**IPO due diligence**

This element outlines the reasons why due diligence is required on a flotation and summarises financial and legal due diligence.

**Introduction**

As established in the element outlining the requirement for a prospectus, a company seeking admission to trading on the Main Market must publish a prospectus.

This element considers due diligence. On an IPO, financial and legal due diligence will be undertaken in order to review whether the company is suitable for listing. In addition, both on a primary and a secondary issue, due diligence will be required to ascertain the necessary information for inclusion in the prospectus.

This element addresses:

* Due diligence
* Content and format requirements
* Validity
* Publication

**Financial due diligence**

Due diligence can be broken down into financial due diligence and legal due diligence. This element considers financial due diligence first.

Reporting accountants will be instructed to start financial due diligence on the company and, if applicable, its group companies, at an early stage of the listing process.

A critical element of the preparatory work for a listing is to undertake detailed due diligence on financial matters relating to the company so that the necessary financial information can be prepared for the prospectus.

The following reports may be prepared:

* Long form report
* FPPP report
* Short form report
* Working capital report
* Other

Each will be considered over the following pages.

**Long form report**

A **long form report** is a confidential report prepared for the company, containing a detailed review of the company's (and, if applicable, its group's) financial position. Although the process of preparing a long form report has some similarities to an audit, its purpose and scope are different.

A long form report is not required by the FCA, nor does it need to be disclosed in full in the prospectus. However, it is a vital source for the financial information which must be included in the prospectus pursuant to the UK PR Regulation (as referenced in the PRRs). The long form report will also be addressed to the company's sponsor.

**FPPP report**

A **financial position and prospects procedures report (‘FPPP report’**)is a confidential report prepared by the reporting accountants for the company, highlighting the changes which should be made to its systems and controls prior to admission or as soon as possible afterwards. The primary purpose of the FPPP report is to ensure that, following admission, the directors will be able to make informed assessments on an ongoing basis of the financial position and prospects of the company.

**Short form report**

The **short form report** is a report on the three years' historical financial information (HFI) included in the prospectus, confirming that it gives a true and fair view.

Broadly speaking, an IPO prospectus must include three years of audited consolidated annual financial results, plus details of more recent trading, and a "fair review" of the group’s financial performance over the three years and any subsequent period (known as an Operating and Financial Review or OFR)

The financial information must be prepared in accordance with the version of IFRS (International Financial Reporting Standards) adopted in the UK. For some companies, this will mean having to re-state their historical financial results in IFRS.

If a company has a “complex financial history”, additional information will usually need to be included in the prospectus and reported on.

**Working capital report and other**

The reporting accountants will also be involved in preparing the **working capital report** which supports the working capital statement to be made by the directors in the prospectus. The purpose of this workstream is to demonstrate that the company (together with its group, if applicable) will have sufficient working capital to satisfy its future spending needs for a period of 12 months from the date of the prospectus. In practice, the working capital report typically covers an 18-month period.

If a profit forecast or pro forma financial information is included in the prospectus, the reporting accountants will also examine these and provide **short reports** on their contents.

**Legal due diligence**

A separate, equally important **legal** due diligence exercise will be undertaken at a very early stage of the process. The main focus of the legal due diligence process is to gather information about the company (and, if applicable, its group) so that all relevant information is included in the prospectus.

It is also important to ensure that the company and its shares satisfy the relevant conditions contained in UKLR 3 and, in the case of a company seeking a premium listing of its equity shares, UKLR 5.

The other main purpose of the legal due diligence process is to identify problems and issues with the company that may need to be fixed or addressed before the marketing process begins.

**Summary**

* Due diligence will be undertaken to ascertain:
  + a company’s suitability for listing; and
  + the necessary information for inclusion in the prospectus.
* Financial due diligence involves reporting accountants preparing reports for the company’s benefit (long form report), to state the information required to be included in the prospectus (short form report).
* Legal due diligence is important to prepare the prospectus and identify problems and issues to be addressed before marketing.
* Important considerations will be whether the company can comply with ongoing disclosure requirements and Listing Principles.