



International Federation of Accountants

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Committee: IAASB Consultative Advisory Group

Meeting Location: Dubai

Meeting Date: March 9-10, 2009

Assurance Engagements on Pro Forma Financial Information

Objective of Agenda Item

1. To consider 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.
2. **The IAASB has not yet considered the issues in this paper. It will do so at its March 16-19, 2009 meeting. A link to the IAASB website where the issues paper for the IAASB can be accessed is provided at the end of this paper.**

Background, Approach to Issues, and Summary of Main EU Requirements

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

3. 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.
4. 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.

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.

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5. 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 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.
6. 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.
7. CAG Representatives discussed the project proposal in March 2008 and expressed support for the project.
8. 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

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").

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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.⁵

APPROACH TO THIS PAPER

9. The discussion of each of the issues below starts with a brief consideration of the relevant aspects of the EU prospectus regime, touching on 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 in this project.
10. On the basis of its work to date, and subject to the CAG's and 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 CAG Representatives' consideration in this paper are set out on the presumption that an ISAE will be developed.

OTHER PRELIMINARY MATTERS

11. 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 3000⁶ 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,⁷ 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.⁸

⁵ A summary and compilation of responses to the survey can be accessed at: <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4604>.

⁶ ISAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information."

⁷ A project proposal to revise ISAE 3000 is included on the March 2009 IAASB meeting agenda.

⁸ 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)."

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12. The Task Force has not addressed any independence considerations, which will be covered by the relevant ethical standards (including the IFAC *Code of Ethics for Professional Accountants*). The Task Force has, however, considered the practitioner's responsibility in relation to association with misleading information.

SUMMARY OF MAIN EU REQUIREMENTS

13. The European Prospectus Directive⁹ (PD) provides for minimum information on the presentation of pro forma financial information in prospectuses. The detailed requirements 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.

14. The PR requires that the pro forma financial information be accompanied by a practitioner's report:¹⁰

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.¹¹

Significant Issues Highlighted for the IAASB CAG's Consideration

- A. DEFINITIONAL CHARACTERISTICS OF "PRO FORMA FINANCIAL INFORMATION" (*See IAASB Issues Paper, paragraphs 15-21*)
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.
16. In the EU, 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.

⁹ Directive 2003/71/EC.

¹⁰ Item 20.2 of Annex I of the PR (see relevant extract in Appendix A).

¹¹ Item 7 of Annex II of the PR (see Appendix A for a list of the requirements in Annex II of the PR).

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17. Some countries within and outside the EU have established definitions of the term in their assurance standards or provided guidance as to its meaning in the context of prospectuses. In the latter case, the guidance is generally in terms of the objective of the pro forma financial information.
18. Responses to the IAASB Survey indicate that the term has not been formally defined in law or regulation in the jurisdictions surveyed.

Preliminary Task Force Views

19. 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.
20. 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.

Matter for IAASB CAG’s Consideration

- Q1. Do Representatives 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?

B. WHAT IS THE MEANING OF “PROPERLY COMPILED?” (See IAASB Issues Paper, paragraphs 28-36)

21. 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.

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22. Standards in the two specific EU countries considered in this project appear to have designated the first interpretation. This is also the case in three non-EU countries surveyed (Hong Kong, Singapore and South Africa).
23. 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."¹² 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."¹³

Preliminary Task Force Views

24. 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. In the latter, the practitioner merely performs the mechanical function of preparing the pro forma financial information – no assurance is provided.
25. 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.
26. The Task Force also believes that the practitioner should do more than just check the arithmetical accuracy of the compilation of the pro forma financial information. The practitioner should also do such work as 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.

¹² PCAOB/ASB AT 401.12e (emphasis added).

¹³ PCAOB/ASB AT 401.12i.

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27. 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.
28. 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.

Matters for IAASB CAG’s Consideration

- Q2. Do Representatives agree that reporting on whether pro forma financial information has been properly compiled on a stated basis is the appropriate objective for the ISAE? If so, do Representatives agree that this involves the provision of assurance on the process of compiling the information and not on the information itself?
- Q3. Do Representatives 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?
- Q4. Do Representatives agree that the terms “properly compiled” and “properly prepared” should have the same meaning for the purposes of the ISAE?

C. NATURE AND LEVEL OF ASSURANCE PROVIDED IN AN ENGAGEMENT TO REPORT ON PRO FORMA FINANCIAL INFORMATION (See IAASB Issues Paper, paragraphs 38-46)

29. The positive form of the opinion required by the PR implies a reasonable assurance engagement. In the two specific EU countries considered in this project, the engagements are unequivocally treated as reasonable assurance engagements.
30. Outside the EU, a number of countries surveyed (i.e., Australia, Hong Kong, Malaysia, Singapore, and the US) require or permit a positive form of the opinion (reasonable assurance). Among those specific jurisdictions, two (Australia and the US) also permit limited assurance engagements. However, one particular jurisdiction (South Africa) requires the practitioner’s opinion to be expressed only in the negative form,¹⁴ i.e., a limited assurance engagement.
31. In the US, 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. Nevertheless, as indicated in

¹⁴ 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.

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paragraph 23 above, although the relevant US standards appear to require an opinion *on* the pro forma financial information, in practical terms the work effort they require and the nature of the opinion to be expressed relate, in effect, to the process of compilation.

Preliminary Task Force Views

32. 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.
33. With respect to the US, 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.
34. 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.
35. 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 enable the standard to achieve broad applicability.

Matter for IAASB CAG's Consideration

- Q5. Do the Representatives 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?

D. ACCEPTABILITY OF FRAMEWORK FOR COMPILATION *(See IAASB Issues Paper, paragraphs 47-54)*

36. There is a general consensus with the EU that the PD and PR, supported by guidance developed by the Committee of European Securities Regulators (CESR), provide a sufficient basis against which auditors can report on pro forma financial information in prospectuses.
37. 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,

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South Africa and the US.¹⁵ 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

38. 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)¹⁶ 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 these 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.
39. 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
 - 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
 - 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

¹⁵ Hong Kong: HKICPA Accounting Guideline 7; South Africa: Guide on Pro Forma Financial Information; and US: Article 11 of SEC Regulation S-X.

¹⁶ ISA 210 (Redrafted), "Agreeing the Terms of Audit Engagements."

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- The need for the criteria not to cause the pro forma financial information to be misleading

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.

Matters for IAASB CAG's Consideration

- Q6. Do the Representatives agree that determining the acceptability of the framework for compiling the pro forma financial information should be a condition for engagement acceptance?
- Q7. Do the Representatives 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, do the Representatives believe that the suggested benchmarks above are sufficient? Would any of them be inappropriate or unduly restrictive?

E. WORK EFFORT REGARDING THE UNADJUSTED FINANCIAL INFORMATION (*See IAASB Issues Paper, paragraphs 55-61*)

40. Within the EU, 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 is also the case in the standards of the two specific EU countries considered in this project.
41. Outside the EU, Hong Kong, Singapore and South Africa do not require the unadjusted financial information to be audited or reviewed. The situation is different in the following two countries:
- In Malaysia, the regulation requires the pro forma financial information to be prepared based on the audited results of the relevant entities.
 - In the US, as previously indicated, a *precondition* of the engagement under the relevant 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."¹⁷

Preliminary Task Force Views

42. The majority of Task Force members believe that it is not feasible to mandate that the unadjusted financial information be audited or reviewed in all cases without creating a

¹⁷ PCAOB/ASB AT 401.07b.

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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 or review 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.

43. 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. However, given the potential difficulty of mandating an audit or review 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.
44. Regardless of the work effort on the unadjusted information, 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.

Matters for IAASB CAG's Consideration

- Q8. In the Representatives' views, should the ISAE impose a condition in all cases that the unadjusted financial information be audited or reviewed?
- Q9. 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?

F. OBTAINING AN UNDERSTANDING OF THE SUBJECT MATTER AND ENGAGEMENT CIRCUMSTANCES *(See IAASB Issues Paper, paragraphs 62-70)*

45. 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 in the EU is the nature and extent of the understanding that the practitioner should obtain regarding the process of compilation (the

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subject matter) and the related engagement circumstances. In this regard, the relevant standards in the two specific EU countries considered in this project appear to have established somewhat similar requirements or guidance. These standards emphasize that the extent of the understanding required of the entity's business is a matter of the practitioner's professional judgment.

46. Standards in Hong Kong and Australia adopt a similarly high level approach to understanding the subject matter.
47. 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 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."¹⁸

Preliminary Task Force Views

48. 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.
49. 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. 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.

¹⁸ PCAOB/ASB AT 401.07c.

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Matter for IAASB CAG's Consideration

Q10. Do the Representatives agree with the Task Force's views regarding the understanding of the subject matter and engagement circumstances?

G. PROCEDURES IN RELATION TO THE PRO FORMA ADJUSTMENTS *(See IAASB Issues Paper, paragraphs 79-82)*

50. In the EU, 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.
51. Consequently, standards in the two specific EU countries considered in this project 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. They also require the practitioner to:
- Discuss with the directors the steps they have taken to identify relevant adjustments and whether such adjustments are permitted to be made;¹⁹
 - 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;²⁰ and
 - Inquire of management and others as to the business relationships and transactions between the issuer and the entity being acquired or disposed of.²¹
52. 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

¹⁹ UK SIR 4000, paragraph 33.

²⁰ UK SIR 4000, paragraphs 42-43.

²¹ IDW AuPS 9.960.1, paragraph 10.

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requirements as part of the benchmarks against which the suitability of criteria should be evaluated (see Issue D, paragraph 39 above).

Preliminary Task Force Views

53. 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.

Matter for IAASB CAG's Consideration

Q11. Do the Representatives agree that the procedures outlined above represent a sufficient and appropriate work effort in relation to the pro forma adjustments?

H. CONSISTENCY OF ACCOUNTING POLICIES *(See IAASB Issues Paper, paragraphs 83-91)*

54. In the EU, the PR requires that the pro forma financial 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.
55. With regard to the two specific EU countries considered in this project, some 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.
56. 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."
57. The relevant guidance in Australia and standard in Singapore are silent as to the nature and extent of work the practitioner 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

58. 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 39 above). This is

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particularly important when an issuer acquires a business that reports under a different 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.

59. 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 CAG's Consideration

Q12. Do the Representatives agree with the Task Force's views regarding consistency of accounting policies as a benchmark?

Q13. Do the Representatives agree that the practitioner's work effort on consistency of accounting policies should be based on the high level principles indicated in paragraph 59 above?

I. "ASSUMPTIONS" UNDERLYING THE COMPILATION OF PRO FORMA FINANCIAL INFORMATION AND RELATED WORK EFFORT (*See IAASB Issues Paper, paragraphs 92-100*)

60. 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.²² 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.

²² 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.

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61. Within the EU, 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.
62. With regard to the specific EU countries considered in this project, the UK standard makes no specific reference to assumptions. The German standard, however, specifies a number of procedures in relation to assumptions.
63. 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. They also mandate the performance of specific procedures regarding assumptions.

Preliminary Task Force Views

64. 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.
65. 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.

Matter for IAASB CAG's Consideration

- Q14. Do the Representatives 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?

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- J. RESPONSIBILITY FOR EVALUATING WHETHER THE PRO FORMA FINANCIAL INFORMATION IS MISLEADING *(See IAASB Issues Paper, paragraphs 110-122)*
66. The IFAC Code of Ethics requires 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
 - (c) Omits or obscures information required to be included where such omission or obscurity would be misleading.
67. Within the EU, there is no explicit requirement in the PR for the pro forma financial information not to be misleading.
68. With regard to EU country circumstances, the UK standard places certain specific responsibilities on the practitioner to evaluate whether the pro forma information is misleading. In Germany, by contrast, there is no specific responsibility for the practitioner to evaluate whether the pro forma financial information is misleading.
69. 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. 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.

Preliminary Task Force Views

70. 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.
71. The Task Force believes that regardless of whether the practitioner should have a responsibility to audit or review 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.

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72. 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 paragraph 39, Issue D above).
73. 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 jurisdictions surveyed, 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.
74. 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 whether the compilation process has resulted in pro forma financial information that is misleading.
75. 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 CAG's Consideration

Q15. Do the Representatives agree with the Task Force's views regarding the above?

Material Presented – IAASB CAG REFERENCE PAPERS ONLY

Agenda Item 2-A of the March 2009 IAASB Meeting – Assurance Engagements on Pro Forma Financial Information – Issues Paper

<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4603>