

FRC Publishes Its Revised Standards for Investment Reporting

15 April 2020

On 26 March 2020, the UK Financial Reporting Council (“**FRC**”) issued its revised Standards for Investment Reporting (the “**SIRs**”), which contain the standards and guidance that reporting accountants must follow when engaged in connection with UK-regulated investment circulars. This memorandum considers the new SIRs and how they may affect the engagement terms and the nature of the reporting by reporting accountants for a corporate finance transaction.

Whilst the SIRs have been used widely by reporting accountants, they had not been subject to a full update for over a decade and therefore no longer properly reflected relevant underlying legislation, regulation, professional guidance and market practice. In May 2019, the FRC published its **Proposal to Revise the Standards for Investment Reporting (SIRs)** and the **Standard for Investment Reporting (SIRs) 1000-6000: Exposure Drafts** (together, the “**Consultation Materials**”), which included changes to the existing SIRs and the introduction of a new SIR 6000 in respect of reporting accountants’ engagements on the proper compilation of a Qualified Financial Benefits Statement (a “**QFBS**”) prepared in accordance with The City Code on Takeovers and Mergers (the “**Takeover Code**”).

The consultation period closed in June 2019 and the FRC published the **Consultation Feedback Statement** (the “**Feedback Statement**”) with the revised SIRs on 26 March 2020. It had initially been the intention that the new SIRs would come into effect in June 2020, however due to the impact of the coronavirus (COVID-19) pandemic, implementation has now been delayed until September 2020 to allow firms time to be ready to implement the changes.

The new SIRs

Once in force, there will be six SIRs:

- **SIR 1000** – All Engagements
- **SIR 2000** – Historical Financial Information
- **SIR 3000** – Profit Forecasts
- **SIR 4000** – Pro Forma Financial Information
- **SIR 5000** – Financial Information Reconciliations under the Listing Rules
- **SIR 6000** – Qualified Financial Benefits Statements

SIR 1000 is relevant to all engagements, whether in connection with public or private reports. SIRs 2000 to 6000 relate to specific public reports prepared by a reporting accountant, although SIR 3000 and SIR 6000 do necessarily inform the approach taken by a reporting accountant when preparing a private report to an issuer, its sponsor, underwriter or financial adviser on the same matters.

Below is a short summary of the key changes that have been made as a result of the consultation. As the changes to SIR 5000 are largely cosmetic and primarily to reflect changes to the Listing Rules since 2008 when SIR 5000 was last published, it is not included in the review below.

SIR 6000 – the new SIR for QFBSs

SIR 6000 has been introduced to provide guidance for reporting accountants on engagements to report publicly on the proper compilation of a QFBS in accordance with Rule 28.1 of the Takeover Code. QFBSs can be prepared by both offerors and target companies as a defensive measure against a hostile bid.

As QFBSs can provide estimates of synergy benefits and other quantified benefits (including costs), the guidance will also undoubtedly inform the approach taken by reporting accountants towards any private assurance report. This will be of particular relevance in the context of reports produced in connection with disclosure of estimated financial benefits (such as the estimated synergy benefits of an acquisition) in a circular published in relation to a Class 1 transaction or a prospectus required for an accompanying equity fundraising or for a re-admission in the context of a reverse takeover.

The final version of SIR 6000 draws upon the requirements for the reporting accountant's report set out in the Takeover Code and layers on the guidance of the Institute of Chartered Accountants of England and Wales (the "ICAEW") and the International Auditing and Assurance Standards Board (the "IAASB"), to provide reporting accountants with a framework for assessing whether a QFBS is reliable and understandable. Some themes that run through the guidance are as follows:

- the value to a bidder of involving the target board in developing a QFBS and the difficulties inherent in making a QFBS in a hostile scenario;
- the need for a robust consideration of sensitivity analysis and risk-weighting, including a focus on any regulatory approval or conditions that the proposed takeover is subject to and any wider public or parliamentary interest, which may undermine confidence in the information presented in the QFBS;
- the importance of properly identifying and properly assessing 'dis-benefits' of the proposed takeover;
- the need for the reporting accountant to consider the relevant systems and procedures of the preparer of the information to assess the reliability of the information; and
- the seniority and knowledge of the individuals who have contributed to formulating the QFBS and the track record of the offeror of achieving financial benefits or cost reductions.

A key aspect of SIR 6000 is the guidance around the criteria of assessing the understandability, reliability and comparability of QFBSs. The FRC defended its expansion of these criteria beyond the definitions provided for under the Takeover Code in order that SIRs 3000 and 6000 align with relevant ICAEW and IAASB guidance.

Changes to SIRs 1000 – 5000

A number of the most noteworthy proposed changes to the pre-existing SIRs in the Consultation Materials were not included in the final versions of the revised SIRs (see below, "Proposals not included in the revised SIRs"), which means that the amendments are mostly of a cosmetic nature to bring the guidance in line with current legislation, regulation and professional standards.

Below is a short summary of some of the more material changes. Note that there were no material changes to SIR 5000 save for the necessary updates for changes to the Listing Rules.

- SIR 1000 – All Engagements
 - The guidance now makes it clear that a reporting accountant should:
 - only accept an engagement where the terms of that engagement have been agreed, which may serve to delay the sharing of early drafts of reports until the engagement letter has been executed;

- require that written representations are only provided as near as practicable, but not subsequent, to the date of the report to which they relate, which should ensure that reports are as accurate as they practicably can be;
 - assess the plausibility of information provided to it for the purposes of its reports rather than simply rely on the representations of the provider of such information; and
 - test the suitability of the criteria and subject matter of its engagement, which should ensure that its scope of work is sufficient to provide the comfort required by the addressees of the report.
- All public reports prepared under SIR 2000 to 6000 are now required to be subject to an engagement quality control review, which risks increasing the length of time reporting accountants need to finalise their reports.
- SIR 2000 – Historical Financial Information
 - The guidance strengthens the requirements on a reporting accountant when relying on other auditors in the preparation of its report. A reporting accountant must consider the relevant auditor’s independence, competence and the regulatory framework in which they conducted the audit. The standard set is now akin to the considerations a group auditor must give under **ISA (UK) 600**. The need to satisfy this question may require the reporting accountant to seek more evidence than was previously required to confirm that the audit can be relied upon.
- SIR 3000 – Profit Forecasts
 - As the requirement for a public report on a profit forecast or profit estimate is no longer required under the Prospectus Regulation, SIR 3000 now focuses solely on the obligation under Rule 28.1 of the Takeover Code for a reporting accountant’s public report on the proper compilation of a profit forecast or profit estimate in the context of a takeover offer.
 - As with SIR 6000, the FRC has expanded the guidance around the criteria of understandability, reliability and comparability to align with relevant ICAEW and IAASB guidance. In turn, the FRC explains that this also allows for the use of SIR 3000 for the types of private engagement as may be required for a profit forecast or estimate in a Class 1 circular or prospectus.
- SIR 4000 – Pro Forma Financial Information
 - Relevant material from the IAASB’s International Standard of Assurance Engagements and the ICAEW’s TECH 06/15FF has been incorporated in particular in relation to how a reporting accountant might challenge the appropriateness of the source of any unadjusted financial information that is used in the pro forma statement and the adjustments that have been made by the company.
 - The FRC has also clarified that pro forma information is not typically included in an investment circular relating to a hostile takeover and that, in such circumstances, it may be more appropriate to include a narrative description instead.

Proposals not included in the revised SIRs

The Consultation Materials attempted to make some other significant amendments to the nature of a reporting accountant’s engagement and what it was required to report, which the FRC decided not to include in the revised SIRs. These included:

- Qualification of opinions

The Consultation Materials included a proposal that the opinions included in the public reports provided under SIRs 3000 to 6000 (i.e., all public opinions covered by the SIRs other than the “true and fair” opinion on historical financial information) would be qualified by materiality. This would have created a disconnect between the requirements under the Takeover Code, the Listing Rules and the Prospectus Regulation which require such opinions to be unqualified. In response to respondents’ concern for the need to have regulatory alignment, the FRC decided not to proceed with this proposal.

- More expansive disclosure in public reports

The FRC had asked respondents to provide feedback as to whether the public reports made under SIR 2000 to SIR 6000 should include disclosure around materiality, scope of work, or key matters / risks identified. The Feedback Statement makes it clear that the FRC was disappointed that investors and other market participants did not provide any responses to this suggestion as they had understood there was a demand for clarity on the nature of a reporting accountant’s engagement. In the absence of such support, the FRC determined that these proposals should not be included in the revised SIRs.

- “Fair, Balanced and Understandable”

The revised SIR 1000 had proposed wording to require a reporting accountant, when providing consent for their public opinion to be included in an investment circular and the issuer is subject (whether mandatorily or voluntarily) to the UK Corporate Governance Code, to assess whether the overall impression given by an investment circular is “fair, balanced and understandable”.

Whilst the FRC has decided not to make this change in the revised SIR 1000, it has rejected the view that the proposed wording could potentially lead to a significant expansion of the role of the reporting accountant. The Feedback Statement makes it clear that a reporting accountant should not interpret the remaining requirements with regard to its review of the entire investment circular too narrowly and suggests that the proposed additional wording did not essentially change the existing requirements: SIR 1000 requires a reporting accountant to ensure that its report is consistent with the other information in the investment circular, and that it has no reason to believe that any information in the investment circular is misleading. On this basis, it may be expected that, whilst some have already taken this approach, all reporting accountants will now pay greater regard to other parts of the investment circular that they had previously believed to be beyond the scope of their work.

Conclusions

The introduction of SIR 6000 will undoubtedly assist reporting accountants, issuers, financial advisers, sponsors and others in clarifying the parameters of a reporting accountant’s role in connection with a QFBS.

Elsewhere, as the FRC has decided not to proceed with some of the more noteworthy proposals in the Consultation Materials, the new SIRs broadly reflect the existing versions albeit tidied up for changes to relevant legislation, regulation and professional standards.

This having been said, we expect to see reporting accountants amending engagement letters and the scope of their work to reflect the limited changes that will take effect in September 2020.

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