

**Assurance Engagements to Report on Pro Forma Financial Information  
Included in a Prospectus—Task Force Recommendations Dated September  
2011 in Response to IAASB’s Consideration of Significant Comments on  
Exposure**

**Significant Issues****A. The Practitioner’s Opinion**

1. At the March 2011 meeting, an IAASB member expressed concern that the proposed wording of the practitioner’s opinion did not appear consistent with the exposure draft (ED) of proposed ISAE 3000 (Revised)<sup>1</sup> in that the reference to materiality was not included in the opinion paragraph itself. Another IAASB member commented that including the reference to materiality in the definition of the term “properly compiled” instead of in the opinion paragraph might be seen as shifting the responsibility to consider materiality from the practitioner to the responsible party.

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2. Both extant ISAE 3000<sup>2</sup> and the ED of proposed ISAE 3000 (Revised)<sup>3</sup> are silent as to the inclusion of an explicit reference to materiality in the opinion paragraph. However, the Task Force notes that the IAASB’s assurance standards have generally strongly suggested, through illustrative reports or other application guidance, that the practitioner’s conclusions include such a reference. Accepting the benefit of maintaining consistency with this practice, the Task Force therefore proposes that the practitioner’s opinion in the draft ISAE include a reference to materiality.
3. A further matter of consistency with ISAE 3000 and the Assurance Framework<sup>4</sup> is the inclusion of a reference to the applicable criteria in the opinion paragraph. In this regard, the Task Force notes that both ISAE 3000 and the Assurance Framework are flexible in terms of the wording that may be used in referencing the applicable criteria. The Task Force therefore proposes that the opinion be worded in terms of whether the pro forma financial information (PFI) has been properly compiled *on the basis of* the applicable criteria, consistent with guidance in ISAE 3000.<sup>5</sup>

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<sup>1</sup> Proposed International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

<sup>2</sup> ISAE 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, paragraph 49(j), requires that “in a reasonable assurance engagement, the [practitioner’s] conclusion be expressed in the positive form.”

<sup>3</sup> The ED of proposed ISAE 3000 (Revised), paragraph 63(a), requires that “the practitioner express an unmodified conclusion when the practitioner concludes ... that the subject matter information is prepared, in all material respects, in accordance with the applicable criteria.”

<sup>4</sup> *International Framework for Assurance Engagements* (Assurance Framework)

<sup>5</sup> ISAE 3000, paragraph 49(j), provides the following example of a practitioner’s opinion expressed in the positive form: “In our opinion, internal control is effective, in all material respects, based on XYZ criteria.”

4. Accordingly, taking these two matters of consistency together, the Task Force proposes, *as one alternative*, that the opinion be worded in the following terms:

The pro forma financial information has, in all material respects, been properly compiled on the basis of the applicable criteria.

5. As highlighted in previous Board discussions, this ISAE would likely have the greatest application and fulfill the greatest market need in jurisdictions where the opinion is prescribed by law or regulation in terms of whether “the pro forma financial information has been properly compiled on the basis stated.”<sup>6</sup> Given this reality and the public interest need for the proposed ISAE 3420<sup>7</sup> to be relevant and of practical use in these jurisdictions, the Task Force believes that it is imperative that the ISAE also provide the aforementioned prescribed wording as an alternative. The Task Force notes that a precedent already exists in the IAASB’s literature in this regard. Specifically, ISA 700 takes a duality approach to the opinion when the practitioner is reporting on financial statements under a fair presentation framework:<sup>8</sup>

When expressing an unmodified opinion on financial statements prepared in accordance with a fair presentation framework, the auditor’s opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

- (a) The financial statements present fairly, in all material respects, ... in accordance with [the applicable financial reporting framework]; or
- (b) The financial statements give a true and fair view of ... in accordance with [the applicable financial reporting framework].

(In this context, the Task Force notes that the “true and fair” alternative to the audit opinion does not include a reference to materiality.)

6. The Task Force therefore proposes that a similar dual approach to the opinion be adopted in the ISAE that establishes equivalency between the two alternative wordings mentioned above (see paragraph 38(h)).<sup>9</sup> This approach sets up the phrase “on the basis stated” as being equivalent in meaning to the phrase “on the basis of the applicable criteria.”
7. Given the establishment of this equivalency in paragraph 38(h), the Task Force believes a specific definition of the term “basis stated” is no longer needed. The Task Force has expanded the definition of the term “applicable criteria” to include “explanatory notes describing how the criteria have been applied in illustrating the effects of the particular event or transaction,” which was the definition of “basis stated” in the draft ISAE presented at the March 2011 IAASB meeting (see paragraph 12(a)).

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<sup>6</sup> Including, but not limited to, the European Union (EU) pursuant to the EU Directive 2003/71/EC (the Prospectus Directive) and Regulation EC 809/2004 (the Prospectus Regulation)

<sup>7</sup> Proposed ISAE 3420, *Assurance Engagements to Report on Pro Forma Financial Information Included in a Prospectus*

<sup>8</sup> ISA 700, *Forming an Opinion and Reporting on Financial Statements*, paragraph 35

<sup>9</sup> Paragraph numbers refer to the draft ISAE unless otherwise stated.

**Matter for IAASB Consideration**

1. Does the IAASB agree with the Task Force’s proposed dual approach to the wording of the practitioner’s opinion and the related changes as described above?

**B. Historical Financial Information of the Entity or of the Acquiree that has Never Been Audited or Reviewed**

8. In response to comments on exposure, the Task Force had proposed that an engagement acceptance precondition be established for the practitioner to determine that the relevant law or regulation requires prior historical financial information of the entity or that of an acquiree to have been published in accordance with such law or regulation or to be included in the prospectus. Such a precondition would have required the practitioner to determine that the relevant law or regulation requires such financial information to be audited or reviewed. While expressing support for the spirit of the proposal, an IAASB member was of the view that clarification was needed regarding the recency of the period for which an audit or a review should have been undertaken. Another IAASB member was concerned that the precondition would be unduly restrictive. In particular, a shell company used to acquire different businesses might not itself have prior financial statements that have been audited or reviewed.
9. Other IAASB members were of the view that the circumstances this precondition was intended to address would not be as rare as suggested. It was also felt that the standard would not have a useful outcome in terms of being usable in meeting market needs if law or regulation did not impose the requirements specified in the precondition.

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10. The Task Force acknowledged the potential practical difficulties that might arise from the precondition as worded. Accordingly, the Task Force has deleted the precondition as part of the engagement acceptance considerations. Instead, the Task Force has retained the principle that, except for the case of an entity formed for purposes of the transaction, there is no basis to undertake the engagement when the entity’s historical financial information has never been audited or reviewed. Accordingly, the Task Force proposes an outright prohibition in such circumstances (see paragraph 15). The Task Force has proposed guidance in paragraph A13 to clarify when the exception would apply.
11. The prohibition in paragraph 15 also applies if the acquiree is a component of another entity, or the acquiree itself is an entity, that has never been audited or reviewed. However, if the acquiree is a component of another entity that has previously been audited or reviewed, it may be possible for the practitioner to obtain the necessary understanding to perform the engagement. Accordingly, it will be necessary for the practitioner to exercise judgment in the circumstances (see paragraphs 16 and A14).

**Other Scenarios**

12. The draft ISAE deals separately with the different possible scenarios regarding whether there has been an audit or a review of the source from which the unadjusted financial

information has been extracted and, if an acquisition is involved, the source from which the acquiree financial information has been extracted:

- (a) *Source from which the unadjusted financial information has been extracted, or source from which the acquiree financial information has been extracted, audited or reviewed by the practitioner*

There is a basis for the practitioner to determine whether the source from which the unadjusted financial information has been extracted is appropriate (see paragraphs 21 and A29), or whether the acquiree financial information is factually supportable (see paragraph A36).

- (b) *Source from which the unadjusted financial information has been extracted, or source from which the acquiree financial information has been extracted, audited or reviewed by another practitioner*

See Issue C below.

- (c) *Source from which the unadjusted financial information has been extracted not audited or reviewed*

The nature and extent of procedures that the practitioner may perform in relation to the appropriateness of the source will depend on a number of factors, including how recently the entity’s historical financial information was audited or reviewed (see paragraph A31). Paragraph A32 sets out a number of procedures the practitioner may consider in the likely case that the entity’s financial statements for the period immediately preceding that of the source from which the unadjusted financial information has been extracted have been audited or reviewed.

- (d) *Source from which the acquiree financial information has been extracted not audited or reviewed*

Considerations similar to those under subparagraph (c) above apply relative to the source from which the acquiree financial information has been extracted (see paragraphs A38-A39).

13. In the case of a divestment, the divestee’s financial information will be derived from the source from which the unadjusted financial information has been extracted, which will often be audited or reviewed. Accordingly, the source from which the unadjusted financial information has been extracted will provide the basis for the practitioner to determine whether there is factual support for the divestee financial information. (See paragraph A34).

#### **Matters for IAASB Consideration**

2. Does the IAASB agree with the Task Force’s proposals regarding how the draft ISAE should address:
- (a) Circumstances where the historical financial information of the entity or that of the acquiree has never been audited or reviewed?

- (b) The other possible scenarios relative to whether there has been an audit or a review of the source from which the unadjusted financial information has been extracted and, if an acquisition is involved, the source from which the acquiree financial information has been extracted?

**C. Source from Which the Unadjusted Financial Information Has Been Extracted, or Source from Which the Acquiree Financial Information Has Been Extracted, Audited or Reviewed by Another Practitioner**

14. At the March 2011 meeting, an IAASB member questioned whether the draft ISAE had adequately dealt with circumstances where the source from which the unadjusted financial information has been extracted, or the source from which the acquiree financial information has been extracted, has been audited or reviewed by another practitioner

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15. The Task Force notes that the IAASB had addressed this matter at length during its deliberations in finalizing the draft ISAE for issuance as an ED. Specifically, the explanatory memorandum to the ED notes that “where the source [from which the unadjusted financial information has been extracted] 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 [reporting under this ISAE] from the need to obtain a sufficient understanding of the [entity] and its accounting and financial reporting practices in order to perform the engagement.”
16. The Task Force believes that the application material in the ED remains appropriate. That is, the reporting practitioner will need to consider in the circumstances whether the reporting practitioner can acquire sufficient knowledge of the entity and its accounting and financial reporting practices to perform the procedures necessary to report under this ISAE. The Task Force has clarified in the draft ISAE that the reporting practitioner would acquire knowledge of such matters pursuant to the requirements of subparagraphs 20(c) and (e) of the proposed standard (see paragraph A30).
17. Where the source from which the acquiree financial information has been extracted has been audited or reviewed by another practitioner, the Task Force believes that similar considerations apply (see paragraph A37).

**Matter for IAASB Consideration**

3. Does the IAASB agree that the guidance referred to above is sufficient to address circumstances where the source from which the unadjusted financial information is extracted, and the source from which the acquiree financial information is extracted, have been audited or reviewed by another practitioner?

#### **D. Disclaimer Language in the Report**

18. At the March 2011 meeting, an IAASB member questioned why the phrase “accordingly, we do not express an opinion on the pro forma financial information” had been deleted from the illustrative report as this seemed to convey a clear message regarding the nature of the engagement. Another IAASB member pointed out that the disclaimer wording “we have not performed an audit or review of the pro forma financial information” seemed to imply that one could in fact perform an audit or review of the PFI. It was, however, argued that the practitioner’s opinion is in fact a proper compilation opinion on the PFI but not an audit or a review opinion as might be expressed on historical financial statements. Many IAASB members supported this view, noting that the PFI is not susceptible to an audit as the information is hypothetical in nature. A few IAASB members suggested considering whether the disclaimer language is necessary given that the report already explains the nature of the engagement.

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19. The Task Force agreed with the general IAASB view that the practitioner’s opinion is a proper compilation opinion on the PFI but not an audit or a review opinion on the PFI because the PFI does not represent the entity’s actual financial position, financial performance and cash flows. The Task Force believes that this should be made clear in the report for the avoidance of doubt. Accordingly, the Task Force proposes that the report include the following explanation in the Practitioner’s Responsibilities section (see paragraph 38(e)(iii) and the illustrative report):

Because pro forma financial information does not represent an entity’s actual financial position, financial performance, or cash flows, it is not possible to express an audit opinion or review conclusion on pro forma financial information.

20. For the further avoidance of doubt, the Task Force also believes that it is appropriate to include a further disclaimer in the report to the effect that the practitioner has not, *in the course of this engagement*, performed an audit or review of the financial information used in compiling the pro forma financial information. (See paragraph 38(e)(ii) and the illustrative report).

#### **Matter for IAASB Consideration**

4. Does the IAASB agree with the proposed disclaimers in the report as described above?

#### **E. Effective Date**

21. The explanatory memorandum to the ED proposed that the ISAE’s effective date be 18 months after the date of final approval of the standard. The overwhelming majority of respondents who commented on the proposed effective date expressed support for it as representing a sufficient period to enable effective implementation of the standard.

22. Accordingly, subject to the IAASB’s approval of the ISAE at the September 2011 meeting, the Task Force proposes that the final standard be effective for assurance reports dated on or after April 1, 2013.
23. Given the public interest need to harmonize inconsistent practice internationally in this area as soon as practicable, the Task Force also recommends, subject to IAASB approval of the ISAE, that the final standard be issued upon Public Interest Oversight Board (PIOB) confirmation of due process, without awaiting finalization of the proposed ISAE 3000 (Revised). The Task Force believes that appropriate conforming amendments can be made to the proposed ISAE 3420 in due course once the IAASB approves the revised ISAE 3000.
24. As provided for under the IAASB’s Preface,<sup>10</sup> early application of the standard would be permitted.

#### **Matters for IAASB Consideration**

5. Does the IAASB agree with the proposed effective date for the ISAE?
6. Subject to approval of the final standard, does the IAASB agree that the proposed ISAE 3420 should be issued without awaiting finalization of the revised ISAE 3000?

#### **F. Consideration of the Need to Re-Expose**

25. Agenda Item 4-D is a marked-up version of the draft ISAE showing changes proposed to the ED. The Task Force believes that the changes reflected in the draft ISAE are in response to matters raised by respondents to the ED, and do not fundamentally change the principles in the ED or represent other changes of substance. In particular, the Task Force believes that the recharacterization of the draft ISAE as addressing reasonable assurance engagements to report on whether PFI has been properly compiled instead of reasonable assurance engagements to report on the process to compile PFI has helped to clarify the objective and focus of the practitioner’s work. This was broadly acknowledged by the IAASB at the March 2011 meeting.
26. In addition, the Task Force believes that the following changes have helped to clarify that the practitioner’s opinion is a proper compilation opinion, and not an audit opinion or a review conclusion, on the PFI:
  - Moving the opinion away from a focus on the process to compile the PFI (which did not properly reflect the work effort set out in the ISAE) to a focus on whether the pro forma financial information has been properly compiled on the basis of the applicable criteria or the basis stated.
  - Clarifying the disclaimer language in the report to the effect that it is not possible to express an audit opinion or review conclusion on PFI because such information does

<sup>10</sup> *Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*, paragraph 17

not represent an entity’s actual financial position, financial performance, or cash flows.

27. Finally, the Task Force believes that the changes made to the requirements addressing the practitioner’s work effort have effectively clarified and strengthened such work effort in response to significant comments received on the ED. Accordingly, the Task Force believes that re-exposure is not necessary.

**Matter for IAASB Consideration**

7. Subject to IAASB approval of the draft ISAE, does the IAASB agree that re-exposure is not necessary?