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# STANDARDS FOR INVESTMENT REPORTING

## 3000 – Investment Reporting Standards Applicable to Public Reporting Engagements on Profit Forecasts

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## Preface

SIR 1000 “Investment reporting standards applicable to all engagements in connection with an investment circular” and contains basic principles and essential procedures (“Investment Reporting Standards”) that are applicable to **all** engagements involving an investment circular prepared for issue in connection with a securities transaction governed wholly or in part by the laws and regulations of the United Kingdom.

SIR 3000 contains only specific additional Investment Reporting Standards, indicated by paragraphs in bold type, with which a reporting accountant is required to comply in the conduct of an engagement involving the examination of Profit Forecasts and/or Profit Estimates published by a securities exchange offeror or the offeree company.

SIR 3000 also includes explanatory and other material, including appendices, in the context of which the Investment Reporting Standards are to be understood and applied. It is necessary to consider the whole text of the SIR to understand and apply the basic principles and essential procedures.

The definitions in the glossary of terms set out in Appendix 3 of SIR 1000 are to be applied in the interpretation of this and all other SIRs. Terms defined in the glossary are underlined the first time that they occur in the text.

To assist readers, SIRs contain references to, and extracts from, certain legislation and chapters of the City Code on Takeovers and Mergers (the “*Takeover Code*”). Readers are cautioned that these references may change subsequent to publication.

## Introduction

1. The purpose of this SIR is to establish specific additional Investment Reporting Standards and provide guidance on the reporting accountant's responsibilities and procedures when engaged to report publicly on the proper compilation of a profit forecast or profit estimate in accordance with Rule 28.1 of the *Takeover Code*. The requirements of Rule 28.1 of the *Takeover Code* apply to offeree companies and securities exchange offerors<sup>1</sup>, but do not apply to cash offerors.
2. An engagement to report publicly on the proper compilation of a profit forecast is a public reporting engagement as described in SIR 1000. The description of a public reporting engagement includes three generic terms having the following meanings in the context of an engagement to report on the proper compilation<sup>2</sup> of a profit forecast:
  - (a) with respect to a profit forecast the “subject matter” is the directors’ expectation of the offeree company or securities exchange offeror’s profit for the period of the forecast;
  - (b) “suitable criteria” to be used by directors in the preparation of the profit forecast are provided by the requirements of the *Takeover Code*. In forming its opinion as to whether the profit forecast has been properly compiled the reporting accountant considers whether those criteria (“reporting accountant’s criteria”) have been properly applied; and
  - (c) with respect to a profit forecast the “outcome”<sup>3</sup> is the directors’ profit forecast and related disclosures, that is included in the investment circular, and on which the reporting accountant expresses an opinion (in the “reporting accountant’s report”) as to whether that forecast is properly compiled on the basis stated and the basis of accounting used is consistent with the accounting policies of the offeree company or securities exchange offeror.
3. The *Takeover Code* defines a profit forecast as “a form of words which expressly states or by implication indicates a figure or a minimum or maximum figure for the likely level of profits or losses for the current financial period and/or financial periods subsequent to that period, or contains data from which a calculation of such a figure for future profits or losses may be made, even if no particular figure is mentioned and the word “profit” is not used”.<sup>4</sup>
4. A profit forecast may include historical financial information relating to a past period. For example, a forecast made on 15 October 20xx for the profit for the year ended 31 December 20xx may include the results for the six months ended 30 June 20xx included

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<sup>1</sup> Any bidder, or potential bidder, other than a cash bidder.

<sup>2</sup> References to ‘proper compilation’ in this SIR should be read as references to the full form of the reporting accountant’s opinion which is set out in an Appendix in the Illustrative Report.

<sup>3</sup> The “outcome” is sometimes described as “subject matter information”.

<sup>4</sup> Note that under rule 28.2 a of the *Takeover Code*, the Panel will normally grant a dispensation from the requirement to include reports from reporting accountants and the financial adviser(s) in the case of a profit forecast for a financial period ending more than 15 months from the date on which it is, or was, first published.

in the offeree company or securities exchange offeror's half yearly report and amounts extracted from management accounts for July and August. A profit estimate is a profit forecast for a financial period which has expired, and for which audited results have not yet been published.

5. In this SIR the term “profit forecasts” is also used to apply to those statements typically referred to as “profit estimates”. In applying the requirements of this standard, consideration needs to be given to the differences between profit forecasts and profit estimates. Whereas profit forecasts relate to the current financial period and/or subsequent financial periods, profit estimates represent historical financial information for a financial period which has expired but for which the results have not yet been published. The Reporting Standards in this SIR are applied to the whole period of the profit forecast including historical financial information included therein.

## The nature of profit forecasts

6. A profit forecast is, by definition, uncertain because events and circumstances may not occur as expected or may not be predicted at all, or because the directors may take actions different to those previously intended. A profit forecast will usually include disclosures which provide information to assist the intended users understand the uncertainties involved.
7. A profit forecast is usually based on assumptions, relating to the expected outcome of future events and possible actions by the entity. As assumptions on which any forward-looking element of a profit forecast is based are a critical element of the profit forecast, the *Takeover Code* requires, among other things, the disclosure of the principal assumptions on which the forecast is based, including a clear distinction between those which the directors (or other members of the company's management) can influence and those which they cannot.<sup>5</sup>
8. The extent to which a profit forecast will differ materially from the actual out-turn will depend on a profit forecast's particular circumstances. The length of the period into the future to which the profit forecast relates is only one, and not necessarily the most significant, factor. For example, an established business may be able to predict with greater certainty its results for the following year, particularly if it operates in a very stable environment, than a start-up business or an established business entering a new field. The fact that a profit forecast does not correctly predict the actual out- turn does not mean that the profit forecast was not properly compiled.
9. Guidance is available for preparers of prospective financial information (PFI) to assist directors in meeting the needs of the intended users of such information and of regulators and to promote the production of high quality prospective financial information, including profit forecasts.<sup>6</sup>
10. The *Takeover Code* requires that profit forecasts must be:

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<sup>5</sup> *The City Code on Takeovers and Mergers*, 28.4

<sup>6</sup> *Guidance for preparers of prospective financial information* (ICAEW, updated periodically).

- a. understandable: *it must not be so complex or include such extensive disclosure that it cannot be readily understood*<sup>7</sup>;
- b. reliable: *it must be supported by a thorough analysis of the offeree company's and/or the offeror's business and must represent factual and not hypothetical strategies, plans and risk analysis*<sup>8</sup>; and
- c. comparable: *it should be capable of justification by comparison with outcomes in the form of historical financial information*<sup>9</sup>.

Consequently, these three principles are considered to be suitable criteria for the evaluation of profit forecasts by the reporting accountant.

## Understandability

11. Understandable information will enable the intended users to identify readily the main points being made and to infer appropriately how significant they are to decision-making. This is likely to be assisted by a clear layout and presentation of the information in a way that effectively summarises and draws attention to these points. In order to be understandable, the profit forecast should be coherent, easy to follow, clear and logical.
12. To be understandable a profit forecast also contains the information necessary for intended users to appreciate the degree of uncertainty attaching to the information and how that uncertainty might impact it. This requires the disclosure of assumptions and other matters relevant to the basis of preparation of the profit forecast which are of importance in assisting the intended users' understanding.
13. What constitutes reasonable disclosure will therefore depend upon the particular circumstances of each profit forecast but will need to take into consideration:
  - (a) sources of uncertainty and the related assumptions made relating to uncertainties;
  - (b) the factors that will affect whether assumptions will be borne out in practice; and
  - (c) alternative outcomes, being the consequences of assumptions not being borne out.

The omission of important information may prevent a profit forecast from being understandable and equally, if the disclosure is too complex or too extensive the understandability of the profit forecast may be also impaired.

14. Any profit forecast also needs to be understandable in the context of the overall investment circular and consistent with the information within the circular.<sup>10</sup>

## Reliability

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<sup>7</sup> *The City Code on Takeovers and Mergers*, 28.3.b.i

<sup>8</sup> *The City Code on Takeovers and Mergers*, 28.3.b.ii

<sup>9</sup> *The City Code on Takeovers and Mergers*, 28.3.b.iii

<sup>10</sup> ICAEW, *Guidance for preparers of prospective financial information*, (updated periodically) preparers to take care to "ensure that there is alignment of information in the investment circular".

15. Reliable information in the context of a QFBS requires the QFBS to be supported by a thorough analysis of the offeree company's and/or the offeror's business and must represent factual and not hypothetical strategies, plans and risk analysis.
16. Reliable information represents what it purports to represent (sometimes referred to as 'faithful representation'), and:
- is materially complete;
  - accurately represents factually based strategies, plans and risk analyses (free from material error); and,
  - is without bias (neutrality).

This requires the underlying data and source information to also be created, collected and processed in a manner that maintains its integrity. Unsubstantiated claims are unlikely to meet this requirement.

17. A profit forecast, including the assumptions used, is more likely to possess the above attributes when the offeree company or securities exchange offeror has undertaken an analysis of the underlying business and its strategies, plans and risks (the directors' business analysis), and the sensitivity of assumptions.<sup>11</sup> The reliability of a profit forecast is, therefore, a function of:
- (a) the quality of the analysis undertaken; and
- (b) the degree to which that analysis is reflected in the profit forecast.
18. The fact that a profit forecast does not correctly predict the actual out-turn once reported, does not necessarily mean that it was not reliable when compiled.

## Comparability

19. The usefulness of a profit forecast is derived partly from its comparability, namely the expectation that it will be possible to compare it to actual results and that it can be compared to equivalent information for other reporting periods. For this to be the case profit forecasts need to be prepared and presented on a basis comparable with the actual financial information for that period.<sup>12</sup>

## Compilation process

20. The compilation of a profit forecast is the gathering, classification, summarizing and presenting of relevant financial information. The process followed by the preparer would be expected<sup>13</sup> to include:
- a. an appropriate analysis of the business (what is appropriate will depend on a number of factors including the complexity and predictability of the business and

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<sup>11</sup> ICAEW, *Guidance for preparers of prospective financial information*, (updated periodically).

<sup>12</sup> On comparability see also ICAEW, *Guidance for preparers of prospective financial information*, (updated periodically).

<sup>13</sup> See ICAEW, *Guidance for preparers of prospective financial information*, (updated periodically)

the length of the period being forecast and accordingly the content, degree of detail and presentation of such analyses may vary significantly);

- b. identification of material uncertainties, risks and opportunities;
  - c. sensitivity analysis to determine the impact on the forecast result in the event that identified risks crystallise;
  - d. selection of appropriate assumptions;
  - e. where relevant, identification of and reference to, appropriate third-party information (e.g. market research reports);
  - f. arithmetic computation of the profit forecast;
  - g. appropriate disclosures to enable the intended users to understand the profit forecast; and
  - h. appropriate consideration of the profit forecast and approval of it by the directors of the entity.
21. The *Takeover Code* requires in Rule 28.1 (a) (ii)<sup>14</sup> that a preparer is required to include in its profit forecast publication a report by their financial advisers that the profit forecast has been prepared with due care and consideration, as well as the reporting accountant's opinion on proper compilation. The reporting accountant considers whether sufficient time has been built into the compilation process to ensure that key individuals from the business and their financial advisers properly engaged with the process.

## Engagement acceptance and continuance

22. When accepting or continuing an engagement to report publicly on a profit forecast, the reporting accountant ascertains whether the directors intend to comply with all relevant requirements of the *Takeover Code*, in particular those that are the basis of the reporting accountant's criteria: reliability, understandability and comparability.<sup>15</sup>

### Agreeing the terms of the engagement

23. The reporting accountant considers whether it will require access to the work of the relevant financial advisers who are responsible for the report under the *Takeover Code* that the Profit Forecast has been prepared with due care and consideration when agreeing the terms of engagement with directors.
24. Examples of engagement letter clauses are set out in Appendix 1 of this SIR.

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<sup>14</sup> *The City Code on Takeovers and Mergers*, 28.1.a.ii

<sup>15</sup> *The City Code on Takeovers and Mergers*, 28.4.b&c.

## Legal and regulatory requirements

25. The *Takeover Code* contains provisions in relation to profit forecasts included in offer documents and requires reports from the auditors or reporting accountants in certain circumstances.<sup>16</sup>

## Planning and performing the engagement

**26. The reporting accountant shall obtain an understanding of the key factors affecting the subject matter sufficient to identify and assess the risk of the profit forecast not being properly compiled and sufficient to design and perform evidence gathering procedures including:**

- **the background to and nature of the circumstances in which the profit forecast, which is included in the investment circular, was made;**
- **the entity's business; and**
- **the procedures adopted, or planned to be adopted, by the directors for the preparation of the profit forecast. (SIR 3000.1)**

27. The reporting accountant gains an understanding of the background to and nature of the circumstances in which the profit forecast is being prepared, by discussion with the directors or management of the offeree company or securities exchange offeror and by reading relevant supporting documentation. In particular, the reporting accountant ascertains whether the profit forecast is being made for the first time or whether it is a forecast that has previously been made by the offeree company or securities exchange offeror that may be required to be updated by the directors.

28. The reporting accountant uses professional judgment to determine the extent of the understanding required of the entity's business. In a start-up situation or where an established business is entering a new field the reporting accountant's understanding of the prospective business is necessarily limited to general knowledge of the field being entered and an understanding of the business analysis undertaken by the entity.

29. Reporting on the proper compilation of a profit forecast generally requires an understanding of the entity's management accounting, budgeting and forecasting systems and procedures beyond that normally considered necessary for an audit of historical financial statements.

30. Discussion with the preparers of a profit forecast will identify the process by which the profit forecast has been, or will be prepared, the sources of information used, areas of significant uncertainty where assumptions have been made and the basis for those assumptions and how those assumptions have been documented. Specific matters for consideration include:

- The organisational structure of the entity and the extent to which subsidiaries or local operating units have been involved in the preparation of the profit forecast.

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<sup>16</sup> *The City Code on Takeovers and Mergers*, 28.1.a.

- Whether the profit forecast is prepared on a basis comparable with the most recent historical financial information in the investment circular.
- The extent to which the period of the forecast includes historical financial information.
- Whether the profit forecast will be capable of comparison to subsequently published historical financial information.

31. Where profit forecasts are regularly prepared by the entity either for internal management purposes or for publication, the reporting accountant considers the closeness to actual out-turns achieved in previous forecasts and the analysis of any variances. As well as helping to provide an understanding of the entity's business this may be helpful in identifying those aspects of the business which are subject to significant uncertainty.

### **Materiality**

**32. The reporting accountant shall consider materiality and public reporting engagement risk in planning its work in accordance with its instructions and in determining the effect of its findings on the report to be issued. (SIR 3000.2)**

33. The *Takeover Code* sets out the matters which are required to be included in a profit forecast, and the criteria which must be used in its preparation. However, it does not prescribe the content elements in detail, and therefore the preparer will need to make judgments about the information to be included within the profit forecast in order to satisfy the requirement that it be understandable, reliable and comparable.

34. Matters are material if their omission or misstatement could, individually or collectively, influence the economic decisions of users of the outcome. Materiality depends on the size and nature of the omission or misstatement judged in light of the surrounding circumstances. The size or nature of the matter, or a combination of both, could be the determining factor.

35. An error in the context of the proper compilation of a profit forecast includes:

- Assumptions that are not consistent with the analysis of the business.
- Mathematical or clerical mistakes in the compilation of the profit forecast.
- Misapplication of accounting policies.
- Misapplication of a stated assumption.
- Known misstatements in historical financial information embodied in the forecast without adjustment.

36. Additionally, there may be deficiencies in the presentation of a profit forecast which may impair the understandability or comparability of the forecast in a way that is material. An error could, therefore, also include:

- a. failure to disclose an assumption or other explanation which is necessary for an understanding of the forecast; or
  - b. presenting the forecast in a way that it is not capable of being compared with subsequent published results.
37. Evaluating whether an omission or misstatement could influence economic decisions of the intended users of the profit forecast, and so be material, requires consideration of the characteristics of those intended users. The intended users are assumed to:
- a. have a reasonable knowledge of business and economic activities and accounting and a willingness to study the profit forecast with reasonable diligence;
  - b. understand that profit forecasts are prepared, presented and reported on to levels of materiality;
  - c. recognise the uncertainties inherent in prospective financial information and the consideration of future events; and
  - d. make reasonable economic decisions on the basis of the profit forecast.

The determination of materiality, therefore, takes into account how intended users with such characteristics could reasonably be expected to be influenced in making economic decisions.

## Public reporting engagement risk

38. “Public reporting engagement risk” is the risk that the reporting accountant expresses the positive and unmodified opinion required by the *Takeover Code* when the profit forecast has not been properly compiled on the basis stated or the basis of accounting used for the profit forecast is not consistent with the accounting policies of the offeree company or securities exchange offeror.
- 39. To form an opinion that the profit forecast has been properly compiled, the reporting accountant shall obtain sufficient appropriate evidence that the forecast is free from material error in its compilation by:**
- **obtaining evidence that the directors have applied the reporting accountant’s criteria, derived from the *Takeover Code* and set out in this SIR;**
  - **checking that the profit forecast has been accurately computed based upon the disclosed assumptions and the preparer’s accounting policies;**
  - **considering whether the assumptions used are consistent with the directors’ business analysis and the reporting accountant’s own knowledge of the business; and**
  - **where applicable, evaluating the basis on which any historical financial information included in the profit forecast has been prepared. (SIR 3000.3)**
40. The reporting accountant considers the business analysis carried out by the preparer of the profit forecast and whether there is prima facie evidence that it has been used by the directors in compiling the profit forecast. The extent and nature of the analysis that is

necessary to support a forecast, and therefore the extent of the reporting accountant's consideration of such analysis, will be dependent upon the specific circumstances in which the forecast is being prepared. The reporting accountant discusses the preparer's plans, strategies and risk analysis with the preparer of the profit forecast, considers documentary support for them and assesses whether they are consistent with the analysis of the business. Where the outcome is dependent upon the intent of the directors and management the reporting accountant will ordinarily obtain representations from the directors concerning such matters.

41. The preparer can be expected to document the assumptions that have been made relating to matters significant to the profit forecast. The reporting accountant will, therefore, obtain from preparers of the profit forecast details of those assumptions identified as being relevant to the compilation of the profit forecast. It will usually be the case that not all of the assumptions made in support of the profit forecast will be published. This is because only those that are material to an understanding of the profit forecast are required to be disclosed.
  
42. There may be a range of appropriate assumptions which can be used as the basis for a profit forecast and the resulting forecast may differ significantly depending on which assumptions are adopted. The reporting accountant is not required to express an opinion on the appropriateness of the assumptions used or the achievability of the results reflected in a profit forecast. The reporting accountant however considers:
  - if any of the assumptions adopted by the directors which, in the opinion of the reporting accountant are necessary for a proper understanding of the profit forecast, have not been adequately disclosed; and
  - whether any material assumption made by the directors appears to be unrealistic.
  
43. When checking whether the profit forecast has been accurately computed the reporting accountant considers whether cash flow statements and balance sheets have been prepared to act as checks against omissions and inconsistencies. If cash flow statements and balance sheets have not been prepared, in circumstances where the reporting accountant considers this to be necessary, the reporting accountant discusses with the directors whether their preparation is necessary in order to properly compile the profit forecast.

## Historical financial information

- 44. When evaluating the basis on which any historical financial information included in the profit forecast has been prepared the reporting accountant shall:**
  - **consider whether any element of that historical financial information has been audited or reviewed by the auditors and, if so, the results of that audit or review;**
  - **evaluate the suitability of unaudited historical financial information included in the profit forecast;**
  - **evaluate how the historical financial information has been embodied into the profit forecast; and**

- **if adjustments have been made to previously published historical financial information evaluate whether the adjustments appear appropriate in the circumstances. (SIR 3000.4)**
45. If historical financial information has been audited or reviewed the reporting accountant evaluates the scope of the audit or review procedures performed. In performing such an evaluation, the reporting accountant seeks access to the working papers of the auditor or reviewer and considers whether the results of those procedures indicate that the historical financial information may be unreliable or reveal uncertainties that ought to require the directors to make and disclose assumptions in the forecast. If the reporting accountant is not allowed access to such documentation it considers the need for alternative procedures, and where these cannot provide sufficient alternative evidence, considers the implications for its report.
46. In order to evaluate the suitability of unaudited historical financial information included in the profit forecast the reporting accountant:
- understands the internal control environment of the entity relevant to the historical financial information;
  - discusses with the management of the offeree company or securities exchange offeror the accounting policies applied and any differences from the method of preparing the entity's published financial statements;
  - enquires of management, including internal audit, whether there have been any changes in the financial reporting systems or internal controls, or any breakdowns in systems and controls, which might affect the reliability of the financial information;
  - enquires about changes in the entity's procedures for recording, classifying and summarising transactions, accumulating information for disclosure, and preparing the financial information;
  - considers the accuracy of unaudited historical financial information by comparing it to audited financial statements for the same period;
  - compares the historical financial information to previous budgets or forecasts prepared by the entity in respect of the period covered by the historical financial information and gains an understanding of the reasons for any significant differences; and
  - checks the historical financial information (if any) used in the profit forecast agrees to, or reconciles with, the underlying accounting records of the entity.
47. Where the reporting accountant determines that it is not able to obtain sufficient appropriate evidence from the above procedures to indicate that the financial information for the expired part of the forecast period forms a suitable basis for inclusion in the profit forecast the reporting accountant discusses the matter with the directors of the offeree company or securities exchange offeror and, if appropriate, their advisers.
48. In considering historical financial information included in a profit forecast, it is important that the reporting accountant understands the manner in which such information has been included in the profit forecast. Where different systems or processes have been used to

produce prospective financial information and the historical information, there is a risk that there may be inconsistencies in the cut-off between these two sources of information which could lead to a material error in the compilation of the profit forecast.

## Accounting policies

**49. The reporting accountant shall consider whether the accounting policies used in connection with the profit forecast are consistent with the entity's accounting policies and result in a profit forecast which is capable of justification by comparison with outcomes in the form of historical financial information.<sup>17</sup> (SIR 3000.5)**

50. Where the profit forecast relates to the expansion of an existing business the reporting accountant's primary consideration is the consistency of the accounting policies used. However, the reporting accountant also considers the ongoing appropriateness of the accounting policies in the light of the business plans underlying the profit forecast.

51. Where the profit forecast relates to a start-up situation the reporting accountant considers the appropriateness of the accounting policies chosen.

## Presentation of the profit forecast

**52. The reporting accountant shall consider whether it has become aware of anything to cause it to believe that:**

- **the profit forecast is presented in a way that is not understandable;**
- **a material assumption is unrealistic;**
- **an assumption or other information which appears to it to be material to a proper understanding of the profit forecast has not been disclosed; or**
- **the profit forecast is not capable of subsequently being compared with historical financial information.**

**If the reporting accountant is aware of such matters it shall discuss them with the parties responsible for the profit forecast and with those persons to whom its report is to be addressed and consider whether it is able to issue its opinion. (SIR 3000.6)**

53. The *Takeover Code* requires<sup>18</sup> that assumptions should provide useful information as to a profit forecast's reasonableness and reliability. They must:

- (i) be readily understandable;

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<sup>17</sup> *The City Code on Takeovers and Mergers*, 28.3(b)(iii)

<sup>18</sup> *The City Code on Takeovers and Mergers*, 28.4.b&c.

(ii) be specific and precise; and

(iii) not relate to the general accuracy of the estimates underlying the profit forecast.

There must be a clear distinction between assumptions about factors which the directors (or other members of the company's management) can influence and those which they cannot influence.

54. When evaluating the presentation of a profit forecast the reporting accountant considers whether the components of the profit forecast are clearly described and whether the descriptions are adequate to allow an intended user to understand the profit forecast.<sup>19</sup> For example, if a profit forecast is presented as a single figure for profit before tax, and *this* was to be achieved by the inclusion of a significant non-recurring profit from the sale of a fixed asset, consideration is given as to whether additional disclosure is necessary to make the profit forecast understandable. It is important that useful information is not obscured through the inclusion of immaterial items or the use of headings or financial measures which are not meaningful to, or may be misunderstood by, the intended users.

55. When evaluating the disclosures made in respect of a profit forecast, the reporting accountant considers whether the degree of uncertainty inherent in the information is clearly disclosed. Disclosure of an assumption may not make the profit forecast understandable if the significance of that assumption is not apparent from the disclosure made.

56. Where a profit forecast is subject to significant uncertainty it is common practice for the preparers to perform a sensitivity analysis in respect of those assumptions which are either believed to be subject to the greatest uncertainty and/or where the profit forecast is most sensitive to variations in such assumptions. The reporting accountant considers such sensitivity analysis, as it may assist in the identification of material assumptions or other aspects of the profit forecast where the uncertainty requires additional disclosure to enable it to be understood.

57. The manner in which the profit forecast is presented in the investment circular will also be considered in respect of whether the profit forecast is capable of being compared with subsequent historical financial information. The choice of captions and disclosure or emphasis of particular numbers or attributes may determine how the profit forecast will be interpreted and consideration is given as to whether this is consistent with the purpose for which the profit forecast has been prepared. In addition, the *Takeover Code* has specific requirements in respect of the use of quotations and pictorial representations:

- *Since the use of a quotation will carry the implication that the quotation is endorsed by the party to the offer using it, quotations must not be used unless the party is prepared, where appropriate, to corroborate or substantiate them and they are covered by the directors' responsibility statement.*<sup>20</sup>
- *Pictorial representations, charts, graphs and diagrams must be presented without distortion and, when relevant, must be to scale.*<sup>21</sup>

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<sup>19</sup> The ICAEW has published guidance for preparers of prospective financial information, including Profit Forecasts. See ICAEW, *Guidance for preparers of prospective financial information*, (updated periodically).

<sup>20</sup> *The City Code on Takeovers and Mergers*, 19.1.3.

<sup>21</sup> *The City Code on Takeovers and Mergers*, 19.1.4.

## Representation letter

58. Some of the assumptions used in the compilation of a profit forecast will be dependent on the intent of the directors and management. Consequently, the representations of directors and management as to their intent are a particularly important source of evidence for the reporting accountant. Examples of representation letter clauses are set out in Appendix 2 of this SIR.

## Reporting

59. **Before finalising its report and opinion on the proper compilation of a profit forecast the reporting accountant shall consider the implications for its opinion of the report by the company's financial advisers on whether the forecast has been prepared with due care and consideration. (SIR 3000.7)**

### Responsibilities

60. **In all reports on profit forecasts in investment circulars the reporting accountant shall explain the extent of its responsibility in respect of the profit forecast by including in its report:**

- **a statement that the reporting accountant's responsibility is to form an opinion as required by the *Takeover Code* on the compilation of the profit forecast and to report its opinion to the addressees of the report; and**
- **a statement that the profit forecast and the assumptions on which it is based are the responsibility of the directors. (SIR 3000.8)**

### Basis of preparation of the profit forecast

61. **The reporting accountant shall include a basis of preparation section of its report that cross refers to disclosures that explain the basis of preparation of the profit forecast including:**

- **assumptions made;**
- **the accounting policies applied; and**
- **where appropriate, the source of historical financial information embodied in the profit forecast. (SIR 3000.9)**

62. Where the accounting policies used in the profit forecast differ from those previously published a more detailed explanation of the accounting policies used in the preparation of the profit forecast will be appropriate.

## Basis of opinion

- 63. The reporting accountant shall include in its report a statement that, where the profit forecast and any assumptions on which it is based relate to the future and may, therefore, be affected by unforeseen events, the reporting accountant does not express any opinion as to whether the actual results achieved will correspond to those shown in the profit forecast. (SIR 3000.10)**
64. By its nature financial information relating to the future is inherently uncertain. For a profit forecast to be understandable sufficient information must be disclosed to allow an intended user to understand this uncertainty. As the reporting accountant is not required to form or express an opinion on the achievability of the result shown in the profit forecast, it is inappropriate for the reporting accountant to include in the basis of preparation section of its report cautionary language relating to uncertainty beyond that referred to above.

## Expression of opinion

- 65. The report shall contain a clear expression of opinion that complies with applicable regulatory requirements. (SIR 3000.11)**
66. In forming its opinion the reporting accountant takes account of those events or information which the reporting accountant becomes aware of occurring up to the date on which the reporting accountant signs the report, that affect the opinion expressed in the report.
67. The investment circular in which the reporting accountant's report is included may be made available in other countries which have their own standards for accountants when reporting on profit forecasts. In such circumstances, the reporting accountant considers whether to include a reference to the fact that a report issued in accordance with the SIRs should not be relied upon as if it had been issued in accordance with the standards applicable in that other country. An example of such a reference is included in the example reports set out in Appendix 3 of this SIR.

## Modified opinions

- 68. The *Takeover Code* requires a positive and unmodified opinion. Therefore, the reporting accountant shall not express an opinion when the directors have not applied the criteria set out in this SIR and in the reporting accountant's judgment the effect of not doing so is, or may be, material. (SIR 3000.12)**
69. In the event that the reporting accountant concludes that it is unable to report in the manner prescribed it invites those responsible for the profit forecast to consider whether the profit forecast can be amended to alleviate its concerns or whether the profit forecast should be omitted from the investment circular.

## Confirmations of the profit forecast continuing to apply - subsequent documents

70. If a profit forecast has been included in any document or announcement published by an offeror or offeree, the *Takeover Code* requires any subsequent document published by the offeror or offeree during an offer period, to include a statement by the directors that the profit forecast remains valid (unless superseded by information included in the new document, in which case a new report from the reporting accountant would be required). In addition, the document is required to include a statement by the directors that the reporting accountant has confirmed that its report continues to apply.<sup>22</sup>
71. In determining whether it can provide such a confirmation, the reporting accountant makes such enquiries of the directors (and, in the case of an offeree's statement, with relevant management within the offeree if possible) as it considers necessary.
72. The reporting accountant considers:
- a. any material uncertainties that existed at the date of its report;
  - b. the evidence that was relied upon in forming its opinion in the context of the matters discussed with the directors; and
  - c. the procedures performed by the directors in determining the continued validity of the profit forecast
- and determines whether such matters give any reason to conclude that the report no longer continues to apply.
73. The procedures performed, and enquiries made by the directors (of the offeror and/or offeree company where relevant) may include matters such as:
- a. further data and other information from relevant personnel within the business following the publication of the profit forecast;
  - b. public statements made in relation to the offer;
  - c. updated versions of the profit statement as a result of discretionary changes in management's intentions;
  - d. details of facts and circumstances outside the control of the directors that may impact the profit forecast, for example changes in legislation or economic conditions;
  - e. latest management information.
74. The reporting accountant considers obtaining updated or additional written representations from the persons responsible for preparing the profit forecast.
75. The reporting accountant satisfies itself about the form and context in which reference is made to the confirmation that the reporting accountant's report continues to apply and provides the company with that confirmation in writing.

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<sup>22</sup> An example of a reporting accountant's confirmation can be found at appendix 2 of SIR 6000.

76. In the event the reporting accountant concludes it is unable to issue a confirmation letter the reporting accountant discusses its concerns with the directors and the financial adviser to explore whether a resolution can be found. If, as a result of these discussions, the reporting accountant is either uncertain about or disagrees with the course of action proposed the reporting accountant may consider it necessary to take legal advice with respect to its responsibilities in the particular circumstances.

## Events occurring between the date of the reporting accountant's report and the completion date of the transaction

77. If, as a result of discussion with those responsible for the investment circular concerning an event that occurred prior to the completion date of the transaction, the reporting accountant is either uncertain about or disagrees with the course of action proposed the reporting accountant may consider it necessary to take legal advice with respect to its responsibilities in the particular circumstances.
78. After the date of its report, the reporting accountant has no obligation to perform procedures or make enquiries regarding the investment circular, other than those described above in respect of confirmations.

## Effective date

79. This Investment Reporting Standard is effective for reporting accountant engagements commencing on or after 15 September 2020. For those engagements already underway before the 15 September 2020, the reporting accountant may comply with the requirements of the previous version of the SIR 3000.

## Appendix 1: Examples of Engagement Letter Clauses

The examples of engagement letter clauses are intended for consideration in the context of a public reporting engagement on a profit forecast. They should be tailored to the specific circumstances and supplemented by such other clauses as are relevant and appropriate.

### Financial information upon which the report is to be given

The [investment circular] will contain a profit [forecast] [estimate] for the company for the period [ending] [ended] [date] (the “PFI”) prepared and presented in accordance with the requirements of the *Takeover Code*. We will prepare a report on the profit [forecast] [estimate] addressed to [...] expressing our opinion on the proper compilation of the profit [forecast] [estimate], in the form described below, to be included in the [investment circular].

We will ask the Directors to make certain representations to us regarding the PFI. If the PFI is intended only to be a hypothetical illustration, or the Directors are unable to make such representations to us, we will not wish to be associated with the PFI and accordingly, will be unable to report publicly on it.

### Responsibilities

The preparation and presentation of the profit forecast will be the responsibility solely of the Directors. [This responsibility includes the identification and disclosure of the assumptions underlying the profit forecast. (omit if no assumptions)] The Directors are also responsible for ensuring that the PFI is prepared and presented in accordance with the requirements of the *Takeover Code*.

We will require the Directors to formally adopt the PFI before we report on it.

It is our responsibility to form an opinion as to whether the profit [forecast] [estimate] has been properly compiled on the basis stated and whether the basis of accounting is consistent with the accounting policies of ABC plc.

If the results of our work are satisfactory, and having regard to the requirements of the *Takeover Code*, we shall prepare a report on the profit [forecast] [estimate] for inclusion in the [investment circular]. An illustration of the form of our report is attached.

### Scope of work

Our work will be undertaken in accordance with Standard for Investment Reporting (SIR) 3000 “Investment Reporting Standards Applicable to Public Reporting Engagements on Profit Forecasts” issued by the Financial Reporting Council and will be subject to the limitations described therein.

We draw your attention in particular to paragraph 68 of SIR 3000 which would preclude us from expressing any opinion if the Directors have not complied with the requirements of the *Takeover Code*.

As the purpose of our engagement is restricted as described above and since the

PFI and the assumptions on which it is based relate to the future and may be affected by unforeseen events, we will not provide any opinion as to how closely the actual result achieved will correspond to the profit [forecast] [estimate]. Accordingly we neither confirm nor otherwise accept responsibility for the ultimate accuracy and achievability of the PFI.

### **Assumptions**

We will discuss the assumptions with the persons responsible for preparing the PFI together with the evidence they have to support the assumptions, but we will not seek to independently verify or audit those assumptions. We are not responsible for identifying the assumptions.

In the event that anything comes to our attention to indicate that any of the assumptions adopted by the Directors which, in our opinion, are necessary for a proper understanding of the PFI have not been disclosed or if any material assumption made by the Directors appears to us to be unrealistic we will inform the directors so that steps can be taken to resolve the matter. If the matter is not satisfactorily resolved we will be unable to issue our report.

## Appendix 2: Examples of Management Representation Letter Clauses

Similar clauses to those below could be amended to be used in connection with a report on a profit estimate.

### Introduction

We refer to the forecast of [insert description of items forecast], profit for the financial year and earnings per share of ABC plc (“the Company”) and its subsidiaries together (“the ABC Group”) for the year ending [date] (“the profit forecast”) set out on page [xx] of the Offer Document to be issued on [date]. We acknowledge that we are solely responsible for the profit forecast and the assumptions on which it is based as set out on page [xx] and confirm on behalf of the Directors [and Proposed Directors] of the Company to the best of our knowledge and belief, having made appropriate enquiries of officials of the Company, the following representations made to you in the course of your work:

### Specific representations

- The profit forecast is based on our assessment of the financial position and results of operations and cash flow for the period and is presented on a basis consistent with the accounting policies [to be] adopted by the ABC Group and has been prepared in accordance with relevant legislative requirements.
- We believe the forecast results are likely to be achieved although achievement of the forecast may be favourably or unfavorably affected by unforeseeable and uncontrollable events.
- We have made available to you all significant information relevant to the profit forecast of which we have knowledge.
- All significant assumptions have been disclosed and the assumptions underlying the profit forecast are reasonable and appropriate.
- The results shown in the [audited/unaudited] financial results for the six months ended [date] and the unaudited management accounts for the [•] months ended [date] which are included in the profit forecast have been prepared in accordance with the accounting policies [normally] [to be] adopted by the ABC Group and are free from material misstatement.

There are no contingencies, (other than those which have been taken into account in making the forecast), that are material in the context of the profit forecast which should be disclosed or taken into account in the profit forecast.

- The profit forecast is presented in a manner which is balanced and fair and not misleading and contains all information necessary for a proper understanding of the profit forecast.

- The profit forecast together with the assumptions and the representations in this letter have been approved by the board of directors.

Representations in respect of specific assumptions such as:

- The assumed like for like increase in sales of 5% in the last quarter of 200X incorporates expected price increases of 2% based on preliminary discussions with three of our major customers.
- The assumed increase in gross margin of 2 percentage points from 1 July 200X is based on manufacturing cost savings as a result of the realisation of efficiencies resulting from the factory reorganisation which we expect to be completed by the end of May 200X.
- The assumed increase in sales prices by 2% more than the general level of inflation in 200Y is based upon the expectation that our major competitor will announce a price increase of at least that amount in November 200X. Our expectation takes account of similar timing of increases in previous years and information derived from conversations with mutual customers.
- The opening of two new sales outlets in the current financial year assumes that negotiations to agree a lease on one out of the three potential units in Guildford will be completed and that refitting and pre-opening will be completed within 10 weeks which is 25% longer than the historical average due to additional building works being required in one of the potential sites.
- The profit forecast assumes that a forward sale of \$x million will be designated as a hedge against expected US\$ income.

## Appendix 3: Illustrative Report

### ACCOUNTANT’S REPORT ON A PROFIT FORECAST

Date

Reporting accountant’s address

Addressees, as agreed between the parties in the engagement letter

Dear xxxx

#### Profit Forecast by XX plc (“XX”)

*We report on the profit forecast (the “Profit Forecast”) by the Directors included in the [ref to document] dated xx xxxx xxxx to the effect that:*

[DETAILS OF THE STATEMENT: We report on the profit forecast comprising [insert description of items comprising the prospective financial information, e.g. [forecast of turnover, operating profit, profit before tax and earnings per share]/[projected profit and loss account]] of ABC plc (“the Company”) and its subsidiaries (together “the ABC Group”) for the [specify period] ending [date] (the “Profit Forecast”). The Profit Forecast, and the material assumptions upon which it is based, are set out on pages [] to [] of the [describe document] (“the [Document]”) issued by the Company dated [date].]

#### Opinion

In our opinion, the Profit Forecast/statement has been properly compiled on the basis stated and that the basis of accounting used is consistent with the Company’s accounting policies]

The Profit Forecast has been made in the context of the disclosures in..[ref]..of the Announcement setting out the principal assumptions supporting the Profit Forecast.

This report is required by Rule [28.1(a)] of the City Code on Takeovers and Mergers (the “Takeover Code”) and is given for the purpose of complying with that requirement and for no other purpose.

#### Responsibilities

It is the responsibility of the Directors/Board to prepare/make the Profit Forecast in accordance with the requirements of Rule 28 of the *Takeover Code*.

It is our responsibility to form an/our opinion, as required by Rule [28.1(a)(i)] of the *Takeover Code*, as to the proper compilation of the Profit Forecast and to report that opinion to you as to whether the Profit Forecast has been properly compiled on the basis stated.

#### Basis of preparation of the Profit Forecast

The Profit Forecast has been prepared on the basis stated on page [ ] of the [Document] and is based on the [audited/unaudited] interim financial results for the [six] months ended [date], the unaudited management accounts for the [x] months ended [date] and a forecast to [date].

The Profit Forecast is required to be presented on a basis consistent with the accounting policies of the ABC Group.

### **Basis of opinion**

We conducted our work in accordance with *Standards for Investment Reporting* issued by the Financial Reporting Council of the United Kingdom. We are independent of the [Company] and the [Target] [and Sponsor/Nominated adviser where relevant] in accordance with relevant ethical requirements. [In the United Kingdom this is the FRC's Ethical Standard] [set out relevant Ethical requirements where the engagements does not involve an investment circular prepared for issue in connection with a securities transaction governed wholly or in part by the laws and regulations of the United Kingdom] as applied to Investment Circular Reporting Engagements, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Our work included [evaluating the basis on which the historical financial information included in the Profit Forecast has been prepared and] considering whether the Profit Forecast has been accurately computed based upon the disclosed assumptions and the accounting policies of the ABC Group. Whilst the assumptions upon which the [profit forecast/statement] are based are solely the responsibility of the Directors, we considered whether anything came to our attention to indicate that any of the assumptions adopted by the Directors which, in our opinion, are necessary for a proper understanding of the [profit forecast/statement] have not been disclosed and whether any material assumption made by the Directors appears to us to be unrealistic.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Profit Forecast has been properly compiled on the basis stated.

[This paragraph may be omitted if the document is not to be distributed outside [the UK] Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in [jurisdictions] and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.]

Since the Profit Forecast and the assumptions on which it is based relate to the future and may therefore be affected by unforeseen events, we express no opinion as to whether the actual profits achieved will correspond to those shown in the [profit forecast/statement] and the differences may be material.

Yours faithfully,

Reporting Accountant



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