

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L.1

Pro Forma Financial Information—Report Back

Pro Forma Financial Information in Prospectuses—Report Back

Objective of Agenda Item

1. The objective of this Agenda Item is to provide a brief report back on proposals of Representatives regarding the development of a proposed International Standard on Assurance Engagements 34XX, “Assurance Reports on the Proper Compilation of Pro Forma Financial Information Included in Prospectuses,” discussed at the March 2009 CAG Meeting.

March 2009 CAG Proposals

2. Below is an extract from the draft minutes of the March 2009 CAG meeting¹ and an indication of how the IAASB Task Force or the IAASB responded to the Representatives’ comments.

Representatives’ Comments	Task Force/IAASB Response
MEANING OF “PROPERLY COMPILED”	
<p>Mr. Swanney noted that 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. He also noted that as law or regulation or market practice in some jurisdictions may use the term “properly prepared” in place of “properly compiled” to describe the matter on which the practitioner is reporting, the Task Force 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.</p> <p>The Representatives commented as follows:</p>	-

¹ The minutes will be approved at the September 2009 CAG meeting.

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L.1

Pro Forma Financial Information—Report Back

Representatives' Comments	Task Force/IAASB Response
<ul style="list-style-type: none"> Ms. Blomme was of the view that it will be very important that there be coordination between this project and IAASB's projects to revise ISAE 3000, ISRE 2400 and ISRS 4410 to ensure consistency between them in terms of use of concepts and terminology. 	<p>Point accepted.</p> <p>The IAASB noted the need for coordination among the task forces for these various projects at its March 2009 meeting. The IAASB will further consider the matter at its September 2009 meeting, when drafts of ISAE 3402,² 3410³ and 34xx will be tabled.</p>
<ul style="list-style-type: none"> Mr. Fleck was of the view that users want to know that the compilation of the pro forma financial information has been done properly. He therefore supported the Task Force's view that the focus of the engagement should be on providing assurance on the process of compiling the pro forma information and not on the pro forma information itself. Mr. Damant supported this view. 	<p>Point accepted.</p>
<ul style="list-style-type: none"> With regard to use of the term "properly prepared" versus "properly compiled" to describe the matter on which the practitioner is reporting, Mr. Damant was of the view that the latter is far better as it suggests a narrower remit. Mr. Fleck supported this view. 	<p>Point accepted.</p> <p>The IAASB generally agreed that the practitioner should report in terms of whether the pro forma financial information has been properly compiled.</p>
<ul style="list-style-type: none"> Mr. Johnson was of the view that the terms "compiled" and "prepared" are fundamentally different, and to imply that they are the same would be misleading. Mr. Fleck supported this view, noting that the term "prepared" is used in some jurisdictions with a unique connotation. 	<p>Point accepted.</p>
<ul style="list-style-type: none"> Mr. Morris was of the view that neither term does justice to the nature of work actually performed when compiling pro forma financial information. 	<p>Point taken into account.</p> <p>The Task Force is proposing to define what the term "proper compilation" means and to make it clear that pro forma financial information that has been produced as a result of the compilation process is</p>

² ISAE 3402, "Assurance Reports on Controls at a Service Organization."

³ ISAE 3410, "Assurance on a Greenhouse Gas Statement."

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L.1

Pro Forma Financial Information—Report Back

Representatives' Comments	Task Force/IAASB Response
	<p>information that has been “properly compiled.” In addition, the Task Force is proposing guidance that outlines broadly the nature of the work that is expected when the responsible party compiles the pro forma financial information.</p> <p><i>See paragraphs 8(e) and A3 of Agenda Item 3-B of the September 2009 IAASB meeting material.</i></p>
<ul style="list-style-type: none"> Mr. Morris suggested that the proposed standard elaborate on the meaning of the term “pro forma financial information.” 	<p>Point accepted.</p> <p><i>See paragraph 8(a) of Agenda Item 3-B of the September 2009 IAASB meeting material.</i></p>
NATURE AND LEVEL OF ASSURANCE PROVIDED IN AN ENGAGEMENT TO REPORT ON PRO FORMA FINANCIAL INFORMATION	
<p>Mr. Swanney noted that widespread general expectation is that reasonable assurance is what is expected in most markets and what countries require in engagements to report on pro forma financial information. Nevertheless, a minority of jurisdictions requires or permits 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.</p> <p>The Representatives commented as follows:</p>	-
<ul style="list-style-type: none"> Mr. Waldron was of the view that users would expect that reasonable assurance has been obtained. Messrs. Fleck, White and Damant supported this view, noting that pro forma financial information is commonly used in connection with transactions that involve an important interaction with the investment community, i.e., the investment community will be investing on the basis of the pro forma financial information. 	<p>Point accepted.</p> <p>The IAASB agreed that the standard should deal only with reasonable assurance engagements.</p>

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L.1

Pro Forma Financial Information—Report Back

Representatives' Comments	Task Force/IAASB Response
<ul style="list-style-type: none"> Mr. Fleck was of the view that if national legislation or regulation requires some level of assurance lower than reasonable assurance, then this is an issue to be addressed at the national level. In his opinion, the fact that there are a few jurisdictions where reasonable assurance is not required is not a sufficient justification for the IAASB to develop a less-stringent international standard. 	Point accepted.
<ul style="list-style-type: none"> Mr. White expressed support for the Task Force's recommendation. He was of the view that the standard should focus on reasonable assurance, as the starting point. However, it should allow for limited assurance where that is required by local legislation or regulation. In such cases, the standard should require explicit disclosure in the practitioner's report that limited assurance, rather than reasonable assurance, has been obtained and an explanation of the fundamental differences between these two levels of assurance. Ms. Blomme supported this view. 	<p>Point taken into account.</p> <p>The IAASB determined that the standard should deal only with reasonable assurance engagements to avoid over-complicating the standard for the relatively few jurisdictions that may mandate limited assurance engagements. The Task Force accepted the point made above that the matter is one that should be dealt with at the national level.</p>
ACCEPTABILITY OF FRAMEWORK FOR COMPILATIONS	
<p>Mr. Swanney summarized the Task Force's view that determining the acceptability of the framework for compiling the pro forma financial information should be a condition for engagement acceptance, and 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.</p> <p>The Representatives commented as follows:</p>	-
<ul style="list-style-type: none"> Mr. Fleck expressed support for the recommendations of the Task Force. He noted that the UK Auditing Practices Board (APB) 	<p>Point accepted.</p> <p>The IAASB generally agreed that providing</p>

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L.1

Pro Forma Financial Information—Report Back

Representatives' Comments	Task Force/IAASB Response
<p>has produced guidance for similar purposes. This guidance was approved by the UK Financial Services Authority and presented as an annex to the APB's standard on pro forma financial information to avoid the argument that the APB has been an arbiter of an accounting framework.</p>	<p>benchmarks in the standard would help to advance practice in this area, which is in the public interest. The IAASB also agreed that the proposed benchmarks are of a sufficiently general nature that they should not be regarded as representing accounting standards. Nevertheless, the IAASB accepted that it would be appropriate to further consult on the matter. Accordingly, it agreed that the explanatory memorandum to the exposure draft should include a specific question on the appropriateness of including these benchmarks in the standard.</p> <p><i>See paragraphs 11-12 of Agenda Item 3-B of the September 2009 IAASB meeting material.</i></p>
WORK EFFORT REGARDING THE UNADJUSTED FINANCIAL INFORMATION	
<p>Mr. Swanney explained that the majority of Task Force believes that it is not feasible to mandate that the unadjusted financial information be audited or reviewed 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. Further, imposing such a requirement would significantly increase the time and cost of the engagement. 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 the unadjusted financial information previously had not been audited or reviewed. However, 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. Regardless of the work effort on</p>	<p>-</p>

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L.1

Pro Forma Financial Information—Report Back

Representatives' Comments	Task Force/IAASB Response
<p>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.</p> <p>The Representatives commented as follows:</p>	
<ul style="list-style-type: none"> Mr. Fleck was of the view that a requirement to disclose whether the underlying information is audited or not is key to avoid misleading information and misunderstanding by users. 	<p>Point taken into account.</p> <p>The Task Force has generally taken the view that imposing such a requirement on the practitioner would not be appropriate given that the primary objective of the engagement is to report on whether the pro forma financial information has been properly compiled, and not on whether the underlying financial information has been audited. Further, one of the applicable criteria for compiling the pro forma financial information is disclosure by the responsible party of whether the source of the unadjusted financial information has been audited. Accordingly, this disclosure should in practice already be made by the responsible party.</p> <p>Nevertheless, the Task Force is proposing guidance to the effect that the practitioner may choose to disclose such matter in the practitioner's report if considered appropriate.</p> <p><i>See paragraph A54 of Agenda Item 3-B of the September 2009 IAASB meeting material.</i></p>
<ul style="list-style-type: none"> Messrs. Fogarty, Pickeur, Scates and Damant were of the view that it would seem peculiar to suggest that the practitioner obtain reasonable assurance on the process of compiling the pro forma financial information while the underlying financial information has not been audited or reviewed. Mr. Fogarty indicated that even with full disclosure the situation is likely to provide a false sense of security that the underlying data is better than it may actually be. Mr. Pickeur suggested that it is confusing to 	<p>Point taken into account.</p> <p>The IAASB noted that it would be difficult to mandate an audit or a review of the unadjusted financial information if law or regulation itself does not impose such a requirement. Nevertheless, the IAASB accepted that the practitioner should perform sufficient procedures on the source(s) of the unadjusted financial information and any other underlying financial information to provide a reasonable basis for the practitioner to report on</p>

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L.1

Pro Forma Financial Information—Report Back

Representatives' Comments	Task Force/IAASB Response
<p>provide a higher level of assurance on the process of compilation than that obtained on the underlying information. Mr. Scates indicated that providing assurance on the compilation process where the underlying data is not audited or reviewed would increase the expectations gap. He was also of the view that there is a significant risk to the practitioner of being associated with information that has not been audited or reviewed. Mr. Damant indicated that the analogy is constructing a building on shifting ground.</p>	<p>whether the pro forma financial information has been properly compiled.</p> <p><i>See paragraphs 20 and 28-29 of Agenda Item 3-B of the September 2009 IAASB meeting material.</i></p>
<ul style="list-style-type: none"> Ms. Blomme was of the view that the ISAE should not impose a condition in all cases that the unadjusted financial information be audited or reviewed. To do so would introduce a major conflict with EU legislation. She indicated that FEE will write to the Task Force explaining its views on the matter. 	<p>Point accepted.</p>
<ul style="list-style-type: none"> Mr. Morris noted that it is important for the Task Force to consider “carve-out” situations, for example where the financial statements of an entity as a whole have been audited but the transaction involves the carve-out of a single division of the entity and the financial information of that division has not been audited. Mr. Johnson supported this view, and suggested that the Task Force consider whether additional procedures by the practitioner should be required in such circumstances. 	<p>Point accepted.</p> <p>The Task Force agrees that the practitioner should also perform sufficient procedures on the financial information of the business that has been carved out if that information has not been audited or reviewed.</p> <p><i>See paragraph 29 of Agenda Item 3-B of the September 2009 IAASB meeting material.</i></p>
CONSISTENCY OF ACCOUNTING POLICIES	
<p>Mr. Swanney noted that 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 pro forma adjustments that are made should be consistent with the issuer's accounting policies.</p>	<p>-</p>

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L.1

Pro Forma Financial Information—Report Back

Representatives' Comments	Task Force/IAASB Response
<p>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. The Task Force recommends, therefore, 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.</p> <p>The Representatives commented as follows:</p>	
<ul style="list-style-type: none"> Mr. White was of the view that the Task Force's proposal does not go far enough. He suggested that it should also be made clear in the practitioner's report that while adjustments have been made to achieve consistency of accounting policies adopted by the issuer, the underlying financial statements of the non-issuing entity have not been audited on the basis of those accounting policies. 	<p>Point accepted.</p> <p>The Task Force agreed that, for the avoidance of doubt, there should be a requirement for the practitioner to make clear in the report 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.</p> <p><i>See paragraph 50(f)(ii) of Agenda Item 3-B of the September 2009 IAASB meeting material.</i></p>
<p>"ASSUMPTIONS" UNDERLYING THE COMPILATION OF PRO FORMA FINANCIAL INFORMATION AND RELATED WORK EFFORT</p>	
<p>Mr. Swanney noted that the term "assumptions" in the context of a compilation of pro forma financial information is different from forward-looking assumptions that may be made in the context of prospective financial information or accounting estimates. The Task Force believes that it would be appropriate to provide guidance to explain what "assumptions" generally mean in the context of the proposed ISAE, 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.</p> <p>The Representatives commented as follows:</p>	-

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L.1

Pro Forma Financial Information—Report Back

Representatives' Comments	Task Force/IAASB Response
<ul style="list-style-type: none"> Mr. Damant noted that accuracy in terminology is particularly important in the context of adoption and translation of the standard in different jurisdictions. Mr. Fleck supported this view, and suggested that “basis for compilation” might be a more suitable phrase than “assumptions.” 	<p>Point accepted.</p> <p>The Task Force is proposing to define the term “basis of compilation” and to provide guidance to illustrate what is intended.</p> <p><i>See paragraphs 8(b) and A6 of Agenda Item 3-B of the September 2009 IAASB meeting material.</i></p>
RESPONSIBILITY FOR EVALUATING WHETHER PRO FORMA FINANCIAL INFORMATION IS MISLEADING	
<p>Mr. Swanney noted that 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.</p> <p>The Representatives commented as follows:</p>	-
<ul style="list-style-type: none"> Ms. Sucher expressed her personal view that the entire point of having a practitioner involved with pro forma financial information is to enhance the credibility of that information. She therefore supports the notion that there should be some responsibility to stand-back to consider whether the pro forma financial information is misleading, notwithstanding the difficulty in making this judgment. Mr. White supported this view, noting that the stand-back function is especially important in this context as the risk that the pro form financial information is contra-factual is greater than in an audit of historical financial statements. 	<p>Point accepted.</p> <p><i>See paragraph 31(b) of Agenda Item 3-B of the September 2009 IAASB meeting material.</i></p>
<ul style="list-style-type: none"> Mr. Fleck suggested that the Task Force consider examining the issue from the perspective of three categories: (i) whether the resulting information is consistent with understanding of the information obtained; (ii) whether subsequent events, such as significant changes in the environment, have occurred that may affect the overall reasonableness of the pro 	<p>Point taken into account.</p> <p>The IAASB generally noted that it is a matter for regulators to determine whether the practitioner should have a responsibility regarding subsequent events. The Task Force also noted that applicable criteria for the compilation of pro forma financial information ordinarily do not require the responsible</p>

IAASB CAG PAPER

IAASB CAG Agenda (September 2009)

Agenda Item L.1

Pro Forma Financial Information—Report Back

Representatives' Comments	Task Force/IAASB Response
forma financial information; and (iii) whether the practitioner is potentially associated with misleading information.	<p>party to adjust the unadjusted financial information or any other underlying financial information for subsequent events. Accordingly, notwithstanding the need for the practitioner to avoid being associated with misleading information, the Task Force is of the view that it would be inappropriate to impose an obligation on the practitioner to obtain evidence and report on the effects of subsequent events. The Task Force has provided guidance to that effect in the proposed standard.</p> <p><i>See paragraph A45 of Agenda Item 3-B of the September 2009 IAASB meeting material.</i></p>

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>