

*Proposed International Standard on Assurance  
Engagements*

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ISAE 3420, Assurance Reports on the  
Process to Compile Pro Forma  
Financial Information Included in a  
Prospectus



## REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB) approved this exposure draft, proposed International Standard on Assurance Engagements (ISAE) 3420, *Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus*, for publication in April 2010. This proposed ISAE may be modified in light of comments received before being issued in final form.

Respondents are asked to submit their comments **electronically** through the IAASB website ([www.iaasb.org](http://www.iaasb.org)), using the “Submit a Comment” link on the Exposure Drafts and Consultation Papers page. Please note that first-time users must register to use this new feature. All comments will be considered a matter of public record and will ultimately be posted on the IAASB website.

Comments can also be faxed to the attention of the IAASB Technical Director at +1 (212) 856-9420, or mailed to:

Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York 10017 USA

Comments should be submitted by **September 30, 2010**.

Copies of this exposure draft may be downloaded free of charge from the IAASB website at [www.iaasb.org](http://www.iaasb.org).

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance.

The objective of the IAASB is to serve the public interest by setting high-quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The structures and processes that support the operations of the IAASB are facilitated by IFAC. The mission of IFAC is to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession’s expertise is most relevant.

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## EXPLANATORY MEMORANDUM

### Introduction

This memorandum provides background to, and an explanation of, the proposed International Standard on Assurance Engagements (ISAE) 3420, *Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus*. The International Auditing and Assurance Standards Board (IAASB) approved the proposed ISAE in March 2010 for exposure.

### Background

The increasingly integrated nature of global capital markets has given rise to greater opportunities for issuers to raise capital, and investors to invest capital, on an international rather than a local basis. Efficient international capital market transactions require information that is understandable across borders, together with assurance designed to enhance users' confidence in how that information has been produced. In the European Union (EU), for example, issuers can now "passport" a prospectus (i.e., a prospectus approved by an appropriate regulator in the issuer's own member state can be used to offer securities into any other EU member state without the need for any additional approval). This has led to an increase in the number of multi-jurisdictional offerings in the EU. This positive outcome has, however, brought into sharp focus differences in reporting practices within the EU. As a result, a clear need has arisen for common assurance standards throughout the EU in relation to pro forma financial information (PFI)<sup>1</sup> included in a prospectus. Representatives from jurisdictions outside the EU, such as Brazil, China (mainland), Hong Kong, Singapore and South Africa, have also highlighted to the IAASB the need for common standards of reporting in relation to such financial information that can be consistently applied internationally.

Recognizing that there may be potential difficulties in developing an international standard in relation to PFI because of differences in legal and regulatory frameworks around the world, the IAASB decided on 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 IAASB identified the prospectus regime<sup>2</sup> in the European Union (EU) as an appropriate starting point.

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<sup>1</sup> PFI is financial information that illustrates, through making appropriate adjustments, the impact of an event or transaction on unadjusted financial information of the issuer assuming that the event or transaction had occurred at an earlier date used for the illustration. This is achieved by applying pro forma adjustments to the unadjusted financial information. PFI in and of itself does not represent the issuer's actual financial position, financial performance, or cash flows. PFI is generally presented in columnar format consisting of (a) the unadjusted financial information of the issuer; (b) the pro forma adjustments; and (c) the resulting PFI.

<sup>2</sup> A European regime for prospectuses became effective on July 1, 2005 with the introduction of Directive 2003/71/EC (the Prospectus Directive) and Regulation EC 809/2004 (the Prospectus Regulation) in the EU. The Prospectus Directive and Regulation were part of the 'Implementing the Framework for Financial Markets: Action Plan' published by the European Commission in 1999. The action plan identified a series of legislative actions needed in order to deliver components of a single European Capital Market. The Prospectus Directive can be accessed at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:345:0064:0089:EN:PDF>. The Prospectus Regulation can be accessed at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:149:0001:0126:EN:PDF>

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While there was a concern about embarking on this 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 EU requirements as there seemed to be already broad consensus within the EU regarding what a compilation of PFI entails,<sup>3</sup> which would provide a strong basis for the project. In addition, the IAASB noted the active support for this project from the European securities regulators. Nevertheless, recognizing the importance for the project to be regarded as one that is not limited to the EU, the IAASB undertook further research<sup>4</sup> into how such a standard would be used in other jurisdictions.

The outcome of this research indicated that a number of jurisdictions outside the EU (e.g. Hong Kong, Malaysia, Singapore and South Africa) had regulatory reporting requirements similar to those in the EU. In addition, the research pointed to the absence of specific and relevant standards and guidance on this topic in several other jurisdictions, suggesting the potential for developing and advancing practice in this area around the world. On this basis, the IAASB proceeded to develop a proposed ISAE for assurance engagements to report in relation to PFI included in a prospectus. Proposed ISAE 3420, which is now being exposed, represents the outcome of the IAASB's deliberations on this project to date.

The IAASB believes that the proposed ISAE will help market practice converge around the world by establishing clear, globally accepted benchmarks for practitioners to perform engagements within the scope of the proposed standard. The proposed ISAE will promote practice and guide practitioners' performance of these engagements in jurisdictions that currently do not have local standards in this area. Importantly, a common international standard will help eliminate the confusion and lack of clarity that currently exist because of the diversity of practice in different jurisdictions. In addition, the IAASB believes that the proposed ISAE will help practitioners better meet user expectations with regard to the consistency and quality of performance and reporting from one jurisdiction to another.

### Drafting Conventions

Consistent with the approach taken for ISAE 3402,<sup>5</sup> the proposed ISAE has been drafted using the conventions developed for International Standards on Auditing by the IAASB ("the clarity drafting conventions"). The IAASB believes it is appropriate to use the clarity drafting conventions in drafting ISAEs, as it represents the IAASB's view of the clearest way of presenting standards so as to distinguish requirements from guidance and promote consistent interpretation and performance by practitioners.

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<sup>3</sup> This was based, in particular, 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*.

<sup>4</sup> The research took the form of a survey of 19 non-EU jurisdictions regarding their regulatory requirements pertaining to the preparation of, and reporting in relation to, PFI, and the nature of any related national assurance standards and guidance. The 19 non-EU jurisdictions surveyed were: 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.

<sup>5</sup> ISAE 3402, *Assurance Reports on Controls at a Service Organization*, issued in December 2009.

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## Significant Matters

### Objectives and Focus of the Proposed ISAE

In considering the EU prospectus regime as the starting point for this project, the IAASB noted that the Prospectus Regulation requires the practitioner to provide an opinion that includes a positive statement “that the pro forma financial information has been *properly compiled* on the basis stated.” However, the regulation does not elaborate on the meaning of the term “properly compiled.” The IAASB recognized that two possible interpretations might be made in this regard, i.e., the practitioner is being asked to provide assurance on:

- (a) The process to compile the PFI;<sup>6</sup> or
- (b) The PFI itself.

In determining what the objectives and focus of the proposed ISAE should be, the IAASB considered relevant assurance standards in a number of countries within and outside the EU as well as existing market practice around the world regarding reporting in relation to PFI. In several jurisdictions,<sup>7</sup> practitioners obtain and convey reasonable assurance on the *process* to compile the PFI and not on the PFI itself. While practices in other jurisdictions may concern the provision of reasonable assurance on the PFI itself, the IAASB generally felt that for purposes of this ISAE, a focus on the process would align with the input received. The focus on reporting on the process also was generally supported by the IAASB Consultative Advisory Group.

On this basis, the IAASB determined that the objectives of the proposed ISAE should be for the practitioner to:<sup>8</sup>

- (a) Obtain reasonable assurance about whether the process to compile the PFI has been applied by the responsible party in accordance with the applicable criteria; and
- (b) Report in accordance with the practitioner’s findings.

To distinguish between reporting on the process and reporting on the PFI, and to emphasize the focus on the process, the proposed ISAE:

- Makes clear upfront that the practitioner’s report does not include the expression of an opinion on the PFI itself or on the unadjusted or any other underlying financial information,<sup>9</sup> and
- Requires the practitioner’s report to clearly describe the practitioner’s responsibility to express an opinion on the process, and include a statement that the practitioner has not performed an audit or review of the PFI and, accordingly, does not express an opinion on the PFI.<sup>10</sup>

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<sup>6</sup> In this context, the process to compile PFI generally involves the responsible party taking steps that include the following:

- Identifying the source of the unadjusted financial information to be used in compiling the pro forma financial information, and extracting the unadjusted financial information from that source;
- Making pro forma adjustments to the unadjusted financial information for the purpose for which the pro forma financial information is presented; and
- Presenting the resulting pro forma financial information with accompanying disclosures.

<sup>7</sup> For example, Hong Kong, Malaysia, Singapore, South Africa and the UK.

<sup>8</sup> Proposed ISAE 3420, paragraph 9.

<sup>9</sup> Proposed ISAE 3420, paragraph 2.

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Notwithstanding the approach taken with regard to the objectives, the IAASB believes that it would be appropriate to take this opportunity to seek respondents' views on the desirability of developing an international standard on reporting on the PFI itself (see the section "Request for Specific Comments" on page 10).

### *The Practitioner's Opinion*

In many jurisdictions, no requirement exists in law or regulation in relation to the wording of the opinion that the practitioner should express when reporting in relation to PFI. In some jurisdictions (including the EU), however, the wording of the practitioner's opinion has been specifically prescribed by law or regulation in terms of whether the PFI has been properly compiled on the basis stated.

In order to maximize the global applicability of the proposed ISAE while maintaining compatibility with existing legal or regulatory requirements, the IAASB proposes the following two alternative wordings of the opinion that the practitioner may use in meeting the requirement to express an opinion on the proper application of the process to compile the PFI:<sup>11</sup>

- Whether the process to compile the PFI has, in all material respects, been applied in accordance with the applicable criteria; or
- Whether the PFI has been properly compiled on the basis stated.

In this regard, the proposed ISAE explains that describing the PFI as being "properly compiled" means that the process to compile the PFI has, in all material respects, been applied by the responsible party in accordance with the applicable criteria.<sup>12</sup> It also proposes guidance that explains the meaning of the term "basis stated" in the context of an engagement to report on the process to compile PFI.<sup>13</sup>

The IAASB is of the view that it should be clear that either form of the opinion, read in the context of the practitioner's report *as a whole*, is addressing the process to compile the PFI and not the PFI itself.

### **Terminology**

A primary consideration for the IAASB in developing this proposed standard was whether to use the terms "compile" and "compilation" to describe the process of producing the PFI. A concern that arose was the potential for confusion among users given that these terms are already used in ISRS 4410<sup>14</sup> in connection with engagements to compile financial statements, and the strong association of these terms with such engagements in some jurisdictions. The IAASB, however, also noted that these terms are well established in relevant law or regulation and market practice in a number of jurisdictions (including the EU) in relation to reporting on the process of producing the PFI.

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<sup>10</sup> Proposed ISAE 3420, paragraph 31(e).

<sup>11</sup> Proposed ISAE 3420, paragraphs 31(h) and A52.

<sup>12</sup> Proposed ISAE 3420, paragraph 5.

<sup>13</sup> Proposed ISAE 3420, paragraph A7.

<sup>14</sup> ISRS 4410, *Engagements to Compile Financial Statements*.

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The IAASB is of the view that it would not be appropriate to use alternative terms to describe the process. The IAASB believes that the benefit of maintaining compatibility with terminology used in existing legal or regulatory requirements and market practice in several jurisdictions around the world pertaining to reporting in relation to PFI – and thereby ensuring the applicability of the proposed standard in those jurisdictions that already use such terminology – would outweigh any potential confusion that might arise from using the same terms that are associated with engagements to compile financial statements.

Importantly, the IAASB is of the view that the contexts in which these two terms are used in ISRS 4410 and the proposed ISAE are very different. In an engagement to compile financial statements, the practitioner is using accounting expertise, as opposed to assurance expertise, to collect, classify and summarize financial information. The compilation is done by the practitioner and no assurance is provided. In an engagement under the proposed ISAE, however, the process to compile the PFI is applied by the responsible party, as opposed to the practitioner, and the practitioner's sole responsibility is to express an opinion in the positive form on the application of that process. To avoid any possible confusion, the introductory section of the proposed ISAE explains this distinction.<sup>15</sup>

### **Suitable Criteria**

The existence of suitable criteria is a prerequisite for any assurance engagement. For an assurance engagement to report on the process to compile PFI, suitable criteria are required for evaluating whether that process has, in all material respects, been appropriately applied by the responsible party.

Unlike a financial reporting framework that is used to prepare financial statements and that guides the determination of specific financial statement amounts and disclosures, applicable criteria in the context of the proposed ISAE represent benchmarks against which the process to compile the PFI is to be applied by the responsible party. As an example, the Appendix to this explanatory memorandum lists some applicable criteria in the context of the EU prospectus regime.

Applicable criteria may be established either by an authorized or recognized standard setting organization or by law or regulation. Where established applicable criteria do not exist, they may be developed by the responsible party.

To ensure an appropriate level of consistency in the application of the proposed ISAE in relation to the suitability of criteria, the IAASB has specified the minimum elements of suitable criteria.<sup>16</sup> These include, in particular, a requirement that the process to compile the PFI encompass the provision of appropriate presentation and disclosures *to enable users to understand the information conveyed*.<sup>17</sup> (By contrast, disclosure criteria in an applicable financial reporting framework for the preparation of financial statements may specify the nature, form, content and extent of relevant disclosures). In the context of reporting on whether the process has been appropriately applied, the proposed ISAE then requires the practitioner to evaluate whether the presentation of the PFI has been made by the responsible party in accordance with this criterion.<sup>18</sup>

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<sup>15</sup> Proposed ISAE 3420, paragraphs 2-3.

<sup>16</sup> Proposed ISAE 3420, paragraph 13.

<sup>17</sup> Proposed ISAE 3420, paragraph 13(c).

<sup>18</sup> Proposed ISAE 3420, paragraph 22.

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## **Nature and Extent of Work Effort on the Unadjusted Financial Information**

An important consideration in establishing a standard on the process to compile PFI is the nature and extent of work effort needed on the unadjusted financial information (UFI) in order for the practitioner to be able to express an opinion on that process. In particular, the IAASB considered whether and, if so, how the practitioner's opinion would be affected if the UFI were audited, reviewed, or neither audited nor reviewed.

The IAASB believes that it would not be appropriate to require the UFI to be audited or reviewed as a precondition for expressing an opinion on the process. This is because the practitioner's focus is on the process applied and not on the PFI itself. Equally, the IAASB did not support the view that as the practitioner is only reporting on the process, the practitioner need not be concerned with the appropriateness of the source of the UFI. The IAASB is of the view that the integrity of the process depends on the appropriateness of this source (i.e. whether it is "fit for purpose"), which is why this is an integral part of suitable criteria.<sup>19</sup>

The proposed ISAE therefore requires the practitioner to determine whether the source of the UFI is appropriate, and provides guidance on factors the practitioner may consider in making this determination.<sup>20</sup> As the relevant criterion is whether the source of the UFI is appropriate, the wording of the opinion will not be a function of whether this source has been audited, reviewed, or neither. Equally, where the source has been audited or reviewed, the IAASB is of the view that the appropriateness of the source should not depend on who has performed the audit or review. However, if the source has been audited or reviewed by another practitioner, this does not absolve the practitioner from the need to obtain a sufficient understanding of the issuer and its accounting and financial reporting practices in order to perform the engagement.<sup>21</sup>

Where the source has not been audited or reviewed (a circumstance that the IAASB does not expect will be common in practice), the IAASB believes that it may be necessary for the practitioner to perform some work on this source in relation to the credibility of that source to establish that it is appropriate. The nature and extent of this work effort is a matter of the practitioner's professional judgment in the circumstances. Accordingly, the proposed ISAE sets out guidance on relevant factors the practitioner may consider and the nature and extent of procedures the practitioner may perform in such circumstances.<sup>22</sup>

### **Materiality**

In accordance with ISAE 3000,<sup>23</sup> the proposed ISAE requires the practitioner to consider materiality with respect to the process to compile the PFI. The relevant issue in this context, however, was how materiality should be considered in the context of an engagement to report on the process to compile PFI. The IAASB is of the view that this consideration should not concern misstatements, or the quantum thereof, in the PFI or the UFI or any other underlying financial information, as the practitioner is not setting out to identify misstatements in such financial information as would be the

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<sup>19</sup> Proposed ISAE 3420, paragraph 13(a).

<sup>20</sup> Proposed ISAE 3420, paragraphs 17(a) and A29.

<sup>21</sup> Proposed ISAE 3420, paragraph A30.

<sup>22</sup> Proposed ISAE 3420, paragraphs A31-A33.

<sup>23</sup> ISAE 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, paragraph 22.

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case in an audit of financial statements. Rather, the aim of the practitioner's procedures with regard to the process is to identify any omission or inappropriate application of an element of the process that would result in the PFI being misleading to the users. Consequently, the practitioner's consideration of materiality in the proposed ISAE is framed in that context.<sup>24</sup>

This consideration of materiality will not depend on a single quantitative measure. Instead, it will depend on the size and nature of the omission or inappropriate application of an element of the process, judged in the context of the event or transaction, the purpose for which the PFI is being compiled, and the related engagement circumstances.<sup>25</sup> To assist practitioners in their consideration of materiality, the proposed ISAE provides illustrative guidance on the types of matters that may result in an inappropriate application of the process to compile the PFI.<sup>26</sup>

### **Linkage with ISAE 3000**

The proposed ISAE requires the practitioner not to represent compliance with the proposed standard unless the practitioner has complied with the requirements of the proposed standard and ISAE 3000.<sup>27</sup> The proposed ISAE makes certain references to the extant ISAE 3000, which has not been redrafted under the clarity drafting conventions. Concurrently with this project, however, the IAASB is undertaking a project to revise and redraft the extant ISAE 3000, an exposure draft of which is anticipated by the end of 2010. The IAASB believes that the revision of ISAE 3000 should not significantly affect respondents' consideration of the proposed ISAE 3420, as ISAE 3000 is a more general standard that establishes the basic principles for the conduct of all assurance engagements.

### **Emphasis of Matter Paragraphs**

The IAASB is of the view that the proposed ISAE 3420 should deal specifically with Emphasis of Matter paragraphs (EOMs) in the practitioner's report. Notwithstanding the fact that reports containing EOMs may not be accepted by the relevant regulatory bodies in some jurisdictions, the IAASB believes that it is helpful to include a specific provision for EOMs in the proposed ISAE to provide a means, if called for in the circumstances, for the practitioner to highlight a matter that the practitioner considers is of fundamental importance to users' understanding of the process that has been applied to compile the PFI.<sup>28</sup>

### **Guide for Respondents**

The IAASB welcomes comments on all matters addressed in the exposure draft. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in this exposure draft (especially those calling for change in current practice), it will be helpful for the IAASB to be made aware of this view.

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<sup>24</sup> Proposed ISAE 3420, paragraph A17.

<sup>25</sup> Proposed ISAE 3420, paragraph A19.

<sup>26</sup> Proposed ISAE 3420, paragraph A18.

<sup>27</sup> Proposed ISAE 3420, paragraph 11.

<sup>28</sup> Proposed ISAE 3420, paragraph 30.

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## Request for Specific Comments

The IAASB would welcome views on the following:

1. In relation to respondents' roles and responsibilities, would respondents adopt or apply the proposed ISAE, or request an engagement in accordance therewith, if it became effective? If not, please explain why (in this regard, respondents are asked to also consider question 4 below).
2. Do respondents believe that the work effort set out in the proposed ISAE is sufficient and appropriate to enable the practitioner to express an opinion as to whether the process to compile the PFI has, in all material respects, been applied in accordance with the applicable criteria?
3. Do respondents believe that it is clear from the illustrative practitioner's report in the Appendix to the proposed ISAE that the practitioner is reporting on the process to compile the PFI and not on the PFI itself? Paragraph A52 of the proposed ISAE, in particular, provides two alternatives for the opinion in relation to the process, i.e.
  - Whether the process to compile the PFI has, in all material respects, been applied in accordance with the applicable criteria; or
  - Whether the PFI has been properly compiled on the basis stated.
4. As the proposed ISAE is designed to convey assurance on the process to compile the PFI, do respondents believe that it would be desirable for the IAASB to also develop a separate standard on reporting on the PFI itself? If yes:
  - (a) What do respondents believe would be the work effort implications in undertaking engagements to report on the PFI itself? In particular, how would such work effort differ from that specified in the proposed ISAE?
  - (b) Should both reasonable assurance and limited assurance on the PFI be addressed? If so, how should the nature and extent of the practitioner's work effort be differentiated between a reasonable assurance engagement and a limited assurance engagement to report on the PFI?

The IAASB is also interested in comments on matters set out below.

- *Issuers, Investors and Regulators*—Recognizing that PFI included in a prospectus is of particular interest and relevance to issuers, investors (including sponsoring banks, lead managers, underwriters, analysts, and institutional and retail investors), and regulators (including securities exchanges), the IAASB invites respondents from these constituencies to comment on the proposed ISAE and, in particular:
  - (a) The content of the illustrative practitioner's report; and
  - (b) Whether the proposed ISAE will contribute to enhancing user confidence in how the PFI is produced.
- *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the International Standards, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed ISAE in a developing nation environment.

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- *Translations*—Recognizing that many respondents may intend to translate the final ISAE for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the proposed ISAE.
- *Effective Date*—Recognizing that the proposals in the proposed ISAE do not establish fundamentally new assurance principles and that the subject matter of the proposed ISAE does not represent a fundamentally new area of practice for the profession, and given the public interest need to harmonize inconsistent practice internationally as soon as practicable, the IAASB believes that an appropriate effective date for the standard would be 18 months after the date of final approval of the standard. The IAASB welcomes comment on whether this lead time relative to the effective date would provide a sufficient period to support effective implementation of the standard.

## Appendix

### Illustrative Applicable Criteria for the Process to Compile PFI

#### *Annex I of EU Prospectus Regulation<sup>29</sup>—Minimum Disclosure Requirements for the Share Registration Document*

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

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

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

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

#### *Annex II of EU Prospectus Regulation—Pro Forma Financial Information Building Block*

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

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

4. The pro forma information must be prepared in a manner consistent with the accounting policies adopted by the issuer in its last or next financial statements and shall identify the following:

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<sup>29</sup> The Committee of European Securities Regulators (CESR) has developed guidance in the form of recommendations (<http://www.cesr.eu/index.php?docid=2999>) and Frequently Asked Questions (<http://www.cesr.eu/index.php?docid=6472>) to assist in the consistent implementation of the EU Prospectus Directive and Regulation.

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

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

**PROPOSED INTERNATIONAL STANDARD ON ASSURANCE ENGAGEMENTS 3420  
ASSURANCE REPORTS ON THE PROCESS TO COMPILE PRO FORMA FINANCIAL  
INFORMATION INCLUDED IN A PROSPECTUS**

(Effective for assurance reports dated on or after [Date])

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## Introduction

### Scope of this ISAE

1. This International Standard on Assurance Engagements (ISAE) deals with reasonable assurance engagements undertaken by a professional accountant in public practice<sup>30</sup> (for purposes of this ISAE referred to as a “practitioner”)<sup>31</sup> to report on the process to compile pro forma financial information included in a prospectus, where such reporting is required by securities law or the regulation of the securities exchange (“relevant law or regulation”) in the jurisdiction in which the prospectus is to be issued, or where this reporting is generally accepted practice in such jurisdiction.
2. In an engagement performed under this ISAE, the practitioner has no responsibility for compiling the pro forma financial information for the entity. Such responsibility rests with the responsible party,<sup>32</sup> with the practitioner being responsible for reporting on the process applied by the responsible party to compile the pro forma financial information. The practitioner’s report does not include the expression of an opinion on the pro forma financial information itself or on the unadjusted or any other underlying financial information.
3. This ISAE does not deal with non-assurance engagements in which the practitioner is engaged by the entity to compile its historical financial statements. Such engagements are dealt with in ISRS 4410.<sup>33</sup>

### *Purpose of Pro Forma Financial Information Included in a Prospectus*

4. The purpose of pro forma financial information included in a prospectus is to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity, had the event occurred or the transaction been undertaken at an earlier date selected for purposes of the illustration. This is achieved by applying pro forma adjustments to the unadjusted financial information. Pro forma financial information in and of itself does not represent the entity’s actual financial position, financial performance, or cash flows. (Ref: Para. A1–A2)

### *Process to Compile Pro Forma Financial Information*

5. The process to compile pro forma financial information involves the responsible party gathering, classifying and summarizing relevant financial information. Steps involved in this process include:

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<sup>30</sup> The *Code of Ethics for Professional Accountants* issued by the International Ethics Standards Board for Accountants defines a professional accountant as “an individual who is a member of an IFAC member body,” and a professional accountant in public practice as “a professional accountant, irrespective of functional classification (e.g., audit, tax or consulting) in a firm that provides professional services. This term is also used to refer to a firm of professional accountants in public practice.”

<sup>31</sup> In many circumstances, the practitioner will be the auditor of the reporting entity.

<sup>32</sup> The *International Framework for Assurance Engagements*, paragraphs 25–26, describes the meaning of the term “responsible party.”

<sup>33</sup> International Standard on Related Services (ISRS) 4410, *Engagements to Compile Financial Statements*.

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- Identifying the source of the unadjusted financial information to be used in compiling the pro forma financial information, and extracting the unadjusted financial information from that source; (Ref: Para. A3–A4)
- Making pro forma adjustments to the unadjusted financial information for the purpose for which the pro forma financial information is presented; and
- Presenting the resulting pro forma financial information with accompanying disclosures.

In this ISAE, describing the pro forma financial information as being “properly compiled” means that the process to compile the pro forma financial information has, in all material respects, been applied by the responsible party in accordance with the applicable criteria. (Ref: Para. A17–A19)

#### *Relationship with Other Professional Pronouncements*

6. The performance of assurance engagements other than audits or reviews of historical financial information requires the practitioner to comply with ISAE 3000.<sup>34</sup> 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 process to compile pro forma financial information included in a prospectus. The *International Framework for Assurance Engagements*, which defines and describes the elements and objectives of an assurance engagement, provides context for understanding this ISAE and ISAE 3000.
7. Compliance with ISAE 3000 requires, among other things, that the practitioner comply with the independence and other requirements of the *Code of Ethics for Professional Accountants* issued by the International Ethics Standards Board for Accountants (IESBA Code), and implement quality control procedures that are applicable to the individual engagement.<sup>35</sup>

#### **Effective Date**

8. This ISAE is effective for assurance reports dated on or after [date].

#### **Objectives**

9. The objectives of the practitioner are:
  - (a) To obtain reasonable assurance about whether the process to compile the pro forma financial information has been applied by the responsible party in accordance with the applicable criteria; and
  - (b) To report in accordance with the practitioner’s findings.

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<sup>34</sup> ISAE 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.

<sup>35</sup> ISAE 3000, paragraphs 4 and 6.

## Definitions

10. For purposes of this ISAE, the following terms have the meanings attributed below:
- (a) *Applicable criteria*—The criteria in accordance with which the process to compile the pro forma financial information is to be applied by the responsible party. Applicable criteria may be established either by an authorized or recognized standard-setting organization or by law or regulation. Where established applicable criteria do not exist, they may be developed by the responsible party. (Ref: Para. A5–A7)
  - (b) *Pro forma adjustments*—Adjustments made to unadjusted financial information, including:
    - (i) Adjustments to illustrate the impact of a significant event or transaction (“event” or “transaction”); and
    - (ii) Adjustments necessary for the pro forma financial information to be compiled on a basis consistent with the applicable financial reporting framework of the reporting entity (“entity”) and its accounting policies under that framework. (Ref: Para. A15–A16)

Pro forma adjustments include the relevant financial information of a business that has been, or is to be, acquired (“acquiree”), or a business that has been, or is to be, divested (“divestee”), to the extent that such information is used in compiling the pro forma financial information (“acquiree or divestee financial information”).
  - (c) *Pro forma financial information*—Financial information shown together with adjustments to illustrate the impact of an event or transaction on unadjusted financial information assuming that the event had occurred or the transaction been undertaken at an earlier date used for the illustration.
  - (d) *Prospectus*—A document issued pursuant to legal or regulatory requirements relating to the entity’s securities on which it is intended that a third party should make an investment decision.
  - (e) *Published financial information*—Financial information of the entity or of an acquiree or a divestee that is made available publicly.
  - (f) *Published audit or review report*—An audit or review report that is made available publicly.
  - (g) *Unadjusted financial information*—Financial information of the entity to which pro forma adjustments are applied by the responsible party. (Ref: Para. A8)

## Requirements

### ISAE 3000

11. The practitioner shall not represent compliance with this ISAE unless the practitioner has complied with the requirements of this ISAE and ISAE 3000.

## Engagement Acceptance

12. Before agreeing to accept an engagement to report on the process to compile pro forma financial information included in a prospectus, the practitioner shall:
  - (a) Determine that the practitioner has the capabilities and competence to perform the engagement; (Ref: Para. A9)
  - (b) On the basis of a preliminary knowledge of the engagement circumstances and discussion with the responsible party, determine that the applicable criteria are suitable and that it is unlikely that the pro forma financial information will be misleading for the purpose for which it is intended;
  - (c) Evaluate the wording of the opinion prescribed by the relevant law or regulation, if any, to determine that the practitioner will likely be able to express the opinion so prescribed based on performing the procedures specified in this ISAE; (Ref: Para. A53–A54)
  - (d) Where applicable, determine whether the relevant law or regulation permits the use of, or reference in the practitioner’s report to, a modified audit opinion or review conclusion or a report containing an Emphasis of Matter paragraph with respect to the source of the unadjusted financial information; and
  - (e) Obtain the agreement of the responsible party that it acknowledges and understands its responsibility for:
    - (i) Adequately disclosing and describing the applicable criteria to the intended users if these are not publicly available;
    - (ii) Applying the process to compile the pro forma financial information in accordance with the applicable criteria; and
    - (iii) Providing the practitioner with:
      - a. Access to all information (including, where possible, information of acquirees in a business combination), such as records, documentation and other material, relevant to the process to compile the pro forma financial information;
      - b. Additional information that the practitioner may request from the responsible party for the purpose of the engagement;
      - c. Access to those within the entity and the entity’s advisors from whom the practitioner determines it necessary to obtain evidence relating to the process to compile the pro forma financial information; and
      - d. Where possible, access to appropriate individuals within acquirees in a business combination.

### *Assessing the Suitability of the Applicable Criteria*

13. As part of assessing whether the applicable criteria are suitable, as required by ISAE 3000,<sup>36</sup> the practitioner shall determine that they encompass, at a minimum, that: (Ref: Para. A12)

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<sup>36</sup> ISAE 3000, paragraph 19.

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- (a) The unadjusted financial information be extracted from an appropriate source;
  - (b) The pro forma adjustments be:
    - (i) Directly attributable to the event or transaction; (Ref: Para. A13)
    - (ii) Factually supportable; and (Ref: Para. A8, A14)
    - (iii) Consistent with the entity's applicable financial reporting framework and its accounting policies under that framework; and (Ref: Para. A15–A16)
  - (c) Appropriate presentation be made and disclosures be provided to enable the intended users to understand the information conveyed. (Ref: Para. A1–A2, A41)
14. In addition, the practitioner shall assess whether the applicable criteria are:
- (a) Consistent, and do not conflict, with relevant law and regulation; and
  - (b) Unlikely to result in pro forma financial information that is misleading.

### **Planning and Performing the Engagement**

#### *Materiality*

15. When planning and performing the engagement, the practitioner shall consider materiality with respect to the process to compile the pro forma financial information. (Ref: Para. A17–A19)

#### *Obtaining an Understanding of the Responsible Party's Process to Compile the Pro Forma Financial Information and Other Engagement Circumstances*

16. The practitioner shall obtain an understanding of: (Ref: Para. A20)
- (a) The event or transaction in respect of which the pro forma financial information is being compiled;
  - (b) The process applied by the responsible party to compile the pro forma financial information; (Ref: Para. A21–A23)
  - (c) The nature of the entity and any acquiree or divestee, including: (Ref: Para. A24–A25)
    - (i) Their operations;
    - (ii) Their assets and liabilities; and
    - (iii) The way they are structured and how they are financed;
  - (d) Relevant industry, legal and regulatory, and other external factors pertaining to the entity and any acquiree or divestee; and (Ref: Para. A26–A28)
  - (e) The applicable financial reporting framework and the accounting and financial reporting practices of the entity and of any acquiree or divestee, including their selection and application of accounting policies.

#### *Evaluating the Process Applied by the Responsible Party to Compile the Pro Forma Financial Information*

17. The practitioner shall determine whether the responsible party has:

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- (a) Used an appropriate source of the unadjusted financial information; and (Ref: Para. A3, A29–A33)
  - (b) Appropriately extracted the unadjusted financial information from the source. (Ref: Para. A4)
18. The practitioner shall determine whether:
- (a) The responsible party has appropriately identified the pro forma adjustments; and (Ref: Para. A34)
  - (b) The pro forma adjustments are in accordance with the applicable criteria. (Ref: Para. A5–A7, A13–A16, A35–A36)
19. The practitioner shall determine whether the calculations within the pro forma financial information are arithmetically accurate.
20. If a modified audit opinion or review conclusion has been expressed with respect to either the source of the unadjusted financial information or the source of the acquiree or divestee financial information, or where a report containing an Emphasis of Matter paragraph has been issued with respect to such source, and the relevant law or regulation does not prohibit the use of such a source, the practitioner shall evaluate:
- (a) The potential consequence on the process to compile the pro forma financial information; (Ref: Para. A37)
  - (b) What further action to take; and (Ref: Para. A38)
  - (c) Whether there is any effect on the practitioner’s ability to report in accordance with the terms of the engagement, including any effect on the practitioner’s report.
21. If, on the basis of the procedures performed, the practitioner concludes that the responsible party has: (Ref: Para. A17–A19)
- (a) Used a source of the unadjusted financial information that is not appropriate; or
  - (b) Omitted a pro forma adjustment that should be included, or otherwise inappropriately applied a pro forma adjustment,
- the practitioner shall discuss the matter with the responsible party. If the practitioner is unable to agree with the responsible party as to how the matter should be resolved, the practitioner shall determine the implications for the practitioner’s report.

*Evaluating the Presentation of the Pro Forma Financial Information*

22. The practitioner shall evaluate whether the presentation of the pro forma financial information is in accordance with the applicable criteria. This shall include consideration of:
- (a) The overall presentation and structure of the pro forma financial information, including whether it is clearly labeled to distinguish it from historical or other financial information; (Ref: Para. A1–A2)
  - (b) Whether the pro forma financial information and related explanatory notes illustrate the impact of the event or transaction in a manner that is not misleading; and (Ref: Para. A39–A40)

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- (c) Whether appropriate disclosures are provided with the pro forma financial information to enable the intended users to understand the information conveyed. (Ref: Para. A41)
23. The practitioner shall read the other information included in the prospectus containing the pro forma financial information to identify material inconsistencies, if any, with the pro forma financial information. If, on reading the other information, the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact in that other information, the practitioner shall discuss the matter with the responsible party. If correction of the matter is necessary and the responsible party refuses to do so, the practitioner shall take further appropriate action. (Ref: Para. A42)

### **Written Representations**

24. The practitioner shall request written representations from the responsible party that:
- (a) The process to compile the pro forma financial information has identified all appropriate pro forma adjustments necessary to illustrate the impact of the event or transaction at the date or for the period of the illustration; (Ref: Para. A43)
  - (b) The omission of any pro forma adjustments from the process to compile the pro forma financial information because they do not meet the applicable criteria does not render the pro forma financial information misleading; and
  - (c) The process to compile the pro forma financial information has been appropriately applied to reflect all the significant effects of the event or transaction, and in a way that does not result in the pro forma financial information being misleading.

### **Forming the Opinion**

25. The practitioner shall form an opinion on whether the process to compile the pro forma financial information has, in all material respects, been applied by the responsible party in accordance with the applicable criteria. (Ref: Para. A5–A7, A44–A46)
26. In order to form that opinion, the practitioner shall conclude as to whether the practitioner has obtained sufficient appropriate evidence about whether the process applied by the responsible party is free from material omissions or inappropriate application of any element thereof. That conclusion shall include an evaluation of whether the responsible party has adequately disclosed and described the applicable criteria if these are not publicly available. (Ref: Para. A47–A48)

### **Form of Opinion**

27. The practitioner shall express an unmodified opinion when the practitioner concludes that the process to compile the pro forma financial information has, in all material respects, been applied by the responsible party in accordance with the applicable criteria.

### *Modified Opinion*

28. In many jurisdictions, the relevant law or regulation will not permit publication of a prospectus that contains a modified opinion with regard to the process to compile the pro forma financial information. Where this is the case and the practitioner concludes that a

modified opinion is appropriate, the practitioner shall discuss the matter with the responsible party. If the responsible party does not agree to make the necessary changes, the practitioner shall withhold the report, withdraw from the engagement or consider seeking legal advice.

29. In the rare circumstances where the relevant law or regulation permits publication of a prospectus that contains a modified opinion with regard to the process to compile the pro forma financial information and the practitioner determines that a modified opinion is appropriate, the practitioner shall apply the requirements in ISAE 3000<sup>37</sup> regarding modified opinions.

#### *Emphasis of Matter Paragraph*

30. In some circumstances, the practitioner may consider it necessary to draw users' attention to a matter presented or disclosed in the pro forma financial information or the accompanying explanatory notes that, in the practitioner's opinion, is of such importance that it is fundamental to users' understanding of the process to compile the pro forma financial information. In such circumstances, the practitioner shall include an Emphasis of Matter paragraph in the practitioner's report provided the practitioner has obtained sufficient appropriate evidence that the matter does not cause the process to compile the pro forma financial information not to be applied in accordance with the applicable criteria. Such a paragraph shall refer only to information presented or disclosed in the pro forma financial information or the accompanying explanatory notes.

#### **Preparing the Assurance Report**

31. The practitioner's report shall include the following basic elements: (Ref: Para. A55)
  - (a) A title that clearly indicates that the report is an independent assurance report; (Ref: Para. A49)
  - (b) An addressee(s), as agreed in the terms of engagement; (Ref: Para. A50)
  - (c) Introductory paragraphs that identify: (Ref: Para. A51)
    - (i) The pro forma financial information;
    - (ii) The source of the unadjusted financial information, and whether or not an audit or review report on such a source has been published;
    - (iii) The period covered by, or the date of, the pro forma financial information; and
    - (iv) A reference to the applicable criteria in accordance with which the process to compile the pro forma financial information has been applied, and the source of the criteria;
  - (d) A description of the responsible party's responsibilities, including a statement that the responsible party is responsible for applying the process to compile the pro forma financial information in accordance with the applicable criteria;
  - (e) A description of the practitioner's responsibilities, including statements that:

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<sup>37</sup> ISAE 3000, paragraphs 51–52.

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- (i) The practitioner's responsibility is to express an opinion about whether the responsible party's process to compile the pro forma financial information has been applied in accordance with the applicable criteria;
  - (ii) The practitioner is not responsible for updating or reissuing any reports or opinions on any financial information used in the process to compile the pro forma financial information; and
  - (iii) The practitioner has not performed an audit or review of the pro forma financial information and, accordingly, does not express an opinion on the pro forma financial information;
- (f) A statement that the engagement was performed in accordance with ISAE 3420, *Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus*, which requires that the practitioner comply with ethical requirements and plan and perform procedures to obtain reasonable assurance about whether the responsible party has applied the process to compile the pro forma financial information in accordance with the applicable criteria;
- (g) A summary of the practitioner's procedures;
- (h) The practitioner's opinion on the proper application of the process to compile the pro forma financial information; (Ref: Para. A52–A54)
- (i) The practitioner's signature;
- (j) The date of the report; and
- (k) The address where the practitioner maintains the office that has responsibility for the engagement.

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## **Application and Other Explanatory Material**

### **Purpose of Pro Forma Financial Information Included in a Prospectus** (Ref: Para. 4, 13(c), 22)

- A1. In most cases, pro forma financial information is presented in columnar format consisting of (a) the unadjusted financial information; (b) the pro forma adjustments; and (c) the resulting pro forma financial information. It is accompanied by related explanatory notes that often disclose the matters set out in paragraph A41.
- A2. Different presentations of pro forma financial information may be included in the prospectus depending on the nature of the event or transaction and how the responsible party intends to illustrate the impact of such event or transaction on the unadjusted financial information of the entity. For example, where the entity is acquiring a number of businesses prior to an initial public offering, the responsible party may choose to present a pro forma net asset statement to illustrate the impact of the acquisitions on the entity's financial position and key ratios such as debt to equity had the businesses been combined with the entity at an earlier date. The responsible party may also choose to present a pro forma income statement to illustrate what the results of operations might

have been for the period ended on that date. In such cases, the nature of the pro forma financial information may be described by titles such as “Statement of Pro Forma Net Assets as at December 31, 20X1” and “Pro Forma Income Statement for the Year Ended December 31, 20X1.”

### **Process to Compile Pro Forma Financial Information**

*Source of the Unadjusted Financial Information* (Ref: Para. 5, 17(a))

- A3. In most cases, the source of the unadjusted financial information will be published financial information such as annual or interim financial statements.

*Extracting the Unadjusted Financial Information* (Ref: Para. 5, 17(b))

- A4. Depending on how the responsible party chooses to illustrate the impact of the event or transaction, the unadjusted financial information may comprise either one or more unabridged single financial statements, such as a statement of financial position and a statement of comprehensive income, or financial information that is appropriately condensed from unabridged financial statements, such as a statement of net assets.

### **Definitions**

*Applicable Criteria* (Ref: Para. 10(a), 18(b), 25)

- A5. Where established criteria do not exist, the responsible party may develop the applicable criteria, for example, based on practice in a particular industry or the criteria of a jurisdiction which has developed established criteria.
- A6. The applicable criteria will be considered suitable in the circumstances if they meet the benchmarks set out in paragraph 13.
- A7. Although the applicable criteria specify how the process to compile the pro forma financial information is to be applied, the responsible party may include some additional detail in the accompanying explanatory notes to describe how the applicable criteria have been applied in the context of the particular event or transaction. This may include, for example, the date or period for which the pro forma financial information is being presented. The overall presentation of the pro forma financial information, including introductory and explanatory notes, may be referred to as being compiled on the basis stated.

*Unadjusted Financial Information* (Ref: Para. 10(g), 13(b)(ii))

- A8. Unadjusted financial information used in the process to compile pro forma financial information will, in most cases, be historical in nature. Some jurisdictions may, nevertheless, permit the use of profit forecasts as the unadjusted financial information. However, as an engagement to be covered by this ISAE requires the relevant pro forma adjustments to be capable of being factually supported, where proposed adjustments are based on future anticipated outcomes related to the profit forecasts, they would not be factually supportable.

## Engagement Acceptance

### *Capabilities and Competence to Perform the Engagement* (Ref: Para. 12(a))

A9. The IESBA Code<sup>38</sup> requires the practitioner to maintain appropriate professional knowledge and skill, and an awareness and understanding of relevant technical, professional and business developments, in order to provide competent professional service. Within this context, relevant capabilities and competence to perform the engagement also include matters such as the following:

- Knowledge and experience of the industry in which the entity operates;
- An understanding of the relevant securities laws and regulations and related developments;
- An understanding of the listing requirements of the relevant securities exchange and of capital market transactions such as mergers, acquisitions and securities offerings; and
- Familiarity with the process of preparing a prospectus and listing securities on the securities exchange.

### *The Responsible Party's Responsibilities* (Ref: Para. 12(e))

A10. An engagement in accordance with this ISAE is conducted on the premise that the responsible party has acknowledged and understands that it has the responsibilities set out in paragraph 12(e). In some jurisdictions, such responsibilities may be specified in the relevant law or regulation. In others, there may be little or no legal or regulatory definition of such responsibilities. An assurance engagement to report on the process to compile pro forma financial information is based on the assumption that:

- (a) The practitioner's role does not involve taking responsibility for the process to compile such information; and
- (b) The practitioner has a reasonable expectation of obtaining the information necessary for the engagement insofar as the responsible party is able to provide or procure it.

Accordingly, this premise is fundamental to the conduct of the engagement. To avoid misunderstanding, agreement is reached with the responsible party that it acknowledges and understands that it has such responsibilities as part of agreeing and recording the terms of the engagement as required by ISAE 3000.<sup>39</sup>

A11. If law or regulation prescribes in sufficient detail the terms of the engagement, the practitioner need not record them in a written agreement, except for the fact that such law or regulation applies and that the responsible party acknowledges and understands its responsibilities as set out in paragraph 12(e).

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<sup>38</sup> IESBA Code, paragraphs 130.1–130.3.

<sup>39</sup> ISAE 3000, paragraph 10.

*Assessing the Suitability of the Applicable Criteria* (Ref: Para. 13)

- A12. Because pro forma financial information, by its nature, is not general purpose financial statements, it is important that the criteria applied in compiling the pro forma financial information are appropriate and transparent.

Directly Attributable Adjustments (Ref: Para. 13(b)(i), 18(b))

- A13. In order to avoid the pro forma financial information reflecting matters that do not arise solely as a result of the event or that are not an integral part of the transaction, it is necessary that pro forma adjustments be directly attributable to the event or transaction. Directly attributable adjustments exclude those that relate to future events or are dependent on actions to be taken once the transaction has been completed, even if such actions are key to the entity entering into the transaction (for example, closing of redundant production sites after an acquisition).

Factually Supportable Adjustments (Ref: Para. 13(b)(ii), 18(b))

- A14. It is also necessary that pro forma adjustments be factually supportable in order to provide a reliable basis for the pro forma financial information. While the nature of the supporting facts will vary with the circumstances, they are nevertheless capable of objective determination. Sources of factual support for the pro forma adjustments include, for example:

- Purchase and sale agreements.
- Financing documents for the event or transaction, such as debt agreements.
- Independent valuation reports.
- Other documents relating to the event or transaction.
- Published financial statements.
- Other financial information disclosed in the prospectus.
- Relevant legal or regulatory actions, such as in the area of taxation.
- Employment agreements.
- Actions of those charged with governance.

Adjustments Consistent with the Entity's Applicable Financial Reporting Framework and Its Accounting Policies under that Framework (Ref: Para. 10(b)(ii), 13(b)(iii), 18(b))

- A15. For the pro forma financial information to be meaningful, it is necessary that the pro forma adjustments be consistent with the entity's applicable financial reporting framework and its accounting policies under that framework. In the context of a business combination, for example, the process to compile the pro forma financial information involves consideration of such matters as:

- Whether differences exist between the acquiree's accounting policies and those of the entity; and

- Whether accounting policies for specific types of transactions in the acquiree's financial information with which the entity has not previously had to deal are policies that the entity would have adopted for such types of transactions under its applicable financial reporting framework.
- A16. A consideration of the appropriateness of the entity's accounting policies may also be necessary in some circumstances. For example, if, as part of the event or transaction, the entity is proposing to issue complex financial instruments for the first time, it may be necessary to consider whether the responsible party has adopted appropriate accounting policies to account for such financial instruments under its applicable financial reporting framework, and whether it has appropriately applied such policies in the process to compile the pro forma financial information.

### **Planning and Performing the Engagement**

#### *Materiality* (Ref: Para. 5, 15, 21)

- A17. In an engagement to report on whether the process to compile pro forma financial information has been properly applied, an omission or the inappropriate application of an element of the process is material if it results in pro forma financial information that is misleading to the intended users of the information.
- A18. Examples of matters that may cause the process to compile the pro forma financial information not to be properly applied include:
- Use of an inappropriate source for the unadjusted financial information.
  - Incorrect extraction of the unadjusted financial information from an appropriate source.
  - In relation to adjustments, the misapplication of accounting policies or the failure of the adjustments to be consistent with the entity's accounting policies.
  - Failure to make an adjustment required by the applicable criteria.
  - Making an adjustment that is not in accordance with the applicable criteria.
  - A mathematical or clerical mistake in the calculations within the pro forma financial information.
  - Inadequate, incorrect or omitted disclosures.
- A19. Materiality with regard to the process to compile the pro forma financial information does not depend on a single quantitative measure. Instead, it depends on the size and nature of the omission or inappropriate application of an element of the process as described in paragraph A18, whether or not intentional, judged in the context of the event or transaction, the purpose for which the pro forma financial information is being compiled, and the related engagement circumstances. The determining factor could be the size or the nature of the matter, or a combination of both.

*Obtaining an Understanding of the Responsible Party's Process to Compile the Pro Forma Financial Information and Other Engagement Circumstances* (Ref: Para. 16)

- A20. The practitioner may obtain this understanding through a combination of procedures such as:
- Inquiring of the responsible party and other entity personnel involved in the process to compile the pro forma financial information.
  - Inquiring of other appropriate parties such as those charged with governance and the entity's advisors.
  - Reading relevant supporting documentation such as contracts or agreements.
  - Reading minutes of meetings of those charged with governance.

The Process to Compile the Pro Forma Financial Information (Ref: Para. 16(b))

- A21. Matters on which the practitioner may obtain an understanding with regard to the process to compile the pro forma financial information include, for example:
- The source of the unadjusted financial information used by the responsible party.
  - The steps taken by the responsible party to:
    - Extract the unadjusted financial information from the source.
    - Identify the appropriate pro forma adjustments, for example, how the responsible party has obtained acquiree financial information in compiling the pro forma financial information.
  - The responsible party's competence in applying the process to compile pro forma financial information.
  - The nature and extent of oversight by the responsible party of other entity personnel involved in the process to compile the pro forma financial information.
  - The responsible party's approach to identifying appropriate disclosures to support the pro forma financial information.
- A22. In a business combination or divestment, areas that may give rise to complexity in the process to compile the pro forma financial information include allocations of income, overheads and assets and liabilities among or between the relevant businesses. Accordingly, it is important for the practitioner to understand the responsible party's approach and criteria for such allocations and that the explanatory notes accompanying the pro forma financial information disclose these matters.
- A23. In contrast to financial statements prepared periodically by the responsible party, the process to compile the pro forma financial information is undertaken solely for purposes of the prospectus. Relevant controls in the latter case will therefore likely be much simpler and much more limited in scope than in the former. These may, for example, be limited to review by the responsible party of relevant analyses and worksheets prepared by entity personnel involved in the process to compile the pro forma financial information, and oversight by the responsible party of such personnel.

Nature of the Entity and Any Acquiree or Divestee (Ref: Para. 16(c))

- A24. An acquiree may be an incorporated entity or a separately identifiable unincorporated operation within another entity such as a division, branch or line of business. A divestee may be an incorporated business such as a subsidiary or joint venture, or a separately identifiable unincorporated operation within the entity such as a division, branch or line of business.
- A25. The practitioner may have all or part of the required understanding of the entity and any acquiree or divestee, and their respective environments, if the practitioner has audited or reviewed their financial information.

Relevant Industry, Legal and Regulatory, and Other External Factors (Ref: Para. 16(d))

- A26. Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments. Examples of matters the practitioner may consider include:
- The market and competition, including demand, capacity, and price competition.
  - Common business practices within the industry.
  - Cyclical or seasonal activity.
  - Product technology relating to the entity's products.
- A27. Relevant legal and regulatory factors include the legal and regulatory environment, which encompasses, among other matters, the applicable financial reporting framework in accordance with which the entity or, if applicable, the acquiree prepares its periodic financial information, and the legal and political environment. Examples of matters the practitioner may consider include:
- Industry-specific accounting practices.
  - Legal and regulatory framework for a regulated industry.
  - Legislation and regulation that significantly affect the entity's or, if applicable, the acquiree's or divestee's operations, including direct supervisory activities.
  - Taxation (corporate and other).
  - Government policies currently affecting the conduct of the entity's or, if applicable, the acquiree's or divestee's business, such as monetary, including foreign exchange controls, fiscal, financial incentives (for example, government aid programs), and tariffs or trade restrictions policies.
  - Environmental requirements affecting the entity's or acquiree's or divestee's industry and business.
- A28. Examples of other external factors affecting the entity and, if applicable, the acquiree or divestee that the practitioner may consider include the general economic conditions, interest rates and availability of financing, and inflation or currency revaluation.

*Evaluating the Process Applied by the Responsible Party to Compile the Pro Forma Financial Information*

Source of the Unadjusted Financial Information (Ref: Para. 17(a))

- A29. As paragraph 13 indicates, a necessary criterion for applying the process to compile pro forma financial information is that an appropriate source be used for the unadjusted financial information, consistent with the purpose of the illustration. In determining whether the source used by the responsible party is appropriate, the practitioner is obtaining evidence to determine whether this criterion has been satisfied by the responsible party in applying the process, and not for the purpose of reporting on the source or on the pro forma financial information itself. Factors that may affect the appropriateness of the source include whether the source:
- Is permitted or specifically prescribed by the relevant law or regulation, or permitted by the relevant securities exchange with which the prospectus is to be filed.
  - Is clearly identifiable.
  - Is credible, for example, whether there is a published audit or review report on the source.
  - Represents a reasonable starting point for compiling the pro forma financial information in the context of the event or transaction, including whether it is at an appropriate date or covers an appropriate period.
  - Is used as such under normal market custom and practice.
- A30. If a published audit or review report on the source has been issued by another practitioner, the need by the practitioner for an understanding of the entity and its accounting and financial reporting practices is not diminished. In the circumstances, the practitioner may need to consider whether the practitioner can acquire sufficient knowledge of these matters to perform the procedures necessary to report under this ISAE.
- A31. If there is no published audit or review report on the source, it may be necessary for the practitioner to perform procedures in relation to the credibility of that source. Factors that may affect the nature and extent of these procedures include, for example:
- Whether an audit or review report on the source has nevertheless been issued by the practitioner or another practitioner, whether or not in the same firm, even if not published.
  - Whether the practitioner has previously audited or reviewed the entity's historical financial information, and the practitioner's knowledge of the entity from such engagement.
  - Whether the entity's financial information is subject to periodic review by the practitioner, for example, for purposes of meeting regulatory filing requirements.
- A32. In most cases, the entity's financial statements for the period immediately preceding that of the source of the unadjusted financial information will have been audited or reviewed, even if the source itself is not. For example, the source may be interim financial statements not audited or reviewed whereas the entity's financial statements for the immediately preceding

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fiscal year may have been audited. In such a case, procedures that the practitioner may perform, having regard to the factors in paragraph A31, in relation to the credibility of that the source include:

- Inquiring of the responsible party about:
  - The process by which the source has been prepared and the reliability of the underlying accounting records to which the source is agreed or reconciled.
  - Whether all transactions have been recorded.
  - Whether the source has been prepared in accordance with the entity's accounting policies.
  - Whether there have been any changes in accounting policies from the immediately preceding prior period and, if so, how such changes have been dealt with.
  - The responsible party's assessment of the risk that the source may be materially misstated as a result of fraud.
  - The effect of changes in the entity's business activities and operations.
- Comparing the source with the corresponding prior period financial information and, as appropriate, the immediately preceding annual or interim financial information, and discussing significant changes with the responsible party.

A33. In the rare circumstances where the entity's financial information has never been audited or reviewed, the practitioner may need to perform additional procedures that may include, for example:

- Obtaining the trial balance and determining whether it agrees with the general ledger and the source.
- Obtaining corroborative evidence regarding the responsible party's responses to the practitioner's inquiries.
- Discussing with the responsible party regarding whether the recognition of income and expenses has taken place in the appropriate periods.

### Pro Forma Adjustments

Identification of appropriate pro forma adjustments (Ref: Para. 18(a))

A34. Informed by the practitioner's understanding of the process to compile the pro forma financial information and other engagement circumstances, the practitioner may obtain evidence regarding whether the responsible party has appropriately identified the pro forma adjustments through a combination of procedures such as:

- Evaluating the reasonableness of the responsible party's approach to identifying the appropriate pro forma adjustments, for example, the method used in identifying appropriate allocations of income, overheads, assets and liabilities among the relevant businesses.

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- Inquiring of relevant parties within an acquiree regarding their approach to extracting the acquiree financial information.
- Evaluating specific aspects of the relevant contracts, agreements or other documents.
- Inquiring of the entity's advisors regarding specific aspects of the event or transaction and related contracts and agreements that are relevant to the identification of appropriate adjustments.
- Evaluating relevant analyses and worksheets prepared by the responsible party and other entity personnel involved in the process to compile the pro forma financial information.
- Obtaining evidence of the responsible party's oversight of other entity personnel involved in the process to compile the pro forma financial information.
- Analytical procedures.

Factual support for any acquiree or divestee financial information included in the pro forma adjustments (Ref: Para. 18(b))

- A35. In determining whether the financial information of the acquiree or divestee is factually supportable, the practitioner may refer to the guidance in paragraphs A30–A33 in relation to the financial information of the acquiree or divestee.
- A36. In some cases, it may not be practicable for the practitioner to obtain evidence to conclude that the financial information of an acquiree is factually supportable. In such circumstances, the practitioner may need to discuss the matter with the responsible party and consider the implications for the practitioner's report.

Modified Audit Opinion or Review Conclusion, or Emphasis of Matter Paragraph, with Respect to the Source of the Unadjusted or Acquiree or Divestee Financial Information

Potential consequence (Ref: Para. 20(a))

- A37. Not all modified audit opinions, review conclusions or Emphasis of Matter paragraphs with respect to either the source of the unadjusted financial information or the source of the acquiree or divestee financial information may necessarily have a consequence on the process to compile the pro forma financial information. For example, if a qualified audit opinion with respect to the source of the unadjusted financial information relates to the non-disclosure of remuneration for those charged with governance as required by the applicable financial reporting framework, this may have no consequence on the process to compile pro forma net asset and income statements.

Further action (Ref: Para. 20(b))

- A38. Further action that the practitioner may take includes, for example:
- Discussing the matter with the responsible party.
  - Making a reference in the practitioner's report to the modified audit opinion, review conclusion, or the Emphasis of Matter paragraph, where, in the practitioner's

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professional judgment, the matter is of sufficient relevance and importance to users' understanding of the pro forma financial information.

- Seeking advice from the practitioner's legal counsel regarding the implications for the engagement.
- Withholding the report or withdrawing from the engagement.

*Evaluating the Presentation of the Pro Forma Financial Information*

Avoidance of Association with Misleading Financial Information (Ref: Para. 22(b))

A39. The IESBA Code requires that a practitioner not be associated with information where the practitioner 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.<sup>40</sup>

A40. As the practitioner is not reporting on the source of the unadjusted financial information, there is no requirement for the practitioner to perform procedures to identify events after the date of that source that require adjustment of, or disclosure in, such source. Nevertheless, evaluating the presentation of the pro forma financial information involves a consideration of whether the practitioner has become aware, through performing the procedures under this ISAE or otherwise, of any significant events subsequent to the date of the source of the unadjusted financial information that may require reference to, or disclosure in, the explanatory notes to the pro forma financial information to avoid the latter being misleading. For example, after the date of the source of the unadjusted financial information, the entity may have entered into a capital transaction involving the conversion of its convertible debt into equity, non-disclosure of which could result in the pro forma financial information being misleading.

Disclosures Accompanying the Pro Forma Financial Information (Ref: Para. 13(c), 22(c))

A41. Appropriate disclosures may include matters such as:

- The nature and purpose of the pro forma financial information, including the nature of the event or transaction;
- The source of the unadjusted financial information, and whether or not an audit or review report on such a source has been published;
- The pro forma adjustments, including a description and explanation of each adjustment. This includes, in the case of acquiree or divestee financial information, the source of such information and whether or not an audit or review report on such a source has been published;

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<sup>40</sup> IESBA Code, paragraph 110.2.

- If not publicly available, a description of the applicable criteria in accordance with which the process to compile the pro forma financial information has been applied; and
- A statement to the effect that the pro forma financial information has been compiled for illustrative purposes only and that, because of its nature, it does not represent the entity's actual financial position, financial performance, or cash flows.

#### Material Inconsistency with Other Information (Ref: Para. 23)

- A42. Further appropriate action that the practitioner may take if the responsible party refuses to revise the pro forma financial information or the other information as appropriate include, for example:
- Describing the material inconsistency in the practitioner's report.
  - Modifying the practitioner's opinion.
  - Withdrawing from the engagement where this is possible under the relevant law or regulation.

#### Written Representations (Ref: Para. 24(a))

- A43. Where the circumstances involve types of transactions that require the responsible party to use accounting policies for the pro forma adjustments that the entity has not previously had to articulate because it had no relevant transactions, the practitioner may request the responsible party to expand the written representation to include confirmation that such accounting policies constitute the entity's adopted policies for such types of transactions.

#### Forming the Opinion

##### *Assurance on Further Matters Required by the Relevant Law or Regulation* (Ref: Para. 25)

- A44. Relevant law or regulation may require the practitioner to express an opinion on matters other than whether the process to compile the pro forma financial information has, in all material respects, been applied by the responsible party in accordance with the applicable criteria. The relevant law or regulation may, for example, require the practitioner to express an opinion about whether the basis on which the responsible party has compiled the pro forma financial information is consistent with the entity's accounting policies. Compliance with the requirement in paragraph 18(b) of this ISAE, which includes determining whether the pro forma adjustments are consistent with the entity's accounting policies, provides a basis for expressing such an opinion. Accordingly, the practitioner need not perform additional procedures in such a case.
- A45. Where the relevant law or regulation requires the practitioner to express an opinion on other matters related to the process to compile the pro forma financial information, this may require the practitioner to perform additional procedures. The nature and extent of such additional procedures will vary with the nature of these other matters.

## Statement of the Practitioner's Responsibility for the Report

- A46. The relevant law or regulation may require the practitioner to include in the practitioner's report an explicit statement of the practitioner's responsibility for the practitioner's report, as distinct from the description of the practitioner's responsibilities in the practitioner's report required by this ISAE. The inclusion of such an additional legal or regulatory statement in the practitioner's report is not incompatible with the requirements of this ISAE.

### *Disclosure of the Applicable Criteria* (Ref: Para. 26)

- A47. The responsible party need not repeat in the explanatory notes accompanying the pro forma financial information any criteria that are prescribed by the relevant law or regulation, or promulgated by an authorized or recognized standard-setting organization. Such criteria will be publicly available as part of the reporting regime and are therefore implicit to the process to compile the pro forma financial information.
- A48. Where the responsible party has developed any specific criteria, it is necessary that those criteria be disclosed so that users may obtain a proper understanding of the process to compile the pro forma financial information.

## Preparing the Assurance Report

### *Title* (Ref: Para. 31(a))

- A49. A title indicating that the report is the report of an independent practitioner, for example, "Independent Practitioner's Assurance Report on the Process to Compile Pro Forma Financial Information," affirms that the practitioner has met all of the relevant ethical requirements regarding independence as required by ISAE 3000.<sup>41</sup> This distinguishes the report of the independent practitioner from reports issued by others.

### *Addressee(s)* (Ref: Para. 31(b))

- A50. The relevant law or regulation may specify the addressee(s) of the report. Alternatively, the practitioner may agree with the entity who the addressee(s) will be as part of the terms of the engagement.

### *Introductory Paragraphs* (Ref: Para. 31(c))

- A51. As the pro forma financial information will be included in a prospectus that contains other information, the practitioner may consider, if the form of presentation allows, including a reference that identifies the section where the pro forma financial information is presented. This helps readers identify the pro forma financial information to which the practitioner's report relates.

### *Wording of Opinion* (Ref: Para. 31(h))

- A52. Because describing pro forma financial information as being properly compiled<sup>42</sup> means that the responsible party has, in all material respects, applied the process to compile the pro

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<sup>41</sup> ISAE 3000, paragraph 4.

<sup>42</sup> See paragraph 5.

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forma financial information in accordance with the applicable criteria, the practitioner may express the opinion in terms of either:

- Whether the process to compile the pro forma financial information has, in all material respects, been applied in accordance with the applicable criteria; or
- Whether the pro forma financial information has been properly compiled on the basis stated.

*Wording of Opinion Prescribed by Law or Regulation* (Ref: Para. 12(c), 31(h))

A53. The relevant law or regulation in some jurisdictions may prescribe the wording of the practitioner's opinion in terms other than those specified in paragraph A52. Where this is the case, it may be necessary for the practitioner to exercise judgment to determine whether performing the procedures set out in this ISAE would enable the practitioner to express the opinion in the prescribed wording, or whether further procedures would be necessary.

A54. Where the practitioner concludes that performing the procedures set out in this ISAE would be sufficient to enable the practitioner to express the opinion in the prescribed wording, it may be appropriate to regard this wording as being generally equivalent to the wording of the opinion in the terms specified in paragraph A52.

*Illustrative Report* (Ref: Para. 31)

A55. A practitioner's report with an unmodified opinion is set out in the Appendix.

## Appendix

(Ref: Para. A55)

### Illustration of a Practitioner's Report with an Unmodified Opinion

#### INDEPENDENT PRACTITIONER'S ASSURANCE REPORT ON THE PROCESS TO COMPILE PRO FORMA FINANCIAL INFORMATION

[Appropriate Addressee(s)]

We have completed our assurance engagement to report on the process applied by ABC Company (the company) to compile the pro forma financial information, consisting of [the pro forma net asset statement as at [date]], [the pro forma income statement for the period ended [date]] [and the pro forma cash flow statement for the period ended [date]] [as set out on pages xx–xx of the prospectus issued by the company]. The applicable criteria in accordance with which this process has been applied are [specified in [Securities Regulation XX]/described in [Note X]].

The pro forma financial information has been compiled by management to illustrate the impact of the [event or transaction] set out in [Note Y] on the [company's financial position as at that date] [and its financial performance [and cash flows] for the period then ended]. As part of this process, information about the company's [financial position], [financial performance] [and cash flows] has been extracted from the company's financial statements [for the period ended [date]], on which [[an audit]/[a review] report]/[no audit or review report] has been published. Because of its nature, the pro forma financial information does not represent the company's actual [financial position], [financial performance], [or cash flows].

#### Management's Responsibility for the Pro Forma Financial Information

Management of ABC Company is responsible for applying the process to compile the pro forma financial information in accordance with the applicable criteria [specified in [Securities Regulation XX]]/[set out in [Note X]].

#### Practitioner's Responsibilities

Our responsibility is to express an opinion [, as required by [Securities Regulation XX],] about whether the process to compile the pro forma financial information has been applied by management in accordance with the applicable criteria. We are not responsible for updating or reissuing any reports or opinions on any financial information used in compiling the pro forma financial information. In addition, we have not performed an audit or review of the pro forma financial information and, accordingly, we do not express an opinion on the pro forma financial information.

We conducted our engagement in accordance with International Standard on Assurance Engagements (ISAE) 3420, *Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus*, issued by the International Auditing and Assurance Standards Board. This standard requires that we comply with ethical requirements and plan and perform our procedures to obtain reasonable assurance about whether the responsible party has applied the process to compile the pro forma financial information in accordance with the applicable criteria.

Our procedures included:

- Making inquiries of management regarding the process management has applied to compile the pro forma financial information;
- Evaluating whether management has used an appropriate source of the unadjusted financial information in compiling the pro forma financial information;
- Checking whether management has appropriately extracted the unadjusted financial information from the source documents;
- Evaluating whether management has compiled the pro forma financial information on a basis consistent with the company's financial reporting framework and its accounting policies under that framework;
- Considering management's evidence supporting the pro forma adjustments;
- Determining whether the calculations within the pro forma financial information are arithmetically accurate; and
- Evaluating the overall presentation and disclosure of the pro forma financial information and related explanatory notes.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Opinion**

In our opinion, [the process to compile the pro forma financial information has, in all material respects, been applied in accordance with the applicable criteria]/[the pro forma financial information has been properly compiled on the basis stated].

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]





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