



International Federation of Accountants

545 Fifth Avenue, 14th Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

Agenda Item

L

Committee: IAASB Consultative Advisory Group

Meeting Location: Washington

Meeting Date: September 9-11, 2009

Assurance Reports on Proper Compilation of Pro Forma Financial Information Included in Prospectuses

Objective of Agenda Item

1. The objective of this agenda item is to obtain the Representatives' views on a number of significant issues and the Task Force's proposals thereon in the development of a proposed International Standard on Assurance Engagement (ISAE) 34XX, "Assurance Reports on the Proper Compilation of Pro Forma Financial Information Included in Prospectuses."
2. The IAASB will consider the significant issues and the proposed ISAE 34XX at its September 21-25, 2009 meeting. Approval of the exposure draft is planned for the December 2009 IAASB meeting.

Note: For purposes of the proposed ISAE 34XX, "pro forma financial information" is defined as "financial information shown together with adjustments to illustrate the significant effects of an event or transaction ("underlying event or transaction") on unadjusted financial information of the entity assuming that the event or transaction had occurred at the date used for the illustration. Pro forma financial information includes related explanatory notes."

IAASB Task Force

3. Full members:

- David Swanney, Chair, IAASB Member
- David Cattermole, KPMG, UK
- Kevin Desmond, PwC, UK
- Dr. Christian Feldmueller, PwC, Germany
- Ashif Kassam, IAASB Member
- Victoria O'Leary, Ernst & Young, US (seconded to Ernst & Young Global, London)

Correspondent members:

- Lotte Andersen, Committee of European Securities Regulators
- Sue Nyman, Grant Thornton, UK

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L

Pro Forma Financial Information – Issues and IAASB Task Force Proposals

- Steve Ong, Hong Kong Institute of CPAs
- Michel Payen, Deloitte, France
- David Simmonds, Ernst & Young, Australia
- Sandy van Esch, Independent Regulatory Board for Auditors, South Africa
- Bob Widdowson, KPMG, Poland

Background

4. In March 2008, the IAASB approved a project proposal to develop an assurance standard on reporting in relation to pro forma financial information included in prospectuses. The ultimate goal of the project is to develop an internationally accepted standard for assurance engagements on pro forma financial 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.
5. In March 2009, the IAASB considered the preliminary issues identified by the Task Force. It also considered the results of an IAASB staff survey of 19 non-EU jurisdictions¹ regarding the regulatory requirements in these jurisdictions pertaining to the preparation of, and reporting on, pro forma financial information, and the nature of any related national assurance standards and guidance. Based on the Task Force's analysis of the issues and the input received from the IAASB staff survey, the IAASB determined that a standard on the subject would be relevant and feasible in a global context. It also determined that a public consultation on the subject would not be necessary at this stage.
6. The IAASB CAG considered the preliminary issues identified by the Task Force at its March 2009 meeting. A report-back on the Representatives' proposals is provided in **Agenda Item L.1.**

Significant Issues

MEANING OF "PROPERLY COMPILED"

7. At its March 2009 meeting, the IAASB agreed that a clear explanation of the term "properly compiled" is of high importance given the potential for confusion with engagements to compile financial information that are long established in a number of jurisdictions. The IAASB also agreed that there is a need to be clear in the practitioner's report about the work performed to report on proper compilation and what work the practitioner did not perform

¹ 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.

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L

Pro Forma Financial Information – Issues and IAASB Task Force Proposals

(i.e., an audit of the pro forma financial information or any of the underlying financial information).

8. In the light of these comments, the Task Force proposes that the ISAE establish a definition of the term “proper compilation” that focuses on the key steps involved in producing the pro forma financial information, i.e.:

The making of:

- (i) Appropriate adjustments on the basis of consistent accounting policies to unadjusted financial information that has been accurately extracted from an appropriate source or sources to reflect the significant effects of an underlying event or transaction on the unadjusted financial information; and
- (ii) Appropriate disclosures to enable intended users to understand the resulting pro forma financial information.

For the avoidance of doubt, this definition makes clear the following:

Pro forma financial information that has been produced as a result of this process is described as being properly compiled. *(See paragraph 8(e) of Agenda Item 3-B of the September 2009 IAASB meeting material).*

9. This definition is complemented by guidance in the application material that explains the key steps that are ordinarily involved in properly compiling pro forma financial information. *(See paragraph A3 of Agenda Item 3-B of the September 2009 IAASB meeting material).*
10. To minimize the potential for confusion with engagements to compile financial information, the Task Force also proposes that the ISAE make clear in its scope section that it does not deal with non-assurance engagements to compile financial statements, and that such engagements are dealt with in ISRS 4410². *(See paragraph 2 of Agenda Item 3-B of the September 2009 IAASB meeting material).*
11. In addition, while the Task Force proposes that the ISAE only mandate the inclusion of a *summary* of the practitioner’s procedures in the report *(see paragraph 50(h) of Agenda Item 3-B of the September 2009 IAASB meeting material)*, the Task Force believes that it would be helpful to provide an illustrative practitioner’s report in the ISAE showing how the practitioner may summarize that work in the report, based in large part on the key steps outlined in paragraph A3 of the proposed ISAE, i.e.:

Our procedures included comparing the unadjusted financial information with the source documents; assessing whether the pro forma financial information has been compiled on the basis of accounting policies consistent with those used by the company; considering the evidence supporting the pro forma adjustments; recomputing the calculation of the pro forma financial information; discussing the

² ISRS 4410, “Engagements to Compile Financial Statements.”

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L

Pro Forma Financial Information – Issues and IAASB Task Force Proposals

pro forma financial information with management; and evaluating the overall presentation and disclosure of the pro forma financial information. *(See Appendix 1 of Agenda Item 3-B of the September 2009 IAASB meeting material).*

12. However, the Task Force believes that it is important that users do not confuse a report on the proper compilation of pro forma financial information as conveying audit-level assurance on that information or any of the underlying financial information. Accordingly, the Task Force proposes that the ISAE mandate the inclusion of the following statements in the practitioner's report:
- (a) That the assurance engagement does not require an audit of the pro forma financial information or any of the underlying financial information, including the pro forma adjustments and the basis of compilation; and
 - (b) That the practitioner is not responsible for updating any reports or opinions on any financial information used in the compilation of the pro forma financial information, and for any events that occurred subsequent to the date of the practitioner's report. *(See paragraph 50(f)(ii) and (iii) of Agenda Item 3-B of the September 2009 IAASB meeting material).*

Matters for CAG Consideration

1. Do the Representatives agree with the proposed definition of the term “proper compilation?”
2. Do the Representatives agree with the proposed description of the work performed in the illustrative practitioner's report?
3. Do the Representatives agree with the proposed inclusion of the statements in paragraph 12(a) and (b) above in the practitioner's report?

REPORTING ON WHETHER THE UNDERLYING FINANCIAL INFORMATION HAS BEEN AUDITED

13. At the March 2009 meeting, some concern was expressed that the practitioner might issue a reasonable assurance report in an engagement to report on proper compilation of pro forma financial information without the sources of the underlying financial information (i.e. unadjusted financial information and any other financial information used in the compilation) having been audited. The IAASB generally agreed that transparency of reporting would be important in this context, i.e., if the sources have not been audited, the practitioner's report should clearly indicate so.
14. The Task Force has, however, further considered this matter. It has taken the general view that including a requirement in the proposed ISAE for the practitioner to report on whether the sources of the underlying financial information have been audited would not be appropriate. This is because the practitioner's primary objective is to report on whether the pro forma financial information has been properly compiled, and not on whether the sources of the underlying financial information have been audited. Further, in respect of the unadjusted financial information of the entity, the responsible party would already be

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L

Pro Forma Financial Information – Issues and IAASB Task Force Proposals

required under the benchmarks for the applicable criteria to disclose whether the source of that information has been audited *(see paragraph 11(b)(ii) of Agenda Item 3-B of the September 2009 IAASB meeting material)*. Accordingly, there is no obligation in the proposed ISAE for the practitioner report on whether the sources of the underlying financial information have been audited.

15. Nevertheless, the Task Force recognizes that the practitioner may consider it appropriate in the context of the engagement to state in the practitioner's report whether the sources of the unadjusted financial information and any other underlying financial information have been audited or reviewed. The Task Force has therefore provided some guidance to that effect in the proposed ISAE. *(See paragraph A54 of Agenda Item 3-B of the September 2009 IAASB meeting material)*.

Matter for CAG Consideration

4. Do the Representatives agree that the practitioner should not have an obligation to disclose in the practitioner's report whether the unadjusted financial information of the entity has been audited?

If so, do the Representatives agree that the practitioner should nevertheless be given the option of providing this information in the practitioner's report if considered appropriate?

WORK EFFORT REGARDING THE UNADJUSTED FINANCIAL INFORMATION

16. At its March 2009 meeting, the IAASB generally agreed that if the unadjusted financial information has not been audited or reviewed, the practitioner should be required to perform sufficient procedures to gain an understanding of the financial and reporting practices associated with that information, as well as other procedures necessary to support the expression of a positive opinion that the pro forma financial information has been properly compiled. The IAASB was of the general view that it would not be practicable to impose an audit or review requirement on the unadjusted financial information for purposes of reporting on the proper compilation of the pro forma financial information.
17. In the light of this general consensus, the Task Force proposes that the practitioner be required to perform a number of specified procedures as set out in the Appendix to this paper.³ In the Task Force's view, the source from which the unadjusted financial information is extracted will in practice ordinarily be audited or reviewed by the practitioner. Where this is not so (e.g., interim management accounts), it will often be the case that the practitioner will have audited or reviewed the prior period's financial information (e.g., annual financial statements). Accordingly, the Task Force believes that it is appropriate that the practitioner be required to perform the specified procedures set out in the Appendix to update as

³ These procedures are based mainly on procedures that the practitioner would ordinarily perform to update the practitioner's understanding of the entity and its environment in a review engagement performed under ISRE 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity."

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L

Pro Forma Financial Information – Issues and IAASB Task Force Proposals

necessary the understanding that the practitioner may have obtained from performing audits or reviews of the entity's prior period financial information. Doing so thus enables the practitioner to gain a sufficient understanding of the financial and reporting practices associated with the unadjusted financial information without going so far as to undertake a full scope review of that information.

18. Where the practitioner has never been engaged to audit or review the entity's financial information, performing the specified procedures would be necessary for the practitioner to obtain the required understanding. Similarly, where additional underlying financial information (such as financial information of businesses that are being acquired or divested) is used in the compilation of the pro forma financial information and such underlying financial information has not been audited or reviewed by the practitioner, the Task Force believes that the practitioner should perform the specified procedures as appropriate in relation to that information to obtain sufficient appropriate evidence that the underlying financial information provides a reasonable basis for the pro forma adjustments (*see paragraphs 28-29 of Agenda Item 3-B of the September 2009 IAASB meeting material*).
19. The Task Force believes that these procedures should in practice not be unduly burdensome, as practitioners may already be performing them in such situations.

Matter for CAG Consideration

5. Do the Representatives agree with the proposed nature and extent of work that the practitioner should perform on the unadjusted financial information of the entity if it has not been audited or reviewed by the practitioner?
6. Do the Representatives agree that similar procedures should apply as appropriate with regard to the underlying financial information of businesses that are being acquired or carved out?

MODIFIED OPINIONS

Modified Opinion on Proper Compilation of Pro Forma Financial Information

20. Circumstances may arise in which the practitioner may be unable to issue an unmodified opinion with regard to the proper compilation of the pro forma financial information. This may be because the practitioner concludes from the evidence obtained that the compilation of the pro forma financial information is not free from material misstatement, or because the practitioner is unable to obtain sufficient appropriate evidence to conclude that the compilation of the pro forma financial information is free from material misstatement. The Task Force, however, recognizes that in most jurisdictions, the relevant securities exchange will not accept a prospectus that includes pro forma financial information in respect of which a modified opinion has been issued regarding the proper compilation of such information.

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L

Pro Forma Financial Information – Issues and IAASB Task Force Proposals

21. Nevertheless, consistent with the umbrella assurance standard ISAE 3000,⁴ the Task Force has included a section on modified opinions in the proposed ISAE to cater for the rare circumstances where a securities exchange may accept a prospectus containing a practitioner's report with a modified opinion on the proper compilation of pro forma financial information included in the prospectus. **(See paragraphs 36-46 of Agenda Item 3-B of the September 2009 IAASB meeting material).** The inclusion of such a section in the proposed ISAE is not to suggest that modified opinions on the proper compilation of pro forma financial information are routine occurrences or that securities exchanges will readily accept prospectuses containing them. To make this clear, the Task Force has included guidance in the proposed ISAE to emphasize that in most jurisdictions, securities exchanges do not accept prospectuses that contain modified opinions on the proper compilation of pro forma financial information. **(See paragraph A46 of Agenda Item 3-B of the September 2009 IAASB meeting material).**
22. In addition, while the Task Force has provided an illustrative practitioner's report containing a qualified opinion **(see Appendix 2 of Agenda Item 3-B of the September 2009 IAASB meeting material)**, it decided not to provide additional illustrative reports containing modified opinions (e.g. adverse opinions and disclaimers of opinion) to avoid suggesting that modifications to the practitioner's opinion are anything other than rare occurrences.

Matter for CAG Consideration

7. Do the Representatives agree with the Task Force's proposal to include a section on modified opinions in the proposed ISAE, even though securities exchanges generally do not accept prospectuses containing modified opinions with regard to pro forma financial information?

Modified Audit Opinion or Review Conclusion on, or Emphasis of Matter Paragraphs with Respect to, the Unadjusted Financial Information

23. Circumstances may also arise where a modified audit opinion or review conclusion has been issued, or where an emphasis of matter has been made, with respect to the source of the unadjusted financial information that is used for the compilation of the pro forma financial information. The Task Force believes that some jurisdictions may not permit the use of, or reference in the practitioner's report to, such a source of the unadjusted financial information. Nevertheless, there may be jurisdictions where the relevant law or regulation is silent as to whether such a source of the unadjusted financial information may be used or referred to in the practitioner's report. In such cases, if a modified audit opinion or review conclusion has been issued regarding the source being used, or if the report thereon includes an Emphasis of Matter paragraph, the Task Force believes that the practitioner should first consider the potential effect on the pro forma financial information before considering the

⁴ ISAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information."

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L

Pro Forma Financial Information – Issues and IAASB Task Force Proposals

need for further action *(see paragraph 23 of Agenda Item 3-B of the September 2009 IAASB meeting material)*. This is because a modified audit opinion or review conclusion, or an Emphasis of Matter paragraph, with respect to the source of the unadjusted financial information may not necessarily have an effect on the pro forma financial information. To make this clear, the Task Force has provided guidance to that effect in the proposed ISAE. *(See paragraph A41 of Agenda Item 3-B of the September 2009 IAASB meeting material)*.

24. Largely for the latter reason, the Task Force also proposes that the ISAE not mandate that the practitioner disclose in the practitioner's report whether a modified audit opinion or review conclusion has been issued with respect to the source of the unadjusted financial information. Nevertheless, the Task Force has provided guidance in the proposed ISAE to indicate that the practitioner has the option of disclosing such a fact in the practitioner's report. *(See paragraph A54 of Agenda Item 3-B of the September 2009 IAASB meeting material)*.

Matters for CAG Consideration

8. Do the Representatives agree with the Task Force's proposal that if a modified audit opinion or review conclusion has been issued with respect to the source of the unadjusted financial information, or if the report thereon contains an emphasis of matter, the practitioner should first consider the potential effect on the pro forma financial information before considering whether further action is needed?
9. Do the Representatives agree with the Task Force's proposal that if a modified audit opinion or review conclusion has been issued with respect to the source of the unadjusted financial information, or if the report thereon contains an emphasis of matter, the practitioner should not have an obligation to disclose that fact in the practitioner's report?
10. What are the Representatives' views on the implications from a securities exchange's perspective if the practitioner were to make such a disclosure?

INTERACTION WITH ISAE 3000

25. Given that ISAE 3000 is the overarching standard for assurance engagements other than audits or reviews of historical financial information, the Task Force has taken the view that the proposed ISAE 34XX should not repeat requirements that are already specified in the former unless it is necessary to expand on these requirements in the specific circumstances of engagements within the scope of the latter. Accordingly, the Task Force proposes that the scope section of the proposed ISAE 34XX include the following explanation:

The performance of assurance engagements other than audits or reviews of historical financial information requires the practitioner to comply with ISAE 3000. ISAE 3000 includes requirements in relation to such topics as engagement acceptance, planning, evidence, and documentation that apply to all assurance engagements, including engagements in accordance with this ISAE. This ISAE expands on how ISAE 3000 is to be applied in a reasonable assurance engagement to report on the

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L

Pro Forma Financial Information – Issues and IAASB Task Force Proposals

proper compilation of pro forma financial information included in a prospectus. The Assurance Framework, which defines and describes the elements and objectives of an assurance engagement, provides context for understanding this ISAE and ISAE 3000. *(See paragraph 4 of Agenda Item 3-B of the September 2009 IAASB meeting material).*

26. Nevertheless, to ensure that practitioners comply with ISAE 3000 in addition to the proposed ISAE 34XX when performing assurance engagements in accordance with the latter, the Task Force has included the following requirement in the proposed ISAE:

The practitioner shall not represent compliance with ISAEs unless the practitioner has complied with the requirements of this ISAE and ISAE 3000. *(See paragraph 9 of Agenda Item 3-B of the September 2009 IAASB meeting material).*

Matter for CAG Consideration

11. Do the Representatives agree with the Task Force's proposed approach to linking the proposed ISAE 34XX with ISAE 3000?

Material Presented – IAASB CAG PAPER

Agenda Item L.1

Pro Forma Financial Information in Prospectuses—
Report Back on Proposals Discussed at the March
2009 IAASB CAG Meeting

Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

Agenda Item 3-B of the September 2009
IAASB Meeting – Proposed ISAE 34XX,
“Assurance Reports on the Proper
Compilation of Pro Forma Financial
Information Included in Prospectuses”

[http://www.ifac.org/IAASB/Meeting-
FileDL.php?FID=4941](http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4941)

Action Requested

27. The Representatives are asked to consider the significant issues highlighted in this paper and to comment on the Task Force's preliminary recommendations.

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L

Pro Forma Financial Information – Issues and IAASB Task Force Proposals

APPENDIX

Proposed Work Effort When Unadjusted Financial Information Has Not Been Audited or Reviewed by the Practitioner

- (a) Inquiring of the responsible party about:
 - (i) The process by which the source of the unadjusted financial information has been prepared and the reliability of the underlying accounting records to which the financial information is agreed or reconciled;
 - (ii) Whether all transactions have been recorded;
 - (iii) Whether the source of the unadjusted financial information has been prepared in accordance with accounting policies consistent with the entity's historical financial statements;
 - (iv) Whether there have been any changes to accounting policies from the prior period and, if so, how the responsible party has dealt with them;
 - (v) The responsible party's assessment of the risk that the source of the unadjusted financial information may be materially misstated as a result of fraud;
 - (vi) The effect of changes in the entity's business activities and operations; and
 - (vii) Any significant changes in internal control and the potential effect of any such changes on the preparation of the source of the unadjusted financial information.
- (b) Checking that the source of the unadjusted financial information agrees with the underlying accounting records;
- (c) If the practitioner has not previously been engaged by the entity to audit or review the entity's financial information, reading the financial information (including the audit or review report) and, where appropriate and practicable, the other practitioner's working papers for the most recent audit or review of the entity's financial information to the extent necessary to identify matters that may affect the unadjusted financial information;
- (d) Comparing the source of the unadjusted financial information with the prior period financial information and, as appropriate, the most recent annual or interim financial information; and
- (e) Considering:
 - (i) The impact of any corrected material misstatements and the potential impact of any identified uncorrected misstatements in the prior period's audited or reviewed financial statements;
 - (ii) Significant financial reporting matters that may be of continuing significance, such as significant deficiencies in internal control;
 - (iii) If appropriate, the results of any audit procedures the practitioner has performed with respect to the current period's financial information; and

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L

Pro Forma Financial Information – Issues and IAASB Task Force Proposals

- (iv) The results of any internal audit or other monitoring performed by the entity with respect to financial reporting and the subsequent actions taken by the responsible party. *(See paragraph 20 of Agenda Item 3-B of the September 2009 IAASB meeting material)*