strategy used to structure the content of the report to provide a clear alignment of strategic priorities, management actions and remuneration; ■ Explanation of the key actions necessary to deliver the strategy and an indication of the timeframe over which performance will be assessed; and ■ Measurement of the achievement of the strategy with qualitative or quantitative targets where applicable. To achieve **good practice** on disclosures on the **market environment**, qualitative or quantifiable evidence should be provided to support the discussion with a forward-looking orientation for readers to understand the quality and sustainability of a company's strategy.

Compliance with this requirement was measured by reference to two areas: strategy and analysis of the market environment.

Strategy

A statement about their overall strategy was disclosed by all of the companies in the sample sufficient to meet the basic requirement, with 20 or 80% providing greater details of key strategic priorities, of which 7 or 28% did so to an excellent standard (an increase from 10%).

Overall, all companies reviewed included some discussion on corporate strategy. The standard of disclosures did continue to vary although there has been an improvement across the population on the prior year when this proportion was 63%. However, only a few companies used the strategy to underpin their reporting and used consistent terminology throughout their annual report. This is an area where the Group expects an improvement next year when companies report under the updated Guidelines.

Market environment

The majority of companies (76% and up from 67%) included at least a good level of disclosure providing users of the accounts with an understanding of the background to the company's performance based on the market in which it operates.

Examples of excellent disclosure often quantified the market using external sources to present a range of information, from the portfolio company's position in the market to the size and nature of the market. The lower quality disclosures only referenced general market conditions, namely the macro-economic environment as a whole and the impact this has had on customer spending.

All companies met this requirement, although there was some variation in the standard of disclosures. Where companies provided a comprehensive analysis, interesting graphics and diagrams were used to aid the disclosures.

Principal risks and uncertainties facing the company	**Expectations for compliance**
"The business review must contain a description of the principal risks and uncertainties facing the company."	To comply with this requirement the annual report and accounts should include an explicit identification of the principal risks and uncertainties facing the company and avoid a long list of boiler-plate risks. Clear alignment between strategy and risks, an explanation of how each risk is managed and an assessment of the risk profile (setting out the likelihood and impact of each risk) are all characteristics of **good practice** in this area. The discussions should be supported with quantifiable evidence, where possible.

The majority of companies disclosed principal risks, either explicitly or implicitly. Companies that obtained good or excellent disclosure in this area (84% of the sample and up from 80%) ensured the risks considered were specific to the business and included a discussion on how those risks were mitigated.

Overall, there is good disclosure of the principal risks and uncertainties in the sample and this was one of the better areas of compliance, seeing significant improvement on the prior year population with 9 companies or 36% of the sample providing excellent disclosure, up from 13%.

Key performance indicators (KPIs)	Expectations for compliance
"The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include analysis using financial key performance indicators, and where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters. "Key performance indicators" means factors by reference to which the development, performance or position of the company's business can be measured effectively."	To comply with the requirements the annual report and accounts should include an explicit identification of the KPIs so as to avoid any misunderstanding or, at the very least, provide performance data, from which a reader might reasonably identify their KPIs. The Group expects most companies should have non-financial KPIs, for example around areas such as employee retention, as for most businesses these are expected to be key to the ongoing success of the business. **Good practice** reporting goes further than just identifying KPIs and also provides: ■ A clear alignment of KPIs to strategic priorities so as to validate them as a basis for management's assessment of strategic success; ■ An explanation of why each KPI has been included; ■ A definition of how they have been calculated; and ■ Trend data and targets, whether qualitative or quantitative.

Financial KPIs

All companies reviewed identified their financial KPIs. In our view, 21 companies (84%) clearly aligned their KPIs with their strategy. These companies also disclosed definitions, quantified and discussed the KPIs identified.

Overall, although all companies reviewed achieved compliance with this requirement, the standard of that compliance was mixed with the level of excellent disclosure falling from 13% of the sample reviewed last year to 8%.

Non-financial KPIs

Consistent with prior years, this disclosure of non-financial KPIs achieved a mixed level of compliance in comparison to financial KPIs. There was a greater proportion in the population that only achieved a basic level (32% compared to 23%), being generally less well explained and quantified. However, there was a marked improvement in the volume of excellent disclosures made for those that chose to provide information in a meaningful way (up from 10% to 24%). Where portfolio companies provided an excellent level of disclosure, metrics presented were tangible, linked to the strategic priorities and entirely transparent.

For many of the portfolio companies reviewed this was an area that could be improved. The fact that there was such a good level of disclosure where portfolio companies demonstrated transparency of these operational measures should be used to encourage those that do not share this information so easily. This is particularly marked for those companies who identify operational strategies and risks, but do not identify corresponding KPIs.

3.4.3 Enhanced Business Review

Trends and factors affecting future development, performance or position	Expectations for compliance
"The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include the main trends and factors likely to affect the future development, performance and position of the company's business."	To meet this requirement the business review should have a high level, forward-looking orientation explaining the trends and factors likely to influence the business including market trends, future strategic priorities or investment in research and development. This can be throughout the annual report or in a specifically headed section. Attributes of **good practice** include: ■ Separately headed, easy to find sections with clear titles; ■ Discussion of specific macro-economic, competitive or regulatory trends and factors shaping the business and identification of product pipeline and expected market size; ■ Discussion of future trends and factors are supported by quantifiable evidence; and ■ Disclosure of targets, whether qualitative or quantitative.

Overall the content of the annual reports reviewed was historical in focus providing a review of the current year and performance and lacking a discussion of future performance. This largely reflects the perceived commercial sensitivity of providing a forward-looking orientation and the judgemental, rather than the factual, nature of compliance.

Examples of poor approaches to compliance include the use of high level generic information with little relevance to the company overall. Some companies provided aspects of a forward-looking orientation but it was scattered throughout the report.

Few companies provided quantitative information to support their discussion.

Overall, portfolio companies complied with this requirement, but the response was mixed. 17 companies (68% and up from 60%) provided a minimum of good disclosures. Given market conditions, we expected to see an increase in the discussion of current market trends as management try to provide a sense of the quality and sustainability of corporate performance (for example issues relating to raising finance).

Environmental matters	Expectations for compliance
"The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include information about environmental matters (including the impact of the company's business on the environment), including information about any policies of the company in relation to those matters and the effectiveness of those policies."	The section should include a discussion of the environmental matters affecting the business, the policies in place to address them, and the impact of these policies. The type of disclosure required is dependent on the nature of the business. **Good practice** would also include a clear explanation, and alignment, of the specific environmental matters and strategy.

All companies reviewed provided some disclosure of their environmental matters. However, the response of companies varied in quality:

- Some companies included a high level overview of environmental matters.
- Some included a detailed discussion of environmental matters and performance.
- Some gave a cross reference to a separate corporate and social responsibility report if there was one, or additional environmental information on their website. This material was included for the purposes of the Group's review if there was a specific cross reference from the annual report.

Several other companies noted that this is an area they have recently started monitoring. Good examples discussed specific plans in place regarding environmental policies, describing how the portfolio company was looking to improve in this area. Examples of excellent disclosure in this area included quantified metrics of results achieved or of targets set for the future.

Overall there appeared to be broad compliance with this requirement, although the responses varied quite considerably between high level statements and more detailed disclosure. The level of good or excellent disclosure fell from 77% in last year's review to 64%.

Employees	**Expectations for compliance**
"The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include information about the company's employees including information about any policies of the company in relation to those matters and the effectiveness of those policies."	Employee disclosures should go beyond those previously required by the Companies Act and to the extent employees are a critical resource of the business, there should be a discussion of the management and development of employees including recruitment, training and development, and retention practices. Attributes of **good practice** include: ■ Alignment of strategy and employee policies and actions; ■ Detailed discussion of employee policies including benefits, share schemes and performance bonuses and explanations of how these link to performance and development; ■ Quantifiable evidence of performance; and ■ Disclosure of targets, qualitative or quantitative, and discussion of performance against targets.

All companies reviewed disclosed information on their employees. However, many of them limited their disclosure to the basic Companies Act requirements.

Of the companies that provided information in addition to the Companies Act requirements, a few provided significant amounts of detailed information that included a comprehensive analysis illustrated with tables and graphics. Examples of good disclosure identified why employees were a key resource for the business and how they were valued, supported and trained, providing further detail on these areas that was often linked to how the employees were key to delivering the portfolio company's strategy.

The overall compliance in this area was generally good with 80% of the sample reviewed achieving good or excellent disclosure (broadly consistent with last year at 77%).

Social and community issues	Expectations for compliance
"The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include information about social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies."	Details should be provided at a high level of the social and community issues affecting the business and policies to address them. The level of disclosure needs to go beyond details of political and charitable donations. Attributes of **good practice** include: ■ Alignment of social and community issues to strategy; ■ Explanation of the actions taken to address the specific social and community issues for example, local recruitment, investment in education and impact on recruitment; and ■ The discussion is supported by quantifiable evidence.

The portfolio companies reviewed this year did not demonstrate the same level of disclosure as the prior year on social and community issues, with a higher proportion (44% compared to 17%) only achieving basic compliance as the disclosures were often generic in nature. The 4 companies (16%, up from 13%) that did comment on social and community issues to an excellent level ensured a clear, detailed, specific discussion on this topic. However, the general trend was more in line with previous year's reviews, few of the population provided any discussion around how they have actively sought local involvement in their communities such as local employment policies.

Given the increased focus on this area by consumers it would be advisable for portfolio companies to enhance their disclosure in this area. Moreover, the updated Guidelines will require them to go further next year and include specific consideration on human rights.

Essential contractual or other arrangements	Expectations for compliance
"The business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include, subject to subsection (11) (disclosure seriously prejudicial in opinion of the directors), information about persons with whom the company has contractual or other arrangements which are essential to the business of the company."	Details of essential contractual arrangements should identify the parties and arrangements involved and not just provide details of supplier payment policies and creditor days. The requirement is directed at reporting significant relationships, such as those with major suppliers or key customers critical to the business, which are likely to influence, directly or indirectly, the performance of the business and its value.

Often the existence of contractual or other arrangements was scattered throughout the report and there were few examples of companies who provided the information under a specific heading. This is not inconsistent with what the Group has observed among listed companies. There was an improvement in the current year in considering significant contracts, and this was often identified through disclosure as a specific risk for the business and addressed in this area of the annual report.

The level of good or excellent disclosure increased this year from 57% to 68%. However, this has continued to be an area where most portfolio companies reviewed could improve significantly, with more explicit references of key contracts and resources and the impact on the business. This disclosure will not be explicitly required in the updated Guidelines; however compliance will need to be carefully judged as there is an expectation this should form part of the business risks assessment.

3.5 Review of disclosure by private equity firms

Review of disclosure by private equity firms	Expectations for compliance
"A private equity firm should publish an annual review accessible on its website or ensure regular updating of its website to communicate information about itself, its portfolio companies and its investors along with a commitment to the guidelines."	The requirement allows firms to either prepare a separate annual report or include the information generally within the firm's website. There is no further detail in the Guidelines on the quantity of disclosure expected and the Group is monitoring how best to measure compliance against this criteria in the future.

This is the second year the Group has reviewed the websites and/or annual reports of all private equity firms covered by the Guidelines to assess if they met the disclosure requirements above. This includes the publication of information covering details on their investment approach, UK portfolio companies, and leadership of the firm. Private equity firms were also required to sign an annual statement of conformity to the Guidelines. Many firms had signed such a statement when the Guidelines were first launched and the Group mandated this as an annual commitment in 2013.

Members of the BVCA met the requirements or were in the process of updating them at the time of the publication of this report. This was not always the case for non-BVCA member firms covered by the Guidelines, of which only two expressed a commitment to comply with the Guidelines. This reflects the growth in the number of 'private equity-like' firms covered by the Guidelines in recent years as set out in section 1.3.1 and table 1.

The majority of firms provided these disclosures through regular updating of the website rather than through an annual report. Some firms included these disclosures in prior years' reports still accessible on the website and it is recommended to re-confirm these each year. The detail included varied with some firms opting for succinct statements and others providing extended information on strategy and detailed case studies.

The BVCA and Group is monitoring how best to assess compliance with the disclosure requirements for private equity firms. Since the Guidelines were first implemented the level of disclosure by firms has increased significantly, and with some firms in the US now also listed on the NYSE, the detail of some of these disclosures has increased. Factors that could contribute to good compliance that the Group is considering include: the accessibility of disclosures (where are they on the website, in a single document or in different parts of the website); whether succinct statements and summaries are provided or detailed disclosures, and whether firms include case studies.

All BVCA members also signed the statement of conformity letter which is an annual requirement.

3.6 Other requirements and recommendations

The Guidelines include additional requirements for private equity firms and portfolio companies regarding the provision of data to the industry association, the adoption of established valuation and reporting guidelines and timely and effective communication at a time of significant strategic change. They also include recommendations for the industry association regarding research capabilities and activities, engagement with "private equity-like" entities and fund performance measurement.

Findings

- In general, most private equity firms owning portfolio companies that meet the criteria are cooperating with the BVCA in collating the detailed information required to prepare the 'BVCA Annual Report on the Performance of Portfolio Companies' commissioned by the BVCA from EY LLP. Disappointingly, there were two owners of two portfolio companies that did not provide the information requested: Camelot (Ontario Teachers' Pension Plan) and Viridian Group (Arcapita). Onex (the owner of Tomkins alongside Canadian Pension Plan) provided an explanation for non-compliance with this requirement. The compliance rate for the provision of data is 96% which has improved slightly from 92% last year.

- The private equity firms apply guidelines published by the International Private Equity and Venture Capital Board or applicable accounting standards.
- Where portfolio companies have undergone significant strategic change, the private equity firms ensured timely and effective communication with employees, as soon as confidentiality constraints ceased to be applicable. The Group did not identify any instance where a private equity firm had not ensured timely and effective communication of a significant strategic change in a portfolio company. This includes Phones4U, which was owned by funds managed by BC Partners, and went into administration in 2014. The Group discussed this case in its meetings and was satisfied that the BC Partners has acted in an appropriate manner.

3.6.1 Performance of portfolio companies

The annual review of the performance of portfolio companies, undertaken by the BVCA and EY is being published alongside this report. The report will be available on the BVCA website at www.bvca.co.uk/Research.

3.6.2 Engagement with "private equity-like" entities

The Guidelines extend to firms that conduct their business in a manner that would be perceived by external stakeholders to be similar to that of other participants in the private equity industry. The Group and the BVCA are continuing to hold discussions with other potential private equity or "private equity-like" firms, including sovereign wealth funds, with the purpose of enlisting their voluntary conformity with the Guidelines. A number of infrastructure fund managers, including Global Infrastructure, Macquarie and Infracapital are complying with the Guidelines and have engaged with the BVCA throughout this process. Värde Partners and Goldman Sachs are firms operating in the credit opportunities space and have also complied with the requirements for portfolio companies this year.

As part of its monitoring activities this year, the Group reviewed the definition of a private equity firm under the Guidelines and amended it to incorporate private equity-like firms. The amended definition is as follows:

Private equity firms for the purposes of the Guidelines include private equity and 'private equity-like' firms (together "PE firms"). PE firms include those that manage or advise funds that either own or control one or more companies operating in the UK and the company or companies are covered by the enhanced reporting guidelines for companies. PE firms include those that acquire portfolio companies: i) with funds provided by one or more investors; ii) an exit/disposal of the company is envisaged and iii) may play an active management role in the company. This would therefore include, but is not limited to, other types of investment funds including infrastructure funds, pension funds, sovereign wealth funds and credit/debt funds. It also applies to firms that may be headquartered outside of the UK. Banks and credit institutions, other than their asset management operations, are specifically excluded.

3.6.3 Fund performance measurement

The Guidelines recommended that the BVCA should participate proactively with private equity trade associations beyond the UK and with the limited partner community to develop a consistent methodology for the content and presentation of fund performance information. The BVCA is continuing to hold discussions with other European private equity trade associations covering a number of areas including fund performance measurement.

APPENDIX 1: PRIVATE EQUITY FIRMS COVERED BY THE GUIDELINES

A1

The following private equity firms and 'private equity-like' firms were in the scope of the Guidelines for 2013, being the period covered by this report. Where more than one PE firm is involved in a transaction and they collectively own a controlling stake in a portfolio company, those firms will be jointly and severally responsible for ensuring that the portfolio company applies the Guidelines, and each of those firms will be assessed for compliance with the requirements that apply to them. Subject to prior approval by the Guidelines Monitoring Group, this does not apply to minority shareholders which invest alongside other majority shareholder(s) and where both the majority shareholder(s) and the portfolio company comply with the Guidelines. The Guidelines Monitoring Group's approval will depend on the specific facts and circumstances and the extent to which control is exercised.

The first table sets out the firms we have monitored for compliance with the Guidelines.

3i Group	Lion Capital
Advent International	Macquarie Infrastructure and Real Assets[#]
Apax Partners	Morgan Stanley Infrastructure Partners[#]
Apollo Global Management	Oaktree Capital Management[1,#]
Arcapita[1]	OMERS PE[2,#]
Arle Capital Partners	Onex Partners[1,#]
Bain Capital	Ontario Teachers' Private Capital[1,#]
BC Partners	PAI Partners
Bridgepoint	Permira Advisers
Charterhouse Capital Partners	Providence Equity[2]
Cinven	Sankaty Advisors[3,#]
Clayton Dubiler & Rice	TDR Capital
CVC Capital Partners	Terra Firma Capital Partners
Global Infrastructure Partners[#]	The Blackstone Group
Goldman Sachs[1,#]	The Carlyle Group
Henderson Equity Partners[1]	TPG Capital
Infracapital Partners[3,#]	Värde Partners[1,#]
Kohlberg Kravis Roberts & Co	

The second table sets out other investors in the portfolio companies covered by this report. These firms have not been reviewed by the Group as it considered that the Guidelines do not apply to them.

AMCO Sarl[1,#]	GoldenTree Asset Management[1,#]
Angelo Gordon & Co[1,#]	Highbridge Capital Management [1]
Avenue Capital[1,#]	JP Morgan Chase[1,#]
Babson Capital[1,#]	Highstar Capital[1,#]
Borealis[3,#]	Industry Funds Management[1,#]
Canadian Pension Plan Investment Board[1,#]	Marathon Asset Management[1,#]
Cerberus Capital Management[1,#]	Palamon Capital Partners
Colonial First State Global Asset Management[1,#]	Park Square Capital[1,#]
Exponent Private Equity [2]	STAR Capital Partners
GIC Special Investments[1,#]	York Capital Management[1,#]

[1] Not a member of the BVCA
[2] Addition this year
[3] Individually not a member of the BVCA although it is an affiliate of one
[#] Private equity-like entity

APPENDIX 2: PORTFOLIO COMPANIES COVERED BY THE GUIDELINES

A2

The following portfolio companies either met the criteria set out in the Guidelines, or have committed to conform to the Guidelines on a voluntary basis during the period under review. Owners disclosed in brackets are not required to comply with the Guidelines for the reasons set out in Appendix 1.

Required portfolio companies

Portfolio company	Owners during 2013
Acromas (AA/Saga)	Charterhouse, CVC, Permira
Affinity Water	Morgan Stanley, Infracapital
Airwave Solutions	Macquarie
Alliance Boots	KKR
Ambassador Theatre Group [1]	Providence Equity Partners, (Exponent)
Amdipharm Mercury (AMCo)	Cinven
Annington Homes	Terra Firma
Associated British Ports [1]	Goldman Sachs, Infracapital, (Borealis, GIC)
B&M Retail [1, 2]	Clayton Dubilier & Rice
Biffa	Sankaty Advisors,(Babson Capital, Angelo Gordon & Co, Avenue Capital)
Birds Eye Iglo	Permira
Brakes Group	Bain Capital
Brit Insurance	CVC, Apollo
British Car Auction [1]	Clayton Dubiler & Rice
Camelot [1]	Ontario Teachers' Private Capital
Card Factory	Charterhouse
Care UK [1]	Bridgepoint
Center Parcs [1]	Blackstone
Civica [3]	OMERS PE
David Lloyd Leisure [2]	TDR Capital
DFS	Advent
Domestic and General Group [1, 3]	CVC
DX Group [1]	Arle
Edinburgh Airport	Global Infrastructure Partners

Portfolio company	Owners during 2013
Enserve [1]	Cinven
Equiniti	Advent
Eversholt Rail [1]	3i, Morgan Stanley, (STAR Capital Partners)
Exova	Clayton Dubiler & Rice
Expro	Goldman Sachs
Fat Face [1]	Bridgepoint
Findus Group	Lion Capital, (Highbridge Capital, JP Morgan Chase)
Fitness First	Oaktree Capital Management, (Marathon Capital)
Four Seasons Health Care	Terra Firma
Gala Coral [1]	Apollo, (Cerberus, Park Square, York Capital Management)
Gatwick Airport [1]	Global Infrastructure Partners
Gondola Holdings	Cinven
Host Europe Group [1,2]	Cinven
Integrated Dental Holdings	Carlyle, (Palamon)
John Laing	Henderson
London City Airport [1]	Global Infrastructure Partners, (Highstar Capital)
Moto	Macquarie
National Car Parks	Macquarie
New Look	Permira, Apax
Northgate Information Solutions [1]	KKR
Odeon & UCI Cinemas	Terra Firma
Osprey (Anglian Water Group)	3i, (Colonial First State Global Asset Management, Canadian Pension Plan Investment Board, Industry Funds Management)
Partnerships in Care	Cinven
Pets at Home [1]	KKR
Phones4U	BC Partners
PHS	Charterhouse
Pret a Manger	Bridgepoint
Priory Group	Advent
RAC	Carlyle
R&R Ice Cream [1,2]	PAI Partners
SAV Credit (now New Day) [1]	Värde Partners
South Staffordshire Water [3]	KKR
Spire Healthcare [1]	Cinven

Portfolio company	Owners during 2013
Stonegate Pub Company [1]	TDR Capital
Thames Water [1]	Macquarie
The Vita Group	TPG
Tomkins [1]	Onex Partners, (Canadian Pension Plan)
Top Right Group	Apax
Trader Media	Apax
Travelex	Apax
Travelodge	Goldman Sachs, (GoldenTree, Avenue Capital)
TSL Education [3]	TPG
United Biscuits	Blackstone, PAI
Virgin Active	CVC
Viridian Group	Arcapita
Vue Cinemas [3]	OMERS PE
World Pay	Advent, Bain

Voluntary portfolio companies

Portfolio company	Owners during 2013
AWAS	Terra Firma
Consolidated Pastoral Company	Terra Firma
Garden Centre Group	Terra Firma
McCarthy & Stone [1,2]	Goldman Sachs, TPG, AMCO Sarl and others
Tragus	Blackstone

[1] Accounts reviewed this year
[2] Addition this year
[3] Portfolio companies that have exited and re-entered population during the year

A3

APPENDIX 3: GUIDELINES FOR ENHANCED DISCLOSURE BY PORTFOLIO COMPANIES AND PRIVATE EQUITY FIRMS

Requirements for portfolio companies covered by the seventh report

These are the current Guidelines that apply for portfolio companies reviewed in the seventh report. From the sixth report, part 2 'Definition of a private equity firm for the purpose of the Guidelines' has been amended.

1. **Conformity with each of the Guidelines** should be on a **comply or explain** basis.

Where an explanation is given for "non-compliance", this should be posted alongside other related relevant disclosures called for under these Guidelines on the website of the private equity firm or portfolio company.

2. Definition of a **private equity firm** for the purpose of the Guidelines:

Private equity firms for the purposes of the Guidelines include private equity and 'private equity-like' firms (together "PE firms"). PE firms include those that manage or advise funds that either own or control one or more companies operating in the UK and the company or companies are covered by the enhanced reporting guidelines for companies. PE firms include those that acquire portfolio companies: i) with funds provided by one or more investors; ii) an exit/disposal of the company is envisaged and iii) may play an active management role in the company. This would therefore include, but is not limited to, other types of investment funds including infrastructure funds, pension funds, sovereign wealth funds and credit/debt funds. It also applies to firms that may be headquartered outside of the UK. Banks and credit institutions, other than their asset management operations, are specifically excluded.

3. Definition of a **portfolio company** to be covered by enhanced reporting guidelines (as amended by the Group in April 2010):

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 £210 million and more than 50% of revenues were generated in the UK or 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 £350 million and more than 50% of revenues were generated in the UK or UK employees totalled in excess of 1,000 full-time equivalents.

4. Content of enhanced disclosure by a portfolio company

A portfolio company should include as part of its audited annual report and accounts the following enhanced disclosures, none of which call for disclosures beyond those specified for quoted companies in the Companies Act 2006 or other disclosure requirements applicable to quoted companies. Such reporting should throughout focus on substance rather than form and on the economic reality of a company or group rather than its legal structure.

a) 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.

b) 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.

c) The report should include a business review that substantially conforms to the provisions of Section 417 of the Companies Act 2006 including sub-section 5 (which is ordinarily applicable only to quoted companies). Section 417 is reproduced in Appendix 6 and sub-section 5 provides:

   "(5) In the case of a quoted company 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 impact of the company's business on the environment),

      (ii) the company's employees, and

      (iii) social and community issues,

   including information about any policies of the company in relation to those matters and the effectiveness of those policies; 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."

d) 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 accounts.

e) To the extent that the guidelines at (b) and (c) 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.

5. Form and timing of public reporting by a portfolio company

a) The audited report and accounts should be readily accessible on the company website;

b) The report and accounts should be made available no more than 6 months after the company year-end; and

c) A summary mid-year update giving a brief account of major developments in the company (but not requiring updated accounts) to be placed on the website no more than 3 months after mid-year.

6. Data input by a portfolio company to the industry association

As input for the enhanced role in data collection, processing and analysis is to be undertaken on an industry-wide basis by the BVCA, portfolio companies should provide to the BVCA (or to a professional firm acting on its behalf) data for the previous calendar or company accounting year on:

- trading performance, including revenue and operating earnings.
- employment.
- capital structure.
- investment in working and fixed capital and expenditure on research and development.
- such other data as may be requested by the BVCA after due consultation and where this can be made available without imposing material further cost on the company.

7. Communication by a private equity firm

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

- a description of the way in which the FCA-authorised 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.
- 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.
- 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.
- a description of UK portfolio companies in the private equity firm's portfolio.
- 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 purpose 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.

8. Reporting to limited partners

In reporting to their limited partners on their interests in existing funds and for incorporation in partnership agreements for new funds, private equity firms should:

a) follow established guidelines such as those published by International Private Equity and Venture Capital Board (IPEV) (or otherwise provide the coverage set out in such guidelines) for the reporting on and monitoring of existing investments in their funds, as to the frequency and form of reports covering fund reporting, a summary of each investment by the fund, detail of the limited partner's interest in the fund and details of management and other fees attributable to the general partner.

b) value investments in their funds using either valuation guidelines published by IPEV or applicable accounting standards.

9. Data input by private equity firms to the industry association

Data to be provided on a confidential basis to an accounting firm (or other independent third party) appointed by the BVCA to cover:

a) In respect of the previous calendar year:

- the amounts raised in funds with a designated capability to invest in UK portfolio companies.
- acquisitions and disposals of portfolio companies and other UK companies by transaction value.
- estimates of aggregate fee payments to other financial institutions and for legal, accounting, audit and other advisory services associated with the establishment and management of their funds.
- such other data as the BVCA may require for the purpose of assessment of performance on an industry-wide basis, for example to capture any material change over time in the terms of trade between general partners and limited partners in their funds.

b) In respect of exits from UK portfolio companies over at least the previous calendar year to support the preparation on an aggregate industry-wide basis of an attribution analysis designed to indicate the major sources of the returns generated by private equity. In broad terms, these are the ingredients in the total return attributable respectively to leverage and financial structuring, to growth in market multiples and market earnings in the relevant industry sector, and to strategic direction and operational management of the business. The relevant data, which will unavoidably involve important subjective assessment, will involve content and format at the outset as in Annex F to the guidelines, to be reviewed and refined as appropriate in the light of initial experience and discussion between the BVCA, with the third-party professional firm engaged for this and related analysis, and the relevant private equity firms.

10. Responsibility at a time of significant strategic change

A private equity firm should commit to ensure timely and effective communication with employees, either directly or through its portfolio company, in particular at the time of a strategic initiative or a transaction involving a portfolio company as soon as confidentiality constraints cease to be applicable. In the event that a portfolio company encounters difficulties that leave the equity with little or no value, the private equity firm should be attentive not only to full discharge of its fiduciary obligation to the limited partners but also to facilitating the process of transition as far as it is practicable to do so.

Requirements for portfolio companies covered by the eighth report onwards

Following a consultation in 2014, part 4 of the Guidelines has been amended and will apply for the majority of portfolio companies covered by the eighth report. Part 11 has also been added to explain the interaction of the Walker Guidelines process with the Alternative Investment Fund Managers Directive. These new sections have been replicated below.

4. Content of enhanced disclosure by a portfolio company

A portfolio company should include as part of its audited annual report and accounts the following enhanced disclosures, none of which call for disclosures beyond those specified for quoted companies in the Companies Act 2006 or other disclosure requirements applicable to quoted companies. Such reporting should throughout focus on substance rather than form and on the economic reality of a company or group rather than its legal structure.

a) 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.

b) 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.

c) The report should include a review that, subject to points i and iv below, meets the requirements of Section 414C of the Companies Act 2006 including sub-sections 7 and 8 (which are ordinarily applicable only to quoted companies). Section 414C is reproduced in Annex 1 of this document and replaces Annex D of the Guidelines.

   i. For a UK portfolio company, this review is required to be included in the strategic report under the Companies Act 2006. A non-UK portfolio company may include this review in a directors' report or equivalent in line with applicable legal requirements in the non-UK country.

   ii. When considering the level of detail and nature of information to be included in the review, the portfolio company should have regard to the guidance set out in the Financial Reporting Council's Guidance on the Strategic Report.

   iii. Section 414C(7) provides:

   "(7) In the case of a quoted company the strategic report 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 impact of the company's business on the environment),

      (ii) the company's employees, and

      (iii) social, community and human rights issues,

      including information about any policies of the company in relation to those matters and the effectiveness of those policies.

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

   When preparing disclosures in respect of environmental matters under section 414C(7)b)(i), a portfolio company may, to the extent it is significant, include in the directors' report the disclosures concerning greenhouse gas emissions as set in Part 7 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. This is not a mandatory requirement of the Guidelines.

   iv. Section 414C(8) provides:

   "(8) In the case of a quoted company the strategic report must include—

   a) a description of the company's strategy,

   b) a description of the company's business model,

   c) a breakdown showing at the end of the financial year—

      (i) the number of persons of each sex who were directors of the company;

      (ii) the number of persons of each sex who were senior managers of the company (other than persons falling within sub-paragraph (i)); and

      (iii) the number of persons of each sex who were employees of the company."

When preparing disclosures in respect of gender diversity under section 414C(8)c)(ii), a portfolio company may apply its own definition of "senior manager" that differs from the definition and requirement provided in sections 414C(9) and (10) as long as it is clearly explained. A reconciliation to the disclosure using the statutory definition will not be required.

d) 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.

e) To the extent that the Guidelines at 4. a) and c) 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.

f) The report should include a statement by the directors of the portfolio company confirming compliance with the Guidelines or setting out explanations for areas of non-compliance.

11. Interaction with the Alternative Investment Fund Managers Directive

Private equity firms and portfolio companies covered by the Guidelines are not expected to provide disclosure in respect of the applicable additional transparency requirements in the Alternative Investment Fund Managers Directive (the "Directive") if they do not fall within the scope of the Directive. Having performed a gap assessment, the Group was of the view that the Guidelines include the information required under the Directive in respect of disclosure in the annual reports of portfolio companies except for details on transactions in own shares. The Group expects this information to be included in the financial statements of the portfolio company where significant.

The disclosures expected by private equity firms on acquisition of portfolio companies under the Directive are more prescriptive than those set out above. The Group has decided not to amend the Guidelines in respect of these specific requirements as they are still within the spirit of the Guidelines for this particular area. Firms that are covered by the Directive may find the Guidelines and examples of good practice reporting by portfolio companies published by the Group as a useful source of guidance but are responsible for taking appropriate advice to ensure they are fully compliant with their obligations.

The tables below set out examples of how the Guidelines interact with the AIFMD's transparency requirements in respect of the annual reports of portfolio companies and the disclosure expected on acquisition of control. The requirements apply to non-listed companies with registered offices in the EU.

a) Annual report disclosures

AIFMD requirements– annual report disclosures *Regulation 42 of the AIFM Regulations (Annual report of AIFs exercising control of non-listed companies)*	**Guidelines requirements** *Part V Sections 4 and 5 of the Guidelines* *(Guidelines for enhanced disclosure by portfolio companies and private equity firms)*
The following disclosures are required about each non-listed company over which an AIF individually or jointly has control. They can be included in the annual report of the AIF and/or the non-listed company.	The following disclosures are required to be included in the annual report of the portfolio company and not the private equity fund.
■ A fair review of the development of the company's business representing the situation at the end of the period covered by the annual report;	Part V section 4 requires portfolio companies to prepare a strategic report which includes provisions in the Companies Act 2006 normally applicable to quoted companies. The strategic report requirements set out in s414C(2) and s414C(3) of the Companies Act 2006 will assist firms to comply with this requirement. They require "a fair review of the company's business" and a "balanced and comprehensive analysis of the development and performance of the company's business" during the financial year and the position at the end of that year. s414C(4) also requires the disclosure of financial and non-financial key performance indicators to support the analysis.
■ Any important events that have occurred since the end of the financial year;	The Group expects this information to be included to comply with the requirements of the strategic report as the report should have forward looking orientation. Further, this information is expected to be disclosed under UK and international accounting standards.
■ The company's likely future development; and	The strategic report requirements set out in s414C(7) of the Companies Act 2006 will assist firms to comply with this requirement. It requires information on "the main trends and factors likely to affect the future development, performance and position of the company's business."
■ Details of any acquisitions or disposals of own shares.	The Group expects this information to be included in the financial statements of the portfolio company where significant and has chosen not to incorporate this disclosure requirement as it was removed by BIS from the directors' report as it was not considered a significant disclosure. This approach is in line with Guidelines which do not prescribe disclosures that go beyond those required of quoted companies.

The disclosures must be made within six months of the year-end of the AIF.	Part V, section 5b) of the Guidelines requires the annual report of the portfolio company to be made available no more than 6 months after the company year end. Where the year end of the portfolio company and the AIF are the same then the AIFMD requirement is likely to be fulfilled. Where the year end of the portfolio company differs to that of the AIF then firms may need to amend the timing of reporting of the portfolio company accordingly.
If the information is included in the AIF's annual report then the AIFM must use best efforts to ensure the board of the company makes the information available to all employee representatives or (where there are none) to the company's employees directly.	Part V, section 5a) of the Guidelines requires the annual report of the portfolio company to be readily accessible on the company website. This ensures that employees and other stakeholders are able to access this information publicly.

b) Disclosures required on acquisition of control

AIFMD requirements – disclosures on acquisition of control *Regulation 39 of the AIFM Regulations (Disclosure in case of acquisition of control)*	**Guidelines requirements** *Part V Sections 4, 5, 7 and 10 of the Guidelines (Guidelines for enhanced disclosure by portfolio companies and private equity firms)*
When control is acquired, the AIFM must disclose its intentions to the regulator, the company and its shareholders about the future of the business and likely repercussions on employment by the company and material change in the conditions of employment.	Part V section 10 of the Guidelines sets out the responsibilities of the private equity firm at a time of significant strategic change. It requires a commitment to ensure "timely and effective communication with employees, either directly or through its portfolio company, in particular at the time of a strategic initiative or a transaction involving a portfolio company." Although the precise wording is not the same, the AIFMD requirements are in the spirit of what is intended by the Guidelines. The Guidelines, however, do not include the obligation to disclose information to regulators.
Other areas where disclosure is required:	
■ The identity of the AIFM(s) with control.	Part V sections 4a) and 4b) of the Guidelines require disclosure of the fund(s) that own the company, details on executives or advisers of the private equity firm that have oversight of the company and details on board composition, identifying those directors from the private equity firm.
■ The policy for preventing and managing conflicts of interest and information about the safeguards established to ensure any agreement between the AIFMs or the AIFs and the company is at arm's length.	Part V section 7 requires the private equity firm to disclose on its website (through an annual review or regular updates) a "confirmation that arrangements are in place to deal appropriately with conflicts of interest, in particular where it has a corporate advisory capability alongside" its fund management business. Details of the policy and applicable safeguards may be disclosed by the private equity firm although the Guidelines do not explicitly require this.
■ The policy for external and internal communication relating to the company, in particular as regards employees.	Part V section 4 requires portfolio companies to prepare a strategic report which includes provisions in the Companies Act 2006 normally applicable to quoted companies. Portfolio companies therefore include extended information about the company, and this occurs throughout the year. Section 5c) of the Guidelines requires the portfolio company to publish "a summary mid-year update giving a brief account of major developments in the company…no more than 3 months after mid-year." s414C(7) of the Companies Act 2006 requires information to be disclosed on the company's employees and the Group expects this to include policies related to employees. Further, Part V section 10 sets out the responsibilities of private equity firms in times of strategic change, including to employees.

APPENDIX 4: GUIDANCE ON THE DEFINITION OF A PRIVATE EQUITY FIRM AND PORTFOLIO COMPANIES WITHIN SCOPE

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The guidance that follows is for the purpose of private equity firms when considering the definition of 'control' which forms part of the definition of a 'private equity firm' in the Guidelines.

New Walker companies

A portfolio company of a private equity firm or firms becomes a Walker company, subject to meeting the other criteria as laid out in the Guidelines, when any one of the following criteria is met:

1. It is evident the private equity firm holds a majority stake (>50% of the ordinary shares) in the underlying business; or
2. If a private equity firm, in its own financial statements, discloses that it maintains control of the portfolio company; or
3. A private equity firm has the ability to direct the financial and operating policies of a portfolio company with a view to gaining economic benefits from its activities. Consideration shall include, but not be limited to: management control; board seats; directors indicative of significant influence.

Where more than one PE firm is involved in a transaction and they collectively own a controlling stake in a portfolio company, those firms will be jointly and severally responsible for ensuring that the portfolio company applies the Guidelines, and each of those firms will be assessed for compliance with the requirements that apply to them. Subject to prior approval by the Guidelines Monitoring Group, this does not apply to minority shareholders which invest alongside other majority shareholder(s) and where both the majority shareholder(s) and the portfolio company comply with the Guidelines. The Guidelines Monitoring Group's approval will depend on the specific facts and circumstances and the extent to which control is exercised.

Walker company exits

A portfolio company of a private equity firm is eligible for removal from the mandatory Walker population when any one of the following criteria is met:

1. The portfolio company is sold via a trade sale; or
2. A private equity firm exits via an Initial Public Offering, even if the private equity firm retains a majority stake. The newly listed vehicle will be bound by the reporting requirements mandatory for listed companies; or
3. An event occurs, such as a restructuring, whereby a private equity firm is no longer able to control the financial and operating policies of a portfolio company.

To ensure that the guidelines consider instances where there has been a dilution of ownership post initial acquisition, a private equity firm that holds 20 percent or more of the voting rights following such dilution will be presumed to exercise significant influence over that portfolio company, and will continue to be a Walker company, unless the contrary is shown. This test will not be applied at initial acquisition by a private equity firm, and will only be applied where there is a dilution of ownership post initial acquisition.

A5 APPENDIX 5: RECOMMENDATIONS FOR THE INDUSTRY ASSOCIATION

These recommendations for initiative by the BVCA cover:

- the BVCA's industry-wide reporting and intelligence function;
- the establishment of a guidelines review and monitoring capability;
- for engagement with major investors and their associated entities or affiliates which, though "private equity-like", do not require authorisation by the FCA; and
- for engagement in discussion with relevant private equity groupings outside the UK in the development of common standards, in particular in respect of fund performance.

A. Reporting and intelligence

1. The BVCA should boost significantly its capability for the collection, processing and analysis of data submitted by private equity firms and portfolio companies. While the main focus of this report is, as indicated and defined at the outset, on the activities of large buyout firms and their portfolio companies, the BVCA's reporting and intelligence function covers the whole of the private equity industry, including venture and development capital. The recommendation here is that this overall capability should be boosted so that the BVCA becomes the recognised authoritative source of intelligence and analysis both of larger-scale and of venture and development capital private equity business based in the UK and a centre of excellence for the whole industry. It is recommended that, alongside the strengthening of the executive that is already in train, the BVCA should retain the services on a fee-paying basis of one or more professional firms to assist in this task as a means of quality input and assurance, as also for the assurance of confidentiality in respect of data that is provided exclusively for incorporation in an aggregation process.
2. This recommended enlargement and strengthening in the BVCA's data gathering, analytical and reporting capability will call for materially increased data input from portfolio companies covered by the enhanced reporting guidelines and from the private equity firms investing in those companies. Responsibility for the sourcing of specific data flows respectively as between private equity firms and portfolio companies should be determined by the BVCA on the basis of prior consultation, to include for the previous calendar year or portfolio company reporting period:
    - amounts raised in funds with designated scope to invest in portfolio companies in the UK.
    - categorisation of limited partners by geography and by type.
    - scale of acquisitions of UK portfolio companies by transaction size at the time of acquisition.
    - trading performance of portfolio companies in terms of revenues and operating earnings.
    - estimates of levels and changes in employment, new capital investment and research and development expenditure by portfolio companies.
    - aggregate fee payments by private equity firms and portfolio companies to other financial institutions and for legal, accounting and other advisory services.
    - such other data collection and analysis as may be required in support of a

comprehensive evidence-based assessment capability on the performance and economic impact of private equity in the UK, with particular reference to employment, productivity, investment and innovation.

3. Data should be collected from private equity firms to support attribution analysis in respect of exits in at least the previous calendar year to provide on an industry wide basis annually an assessment of percentages of total return over the holding period attributable to:
   - leverage and financial structuring.
   - growth in market multiples and market earnings in the relevant industry sector.
   - strategic direction and operational management of the business.
4. It is recommended that the BVCA should publish an enlarged version of its economic impact and associated surveys to cover both the industry overall and giving separate data and analyses for
   - larger-scale private equity business to present an authoritative evidence based account of the performance of the industry in the UK over the holding periods of portfolio companies and of the subsequent performance of former portfolio companies where exit by the fund or funds is to the public market by means of an IPO process.
   - venture and development capital, which will call for an increase in the sample sizes for data collection.

B. Guidelines review and monitoring

For the purpose of ensuring that the guidelines for disclosure by portfolio companies and private equity firms remain appropriate in the light of changing conditions and to monitor conformity with the guidelines, the BVCA should establish a Guidelines Review and Monitoring Group (the "Group") with the following elements:

1. Terms of reference of the Group:
   a) to keep the guidelines under review and to make recommendations for changes when necessary to be implemented by the BVCA after due consultation to ensure that the Guidelines remain appropriate in changing market and industry circumstances.
   b) to review the extent of conformity with the guidelines, through compliance or explanation, on an ongoing basis.
   c) to publish a brief annual report on the work of the Group.
2. Composition of the Group:
   a) a Chairman with substantial experience but independent of private equity.
   b) total size of 5 to include 2 executives of GPs or advisers to funds investing in portfolio companies covered by the Guidelines.
   c) 2 independent members additionally to the Chairman with substantial professional or business experience.
   d) thus a majority of independents.
3. Appointment of the Group:
   a) to be appointed by the Chairman and Council of the BVCA on the advice of a Nominations Committee of the Council.
   b) the Chairman of the Group to have a term of 3 years with provision for appropriate rotation of other members to ensure continuity.
   c) the Chairman and the independent members to be paid appropriate fees.

4. Operations of the Group:

   The guidelines review and monitoring processes under paragraph 1 (a) and (b) above to be supported by an accounting firm appointed by and under the direction of the Group:

   a) undertaking data processing and assessment on the basis of initial self assessment on conformity by private equity firms and portfolio companies.

   b) appropriate spot-check sampling.

   c) funded under budget provisions agreed between the Group and the Chairman and Council of the BVCA.

5. Conformity with the Guidelines:

   On the basis that BVCA member firms commit to conform to the guidelines as a condition of membership, the Group would discuss in confidence with a private equity firm or portfolio company any case of non-conformity which it considered to be material. In the absence of commitment to early remedial action, the matter would be for discussion and determination of appropriate action between the Chairman of the Group and the Chairman of the BVCA and might, after due process, involve public disclosure and termination of membership of the BVCA.

C. Engagement with "private equity-like" entities

1. The BVCA should identify entities whose business, though not requiring authorisation by the FCA, is similar to that of the private equity firms covered by these guidelines, to include in particular the UK affiliates of sovereign wealth funds and other major principal or proprietary investors whose funding is not dependent on limited partners.
2. The BVCA should initiate discussion with such groups (where appropriate, in the case of sovereign wealth funds, after consultation with government) with the purpose of enlisting their voluntary undertaking to conform to the Guidelines, on the basis that this will be in their own interest as a manifest of their commitment to established good practice as to disclosure and transparency in such business conducted in the UK.
3. The BVCA is recommended to create an appropriate category of membership to enable such entities to be associated appropriately with the activities of the association.

D. Fund performance measurement

The BVCA should participate proactively with private equity trade associations beyond the UK and with representatives of the domestic and international limited partner community to develop a methodology for the content and presentation of fund performance information with particular relevance for prospective future limited partners as well as those in existing funds. The Global Investment Performance Standards ("GIPS") prepared under the auspices of the CFA Institute represent a possible approach on which the BVCA should engage during the impending five year review of GIPS. Any standard to emerge from this process should be incorporated in the guidelines in due course.

APPENDIX 6: EXTRACTS FROM THE COMPANIES ACT 2006

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Requirements for portfolio companies covered by the seventh report

These are the current requirements that apply for portfolio companies reviewed in the seventh report. Note that this section of the Companies Act has been repealed for companies with years ending on or after 30 September 2013. This content now falls within the strategic report which is set out in the next section.

Section 417 Contents of directors' report: business review

1. Unless the company is subject to the small companies' regime, the directors' report must contain a business review.
2. The purpose of the business review is to inform members of the company and help them assess how the directors have performed their duty under section 172 to promote the success of the company.
3. The business review must contain:
   a. a fair review of the company's business, and
   b. a description of the principal risks and uncertainties facing the company.
4. The review required is a balanced and comprehensive analysis of:
   a. the development and performance of the company's business during the financial year, and
   b. the position of the company's business at the end of that year, consistent with the size and complexity of the business.
5. In the case of a quoted company 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,
      ii. the company's employees, and
      iii. social and community issues

      including information about any policies of the company in relation to those matters and the effectiveness of those policies; 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 bi, ii and iii and c., it must state which of those kinds of information it does not contain.
6. The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:

a. analysis using financial key performance indicators, and

b. where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters. "Key performance indicators" means factors by reference to which the development, performance or position of the company's business can be measured effectively.

7. Where a company qualifies as medium-sized in relation to a financial year see sections 465 to 467), the directors' report for the year need not comply with the requirements of subsection 6) so far as they relate to non-financial information.

8. The review must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.

9. In relation to a group directors' report this section has effect as if the references to the company were references to the undertakings included in the consolidation.

10. Nothing in this section requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company.

11. Nothing in subsection 5) c) requires the disclosure of information about a person if the disclosure would, in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest.

Requirements for portfolio companies covered by the eighth report 414C. Contents of strategic report

1. The purpose of the strategic report is to inform members of the company and help them assess how the directors have performed their duty under section 172 (duty to promote the success of the company).

2. The strategic report must contain—

   a. fair review of the company's business, and

   b. a description of the principal risks and uncertainties facing the company.

3. The review required is a balanced and comprehensive analysis of—

   a. the development and performance of the company's business during the financial year, and

   b. the position of the company's business at the end of that year, consistent with the size and complexity of the business.

4. The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include—

   a. analysis using financial key performance indicators, and

   b. where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.

5. In subsection (4), "key performance indicators" means factors by reference to which the development, performance or position of the company's business can be measured effectively.

6. Where a company qualifies as medium-sized in relation to a financial year (see sections 465 to 467), the review for the year need not comply with the requirements of subsection (4) so far as they relate to non-financial information.

7. In the case of a quoted company the strategic report 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 impact of the company's business on the environment),
   ii. the company's employees, and
   iii. social, community and human rights issues

   including information about any policies of the company in relation to those matters and the effectiveness of those policies.

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

8. In the case of a quoted company the strategic report must include—
   a. a description of the company's strategy,
   b. a description of the company's business model,
   c. a breakdown showing at the end of the financial year—
      i. the number of persons of each sex who were directors of the company;
      ii. the number of persons of each sex who were senior managers of the company (other than persons falling within sub-paragraph (i)); and
      iii. the number of persons of each sex who were employees of the company.
9. In subsection (8), "senior manager" means a person who—
   a. has responsibility for planning, directing or controlling the activities of the company, or a strategically significant part of the company, and
   b. is an employee of the company.
10. In relation to a group strategic report—
    a. the reference to the company in subsection (8)(c)(i) is to the parent company; and
    b. the breakdown required by subsection (8)(c)(ii) must include the number of persons of each sex who were the directors of the undertakings included in the consolidation.
11. The strategic report may also contain such of the matters otherwise required by regulations made under section 416(4) to be disclosed in the directors' report as the directors consider are of strategic importance to the company.
12. The report must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.
13. Subject to paragraph (10), in relation to a group strategic report this section has effect as if the references to the company were references to the undertakings included in the consolidation.
14. Nothing in this section requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company.

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