

**Assurance Engagements on Pro Forma Financial Information
Issues Paper****I. Objectives of this Paper**

1. To consider:
 - a) The significant issues that should be addressed in the development of an international assurance standard (ISAE 3XXX) for engagements to report on pro forma financial information in a prospectus; and
 - b) In the light of those issues, the need for an IAASB consultation paper, and the relevance and feasibility of a standard in a global context.

II. Background

REMIT OF THE PROJECT, AND PRELIMINARY IAASB SURVEY OF NON-EU JURISDICTIONS

2. The cross-border nature of transactions has created a desire for common standards of reporting in relation to pro forma and prospective financial information included in prospectuses that can be consistently applied internationally. In response to this need, the IAASB commissioned a working group¹ in February 2007 to:
 - a) Explore the feasibility of developing appropriate international standards, focusing in the first instance on reporting with respect to pro forma financial information; and
 - b) If warranted, to consider an appropriate approach to such a project.
3. The working group presented a project proposal at the March 2008 IAASB meeting. Recognizing that there may be potential difficulties in developing an international standard with respect to pro forma financial information because of differences in legal and regulatory frameworks around the world, the working group's proposal recommended an approach focused initially on identifying and understanding the reporting issues that arise in the context of one jurisdiction that already has a recognized and established framework, and thereafter expanding the consideration of the issues to other jurisdictions. The working group identified the European Union (EU) and its prospectus regime² as an appropriate starting point.
4. While there was some initial concern at the IAASB as to whether it would be appropriate to embark on such a project by starting with a particular jurisdiction, the IAASB noted the greater risk that starting with a broader scope could result in a standard that would not be useful for any particular jurisdiction. The IAASB therefore determined that the project should initially focus on the European requirements as there was already broad consensus

¹ The working group was chaired by IAASB member David Swanney and included representatives from the firms.

² The European prospectus regime became effective on July 1, 2005 with the introduction of the Prospectuses Directive and Prospectus Regulation.

within the EU regarding what a compilation of pro forma financial information entails,³ which would provide a strong basis for the project. In addition, the IAASB acknowledged that there was active support for this project from the European securities regulators. Nevertheless, recognizing the importance for the project to be regarded as one that goes beyond Europe, the IAASB agreed that further research should be done as to how such a standard would be used in other jurisdictions.

5. Accordingly, the IAASB approved the project proposal with the following remit:

“The ultimate goal of the project is to develop an internationally accepted standard for assurance engagements on pro forma information in prospectuses. The development approach is to use an international task force to focus on a single market model (EU), and: (a) identify principal issues for this market; (b) obtain input on the applicability and relevance of these issues and a project standard on the subject in a more global context; and (c) determine steps in progressing the development of the standard.

Because of the nature of the subject, the task force will consider specifically whether a consultation paper would be appropriate to obtain necessary input before issue of the draft ISAE.

In progressing the project, the task force is to present to the IAASB its proposals for: (a) a consultation paper, for approval prior to public dissemination; and (b) specific recommendations on relevance and feasibility in a global context.”

6. The IAASB Consultative Advisory Group (CAG) discussed the project proposal at its March 2008 meeting, and expressed support for the project. An IAASB CAG Working Group consisting of 2-3 CAG Representatives will be established in due course to track the progress of the project.
7. The IAASB agreed that most of the research work on the topic would be concentrated in a small number of countries, and that reviewing the different requirements in those countries would provide insight into how difficult it may be to develop an international, framework-neutral standard. Accordingly, in June 2008, IAASB staff undertook a survey (IAASB Survey) of 19 non-EU jurisdictions⁴ regarding their regulatory requirements pertaining to the preparation of, and reporting on, pro forma financial information, and the nature of any related national assurance standards and guidance. Responses were received from 16 of those jurisdictions. Agenda Item 2-B includes a summary and detailed compilation of those responses.

³ In particular, based on research evidence from the October 2005 Fédération des Experts Comptables Européens’ (FEE’s) paper, “Analysis of Responses to FEE Discussion Paper on the Auditor’s Involvement with the New EU Prospectus Directive.”

⁴ The 19 non-EU jurisdictions surveyed included: Australia, Brazil, Canada, China (Mainland), Hong Kong, India, Japan, Kenya, Korea, Malaysia, New Zealand, Russia, Saudi Arabia, Singapore, South Africa, USA, Argentina, Mexico, and United Arab Emirates. Responses were received from the first 16 of these jurisdictions (hereinafter referred to as “Survey countries”).

III. Approach to Paper and Summary of Main EU Requirements

APPROACH TO THIS PAPER

8. As guided by the IAASB, the discussion of the issues below starts with a consideration of the relevant aspects of the EU prospectus regime, examining in detail how standard setters in two specific EU countries (Germany and the UK) have dealt with them. It then considers how the EU requirements compare with those in the non-EU jurisdictions included in the IAASB Survey, and contrasts the German and UK assurance standards with those of Survey countries, to the extent that the latter have submitted copies of their relevant standards or guidance with their responses (i.e., Australia, Canada, Hong Kong, Singapore, South Africa and the US). The Task Force believes that this information provides a reasonable basis for a discussion of the issues. Relevant standards and guidance may be available in other countries but have not been considered for the purposes of this paper.
9. On the basis of its work to date, and subject to the IAASB's views, the Task Force believes that a standard on the topic would be relevant and feasible in a global context. Accordingly, the matters for the IAASB's consideration in this paper are set out on the presumption that an ISAE will be developed.

OTHER PRELIMINARY MATTERS

10. It is presumed that the development of the proposed ISAE will be guided by the general principles in the IAASB's International Framework for Assurance Engagements ("Assurance Framework"). It is also presumed that ISAE 3000⁵ will provide an appropriate "backbone" on which the specific requirements and guidance of the proposed ISAE can be crafted. The Task Force, however, notes that the IAASB's work program for 2009 includes a project to revise that standard,⁶ which may affect the timing of this project and the form and structure of the proposed ISAE 3XXX. Nevertheless, the Task Force does not anticipate that the project to revise ISAE 3000 will entail a reconsideration of fundamental principles of assurance or a revision of the substance of ISAE 3000 that would give rise to a need for this project to be deferred.⁷
11. This paper does not address any independence considerations, which will be covered by the relevant ethical standards (including the IFAC Code of Ethics). It does, however, consider the practitioner's responsibility in relation to association with misleading information.

SUMMARY OF MAIN EU REQUIREMENTS

12. The European Prospectus Directive⁸ (PD) provides for minimum information on the presentation of pro forma financial information in prospectuses. The detailed requirements

⁵ ISAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information."

⁶ A project proposal to revise ISAE 3000 is included on the March 2009 IAASB meeting agenda.

⁷ The Basis for Conclusions for the IAASB's July 2008 *Strategy and Work Program, 2009-2011*, paragraph 49, states that future actions in relation to a revision of ISAE 3000 "should not entail revisiting conceptual matters settled at the time of revising the *International Framework for Assurance Engagements* (which was done in conjunction with the last revision of ISAE 3000)."

⁸ Directive 2003/71/EC.

regarding pro forma financial information are set out in the Prospectus Regulation (PR). Specifically, Recital 9 of the PR states the following:

“Pro forma financial information is needed in case of significant gross change, i.e., a variation of more than 25% relative to one or more indicators of the size of the issuer’s business, in the situation of an issuer due to a particular transaction, with the exception of those situations where merger accounting is required.”

13. The PR requires that the pro forma financial information be accompanied by a practitioner’s report:⁹

“The report prepared by the independent accountants or auditors must state that in their opinion:

- (a) The pro forma financial information has been properly compiled on the basis stated;
- (b) That basis is consistent with the accounting policies of the issuer.”¹⁰

IV. Significant Issues

14. The issues discussed below are grouped under the following main headings:

A. Definitional considerations

A.1 Definitional characteristics of pro forma financial information and related scope considerations

A.2 What is the meaning of “properly compiled”?

B. Nature and level of assurance provided in an engagement to report on pro forma financial information

C. Engagement acceptance considerations

C.1 Acceptability of framework for compilation

D. Nature and extent of work effort

D.1 Work effort regarding the unadjusted financial information

D.2 Obtaining an understanding of the subject matter and engagement circumstances

D.3 Materiality

D.4 Nature and extent of work effort on pro forma adjustments

D.5 Subsequent events

E. Reporting

E.1 Responsibility for evaluating whether the pro forma financial information is misleading

E.2 Form and content of the practitioner’s report

⁹ Item 20.2 of Annex I of the PR (see relevant extract in Appendix A).

¹⁰ Item 7 of Annex II of the PR (see Appendix A for a list of the requirements in Annex II of the PR).

F. Consent

A. Definitional Considerations

A.1 DEFINITIONAL CHARACTERISTICS OF “PRO FORMA FINANCIAL INFORMATION” AND RELATED SCOPE CONSIDERATIONS

15. A preliminary question that needs to be considered is the basic meaning of the term “pro forma financial information” insofar as prospectuses are concerned, as this defines the subject matter information that this proposed standard is seeking to address. A clear consensus on the meaning of the term is all the more important given that the words “pro forma” can convey a different meaning when used in a different context.

The EU Context

16. Neither the PD nor the PR contains an explicit definition of the term. There is also no accounting definition for it in the International Accounting Standards Board’s standards. Nevertheless, the PR appears to describe the meaning of the term in relation to the purpose of the information, i.e.,:

“... description of how the transaction might have affected the assets and liabilities and earnings of the issuer, had the transaction been undertaken at the commencement of the period being reported on or at the date reported.”²

17. At the national level, the German and UK standard setters have defined or described the term in their authoritative literature within the context of the PD/PR:

- In Germany, the Institut der Wirtschaftsprüfer (IDW) has provided guidance in relation to the purpose of the information:

“The purpose of pro forma financial information is to present the material effects the business transaction(s) would have had on the historical financial statements if the entity had existed in the structure created by the business transaction(s) throughout the entire reporting period.”¹¹

- In the UK, the Auditing Practices Board (APB) has defined pro forma financial information as:

“...including financial information such as net assets, profit or cash flow statements that demonstrate the impact of a transaction on previously published financial information together with the explanatory notes thereto.”¹²

The Context Outside of the EU

18. As set out in Appendix B, some jurisdictions outside the EU have established definitions of the term “pro forma financial information.” In other jurisdictions, guidance has been

¹¹ IDW Accounting Practice Statement AAB 1.004, “Preparation of Pro Forma Financial Information,” paragraph 2.

¹² Standard for Investment Reporting (SIR) 4000, “Investment Reporting Standards Applicable to Public Reporting Engagements on Pro Forma Financial Information,” paragraph 3.

provided generally in terms of the objective of the pro forma financial information for the purposes of prospectuses.

19. Responses to the IAASB Survey indicate that the term has not been formally defined in law or regulation in the jurisdictions surveyed.

Matters for Consideration and Preliminary Task Force Views

A.1.1 Feasibility of Identifying Defining Characteristics of Pro Forma Financial Information

20. Given the absence of formal definitions of the term in law or regulation in the jurisdictions surveyed, the Task Force believes that it would be desirable to identify the defining characteristics of pro forma financial information such that it would be possible to differentiate the nature of this information as used in prospectuses from that of other financial information that might also be called pro forma but used in a different context. The Task Force believes that if there can be agreement as to those characteristics, this could possibly lead to a definition being established in the ISAE that would be universally applicable. In this regard, illustrations of the types of transactions that generally give rise to the preparation of pro forma financial information could be used as a way to help formulate an appropriate definition.
21. Support for identifying defining characteristics also comes from the fact that there appears to be a common general understanding of the meaning of pro forma financial information among those jurisdictions surveyed that have defined it or that have provided guidance regarding its meaning in the context of prospectuses, i.e., that it is unadjusted financial information shown together with adjustments to illustrate the significant effects of an event or transaction as if it had occurred at an earlier date. Even among jurisdictions that do not currently have standards relating to the preparation of, or reporting on, pro forma financial information, responses to the IAASB Survey indicate a general understanding of the meaning of the term in the context of prospectuses that is broadly consistent with definitions or guidance provided elsewhere. For example, in one particular case (Brazil), the national standard setter has indicated that market practice tends to follow guidance that has been established in another jurisdiction (the US).

Matter for IAASB Consideration

- Q1. Does the IAASB agree that it would be appropriate to identify the defining characteristics of “pro forma financial information” for the purposes of the ISAE, and that the project should explore the possibility of establishing a definition of the term in the ISAE based on those characteristics?

A.1.2 Profit Forecasts as the Basis for the Unadjusted Financial Information

22. Although pro forma profit forecasts are not common, an example of circumstances where one might be prepared is as follows. An issuer may have prepared a profit forecast in April 2009 for the year ending June 30, 2009. If it had acquired a subsidiary on February 1, 2009, the profit forecast would include the forecast results of the acquired subsidiary for the 5 months to June 30, 2009. The issuer may decide to prepare a pro forma profit forecast for

the enlarged group as if the acquisition had occurred at the beginning of the forecast period by adjusting the forecast to include the historical results of the acquired subsidiary for the 7-month period prior to the acquisition from July 1, 2008 to January 31, 2009.

23. Within the EU, the PR requires that pro forma financial information in prospectuses be published only in respect of:
 - a) the current financial period;
 - b) the most recently completed financial period; and/or
 - c) the most recent interim period for which relevant unadjusted information has been or will be published or is being published in the same document.¹³
24. Within the EU, the “current financial period” has been interpreted to include profit forecasts. The Committee of European Securities Regulators (CESR) has, however, issued interpretive guidance indicating that the current financial period refers to a certain period in the current financial year for which interim information different from statutory interim information is prepared,¹⁴ thus precluding profit forecasts from being used in the EU as the basis for the unadjusted financial information. A number of other jurisdictions (e.g., Australia, Canada and the US) have more explicitly prohibited the use of profit forecasts by specifically referring to *historical* financial information as the unadjusted basis in their definitions or guidance. However, certain other jurisdictions (e.g., Hong Kong and South Africa)¹⁵ do permit the unadjusted financial information to be derived from profit forecasts, while some (e.g., Singapore) are silent as to whether profit forecasts may be used.
25. Given these national differences, the Task Force believes that the project should not seek to debate the merits of imposing a prohibition in the ISAE on the use of profit forecasts as the unadjusted basis for the pro forma financial information. The Task Force is of the view that it should be a matter for the legal or regulatory framework to determine whether to permit the use of profit forecasts, and if the practitioner determines that a framework that permits such use is acceptable, that would represent an appropriate basis for the engagement. This approach has the benefit of enabling the ISAE to achieve broad applicability.

Matters for IAASB Consideration

- Q2. Does the IAASB agree that the ISAE should not deal with the matter of whether profit forecasts may be used as the basis for the unadjusted financial information for pro forma financial information?
- Q3. Does the IAASB nevertheless agree that some guidance could be provided in the ISAE to acknowledge the fact that some jurisdictions may restrict the unadjusted financial information to historical financial information while others may permit the use of profit

¹³ Item 5 of Annex II of the PR.

¹⁴ CESR Frequently Asked Questions Regarding Prospectuses, Version 7 December 2008, Item 50 Q(c)(a).

¹⁵ HKICPA Accounting Guideline AG 7, paragraph 43; Johannesburg Stock Exchange Listing Requirements, paragraphs 8.28-8.29.

forecasts?

A.1.3 Other Scope Consideration

A.1.3.1 Private Reporting

26. The Task Force also considered the merits of broadening the scope of the ISAE to include reporting on pro forma financial information prepared for purposes other than inclusion in a prospectus (“private reporting”). The Task Force generally agreed that the scope of the ISAE should remain focused on reporting on pro forma financial information included in prospectuses in accordance with the original remit of the project, to ensure that the project is responsive to where user needs are presently the greatest.
27. Nevertheless, to acknowledge that the ISAE contains guidance that practitioners may find helpful when considering private reporting engagements, the Task Force believes that it would be appropriate to include a general statement in the ISAE to the effect that it may be adapted as necessary in the circumstances when applied to private reporting engagements.

Matter for IAASB Consideration

- Q4. Does the IAASB agree that the scope of the project should remain focused on public reporting engagements, but that some general guidance could nevertheless be provided to indicate that practitioners may find the ISAE of assistance when undertaking private reporting engagements?

A.2 WHAT IS THE MEANING OF “PROPERLY COMPILED?”

The EU Context

28. The extent of the practitioner’s¹⁶ work on pro forma financial information is determined by the opinion that the practitioner has been engaged to provide when reporting on the information. The PR requires that the practitioner provide an opinion that includes a positive statement “that the pro forma financial information has been *properly compiled* on the basis stated.” However, it does not elaborate on the meaning of the term “properly compiled.” Two possible interpretations exist in this regard, i.e., the practitioner is being asked to provide assurance on:
- a) The process of compiling the pro forma information; or
 - b) The pro forma information itself.
29. The German and UK standards appear to have designated the first interpretation:
- The IDW’s AuPS 9.960.1 states that “auditing whether the pro forma financial information has been properly compiled on the basis stated in the pro forma notes

¹⁶ For the purposes of this paper, the generic term “practitioner” is used (consistent with its use in ISAE 3000, “Assurance Engagements”).

focuses on auditing the pro forma adjustments and the arithmetical accurate addition of the adjustments to the basic figures resulting in the pro forma financial information.”¹⁷

- The APB’s SIR 4000 states that “the compilation of pro forma information is the gathering, classification and summarisation of relevant financial information.”¹⁸ It further requires the practitioner to obtain sufficient appropriate evidence that the pro forma financial information is free from material error *in its compilation*¹⁹ (as contrasted with obtaining sufficient appropriate evidence *about* the pro forma information).

The Context Outside of the EU

30. Among the non-EU jurisdictions included in the IAASB Survey, three (Hong Kong, Singapore and South Africa) appear to have taken the view that the objective of such reporting is to provide assurance on the process of putting the information together and not on the information itself (see Appendix C).
31. In the US, the relevant standards of the Public Company Accounting Oversight Board (PCAOB) and the AICPA’s Auditing Standards Board (ASB) require the practitioner’s examination report to include “a statement that the practitioner’s responsibility is to express an opinion *on* the pro forma financial information based on his or her examination.”²⁰ Nevertheless, in practical terms, the standards appear to deal only with the process of compilation as they require the practitioner’s examination report to state “the practitioner’s opinion as to whether management’s assumptions provide a reasonable basis for presenting the significant effects directly attributable to the transaction (or event), whether the related pro forma adjustments give appropriate effect to those assumptions, and whether the pro forma column reflects the proper application of those adjustments to the historical financial statements.”²¹ (See further discussion in Issues **B** and **D.1** below).
32. In a further jurisdiction (Australia), regulation or national standards do not prescribe any level of assurance to be provided in relation to pro forma financial information. However, there is guidance regarding how the practitioner may provide assurance. This guidance specifies “at least negative assurance in relation to whether the pro forma historical financial information has been properly *prepared* on the basis of the pro forma transactions”²² but does not elaborate on the meaning of the opinion.
33. Finally, in one jurisdiction where assurance on pro forma financial information is not required (Canada), the relevant guidance states that “generally, it is not feasible for the auditor to audit pro forma financial statements, since this would entail performing an audit of all of the underlying historical financial statements, in addition to auditing the pro forma

¹⁷ Auditing Practice Statement 9.960.1, “Audit of Pro Forma Financial Information,” paragraph 9 (English translation).

¹⁸ SIR 4000, paragraph 5.

¹⁹ SIR 4000, paragraph 25.

²⁰ PCAOB/ASB AT 401.12e (emphasis added).

²¹ PCAOB/ASB AT 401.12i.

²² AGS 1062.58(a).

adjustments and the compilation of the pro forma statements. There are no generally accepted standards in Canada regarding the preparation and presentation of pro forma financial statements that allow the auditor to assess the fairness of presentation of the pro forma financial statements appearing in a prospectus. As a result, the auditor's work is normally confined to making enquiries about the pro forma adjustments and compliance of the statements with any regulatory requirements, and performing mechanical procedures on their compilation."²³

Preliminary Task Force Views

34. A distinction first needs to be made between an engagement to report on proper compilation of pro forma financial information (the subject of this project) and an engagement to compile pro forma financial information (or any other financial information). In the former, the practitioner is engaged to provide assurance on whether the pro forma financial information has been properly compiled on a stated basis by performing such procedures as obtaining evidence to support the adjustments; evaluating whether the basis of compilation is acceptable; and determining whether the adjustments give appropriate effect to the transaction. In the latter, the practitioner merely performs the mechanical function of preparing the pro forma financial information without undertaking any procedures to test the adjustments or the reasonableness of the basis on which the information is prepared, i.e., no assurance is provided.
35. The Task Force believes that the objective of an assurance engagement in relation to pro forma financial information should be to report on whether that information has been properly compiled. In addition, reporting on the proper compilation of the pro forma financial information should concern the process of putting the information together and not the provision of assurance on the information itself. This is consistent with the views taken by most of the jurisdictions above. Thus, the process of reporting on the proper compilation of the information should not extend to expressing an opinion on the underlying information.
36. The Task Force also believes that reporting on proper compilation should involve more than just checking the arithmetical accuracy of the compilation of the pro forma financial information. It should also include comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments made by management, and making appropriate inquiries of management regarding the process by which they have prepared the pro forma financial information.²⁴ The Task Force believes that there would be benefit in providing guidance in the ISAE to explain what reporting on proper compilation generally entails, and to make it clear that this work does not constitute an audit or review of the pro forma financial information.

²³ CICA Assurance Section 1170.34.

²⁴ This is the approach taken in, for example, the Hong Kong Standard on Investment Circular Reporting Engagements 300, "Accountants' Reports on Pro Forma Financial Information in Investment Circulars" (paragraph 2).

37. Recognizing that law or regulation or market practice in some jurisdictions (e.g., Australia) may use the term “properly prepared” in place of “properly compiled” to describe the matter on which the practitioner is reporting, the Task Force also believes it would be appropriate to provide guidance in the ISAE to explain how these two terms interrelate. In the Task Force’s view, these two terms should have the same meaning for the purposes of the ISAE (see also discussion under Issue **E.2.3**).

Matters for IAASB Consideration

- Q5. Does the IAASB agree that reporting on whether pro forma financial information has been properly compiled is the appropriate objective for the ISAE? If so, does the IAASB agree that this involves the provision of assurance on the process of compiling the information and not on the information itself?
- Q6. Does the IAASB agree that it would be appropriate for the ISAE to provide guidance to explain what reporting on proper compilation entails, and that it does not constitute an audit or review of the pro forma financial information?
- Q7. Does the IAASB agree that the terms “properly compiled” and “properly prepared” should have the same meaning for the purposes of the ISAE?

B. Nature and Level of Assurance Provided in an Engagement to Report on Pro Forma Financial Information

The EU Context

38. The positive form of the opinion required by the PR implies a reasonable assurance engagement under the Assurance Framework.²⁵ Most of the respondents (including CESR) to the discussion paper that FEE issued in November 2004, “The Auditor’s Involvement with the New EU Prospectus Directive” (FEE Discussion Paper) agreed that reasonable assurance is what is intended by the PR.
39. In Germany and the UK, the engagements are unequivocally treated as reasonable assurance engagements:
- The IDW’s standard states the following:

“The objective of an audit of pro forma financial information is to be able to express an opinion with *reasonable assurance* whether the pro forma financial information has been properly compiled on the basis stated in the pro forma notes, and ...”²⁶
 - The APB’s illustrative report states the following under the Basis of Opinion paragraph:

²⁵ The Assurance Framework (paragraph 11) states that “the objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the practitioner’s conclusion.”

²⁶ AuPS 9.960.1, paragraph 6.

“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 Pro forma financial information has been properly compiled on the basis stated”²⁷

The Context Outside of the EU

40. From the IAASB Survey, a number of non-EU jurisdictions (i.e., Australia, Hong Kong, Malaysia, Singapore, and the US) require or permit a positive form of the opinion. Among those specific jurisdictions, two (Australia and the US) also permit limited assurance engagements. However, one jurisdiction (South Africa) requires the practitioner’s opinion to be expressed only in the negative form,²⁸ i.e., a limited assurance engagement.

41. As explained in the *Assurance Framework*, the level of assurance to be provided in an engagement determines the nature, timing and extent of work performed on the subject matter or subject matter information. In Australia, the relevant guidance statement indicates that both reasonable assurance and limited assurance engagements may be performed:

“The professional accountant may adopt the basic principles and essential procedures in AUS 702 “The Audit Report on a General Purpose Financial Report” for positive assurance on historical and pro forma historical information respectively. AUS 902 “Review of Financial Reports” may also be adapted for negative assurance engagements.”²⁹

42. In the US, however, the level of assurance that the practitioner can provide is constrained not by the extent of work on the process of compilation but by the level of assurance that has been provided on the underlying historical financial statements:

“The practitioner’s attestation risk relating to the pro forma financial information is affected by the scope of the engagement providing the practitioner with assurance about the underlying historical financial information to which the pro forma adjustments are applied. Therefore, *the level of assurance given by the practitioner on the pro forma financial information, as of a particular date or for a particular period, should be limited to the level of assurance provided on the historical financial statements* (or, in the case of a business combination, the lowest level of assurance provided on the underlying historical financial statements of any significant constituent part of the combined entity). For example, if the underlying historical financial statements of each constituent part of the combined entity have been audited at year-end and reviewed at an interim date, the practitioner may perform an examination or a review of the pro forma financial information at year-end but is limited to performing a review of the pro forma financial information at the interim date.”³⁰

43. As indicated in paragraph 31 above, although the relevant US standards appear to require an opinion *on* the pro forma financial information, in practical terms the work effort they

²⁷ SIR 4000.

²⁸ In South Africa, the relevant regulation requires a negative form of the opinion to avoid the practitioner’s report giving any misleading impression, particularly if profit forecasts are used as the unadjusted basis as is permitted in that jurisdiction.

²⁹ AGS 1062.58.

³⁰ PCAOB/ASB AT 401.07b.

require and the nature of the opinion relate to whether management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the transaction (or event), whether the related pro forma adjustments give appropriate effect to those assumptions, and whether the pro forma column reflects the proper application of those adjustments to the historical financial statements, that is, in effect, the process of compilation. The basis for the US view of the subject matter on which the opinion is being given appears to be the fact that the US standards require the unadjusted financial information to be either audited or reviewed as a precondition for the engagement.

Preliminary Task Force Views

44. The Task Force believes that the principal objective of an engagement under the ISAE should be to provide reasonable assurance as to whether the pro forma financial information has been properly compiled in accordance with the applicable framework. This seems to be the general consensus among most of the above jurisdictions, with the exception of South Africa and perhaps the US. However, with respect to the latter, the Task Force believes that the approach in the US standards has more in common with the general consensus than might appear at first sight, as the work effort they require is focused primarily on the process of compilation.
45. With regard to South Africa, the work effort required by the national standard would appear to provide a sufficient basis for a positive form of the opinion on the process of compilation. Nevertheless, the regulatory requirement calls for only a limited assurance report, which the Task Force understands is intended to mitigate the risk that users might view the practitioner's report as providing reasonable assurance *on* the pro forma results.
46. Even though there appears to be only a minority of jurisdictions that require or permit limited assurance engagements on proper compilation of pro forma financial information, the Task Force is of the view that the ISAE should cater for this type of engagement in addition to reasonable assurance engagements so as to achieve broad applicability for the standard.

Matter for IAASB Consideration

- Q8. Does the IAASB agree that the ISAE should cater for both reasonable and limited assurance engagements in respect of the process of compilation of pro forma financial information?

C. Engagement Acceptance Considerations

C.1 ACCEPTABILITY OF FRAMEWORK FOR COMPILATION

47. The Assurance Framework states that "suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. Suitable criteria are context-sensitive, that is, relevant to the engagement circumstances. Even for the same subject

matter there can be different criteria.”³¹ The Assurance Framework also states that “the evaluation or measurement of a subject matter on the basis of the practitioner’s own expectations, judgments and individual experience would not constitute suitable criteria.”³²

48. Under the Assurance Framework, the practitioner has a specific responsibility to assess the suitability of criteria for a particular engagement by considering whether these criteria exhibit the characteristics of relevance, completeness, reliability, neutrality and understandability.³³ Criteria can either be established (as in law or regulation, or in a standard issued by a recognized standard setter), or specifically developed for the purpose of the engagement. Criteria need to be available to the intended users in any one or more of the following ways:
- a) Publicly.
 - b) Through inclusion in a clear manner in the presentation of the subject matter information.
 - c) Through inclusion in a clear manner in the assurance report.
 - d) By general understanding, for example the criterion for measuring time in hours and minutes.³⁴

The EU Context

49. In its Discussion Paper, FEE asked respondents for views as to whether the PR, as supported by guidance developed by CESR, provide a sufficient basis against which auditors can report as required by the PR. Respondents were unanimous that this is the case.
50. With regard to the two specific EU countries that this paper considers:
- In Germany, a pre-condition for an engagement to report on pro forma financial information is that the information has been compiled on the basis of the German standard³⁵ governing the preparation of such information, whether such preparation is voluntary or required by the PD/PR. That standard, therefore, effectively provides the suitable criteria.
 - In the UK, the APB has determined that the PD and PR, supported by guidance issued by CESR, provide suitable criteria for the preparation of the information. Accordingly, there is no specific requirement that the practitioner evaluate the suitability of these criteria.

The Context Outside of the EU

³¹ Assurance Framework, paragraph 35.

³² Assurance Framework, paragraph 36.

³³ Assurance Framework, paragraphs 36-37.

³⁴ Assurance Framework, paragraph 38.

³⁵ IDW Accounting Practice Statement AAB 1.004, “Preparation of Pro Forma Financial Information.”

51. Based on the IAASB Survey responses, established criteria for the preparation of pro forma financial information exist in a few other jurisdictions outside the EU, notably Hong Kong, South Africa and the US.³⁶ However, in several other jurisdictions (e.g., Australia, Canada, China, New Zealand and Singapore), there appears to be either minimal or no guidance regarding the preparation of pro forma financial information.

Preliminary Task Force Views

52. The Task Force believes that as a precondition for the engagement, the practitioner should be required to determine whether the criteria applied in the compilation of the pro forma financial information are acceptable, much along the lines of the ISA 210 (Redrafted)³⁷ requirement for the auditor to determine the acceptability of the financial reporting framework as a precondition for an audit of financial statements. Where established criteria exist, fulfilling this precondition will likely not be problematical. Difficulties, however, may arise in jurisdictions where no established criteria exist. In those circumstances, it becomes necessary, in accordance with the requirements of the Assurance Framework, for the practitioner to evaluate the suitability of the basis on which management has compiled the pro forma financial information.
53. In the latter case, the question arises as to whether the ISAE should establish benchmarks to ensure that the practitioner's evaluation of the suitability of management's criteria is done on a consistent basis. In the Task Force's view, it would be in the public interest to specify high level benchmarks against which management's criteria should be evaluated, particularly for jurisdictions that have not established any formal frameworks for the compilation of pro forma financial information. These benchmarks could cover such matters as:
- Presentation of the pro forma financial information
 - Disclosure of the basis of compilation, including the nature of the adjustments
 - The need for consistency of the adjustments with the accounting policies of the issuer (see further discussion in Issue D.4.2 below)
 - The need to reflect at least those adjustments that are material
 - The need for the adjustments to be directly attributable to the transaction and factually supportable (see further discussion in Issue D.4.1 below)
 - The appropriateness of the source of the unadjusted financial information and the period covered by the pro forma financial information
 - Whether the criteria meet, or do not conflict with, the requirements of laws and regulations
 - The need for the criteria not to cause the pro forma financial information to be misleading (see further discussion in Issue E.1 below)

³⁶ Australia: ASIC Regulatory Guides 56 and 170; HK: HKICPA Accounting Guideline 7; South Africa: Guide on Pro Forma Financial Information; and US: Article 11 of SEC Regulation S-X.

³⁷ ISA 210 (Redrafted), "Agreeing the Terms of Audit Engagements."

Guidance could also be provided to illustrate the application of these benchmarks, e.g., examples of adjustments that generally are not factually supportable or directly attributable to the transaction.

54. Thus, if the practitioner determines that management's criteria are not suitable, it would not be appropriate for the practitioner to accept the engagement unless management includes the necessary additional criteria.

Matters for IAASB Consideration

- Q9. Does the IAASB agree that determining the acceptability of the framework for compiling the pro forma financial information should be a condition for engagement acceptance?
- Q10. Does the IAASB agree that it would be appropriate to provide high-level benchmarks in the ISAE to assist the practitioner in evaluating the suitability of management's criteria where no formal framework exists in the jurisdiction? If so, does the IAASB believe that the suggested benchmarks above are sufficient? Would any of them be inappropriate or unduly restrictive?

D. Nature and Extent of Work Effort

D.1. WORK EFFORT REGARDING THE UNADJUSTED FINANCIAL INFORMATION

The EU Context

55. The PD and PR do not specify any requirement that the unadjusted information used to prepare the pro forma financial information be audited or reviewed. This matter is addressed in the assurance standards of the two specific EU countries considered in this paper as follows:

- In Germany:

“The basis stated in the ... notes shows how ... the pro forma financial information is derived from the basic figures. The basic figures themselves are not subject to the audit of the pro forma financial information.”³⁸

- In the UK:

“The reporting accountant is not required to perform specific procedures on the unadjusted financial information of the issuer [except:

- Considering whether the period in respect of which the pro forma financial information is proposed to be published is permitted under the PD Regulation.
- Considering whether the source of the unadjusted financial information is appropriate and whether that source is clearly stated.]”³⁹

³⁸ IDW AuPS 9.960.1, paragraph 7.

³⁹ SIR 4000, paragraphs 27-28.

The UK standard nevertheless requires that where the practitioner has reason to believe that the unadjusted financial information is, or may be, unreliable, or if a report thereon has identified any uncertainties or disagreements, the practitioner should consider the effect on the pro forma information.⁴⁰

56. However, the assurance standard in one other EU country (the Netherlands) not otherwise considered in this paper requires the following:

“If the unadjusted financial information of the issuer is unaudited, the auditor should perform review procedures on the unadjusted financial information of the issuer in accordance with Standard 2410.”⁴¹

The Context Outside of the EU

57. From the IAASB Survey, of those jurisdictions that have promulgated standards for reporting on pro forma financial information, Hong Kong, Singapore and South Africa do not require the unadjusted financial information to be audited or reviewed if it is historical, or examined if it is a profit forecast. The situation is different in the following two jurisdictions:

- In Malaysia, the Prospectus Guidelines issued by the Malaysian Securities Commission state that “for a group of corporations, constituted during the period under review, pro forma financial information must be prepared based on the audited results of the corporations.”⁴²
- As previously indicated (paragraph 43 above), in the US, a precondition of the engagement under the relevant attest standards is that the “historical financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based have been audited or reviewed.”⁴³ This appears to be the basis for the standards to impose a responsibility on the practitioner to express an opinion *on* the pro forma financial information:

“The level of assurance given by the practitioner on the pro forma financial information, as of a particular date or for a particular period, should be limited to the level of assurance provided on the historical financial statements.”⁴⁴

In addition, in its training manual on Regulation S-X, the SEC states that “generally, reports on pro forma data are only appropriate where the auditor has a sufficient basis to express an opinion because it also audited the majority of the underlying historical financial statements and issued a report thereon.”⁴⁵

⁴⁰ SIR 4000, paragraph 28.

⁴¹ 3850N, “Assurance-Engagements in Connection with Prospectus Reporting,” paragraph 113.

⁴² Malaysian Securities Commission Prospectus Guidelines, paragraph 13.15.

⁴³ PCAOB/ASB AT 401.07b.

⁴⁴ PCAOB/ASB AT 401.07b.

⁴⁵ Section E of 2000 SEC training manual on Article 11 of Regulation S-X.

In Australia, the relevant guidance statement appears silent as to whether the unadjusted financial information should be audited or reviewed; it only refers to “altering the figures previously reported in the *audited* financial report”.⁴⁶

Preliminary Task Force Views

58. The majority of Task Force members believe that it is not feasible to mandate that the unadjusted financial information be audited, reviewed or examined in all cases without creating a conflict with frameworks for the preparation of pro forma financial information in jurisdictions (such as the EU) where no such requirement exists in law or regulation. Conversely, an ISAE that does not impose such a requirement would not preclude individual jurisdictions from adding more stringent audit, review or examination requirements on that information if considered appropriate in the national context. More importantly, however, these members believe that imposing such a requirement would significantly increase the time and cost of the engagement, and thus likely engender resistance from issuers.
59. A minority of Task Force members, however, believe that the practitioner would not have a sufficient understanding of the compilation process and, therefore, a basis to report on whether the pro forma financial information has been properly compiled if a significant element of the compilation process, i.e., the unadjusted financial information, previously had not been audited or reviewed. Equally, these members are of the view that the practitioner cannot fulfill the practitioner’s responsibility with respect to the information not being misleading if the unadjusted financial information has not been audited or reviewed. Given the potential difficulty of mandating an audit, review or examination on the unadjusted financial information, these members thought that a compromise approach could be to require the practitioner to perform sufficient procedures to gain an understanding of the financial and reporting practices associated with the unadjusted financial information, as well as other procedures necessary to support the expression of a positive opinion that (a) the pro forma financial information has been properly compiled on the basis stated, and (b) that basis is consistent with the accounting policies of the issuer.
60. Regardless of the work effort on the unadjusted information, the Task Force is of the view that the practitioner should still have at a minimum a responsibility to consider whether anything has come to the practitioner’s attention during the engagement to cause the practitioner to believe that the unadjusted financial information might be unreliable, not least to avoid being associated with misleading information. Consequently, if something did come to the practitioner’s attention to cause the practitioner to question the reliability of the unadjusted financial information, it would be necessary for the practitioner to take appropriate action, including discussing the matter with management and considering the effect on the practitioner’s report. (See further discussion in Issue **E.1** below).
61. The Task Force believes the practitioner’s report and the basis of preparation should disclose when the unadjusted financial information has not been derived from historical financial information that was audited or reviewed.

⁴⁶ AGS 1062.41.

Matters for IAASB Consideration

- Q11. What are the IAASB's views as to whether the ISAE should impose a condition in all cases that the unadjusted financial information be:
- a) Audited or reviewed, if it is historical?
 - b) Subject to an examination (based on the IAASB's ISAE 3400),⁴⁷ if it is a forecast?
- Q12. If there should be no such condition, should the practitioner have a responsibility to perform procedures on the unadjusted financial information to gain an understanding of the accounting and financial reporting practices in order to report on the pro forma financial information?
- Q13. Regardless of whether that condition should be imposed:
- (a) Does the IAASB agree that the practitioner should have a responsibility to consider whether anything has come to the practitioner's attention to cause the practitioner to believe that the unadjusted financial information may be unreliable? Does the IAASB consider that the practitioner has any additional responsibility? If so, what should be that responsibility and how should the practitioner discharge it?
 - (b) Does the IAASB agree that the practitioner should take the action outlined in paragraph 60 above when the practitioner suspects that the unadjusted financial information might be unreliable?

D.2 OBTAINING AN UNDERSTANDING OF THE SUBJECT MATTER AND ENGAGEMENT CIRCUMSTANCES

62. The Assurance Framework states that "to be in a position to express a conclusion in the positive form required in a reasonable assurance engagement, it is necessary for the practitioner to obtain sufficient appropriate evidence as part of an iterative, systematic engagement process involving [among other things] obtaining an understanding of the subject matter and other engagement circumstances which, depending on the subject matter, includes obtaining an understanding of internal control."⁴⁸ The process of obtaining this understanding enables an assessment of the risks of material misstatement to be made.

The EU Context

63. Given the positive form of the opinion required by the PR, a key question that needs to be addressed when reporting under the PD/PR is the nature and extent of the understanding that the practitioner should obtain regarding the process of compilation (the subject matter) and the related engagement circumstances. In this regard, the relevant standards in the two specific EU countries considered in this paper appear to have established somewhat similar requirements or guidance:

⁴⁷ ISAE 3400, "The Examination of Prospective Financial Information."

⁴⁸ Assurance Framework, paragraph 51.

- The German requirement/guidance:

“The auditor should be sufficiently familiar with the business activities, and the accounting policies applied by the entities whose financial information is incorporated in the pro forma financial information.”⁴⁹

“A specific audit procedure is reading the contracts relating to the transaction(s) as well as inquiring of management and, if appropriate, other persons in order to understand the transaction(s) underlying the pro forma financial information.”⁵⁰

- The UK requirement:

“The reporting accountant should obtain an understanding of the key factors affecting the subject matter sufficient to identify and assess the risk of the pro forma financial information not being properly compiled and sufficient to design and perform evidence gathering procedures including:

- a) The nature of the transaction being undertaken by the issuer;
- b) The entity’s business; and
- c) The procedures adopted, or planned to be adopted, by the directors for the preparation of the pro forma financial information.”⁵¹

64. While these standards indicate that the extent of the understanding required of the entity’s business is a matter of the practitioner’s professional judgment, the German standard explains that “auditors usually obtain knowledge of the business activities and accounting policies applied by the entities by auditing or reviewing all or the material historical financial statements incorporated in the pro forma financial information. In respect of those entities whose financial statements have not been audited or reviewed by the auditor him-/herself, the auditor should decide in each individual case how to obtain the necessary knowledge of the business activities as well as of the accounting policies applied.”⁵²

The Context Outside of the EU

65. The requirement in the Hong Kong standard regarding obtaining an understanding of the subject matter and the engagement circumstances is similar to the UK’s. In Australia, the relevant guidance statement explains that the practitioner “obtains knowledge of the business sufficient to enable identification and understanding of the events, transactions and practices that may have a significant effect on the financial information or on the accountant’s report. Knowledge of the business includes a general knowledge of the economy and the industry within which the client entity operates.”⁵³

66. In the US, the relevant standards require “the practitioner to have an appropriate level of knowledge of the accounting and financial reporting practices of each significant

⁴⁹ IDW AuPS 9.960.1, paragraph 4.

⁵⁰ IDW AuPS 9.960.1, paragraph 10.

⁵¹ SIR 4000, paragraph 15.

⁵² IDW AuPS 9.960.1, paragraph 4.

⁵³ AGS 1062.30.

constituent part of the combined entity. This would ordinarily have been obtained by the practitioner auditing or reviewing [the underlying] historical financial statements. If another practitioner has performed such an audit or a review, the need for the reporting practitioner to obtain an understanding of the entity's accounting and financial reporting practices is not diminished.”⁵⁴

67. In South Africa, the relevant standard requires the practitioner to “make enquiries of the directors regarding the process by which they have fulfilled their responsibilities”⁵⁵ but does not require any procedure with regard to understanding the relevant entities' businesses.
68. In Singapore, the relevant standard is silent as to the practitioner's responsibility regarding that understanding.

Preliminary Task Force Views

69. The Task Force believes that the extent of the understanding required of the subject matter and the engagement circumstances depends on the nature of the event or transaction, the effect of which is being illustrated through the pro forma financial information. Thus, if the event involves only the entity (e.g., a disposal of assets or a capital raising event such as a rights issue), the practitioner need only understand the specifics of the transaction and the adjustments to which it gives rise, assuming the practitioner has prior knowledge of the entity and its business. Where the event is an acquisition, however, further work will be needed in that the practitioner should obtain an understanding of the acquired entity sufficient to understand the adjustments that are necessary and whether they are appropriate. In such a case, the breadth of the understanding needed will be a function of the nature and size of the acquired business, and the complexity of the transaction.
70. Given the variety of transactions that can occur in practice, the Task Force generally is of the view that the ISAE should not be overly prescriptive in the understanding that the practitioner should obtain regarding the subject matter and engagement circumstances. Subject to the IAASB's views regarding the issue of whether the ISAE should impose a condition that the unadjusted financial information be audited, reviewed or examined (Issue **D.1** above), the Task Force believes that an approach focused on obtaining a sufficient understanding of the relevant entities' businesses, the nature of the transaction, and management's compilation process would be an appropriate way to proceed. The Task Force believes that this approach is generally consistent with the way the jurisdictions mentioned above have addressed this matter.

Matter for IAASB Consideration

Q14. Does the IAASB agree with the Task Force's views regarding the understanding of the subject matter and engagement circumstances?

⁵⁴ PCAOB/ASB AT 401.07c.

⁵⁵ SAICA Guide on Pro Forma Financial Information, paragraph .90.

D.3 MATERIALITY

71. ISAE 3000 requires the practitioner to consider materiality and assurance engagement risk when planning and performing an assurance engagement.⁵⁶

The EU Context

72. In the context of the two specific EU countries considered in this paper, the APB in the UK has established guidance on materiality that focuses on the size and nature of any omission or misstatement in the compilation of the pro forma information:

“Matters are material if their omission or misstatement could, individually or collectively, influence the economic decisions of the intended users of the pro forma financial information. 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.”

“A misstatement in the context of the compilation of pro forma financial information includes, for example:

- Use of an inappropriate source for the unadjusted financial information.
- Incorrect extraction of the unadjusted financial information from an appropriate source.
- In relation to adjustments, the misapplication of accounting policies or failure to use the accounting policies adopted in the last, or to be adopted in the next, financial statements.
- Failure to make an adjustment required by the PD regulation.
- Making an adjustment that does not comply with the PD regulation.
- A mathematical or clerical mistake.
- Inadequate, or incorrect, disclosures.”

“Evaluating whether an omission or misstatement could influence economic decisions of the intended users of the pro forma financial information, 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 pro forma financial information with reasonable diligence; and

⁵⁶ ISAE 3000, paragraphs 22-23, states that “... considering materiality requires the practitioner to understand and assess what factors might influence the decisions of the intended users. For example, when the identified criteria allow for variations in the presentation of the subject matter information, the practitioner considers how the adopted presentation might influence the decisions of the intended users. Materiality is considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and extent of the effect of these factors on the evaluation or measurement of the subject matter, and the interests of the intended users. The assessment of materiality and the relative importance of quantitative and qualitative factors in a particular engagement are matters for the practitioner’s judgment.”

- b) make reasonable economic decisions on the basis of the pro forma financial information.

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.”⁵⁷

73. In Germany, the IDW’s standard is silent on how the practitioner should determine materiality for the purposes of the engagement, except that it requires the practitioner’s report to state that “the purpose of the pro forma financial information is to present the *material* effects the transaction(s) ...,” and that the practitioner “planned and performed the audit in such a way that *material* errors in the compilation of the pro forma financial information on the basis stated in the pro forma notes and in the compilation of this basis consistent with the accounting policies of the company are detected with reasonable assurance.”⁵⁸
74. Also, with regard to the UK, one of the professional bodies has produced guidance for preparers that focuses on the concept of materiality as it applies to the process of compiling the pro forma information:

“Issuers are required to include all appropriate adjustments of which they are aware. ... The reference to all appropriate adjustments should also be read on the basis that the concept of materiality applies to the process of preparing pro forma financial information. Therefore, issuers need only reflect those adjustments which are likely to influence the decisions of investors. Indeed, by making adjustments for immaterial items, directors may give a false impression of the precision and reliability of the resulting pro forma information and detract from disclosures they make under Listing Rule 12.30 about the nature and limitations of the information. Nevertheless, issuers should bear in mind that the materiality of an item is determined not only by its size but also by the qualitative factors of its nature and circumstances.”⁵⁹

(There is no explicit requirement under the PD/PR for “all appropriate adjustments” to be included in the pro forma information.)

The Context Outside of the EU

75. In Australia, the relevant guidance statement leads the practitioner to consider management’s adjustments in relation to audit materiality:

“The professional accountant considers management’s adjustments in accordance with AUS 306 “Materiality and Audit Adjustments”. Adjustments are made to the historical information only if they are material. Materiality should also be considered under Section 728 of the Act from the perspective of investors which determines that an offence has

⁵⁷ SIR 4000, paragraphs 20-22.

⁵⁸ IDW AuPS 9.960.1, paragraph 17.

⁵⁹ ICAEW Technical Release 18/98, “Pro Forma Financial Information,” paragraphs 16-17.

occurred if the misleading or deceptive statement, omission or new circumstance is materially adverse from the point of view of investors.”⁶⁰

76. Guidance on materiality in Hong Kong and South Africa is similar to the UK’s. In the US and Singapore, the relevant standards are silent as to how the practitioner should consider materiality when reporting on the pro forma financial information.

Preliminary Task Force Views

77. The Task Force is of the view that a formulaic and prescriptive approach to determining materiality would be inappropriate and impracticable for the purposes of the ISAE, especially given the broad range of transactions that can occur in practice and the different regulatory requirements that may exist. Therefore, it would seem more appropriate to adopt a high level approach to guidance that focuses on consideration of the engagement circumstances, perhaps drawing from relevant national guidance as illustrated above.
78. The Task Force notes that in some jurisdictions (e.g., the EU), the applicable regulation may prohibit adjustments that might be considered quantitatively material if they are not factually supportable. Materiality considerations therefore need to have specific regard to qualitative factors, including whether the relevant adjustments comply, or do not conflict, with the applicable laws and regulations.

Matter for IAASB Consideration

Q15. Does the IAASB agree that a high level approach focusing on consideration of the engagement circumstances and qualitative factors would be an appropriate basis for guidance on materiality in the ISAE?

D.4 NATURE AND EXTENT OF WORK EFFORT ON PRO FORMA ADJUSTMENTS

D.4.1 Procedures in Relation to the Adjustments

The EU Context

79. The basic work required in relation to pro forma adjustments stems in large part from the specific requirements of the PR, i.e., that the adjustments be:
- a) Clearly shown and explained;
 - b) Directly attributable to the transaction; and
 - c) Factually supportable.
80. Consequently, standards in the two specific EU countries considered direct the practitioner to obtain sufficient appropriate evidence that the adjustments made fulfill these requirements, including inspecting purchase and sale agreements and other relevant documents. In addition:
- The UK standard requires the practitioner to:

⁶⁰ AGS 1062.43 (AUS 306 has been replaced by ASA 320, “Materiality and Audit Adjustments”).

- Discuss with the directors the steps they have taken to identify relevant adjustments and whether such adjustments are permitted to be made;⁶¹
- Verify that the adjustments are included under the appropriate financial statement caption;
- Verify the arithmetical accuracy of the calculations within the pro forma financial information; and
- Evaluate whether the adjustments made are consistent with the accounting policies adopted in the last, or to be adopted in the next, financial statements of the entity presenting the pro forma financial information;⁶² and
- The German standard requires the practitioner to inquire of management and others as to the business relationships and transactions between the issuer and the entity being acquired or disposed of.⁶³

The Context Outside of the EU

81. Standards or guidance in Australia, Hong Kong, Singapore, South Africa, and the US contain largely similar procedures with respect to the adjustments. The fact that most of them include a specific focus on ensuring that the adjustments are directly attributable to the transaction and factually supportable suggests indirect support for including these two requirements as part of the benchmarks against which the suitability of criteria should be evaluated (see paragraph 53 in issue **C.1** above).

Preliminary Task Force Views

82. The Task Force believes that the procedures outlined above represent an appropriate work effort in relation to the pro forma adjustments, in addition to evaluating whether:
- Adjustments have been made for the significant effects directly attributable to the transaction; and
 - All material adjustments pertaining to such transaction are consistent with the transaction and have been reflected in the compilation.

Matters for IAASB Consideration

- Q16. Does the IAASB agree that the procedures outlined above represent a sufficient and appropriate work effort in relation to the pro forma adjustments?
- Q17. How should the extent of these procedures vary depending on whether the objective of the engagement is to provide reasonable or limited assurance on the process of compilation?

D.4.2 Consistency of Accounting Policies

⁶¹ SIR 4000, paragraph 33.

⁶² SIR 4000, paragraphs 42-43.

⁶³ IDW AuPS 9.960.1, paragraph 10.

The EU Context

83. The PR requires that the pro forma information be prepared in a manner consistent with the accounting policies adopted by the issuer in its last or next financial statements, and that the practitioner's opinion state that the basis on which the pro forma information has been compiled is consistent with the accounting policies of the issuer.
84. With regard to the two specific EU countries considered in this paper, differences appear to exist between the requirements in Germany and those in the UK regarding the nature and extent of the work the practitioner should perform to support the opinion required by the PR. In Germany, the practitioner is required to:
- Read the historical financial statements underlying the pro forma financial information as well as inquire of management and, if appropriate, other persons in order to obtain knowledge of the accounting policies applied by the reporting entity; and
 - Read the pro forma notes and compare them with the information in the notes to the historical financial statements in order to determine whether the underlying accounting policies have been properly stated in the pro forma notes, or whether they include appropriate references to the notes to the historical financial statements.⁶⁴
85. The German standard emphasizes that adjustments made to unadjusted financial information to align it with the accounting policies of the issuer are not expected to be subject to audit:
- “The basic figures themselves are not subject to the audit of pro forma financial information. The same applies to necessary adjustments of the historical figures of the acquired subsidiary, subgroup or component of an entity to the accounting policies of the acquiring reporting entity.”⁶⁵
86. Nevertheless, it suggests the performance of certain procedures in some circumstances:
- “When there are uncertainties relating to the accounting policies applied by the acquired subsidiaries, subgroups or components of an entity, it may, in individual cases, be necessary to obtain information from the management of the acquired entities or their (former) auditors, as required for group audits.”
- “When audit procedures indicate that different accounting policies have been applied including any deviations in exercising accounting options, the auditor should discuss with the management of the reporting entity whether adjustments of the basic figures are required.”⁶⁶
87. In the UK, the relevant standard requires the practitioner to evaluate whether the adjustments made to the unadjusted financial information are consistent with the accounting policies adopted in the last, or to be adopted in the next, financial statements of the entity presenting the pro forma financial information. It also states that where the

⁶⁴ IDW AuPS 9.960.1, paragraph 14.

⁶⁵ IDW AuPS 9.960.1, paragraph 7.

⁶⁶ IDW AuPS 9.960.1, paragraphs 11-12.

practitioner is not the auditor of the issuer or has not otherwise reported on the financial information relating to the subject of the transaction, he or she evaluates the steps taken to ensure that the pro forma financial information has been prepared in a manner consistent with the accounting policies of the issuer.

The Context Outside of the EU

88. In the US, the relevant standards specify only a high level requirement, in the context of both reasonable and limited assurance engagements, that the practitioner “obtain sufficient appropriate evidence in support of the pro forma adjustments.” However, they indicate that:

“The evidence required to support the level of assurance given is a matter of professional judgment. The practitioner typically would obtain more evidence in an examination engagement than in a review engagement.”⁶⁷

89. The relevant guidance in Australia and standard in Singapore are silent as to the nature and extent of work the reporting accountant should perform in relation to adjustments made for accounting policy consistency. The Hong Kong and South African approaches appear similar to the UK’s.

Preliminary Task Force Views

90. Not all frameworks necessarily require that pro forma adjustments that are made should be consistent with the issuer’s accounting policies. However, the Task Force believes that it should be a precondition for the acceptability of the framework that the criteria used for the compilation include a requirement that the adjustments made are consistent with the issuer’s accounting policies (see discussion on benchmarks in paragraph 53 above). This is particularly important when an issuer acquires a business that reports under a different financial reporting framework (for example, US GAAP instead of IFRS). Without adherence to a fundamental principle of reporting on the basis of consistent accounting policies, the results of the compilation could be confusing and potentially misleading to users.

91. Therefore, the Task Force believes that the practitioner’s work effort on the adjustments should include an evaluation of whether these have been made on a basis consistent with the accounting policies of the issuer. This evaluation should include at a minimum:

- Obtaining an understanding of the significant accounting policies of the issuer and the acquiree, where the transaction is an acquisition;
- Obtaining an understanding of how the accounting policy adjustments are identified and calculated; and
- Reviewing the adjustments to obtain evidence that they conform with the accounting policies of the issuer.

Matters for IAASB Consideration
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⁶⁷ PCAOB/ASB AT 401.10e.

- Q18. Does the IAASB agree with the Task Force's views regarding consistency of accounting policies as a benchmark?
- Q19. Does the IAASB agree that the practitioner's work effort on consistency of accounting policies should be based on the high level principles indicated in paragraph 91 above if the objective of the engagement is to provide reasonable assurance on proper compilation? How should the work effort differ if that objective is limited assurance?

D.4.3 "Assumptions" Underlying the Compilation of Pro Forma Financial Information and Related Work Effort

92. In the FEE Discussion Paper, FEE suggested that, as a basis for a "properly compiled" opinion, the practitioner should (among other procedures):
- Ascertain that the assumptions underlying the pro forma information appropriately reflect the material effects of the transaction on the financial statements;
 - Ascertain that the pro forma adjustments have been derived properly on the basis of these assumptions; and
 - Assess whether the underlying assumptions have been described appropriately in the pro forma notes.
93. While assumptions may be made in a compilation of pro forma financial information, these will generally not be of the same nature as the forward looking assumptions on which prospective financial information is ordinarily prepared. This is because in practice, the pro forma adjustments are often required to be directly attributable to the transaction and factually supportable.⁶⁸ Assumptions in the context of pro forma financial information tend to be about matters such as the choice of the starting point for the compilation of the pro forma financial information (if that starting point has not already been specified in law or regulation), and management's decisions as to how the pro forma information should be constituted based on the entity circumstances (e.g., applicable interest rates, taxation rates, accounting policies, etc.) and the applicable framework.

The EU Context

94. The PR contains no specific reference to assumptions, and accordingly has no requirement for the practitioner to evaluate the reasonableness of any assumptions underlying the pro forma information. However, it requires that pro forma adjustments be directly attributable to the transaction and factually supportable.
95. With regard to the specific country consideration in this paper, the UK standard makes no specific reference to assumptions. The German standard, however, specifies that although "the appropriateness of the pro forma assumptions [made by management] and presented in the pro forma notes is not subject to the audit of pro forma financial information," the practitioner "may consider performing specific audit procedures such as:

⁶⁸ For example, apart from the EU, this is the case in Hong Kong, Singapore, South Africa and the US, among Survey countries that have submitted copies of their relevant standards or guidance.

- Inquiring of management and, if appropriate, other persons *which pro forma assumptions have been made* regarding the effects of the transaction(s) on the financial statements.
- Reading the pro forma notes as to whether the transaction(s) and the *pro forma assumptions* underlying the pro forma financial information are presented in a comprehensible form.
- Determining whether the pro forma adjustments have *consistently been derived from the pro forma assumptions* and are free from any discrepancies.”⁶⁹

The Context Outside of the EU

96. In the US, the relevant standards impose a specific obligation on the practitioner, in both an examination engagement and a review engagement, to provide the appropriate level of assurance regarding management’s assumptions on which the pro forma adjustments are based. For example, in a reasonable assurance engagement:

“The objective of the practitioner’s examination procedures applied to pro forma financial information is to provide reasonable assurance as to whether management’s assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event), and whether the related pro forma adjustments give appropriate effect to those assumptions.”

“The practitioner’s examination report should include ... the practitioner’s opinion as to whether management’s assumptions provide a reasonable basis for presenting the significant effects directly attributable to the transaction (or event), whether the related pro forma adjustments give appropriate effect to those assumptions, ...”⁷⁰

97. The US standards also mandate the performance of the following specific procedures regarding assumptions in both reasonable and limited assurance engagements:
- Discuss with management their assumptions regarding the effects of the transaction (or event).
 - Evaluate whether management’s assumptions that underlie the pro forma adjustments are presented in a sufficiently clear and comprehensive manner.
 - Obtain written representations from management concerning their responsibility for the assumptions used in determining the pro forma adjustments and their assertion that the assumptions provide a reasonable basis for presenting all of the significant effects directly attributable to the transaction (or event).
 - Read the pro forma financial information and evaluate whether the underlying transaction (or event), the pro forma adjustments, the significant assumptions and the significant uncertainties, if any, about those assumptions have been appropriately described.

⁶⁹ IDW AuPS 9.960.1, paragraph 10.

⁷⁰ PCAOB/ASB AT 401.08 and .12.

98. The relevant standards and guidance in Australia, Hong Kong, Singapore and South Africa do not make any explicit reference to management assumptions.

Preliminary Task Force Views

99. The Task Force believes that the fact that some jurisdictions refer to assumptions to a significant extent in their assurance standards while others do not does not reflect an inherent inconsistency in conceptual approach or a difference in views as to how pro forma financial information is constituted. As noted above, the Task Force is of the view that assumptions in the context of pro forma financial information generally represent the choices and decisions (collectively “judgments”) that management needs to make regarding the various elements that comprise the basis of compilation of the pro forma information, having regard to the transaction circumstances. As such, the Task Force believes that the practitioner’s work effort needs to revolve around determining whether the assumptions provide a reasonable basis for compiling the pro forma financial information, whether the pro forma adjustments have been properly derived on the basis on those assumptions and the transaction circumstances, and whether the assumptions have been appropriately disclosed as part of the basis of compilation.
100. To clarify the matter of assumptions, the Task Force believes that it would be appropriate to provide guidance in the ISAE to explain what assumptions generally mean in the context of a compilation of pro forma financial information, i.e., that they are the judgments that management has to make in establishing the basis of the compilation to illustrate the significant effects of the transaction.

Matters for IAASB Consideration

- Q20. Does the IAASB agree with the Task Force’s views above? Is there a more appropriate term or phrase that the ISAE could use other than “assumptions” that would minimize the risk of confusion with forward-looking assumptions?
- Q21. Should there be any difference in the level of the practitioner’s responsibility regarding assumptions if the engagement objective is limited assurance on proper compilation as opposed to reasonable assurance?

D.5 SUBSEQUENT EVENTS

101. ISAE 3000 requires the practitioner to consider the effect on the subject matter information and on the assurance report of events up to the date of the assurance report. In the context of an engagement to report on proper compilation, the following two questions arise:
- Does the practitioner have any responsibility to perform procedures to identify any material subsequent events between the end of the period for which the pro forma financial information has been compiled and the date of the practitioner’s report, and for which adjustments to the underlying financial information might be required (“hindsight adjustments”)?

- What should be the practitioner's responsibility regarding subsequent events that occur after the date of the practitioner's report but before the completion date of the transaction?

The EU Context

102. The PR is silent as to the practitioner's responsibilities regarding subsequent events.
103. In the specific country context, Germany is likewise silent. In the UK, however, the relevant standard addresses only the second question:

"If, in the period between the date of the reporting accountant's report and the completion date of the transaction, the reporting accountant becomes aware of events and other matters which, had they occurred and been known at the date of the report, might have caused it to issue a different report or withhold consent, the reporting accountant should discuss the implications of them with those responsible for the investment circular and take additional action as appropriate."

"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, it may consider it necessary to take legal advice with respect to its responsibilities in the particular circumstances."

"After the date of its report, the reporting accountant has no obligation to perform procedures or make enquiries regarding the investment circular."⁷¹

The Context Outside of the EU

104. The relevant standards and guidance in Australia, Singapore, South Africa and the US are silent as to the practitioner's responsibilities regarding subsequent events. The relevant standard in HK addresses the second question above and refers the practitioner to the auditing standard on subsequent events for appropriate action if material subsequent events arise after the date of the practitioner's report that affect the pro forma financial information.

Preliminary Task Force Views

105. In relation to the first question above, the Task Force notes that, in principle, subsequent events arising between the end of the period covered by pro forma financial information compiled on the basis of historical financial information and the date of the practitioner's report should have little significance to the pro forma financial information. This is because the purpose of the compilation is to illustrate the hypothetical effect of the transaction on a starting point (i.e., the unadjusted financial information), whatever that starting point might be, and not to show what effects subsequent events might have on it.
106. Nevertheless, some Task Force members are of the view that subsequent events could arise in practice that affect the *pro forma adjustments*, such as changes to preliminary purchase price allocations or pre-acquisition contingencies. For example, the entity might acquire

⁷¹ SIR 1000, paragraphs 75-77.

patents in purchasing a business, and soon after the acquisition a competitor might release a better product that adversely affects the valuation of the acquired intangibles. Whether the subsequent event requires adjustment or disclosure, these Task Force members believe that it would be prudent for the practitioner to at least make the relevant inquiries and read minutes of meetings of those charged with governance and management – procedures that should not be unduly burdensome.

107. In addition, the Task Force notes that a responsibility might arise if certain subsequent events happen to be of such significance as to cause the pro forma financial information to now become misleading if it is not adjusted for these events. The Task Force believes that such a responsibility would be part of a broader responsibility for the practitioner not to be associated with misleading information. (See further discussion in Issue E.1 below).
108. In relation to the second question, the Task Force believes that the practitioner should only have a responsibility to take appropriate action if the practitioner becomes aware of anything after the date of the practitioner's report but before the completion date of the transaction that causes the practitioner to believe that the report may be inappropriate.
109. Finally, consistent with the guidance established in ISA 560 (Redrafted),⁷² the Task Force believes that the ISAE should include a requirement for the practitioner to consider any legal or regulatory requirements applicable to the practitioner regarding carrying out procedures after the date of the practitioner's report.

Matters for IAASB Consideration

Q22. Does the IAASB agree with the Task Force's views above?

Q23. Does the IAASB agree that the practitioner's responsibilities with regard to subsequent events should be the same for both reasonable and limited assurance engagements?

E. Reporting

E.1 RESPONSIBILITY FOR EVALUATING WHETHER THE PRO FORMA FINANCIAL INFORMATION IS MISLEADING

110. Section 110 of Part A of the IFAC Code of Ethics requires that a professional accountant not be associated with reports, returns, communications or other information where he or she believes that the information:
 - a) Contains a materially false or misleading statement;
 - b) Contains statements or information furnished recklessly; or

⁷² ISA 560 (Redrafted), "Subsequent Events," paragraph A1:

"When the audited financial statements are included in other documents subsequent to the issuance of the financial statements, the auditor may have additional responsibilities relating to subsequent events that the auditor may need to consider, such as legal or regulatory requirements involving the offering of securities to the public in jurisdictions in which the securities are being offered. For example, the auditor may be required to perform additional audit procedures to the date of the final offering document. ..."

- c) Omits or obscures information required to be included where such omission or obscurity would be misleading.

111. Additional requirements exist in ISAE 3000 as follows:

- The practitioner considers whether specifically developed criteria result in an assurance report that is misleading to the intended users.
- When it is discovered, after the engagement has been accepted, that the criteria are unsuitable or the subject matter is not appropriate for an assurance engagement, the practitioner should express a qualified conclusion or adverse conclusion when the unsuitable criteria or inappropriate subject matter is likely to mislead the intended users.⁷³

The EU Context

112. There is no explicit requirement in the PR for the pro forma financial information not to be misleading.

113. With regard to country circumstances, the UK standard places certain specific responsibilities on the practitioner to evaluate whether the pro forma information is misleading. In particular:

“If any adjustments are excluded because of the requirement in item 6 of Annex II of the PD Regulation for adjustments to be factually supportable, the reporting accountant considers the effect on the pro forma financial information and in particular whether the exclusion renders the pro forma financial information misleading. In such circumstances, the reporting accountant may consider that disclosure in the notes to the pro forma financial information of the fact that such an adjustment has not been made is sufficient in the context of the overall purpose of the pro forma financial information.”

“However, if the reporting accountant concludes that an omitted adjustment is so fundamental as to render the pro forma statement misleading in the context of the investment circular, it discusses the matter with the directors and, if necessary, the issuer’s advisers and in the event that acceptable changes to the disclosures are not made, considers whether it is able to issue its report.”

“The reporting accountant should consider whether it has become aware of anything to cause it to believe that the pro forma financial information is presented in a way that is not understandable or is misleading in the context in which it is provided.”⁷⁴

114. In Germany, by contrast, there is no specific responsibility for the practitioner to evaluate whether the pro forma financial information is misleading.

The Context Outside of the EU

⁷³ ISAE 3000, paragraphs 21 and 51(c)(i).

⁷⁴ SIR 4000, paragraphs 40-41, 46.

115. In Hong Kong and South Africa, practice appears similar to the UK's. However, in Singapore and the US, there are no specific requirements for the practitioner to evaluate whether the pro forma information is misleading.
116. In Australia, there appears to be only an indirect responsibility through guidance that steers the practitioner to consider materiality from the perspective of investors under the applicable law, which determines that an offence has occurred if the misleading or deceptive statement, omission or new circumstance is materially adverse from investors' viewpoint.⁷⁵

Preliminary Task Force Views

117. The Task Force generally believes that providing an opinion on whether the pro forma financial information has been properly compiled includes a responsibility to ensure that the information resulting from the compilation is not misleading. The extent of that responsibility needs to be considered in the following four distinct respects:
 - a) The unadjusted financial information;
 - b) The criteria applied;
 - c) The pro forma adjustments; and
 - d) The overall pro forma financial information.
118. As discussed in issue **D.1** above (see paragraph 60), the Task Force believes that regardless of whether the practitioner should have a responsibility to audit, review or examine the unadjusted financial information when reporting on the process of compilation, at a minimum the practitioner should have a responsibility to consider whether anything has come to the practitioner's attention during the engagement to cause the practitioner to believe that the unadjusted financial information may be misleading.
119. In relation to the criteria used, the Task Force believes that it should be a necessary characteristic of an acceptable framework that the criteria not result in pro forma financial information that might be misleading to the users. For this reason, the Task Force believes that this should be recognized as a benchmark for evaluating the suitability of criteria prior to engagement acceptance. (See para 53, Issue **C.1**).
120. With regard to the pro forma adjustments, the Task Force is of the view that the practitioner's responsibility to evaluate the completeness and appropriateness of all material adjustments includes a responsibility to ensure that those adjustments are not misleading. Further, as recognized in a number of the jurisdictions above, the Task Force believes that the practitioner also should have a responsibility to consider whether the omission of any material adjustments to comply with applicable regulatory requirements is so fundamental as to result in pro forma financial information that might be misleading.
121. Finally, with regard to the pro forma financial information itself, the Task Force is of the view that the practitioner should have an overall stand-back responsibility to consider

⁷⁵ AGS 1062.43.

whether the compilation process results in pro forma financial information that is misleading.

122. While it will often be clear in the engagement when a particular aspect of the compilation is misleading, the Task Force recognizes that in other cases it may be a difficult judgment call for the practitioner. In those circumstances, the Task Force believes that guidance could be provided to direct the practitioner to ask the client to seek further advice from the appropriate parties, e.g., the client's legal counsel.

Matter for IAASB Consideration

Q24. Does the IAASB agree with the Task Force's views regarding the above?

E.2 FORM AND CONTENT OF THE PRACTITIONER'S REPORT

123. The basic requirement in relation to the form of the practitioner's report is specified by ISAE 3000:

"The assurance report should be in writing and should contain a clear expression of the practitioner's conclusion about the subject matter information."⁷⁶

124. ISAE 3000 also provides the necessary structure for the content of the practitioner's report, which is to comprise, among other things:

- Identification of the criteria.
- Where appropriate, a description of any significant, inherent limitation associated with the evaluation or measurement of the subject matter against the criteria.
- When the criteria used to evaluate or measure the subject matter are available only to specific intended users, or are relevant only to a specific purpose, a statement restricting the use of the assurance report to those intended users or that purpose.
- A statement to identify the responsible party and to describe the responsible party's and the practitioner's responsibilities.
- A summary of the work performed.
- The practitioner's conclusion.
- Where the practitioner expresses a conclusion that is other than unqualified, a clear description of all the reasons.⁷⁷

The EU Context

125. Within the EU, the PR does not prescribe the content of the practitioner's report other than in relation to the wording of the opinion.

⁷⁶ ISAE 3000, paragraph 46.

⁷⁷ ISAE 3000, paragraph 49.

126. In the specific country context, the relevant standards in Germany and the UK differ in the manner and detail of their descriptions of the practitioner's responsibilities and the basis of the opinion in the report (see Appendix D).

The Context Outside of the EU

127. While practice in Hong Kong and Singapore is generally consistent with the UK's, differences exist in Australia, South Africa and the US (see also Appendix D).

Matters for Consideration and Preliminary Task Force Views

E.2.1 Description of the Practitioner's Responsibilities

128. While there is variation among the jurisdictions surveyed regarding how the practitioner's responsibilities are described in the report, the Task Force believes that there is scope for achieving a common ground in describing those responsibilities in a report issued pursuant to the ISAE, i.e.,:

- That the practitioner has been engaged to report on the process of compilation;
- If appropriate, that the practitioner's responsibility to express an opinion (or conclusion in the case of a review) derives from the applicable law or regulation; and
- That the opinion (or conclusion in the case of a review) is being given as to the proper compilation of the pro forma financial information on the basis stated.

129. But more importantly to minimize any expectation gaps, the Task Force believes that it would be appropriate to make clear in the description that the practitioner's responsibilities do not include refreshing any reports that the practitioner or any other practitioner may have provided on the financial information used in the compilation.⁷⁸

E.2.2 Basis of the Practitioner's opinion

130. The Task Force is of the view that the practitioner's report should include a high level summary of the work performed on the compilation, with a specific reference to the ISAE as the standard applied.

131. In addition, if the ISAE should not mandate that the practitioner audit or review the underlying financial information, the Task Force believes that it would be particularly important to make clear that the work performed did not involve any audit or review of that information.

E.2.3 Wording of the Opinion

⁷⁸ This view is supported by the responses to the FEE Discussion Paper. In that paper, FEE asked respondents whether they agreed that an opinion that pro forma financial information is properly compiled does not include any restatement of the opinions provided on any part of the underlying financial information. Of the 9 respondents who addressed this question, all agreed that this opinion does not extend to refreshing the opinions provided on the underlying financial information, with several of them expressing the view that reporting on proper compilation does not include any opinion on the underlying information.

132. While the wording of the practitioner’s opinion may be prescribed by law or regulation in many cases, the Task Force generally believes that the wording specified by the ISAE should be:
- In the case of a reasonable assurance engagement, a positive statement as to whether the pro forma financial information has been *properly compiled* on the basis stated, as this appears to be the wording that is most commonly used; or
 - In the case of a limited assurance engagement, a negative form of conclusion (consistent with the Assurance Framework) as to whether anything has come to the practitioner’s attention to cause the practitioner to believe that the pro forma information has not been properly compiled.
133. Notwithstanding this proposed wording, the Task Force notes a risk that some users might misinterpret a ‘properly compiled’ opinion as implying that a compilation engagement has been performed in accordance with ISRS 4410,⁷⁹ with no assurance provided. While the summary of the work performed in the report will to some extent mitigate that risk, the Task Force believes that there would be merit in providing an alternative wording for the opinion in the ISAE that would be considered equivalent to a ‘properly compiled’ opinion – for example, ‘properly prepared’ – and that could be used in jurisdictions where that particular concern might exist.
134. With regard to other wording for the opinion that may be used in individual jurisdictions, e.g., if the engagements are mandated by law or regulation, the Task Force is of the view that it would not be practicable for the ISAE to identify all of these and to determine whether they have the same meaning as an opinion on proper compilation. Accordingly, to deal with cases where law or regulation prescribes the wording of the opinion in terms that are significantly different from the ISAE’s, the Task Force believes that relevant guidance should be provided in the ISAE along the lines of guidance in ISA 700 (Redrafted)⁸⁰ and ISA 210 (Redrafted)⁸¹ in the context of audits.

⁷⁹ International Standard on Review Services (ISRS) 4410, “Engagements to Compile Financial Statements.”

⁸⁰ ISA 700 (Redrafted), “Forming an Opinion and Reporting on Financial Statements,” paragraph A26:

“ISA 210 (Redrafted) explains that, in some cases, law or regulation prescribes the wording of the auditor’s report (which in particular includes the auditor’s opinion) in terms that are significantly different from the requirements of ISAs. In these circumstances, ISA 210 (Redrafted) requires the auditor to evaluate:

- (a) Whether users might misunderstand the assurance obtained from the audit of the financial statements and, if so,
- (b) Whether additional explanation in the auditor’s report can mitigate possible misunderstanding.

If the auditor concludes that additional explanation in the auditor’s report cannot mitigate possible misunderstanding, ISA 210 (Redrafted) requires the auditor not to accept the audit engagement, unless required by law or regulation to do so. In accordance with ISA 210 (Redrafted), an audit conducted in accordance with such law or regulation does not comply with ISAs. Accordingly, the auditor does not include any reference in the auditor’s report to the audit having been conducted in accordance with International Standards on Auditing.”

⁸¹ ISA 210 (Redrafted), “Agreeing the Terms of Audit Engagements,” paragraph 21:

E.2.4 Modified Opinions and Emphases of Matter

135. While regulators in many jurisdictions do not accept practitioners' reports that contain modified opinions, the Task Force is of the view that the ISAE should allow for situations where a modification becomes necessary. In cases where modified opinions are not accepted by the relevant authorities, the Task Force believes that the practitioner can consider a number of possible actions, including discussing the matter with management and the entity's legal counsel or underwriters, seeking further advice from the practitioner's legal counsel, and not issuing the report.
136. The Task Force also believes that it may be appropriate to allow for emphasis of matters paragraphs in the practitioner's report to highlight, for example, any particular uncertainties. However, the Task Force notes that an emphasis of matter may be regarded by some regulators as a de facto modification of the opinion. Accordingly, it may be appropriate to emphasize to the practitioner the need for prior discussion with management and the client's legal counsel, and, if warranted, consultation with the relevant authorities, before including such a matter in the report.

E.2.5 Other Responsibilities/Other Matters Sections

137. To accommodate any other reporting responsibilities that law or regulation may impose, and to provide a means for the practitioner to communicate any other matters considered relevant, the Task Force believes that separate Other Reporting Responsibilities/Other Matters sections should be established in the practitioner's report along the lines of those described in paragraphs 38-39 of ISA 700 (Redrafted), and paragraph 8 of ISA 706 (Revised and Redrafted).⁸²

Matter for IAASB Consideration

Q25. Does the IAASB agree with the Task Force's views regarding the above?

"In some cases, law or regulation of the relevant jurisdiction prescribes the layout or wording of the auditor's report in a form or in terms that are significantly different from the requirements of ISAs. In these circumstances, the auditor shall evaluate:

- (a) Whether users might misunderstand the assurance obtained from the audit of the financial statements and, if so,
- (b) Whether additional explanation in the auditor's report can mitigate possible misunderstanding.

If the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, the auditor shall not accept the audit engagement, unless required by law or regulation to do so. An audit conducted in accordance with such law or regulation does not comply with ISAs. Accordingly, the auditor shall not include any reference within the auditor's report to the audit having been conducted in accordance with ISAs."

⁸² ISA 706 (Redrafted), "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report."

F. Consent

138. Practices relating to practitioners' consent to the inclusion of their reports in prospectuses vary among jurisdictions, depending on local law or regulation and established local practice. There are currently no common standards internationally in relation to the work, if any, that a practitioner should perform before giving consent to the inclusion of his or her report on pro forma financial information in a prospectus.
139. Specific requirements have been promulgated in the UK in relation to practitioners' reports on financial information that may generally be included in prospectuses:

"Where the reporting accountant is required to give consent to the inclusion of its public report, or references to its name, in an investment circular the reporting accountant should, before doing so, consider its public report in the form and context in which it appears, or is referred to, in the investment circular as a whole by:

- a) comparing its public report together with the information being reported on to the other information in the rest of the investment circular and assessing whether the reporting accountant has any cause to believe that such other information is inconsistent with the information being reported on; and
- b) assessing whether the reporting accountant has any cause to believe that any information in the investment circular is misleading.

When the reporting accountant believes information in the investment circular is either inconsistent with its public report, together with the information being reported on, or misleading, the reporting accountant should withhold its consent until the reporting accountant is satisfied that its concerns are unwarranted or until the investment circular has been appropriately amended."

"The reporting accountant should give consent to the inclusion of any report in an investment circular only when all relevant reports that it has agreed to make, in that investment circular, have been finalised."⁸³

(Similar requirements exist in Hong Kong.)

140. In Australia, the relevant guidance appears more general:

"As the professional accountant consents to the report being issued as part of the disclosure document under the Act, the professional accountant needs to ensure that the Independent Accountant's Report is:

- a) issued by the professional accountant, and included in the disclosure document. The professional accountant takes responsibility only for the specific section(s) in the disclosure document that the professional accountant has agreed to in the terms of engagement with management;
- b) appropriately cross referenced and consistent with other information disclosed in the disclosure document; and

⁸³ SIR 1000, paragraphs 66-67.

- c) appropriately positioned in the disclosure document in relation to the information on which the professional accountant gives assurance.”⁸⁴

Preliminary Task Force Views

141. The Task Force believes that consent is essentially a risk management matter that should be dealt with through a separate project as it does not concern only pro forma financial information. The need for consent to the use of the practitioner’s report may arise in the context of other financial information generally (e.g., prospective financial information), although the Task Force notes that consent with regard to audited financial statements included in prospectuses is already implicitly addressed through the work effort specified in ISA 720 (Redrafted).⁸⁵
142. The Task Force is of the view that the issues that need to be explored regarding consent would go beyond the scope of this project, for example:
- The meaning of consent
 - The circumstances in which consent may be given
 - The nature and extent of the work the practitioner should perform before giving consent, including whether an ISA 720 (Redrafted) approach would be sufficient and appropriate in all circumstances
 - Whether the practitioner’s report should be refreshed to the date of the consent
 - The purposes for which the consent may be used
 - The form and content of the consent
 - The nature of any further legal or regulatory requirements
 - Whether consent in respect of financial information generally should be dealt with in an overarching standard and, if so, whether the principles in ISA 720 (Redrafted) should be subsumed in that overarching standard, or whether consent should be dealt with more narrowly within a revision of ISAE 3000.
143. Given the variation in practice internationally, there would be benefit in undertaking a survey of market practice and legal and regulatory requirements at the jurisdictional level to provide a basis for a thorough consideration of the issues.
144. In view of the above, and given that ISAE 3000 does not currently impose any specific requirement regarding consent, the Task Force believes that the matter should be addressed outside the scope of this project. Nevertheless, the Task Force is of the view that some guidance could be provided to alert the practitioner to the need to comply with any requirements that law or regulation may have established regarding consent.

⁸⁴ AGS 1062.62.

⁸⁵ ISA 720 (Redrafted), “The Auditor’s Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements.”

Matters for IAASB Consideration

- Q26. Does the IAASB agree that the matter of consent should be addressed outside the scope of this project?
- Q27. Does the IAASB agree that some guidance could nevertheless be provided to highlight the need for the practitioner to comply with any legal or regulatory requirements that may exist regarding consent?

V. Consideration of the Need for a Consultation Paper

145. The project proposal emphasized the need for the Task Force to consider specifically whether a consultation paper would be appropriate to obtain necessary input before the issue of a draft ISAE. The Task Force believes that the responses to the IAASB Survey have shown that common ground exists in many respects regarding the nature of an assurance engagement in relation to pro forma financial information, and the nature and extent of the work that the practitioner should perform. With the apparent exception of one jurisdiction (the US), it appears that practitioners in the jurisdictions surveyed as well as in the EU are generally required to report on the process of compilation of the pro forma information.
146. In the case of the US, the Task Force believes that the difference is more one of perception than actual fact. While engagements performed under the US standards are predicated on the unadjusted financial information having been audited or reviewed, the procedures they require the practitioner to perform are directed to the process of compilation. In addition, the Task Force notes that the US does not impose any public reporting requirements in respect of pro forma financial information, although practitioners do have to comply with the relevant US standards when engaged to report on such information. Thus, to a large extent, the absence of any public reporting requirement in the US context mitigates the risk of conflict between the ISAE and regulatory requirements in that jurisdiction. Therefore, subject to the IAASB's views and notwithstanding the fact that the US standards require the unadjusted financial information to be audited or reviewed, the Task Force believes that there is scope for reconciling existing US practice with the approach the Task Force recommends for this ISAE (i.e., to report on the process of compilation).
147. In the light of the coverage achieved in the IAASB Survey (covering non-EU jurisdictions representing a very substantial proportion of the world's market capitalization) and the information obtained from the responses, the Task Force believes that issuing a public consultation paper that would deal with the issues discussed in this paper would not elicit any useful new input for this project to any significant extent. The Task Force is of the view that timely input from specific constituencies can be obtained via other available IAASB consultative channels, including:
- The Consultative Advisory Group (for regulators, investor organizations, etc.) (meetings in March and September 2009)
 - The IAASB's annual liaison with national standard setters (April 2009 meeting)
 - The Forum of Firms

148. Accordingly, the Task Force believes that a consultation paper on this topic is not necessary at this stage.

Matter for IAASB Consideration

Q28. Does the IAASB agree that a consultation paper would not be necessary at this stage of the project?

APPENDIX A

Annex I of EU Prospectus Regulation – Minimum Disclosure Requirements for the Share Registration Document

20.2 In the case of a significant gross change, a description of how the transaction might have affected the assets and liabilities and earnings of the issuer, had the transaction been undertaken at the commencement of the period being reported on or at the date reported.

This requirement will normally be satisfied by the inclusion of pro forma financial information.

This pro forma financial information is to be presented as set out in Annex II and must include the information indicated therein.

Pro forma financial information must be accompanied by a report prepared by independent accountants or auditors.

Annex II of EU Prospectus Regulation – Pro Forma Financial Information Building Block

1. The pro forma information must include a description of the transaction, the businesses or entities involved and the period to which it refers, and must clearly state the following:
 - a) the purpose to which it has been prepared;
 - b) the fact that it has been prepared for illustrative purposes only;
 - c) the fact that because of its nature, the pro forma financial information addresses a hypothetical situation and, therefore, does not represent the company's actual financial position or results.
2. In order to present pro forma financial information, a balance sheet and profit and loss account, and accompanying explanatory notes, depending on the circumstances may be included.
3. Pro forma financial information must normally be presented in columnar format, composed of:
 - a) the historical unadjusted information;
 - b) the pro forma adjustments; and
 - c) the resulting pro forma financial information in the final column.

The sources of the pro forma financial information have to be stated and, if applicable, the financial statements of the acquired businesses or entities must be included in the prospectus.

4. The pro forma information must be prepared in a manner consistent with the accounting policies adopted by the issuer in its last or next financial statements and shall identify the following:
 - a) the basis upon which it is prepared;
 - b) the source of each item of information and adjustment.

5. Pro forma information may only be published in respect of
 - a) the current financial period;
 - b) the most recently completed financial period; and/or
 - c) the most recent interim period for which relevant unadjusted information has been or will be published or is being published in the same document.
6. Pro forma adjustments related to the pro forma financial information must be:
 - a) clearly shown and explained;
 - b) directly attributable to the transaction;
 - c) factually supportable.

In addition, in respect of a pro forma profit and loss or cash flow statement, they must be clearly identified as to those expected to have a continuing impact on the issuer and those which are not.

7. The report prepared by the independent accountants or auditors must state that in their opinion:
 - a) the pro forma financial information has been properly compiled on the basis stated;
 - b) that basis is consistent with the accounting policies of the issuer.

APPENDIX B

Definitions of, or Guidance Regarding, the Term “Pro Forma Financial Information”

Definitions

Specific instances where definitions have been provided include the following:

- In Australia:

“Pro forma historical information” comprises historical information, adjusted for significant subsequent events and other matters relating to transactions associated with the fundraising. Pro forma historical information also includes adjustments for presentation and/or disclosure. Specific adjustments involved in preparing pro forma historical information include adjustments to the financial statements, including the statement of financial position, which may have formed part of the historical financial report, to show the impact of transactions associated with fundraising. The adjustments may also include, for example, adjustments for a discontinued part of operations, or sale of a business segment.”⁸⁶

- In Canada:

“Pro forma financial statements are historical financial statements adjusted to show the effect of an event, transaction or proposed transaction as if it had occurred previously.”⁸⁷

Guidance

Instances where guidance has been provided include the following:

- In the US:

- PCAOB/AICPA Auditing Standards Board:

“The objective of pro forma financial information is to show what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date.”⁸⁸

- SEC:

“Pro forma financial information should provide investors with information about the continuing impact of a particular transaction by showing how it might have affected historical financial statements if the transaction had been consummated at an earlier time. Such statements should assist investors in analyzing the future prospects of the registrant because they illustrate the possible scope of the change in the registrant's historical financial position and results of operations caused by the transaction.”⁸⁹

⁸⁶ Australian Accounting Research Foundation’s Auditing and Assurance Guidance Statement (AGS) 1062.04(e)(ii), “Reporting in Connection with Proposed Fundraisings.”

⁸⁷ CICA Assurance Handbook, Section 7110.33, “Auditor Involvement with Offering Document of Public and Private Entities.”

⁸⁸ PCAOB/ASB AT 401, “Reporting on Pro Forma Financial Information,” paragraph .04.

⁸⁹ Rule 11-02 of the SEC’s Financial Statement Requirements Regulation S-X

- In Hong Kong:

“The purpose of pro forma financial information is to provide investors with relevant information about the impact of the transaction by illustrating how that transaction might have affected the financial information presented in the investment circular, had the transaction been undertaken at an earlier date.”⁹⁰

- In Singapore:

“Group pro forma financial information should provide investors with information about the impact of the transaction by illustrating how that transaction might have affected the financial information presented in the document, had the transaction been undertaken at the commencement of the period being reported on or, in the case of pro forma balance sheet, at the date reported on.”⁹¹

- In South Africa:

“Pro forma financial information is to provide investors with information about the impact of the corporate action ... by illustrating how that corporate action might have affected the reported results of the issuer had the corporate action been undertaken at the commencement of the period being reported on or, in the case of a pro forma balance sheet, at the date reported on.”⁹²

⁹⁰ HKICPA Accounting Guideline 7, “Preparation of Pro Forma Financial Information for Inclusion in Investment Circulars,” paragraph 3.

⁹¹ Statement of Auditing Practice 24, “Auditors and Public Offering Documents,” paragraph 13.

⁹² Johannesburg Stock Exchange Listing Requirements, paragraph 8.17; SAICA Guide on Pro Forma Financial Information, paragraph .13.

APPENDIX C

Guidance Regarding the Meaning of “Properly Compiled” in Non-EU Jurisdictions

Hong Kong

The work [required] does not constitute an audit or review ...” but it “consists primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments made by the directors and making enquiries of the directors regarding the process by which they have prepared the pro forma financial information.”⁹³

Singapore

The reporting auditor’s responsibility is to report whether the pro forma financial information has been compiled on a basis consistent with the accounting policies of the issuer.”⁹⁴ It also requires that “the reporting auditor check whether the adjustments made in the pro forma financial information are correctly compiled from the source documentation and correctly included under the appropriate financial statement caption, as well as the arithmetical accuracy of the compilation of the pro forma financial information itself.”⁹⁵

South Africa

The ... conclusion [as to whether or not the pro forma financial information has been properly compiled on the basis stated] relates to the compilation of the pro forma financial information from the stated sources, and entails consideration of the accuracy of extraction of information from the sources and the arithmetical accuracy of the calculations in arriving at the pro forma financial information.”⁹⁶

⁹³ Standard on Investment Circular Reporting Engagements 300, “Accountants’ Reports on Pro Forma Financial Information in Investment Circumstances,” paragraph 2.

⁹⁴ SAP 24, paragraph 16.

⁹⁵ SAP 24, paragraph 17.

⁹⁶ SAICA Guide on Pro Forma Financial Information, paragraph .86-.87.

APPENDIX D

Extracts from Illustrative Practitioner's Reports in Various Jurisdictions

1. *The Practitioner's Responsibilities*

- In Germany:

“My/Our responsibility is to express an opinion, based on my/our audit, whether the pro forma financial information has been properly compiled on the basis stated in the pro forma notes and whether this basis is consistent with the accounting policies of the company. The subject matter of this engagement does neither include an audit of the basic figures including their adjustment to the accounting policies of the company, nor of the pro forma assumptions stated in the pro forma notes.”

- In the UK:

“It is our responsibility to form an opinion, as required by [item 7 of Annex II of the PD Regulation] [guidance issued by the London Stock Exchange], as to the proper compilation of the Pro forma financial information and to report that opinion to you.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro forma financial information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.”

- In Australia (in the context of a report on audited historical financial information that includes pro forma financial information):

“We have audited the historical financial information of the [Company / Trust] for the period(s) ended [insert end(s) of the period(s)]. Our audit has been conducted in accordance with Australian Auditing and Assurance Standards to provide reasonable assurance whether the historical financial information is free of material misstatement.”

- In South Africa:

“Our responsibility is to express our limited assurance conclusion on the pro forma financial information included in the [*prospectus, pre-listing statement or circular*] to [*issuing company*] shareholders. We conducted our assurance engagement in accordance with the International Standard on Assurance Engagements applicable to *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* and the *Guide on Pro Forma Financial Information* issued by SAICA.

This standard requires us to obtain sufficient appropriate evidence on which to base our conclusion.

We do not accept any responsibility for any reports previously given by us on any financial information used in the compilation of the pro forma financial information beyond that owed to those to whom those reports were addressed by us at the dates of their issue.”

- In the US:

“Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants... .”

2. *The Basis of the Opinion*

- In Germany:

“I/We have planned and performed my/our audit in accordance with the IDW Auditing Practice Statement: Audit of Pro Forma Financial Information (IDW AuPS 9.960.1) promulgated by the Institut der Wirtschaftsprüfer in Deutschland e.V. (IDW) in such a way that material errors in the compilation of the pro forma financial information on the basis stated in the pro forma notes and in the compilation of this basis consistent with the accounting policies of the company are detected with reasonable assurance.”

- In the UK:

“We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro forma financial information with the directors of ABC plc.

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 Pro forma financial information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of ABC plc.”

- In Australia (in the context of a report on audited historical financial information that includes pro forma financial information):

“Our procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the historical financial information, and the evaluation of accounting policies and significant accounting estimates. Our procedures also included:

- consideration of the assumptions used to compile the pro forma statement of financial position and/or statement of financial performance;
- audit of the pro forma historical financial information; and
- comparison of consistency in application of the recognition and measurement principles in Accounting Standards and other mandatory professional reporting requirements in Australia, and the accounting policies adopted by the [Company / Trust] disclosed in Section [] of the {disclosure document} [and the requirements of the constitution].”

- In South Africa:

“Our procedures consisted primarily of comparing the unadjusted financial information with the source documents, considering the pro forma adjustments in light of the accounting policies of [issuing company]the issuer, considering the evidence supporting the pro forma adjustments and discussing the adjusted pro forma financial information with the directors of the company in respect of the corporate actions that are the subject of this [prospectus, pre-listing statement or circular].

In arriving at our conclusion, we have relied upon financial information prepared by the directors of [issuing company] and other information from various public, financial and industry sources.

While our work performed has involved an analysis of the historical published audited financial information and other information provided to us, our assurance engagement does not constitute an audit or review of any of the underlying financial information conducted in accordance with *International Standards on Auditing or International Standards on Review Engagements* and accordingly, we do not express an audit or review opinion.

In a limited assurance engagement, the evidence-gathering procedures are more limited than for a reasonable assurance engagement and therefore less assurance is obtained than in a reasonable assurance engagement. We believe our evidence obtained is sufficient and appropriate to provide a basis for our conclusion.”

- In the US (for an examination engagement):

“Our examination ... included such procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.”

3. *The Form of the Opinion*

- In Australia:

“In our opinion, the pro forma statement of financial position has been properly prepared on the basis of the transactions described in Section [] Notes to the Financial Information in the {disclosure document}; ...”

- In South Africa:

“Based on our examination of the evidence obtained, nothing has come to our attention, which causes us to believe that:

- the pro forma financial information has not been properly compiled on the basis stated,
- such basis is inconsistent with the accounting policies of the issuer, and
- the adjustments are not appropriate for the purposes of the pro forma financial information as disclosed in terms of the section 8.17 and 8.30 JSE Listings Requirements.”

- In the US (for an examination engagement):

“In our opinion, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction [*or event*] described in Note 1, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma column reflects the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet as of December 31, 20X1, and the pro forma condensed statement of income for the year then ended.”