



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

3 January 2008

Our ref: ICAEW Rep 127/07

Treasury Committee
By email

Dear Sirs

**TREASURY COMMITTEE INQUIRY INTO PRIVATE EQUITY 2007-08
(PRESS NOTICE NO. 05)**

The Institute of Chartered Accountants in England and Wales (the ICAEW) is pleased to respond to your call for evidence on your inquiry into private equity, on the topic of transparency.

Private equity, a significant contributor to the economy, has come under attack because its strategy and operating tactics have not always been communicated appropriately or in a timely fashion.

The ICAEW views Sir David Walker's Guidelines for Disclosure and Transparency in Private Equity as a positive development in the disclosure regime for the private equity industry and considers the code to be a proportionate response to calls for greater transparency and accountability. The code separately addresses private equity-owned businesses and private equity firms and their conformity will be on a 'comply or explain' basis. The onus is on the industry as a whole to respond appropriately and demonstrate that the code can work so as to enhance market confidence and public trust in the industry and ensure its sustainability.

The ICAEW Corporate Finance Faculty has many members engaged in or working with the private equity industry. Working in the public interest, the Faculty is committed to ensuring that the markets and the public are well informed about the risks and benefits associated with private equity. The Faculty plans to publish a guide to private equity to bring clarity to the commercial rationale and the wider impact of private equity and management buy-outs and the extent to which these are supported by research evidence.

This response draws on the expertise of Faculty members as well as the wider experience of the ICAEW in corporate governance and corporate reporting.

Please contact me should you wish to discuss any of the points raised in this response.

Yours faithfully

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ICAEW Representation

ICAEW REP 127/07

TREASURY COMMITTEE INQUIRY INTO PRIVATE EQUITY

Memorandum of comment submitted in December 2007 by
The Institute of Chartered Accountants in England and Wales, in
response to an invitation by the House of Commons' Treasury
Committee to comment on its resumed inquiry into private equity
published in November 2007 (Press Notice No. 05)

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to submit evidence on the topic of transparency to the inquiry into private equity of the House of Commons' Treasury Committee.

WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the ICAEW provides leadership and practical support to over 128,000 members in more than 140 countries.
3. The ICAEW's Corporate Finance Faculty (the Faculty) is a network of over 6,000 corporate finance professionals, many of whom are engaged in the private equity industry. Working in the public interest, the Faculty and the ICAEW are committed to ensuring that the markets and the public are well informed about the risks and benefits associated with private equity.
4. The ICAEW is also committed to encouraging dialogue on corporate governance and is involved in the development of corporate governance in the UK and internationally. This includes the publication of the Turnbull guidance on internal control (1999) and the *Beyond the myth of Anglo-American corporate governance* initiative.
5. This response draws on the expertise of Faculty members as well as the wider experience of the ICAEW in corporate governance and corporate reporting.

EVIDENCE ON THE TOPIC OF TRANSPARENCY AND SIR DAVID WALKER'S PROPOSALS FOR IMPROVING THE TRANSPARENCY OF THE PRIVATE EQUITY INDUSTRY

MAJOR POINTS

6. The ICAEW views Sir David Walker's Guidelines for Disclosure and Transparency in Private Equity ('the code') as a positive development in the disclosure regime for the private equity industry and considers the code to be a proportionate response to calls for greater transparency and accountability. The code separately addresses private equity-owned businesses and private equity firms and their conformity will be on a 'comply or explain' basis. The onus is on the industry as a whole to respond appropriately and demonstrate that the code can work so as to enhance market confidence and public trust in the industry and ensure its sustainability. The recently established BVCA panel for monitoring and encouraging conformity with the code will play a major role in this.
7. The BVCA panel will need to be vigilant as to how the market receives the data analysis and the industry's conformity with the code. If necessary, the panel may need to adapt its approach to meet the objective of enhancing wider public trust in the industry. The panel will also need to be mindful of how the principles underlying the code could influence overseas private equity business.

COMMENTS ON SPECIFIC AREAS SET OUT IN PRESS NOTICE NO. 05

The structure and effectiveness of the recently established BVCA panel for monitoring, and encouraging compliance with, the code of conduct

8. The key principles of a voluntary code of conduct for transparency are:
 - confidence in its structure and the practice it promotes;
 - flexibility, ie the ability of being modified; and
 - a monitoring mechanism which is seen to be independent and effective.
9. In assessing the structure and effectiveness of the BVCA panel for monitoring and encouraging compliance with the code it is useful to draw analogies with the Corporate Governance Committee of the Financial Reporting Council and the Code Committee of the Takeover Panel.
10. The structures of these committees are characterised by their independence and their inclusion of the main market participants.
11. It is significant that both committees have members with experience of or a direct role in reporting. This is particularly important for the monitoring role of the BVCA panel, ie when evaluating conformity, as it will help build the perception of good practice. It would also be an instrumental factor in ensuring that future changes to the regime are considered workable and are accepted.
12. Thus we support the intended inclusion of representatives of General Partners on the BVCA panel and would support inclusion of advisers to funds who can bring experience of the reporting process. We would also support the inclusion of Limited Partners. This would demonstrate that the interests of the investor community are aligned with the objects of the code and would help conformity with the code to become a generally accepted yardstick.
13. In addition to structural matters, the BVCA panel will need to consider issues relating to process, such as fair and appropriate sanctions in the case of non-conformity and a mechanism for dealing with objections to decisions. It will also need to evaluate the implications of making public the results from monitoring.
14. The structure of the BVCA panel and its terms of reference are likely to evolve over time. Developments may come about depending on how the wider public perceives the panel is performing in its objective of encouraging greater transparency in the private equity industry. The panel should be given a reasonable period to implement its terms of reference and to demonstrate its independence and authority. The ultimate test of its effectiveness will be whether the wider public concerns are addressed.

The appropriateness of the proposed level and type of disclosure for the various stakeholders in private equity-owned businesses

15. During the consultation period the ICAEW highlighted certain concerns that the enhanced reporting requirements for a subset of private companies (in this case, private equity-owned companies) were unfair and could cause market distortion

by deterring private equity deals. Notwithstanding this we consider that the disclosures for private equity-owned businesses are proportionate and will address specific needs for communication and acknowledge the importance of maintaining good stakeholder relations.

16. The requirement to identify the private equity fund or funds that own the business will help prevent mistrust and uncertainty caused by the perception that the owners are anonymous. In terms of identifying the senior executives of advisers of the private equity firm with oversight of the business on behalf of the fund(s), we agree that this will improve accountability but we consider it would be more in line with being transparent not to restrict disclosure to UK-based individuals as is currently the case in the code.
17. We agree that, in developing the code, it was appropriate to refrain from setting guidelines in respect of board composition and corporate governance of portfolio companies. The board is responsible as a whole for ensuring a balance of skills and experience appropriate for the company and a rigorous appointment process will normally address this. We consider it helpful to stakeholders to expect companies to identify executives of the company, representatives of the private equity firm and outside directors on the board.
18. The requirement for private equity-owned businesses to include, as part of their annual report and accounts, a business review that conforms to s417 Companies Act 2006 (including subsection 5) is sensible and provides practical guidance for such reporting. As market practice in conforming to the Act's provisions evolves, it will provide a useful benchmark in communicating to the various stakeholders and help reporting focus on the economic substance rather than the legal form of the business.
19. Much of the negative coverage of private equity activity can be attributed to poor communication and analysis of the context in which private equity transactions take place (including the risks). The requirement that a private equity-owned business's financial review should cover risk management objectives and policies in the light of the principal financial risks and uncertainties facing the company, will bring clarity and increase understanding of the risks involved.
20. The benefits of additional disclosures by private equity-owned businesses are accompanied by associated cost and time implications. Certain companies will not have previous experience of quoted company reporting requirements and deadlines. Stakeholders and the monitoring panel will need to recognise this when evaluating a business's conformity with the code.

Proposals for a respected capability for providing comprehensive, industry-wide data on the private equity industry

21. Sir David Walker's proposals for 'a respected capability' seek to establish the BVCA as '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'.
22. The data agenda in the proposals will, in our view, be a major contributor to the reputation and sustainability of the private equity industry providing the following apply:

- There needs to be confidence in the quality of data collected and in the robustness and objectivity of the data aggregation and analysis. This implies that ‘bad news’ or unfavourable performance indicators must also be disclosed. We believe that this can be supported through engaging, as proposed, the services of professional firms. It will also be important for private equity-owned businesses and private equity firms to feel responsibility to provide appropriate data and it is up to the BVCA to create and foster momentum in the process.
 - Data analysis must be representative of the industry as a whole and efforts may be needed to persuade private equity firms at the larger buyout end (where they are not members of the BVCA) to contribute data.
 - There needs to be commitment to appropriately resource the data capability including the costs of engaging the services of professional firms, the costs to private equity-owned businesses and private equity firms of providing the data and the costs to the BVCA of gathering and reporting data.
 - The wider public response to data analysis and the industry’s conformity with the code needs to be monitored. If necessary, the panel may need to adapt its approach to meet the objective of enhancing wider public trust in the industry.
23. We support the publication of attribution analysis as an effective way of encouraging accountability. Doing this, as proposed, on an industry-wide basis will require consistent judgements to be made in preparing the analysis so as to facilitate verification and comparison over time. There have been criticisms of the failure of the code to require individual firms to produce attribution analyses. However, there are suggestions that the industry-wide approach should be treated as work-in-progress towards developing a ‘template’ with which individual firms can conform. We would support this approach as it will help eliminate some of the inherent limitations in producing attribution analyses, such as subjectivity and comparability.
24. The UK has the largest concentration of private equity business in Europe and private equity is a cross border business. Given also that there is no such code of conduct overseas, the BVCA will be well placed to give early consideration as to how data input requirements on private equity firms and the businesses they own, as well as the resulting analysis, might be developed or expanded to include data on non-UK private equity portfolios and, potentially, data from overseas private equity industries.

The private equity-owned companies to be covered by the code

25. Companies’ legislation requires directors to promote the success of the company for the benefit of members while having regard to a number of other stakeholders. Well-governed companies will provide relevant and proportionate information even in the absence of reporting guidelines.
26. The private equity-owned companies to be covered by the code have to satisfy a ‘test of UK significance’ as measured by the percentage of revenue generated in the UK. While this provides welcome clarity as to which companies should adhere to the enhanced disclosure requirements, it is important for judgement to be

exercised in the case of companies with UK-generated turnover (and indeed other measures such as employee numbers) immediately below the thresholds.

27. The monitoring mechanism for the code will enable review of the thresholds for private equity-owned companies. It may be appropriate for changes to be made in light of experience, including where reporting is a matter of judgement rather than strict adherence to a requirement.

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