

*Prepared by the Staff of the International Auditing and
Assurance Standards Board*

**Basis for Conclusions:
ISAE 3420, Assurance Engagements to
Report on the Compilation of Pro Forma
Financial Information Included in a
Prospectus**

Copyright © December 2011 by the International Federation of Accountants (IFAC). All rights reserved. Permission is granted to make copies of this work provided that such copies are for use in academic classrooms or for personal use and are not sold or disseminated and provided that each copy bears the following credit line: “*Copyright © December 2011 by the International Federation of Accountants (IFAC). All rights reserved. Used with permission of IFAC. Contact permissions@ifac.org for permission to reproduce, store or transmit this document.*” Otherwise, written permission from IFAC is required to reproduce, store or transmit, or to make other similar uses of, this document, except as permitted by law.

BASIS FOR CONCLUSIONS:

ISAE 3420, ASSURANCE ENGAGEMENTS TO REPORT ON THE COMPILATION OF PRO FORMA FINANCIAL INFORMATION INCLUDED IN A PROSPECTUS

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, ISAE 3420, *Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus*, which was approved by the IAASB in September 2011 with 16 votes in favor, one against and one abstention.¹

Background

1. The IAASB commenced this project in March 2008 to fulfill a significant market need for harmonized practice internationally regarding reporting on the compilation of pro forma financial information (PFI) included in a prospectus. The IAASB noted that the increasing trend towards globalization of the capital markets had made it important for the financial information used in capital market transactions to be understandable across borders, and for assurance to be provided to enhance users' confidence in how such information has been produced.
2. Developments in the European Union (EU), where issuers can now "passport" a prospectus,² provided evidence of this trend towards multi-jurisdictional offerings. However, they also brought into sharp focus differences in reporting practices within the EU particularly with regard to PFI included in a prospectus, and thus a heightened need for common assurance standards for reporting on this financial information. Stakeholders in other jurisdictions, such as Brazil, China (mainland), Hong Kong, Singapore and South Africa, had also highlighted to the IAASB the need for common standards of reporting on such financial information that can be consistently applied internationally.
3. In seeking to develop an international standard on PFI, the IAASB recognized that potential difficulties might arise because of differences in legal and regulatory frameworks around the world. The IAASB therefore adopted an approach focused initially on identifying and understanding the reporting issues that exist 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 regime³ in the EU as an appropriate starting point.

¹ For a summary of the rationale given by the IAASB members who voted against or abstained, see the minutes of the September 19-23, 2011 IAASB meeting at www.ifac.org/sites/default/files/meetings/files/20111205-IAASB-Beijing_September%202011_Public_Session_Minutes_Approved_%20Final.pdf.

² A "passport" prospectus is one approved by an appropriate regulator in the issuer's own member state that can be used to offer securities into any other EU member state without the need for any additional regulatory approval.

³ 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:

4. While there was some 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 consensus within the EU regarding what a compilation of PFI entails,⁴ 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 of the project not being viewed as one limited to the EU, the IAASB undertook further research⁵ into how such a standard would be used in other jurisdictions.
5. 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 comparable to those in the EU. In addition, the research indicated that even in some of those jurisdictions with regulatory reporting requirements, there was little in the way of standards and guidance on the topic. The research also pointed to the absence of specific standards and guidance on the topic in several other jurisdictions. These findings strongly suggested under-developed or lack of uniform practice in this area around the world. On this basis, the IAASB decided to develop an assurance standard for engagements to report on the compilation of PFI included in a prospectus. The IAASB published its proposals in an exposure draft (ED or ED-ISAE 3420) in April 2010.
6. The comment period for ED-ISAE 3420 closed on September 30, 2010. The IAASB received 36 comment letters from various respondents, including regulators and oversight bodies, national standard setters, IFAC member bodies, and firms. This Basis for Conclusions explains the more significant issues raised by respondents to the ED, and how the IAASB has addressed them.
7. The IAASB has discussed this project with its Consultative Advisory Group (CAG) on six separate occasions.

Use and Applicability of the Standard

8. The explanatory memorandum to ED-ISAE 3420 asked respondents whether, in the context of their roles and responsibilities, they would adopt or apply the proposed ISAE, or request

eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:345:0064:0089:EN:PDF. The Prospectus Regulation can be accessed at:

eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:149:0001:0126:EN:PDF.

⁴ This was based, in particular, on research evidence from the October 2005 Fédération des Experts Comptables Européens' (FEE) paper, *Analysis of Responses to FEE Discussion Paper on the Auditor's Involvement with the New EU Prospectus Directive*.

⁵ 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.

an engagement in accordance therewith, if it became effective. A majority of those who responded to this question indicated strong support for the ISAE, subject to appropriate clarifications in the proposed standard. A number of other respondents were also supportive of adoption where consistent with national regulatory requirements. As expected, however, some respondents indicated that they would not adopt or apply the proposed ISAE, either because it would conflict with local regulation or existing standards, or because it would be incompatible with prevailing market practice.

IAASB Decision

9. The IAASB concluded that there was overall strong support, and compelling reasons offered by respondents, for developing the standard. These reasons include the following:
 - The standard would meet a specific need, and it would be extensively applied, in jurisdictions where law or regulation requires assurance regarding the compilation of pro forma financial information included in a prospectus.
 - It also would be applied in jurisdictions where such reporting is generally accepted practice.
 - It would promote consistency in the nature and extent of work as well as reporting in jurisdictions where there is demand for such assurance engagements.
 - It would help practitioners better explain to users the nature and scope of work performed.
 - It would fill a gap in the suite of international standards.
10. The IAASB also noted that the risk of user misunderstanding regarding the subject matter on which the practitioner is providing assurance would be minimized given the limitation in the scope of ISAE 3420 to those jurisdictions where the reporting is required by relevant law or regulation, or is generally accepted practice.
11. Accordingly, the IAASB decided that the project should proceed as planned.

Nature and Focus of the Practitioner's Work under the Standard

12. In developing ED-ISAE 3420, the IAASB deliberated extensively the nature and focus of the practitioner's work effort under the standard. The IAASB settled on placing a strong emphasis on the *process* to compile the PFI in the ED in an effort to minimize potential confusion amongst users that the practitioner is reporting *on* the numbers in the pro forma column. Feedback was therefore solicited in the explanatory memorandum to the ED regarding whether it was clear that the practitioner's work and reporting focused on the process to compile the PFI as opposed to the PFI itself.
13. Several respondents observed that the work effort described in the ED in fact went beyond a focus on the purely mechanical "process" of compiling the PFI. In particular, they noted that, in some instances, the work effort set out in the ED involved considerations relating to the sources and qualities of financial information that would not be expected in a strict assessment of the process. In addition, they observed that some aspects of the ED, such as the benchmark applicable criteria, seemed more relevant to the PFI than to the process itself. All but one of those respondents agreed that this level of work effort was indeed

appropriate for this type of engagement, with some highlighting the public interest benefit of going beyond a narrow focus on the process.

14. Further, some of the respondents argued that this excessive emphasis on the process had resulted in a misalignment between the work proposed and the opinion required. In particular, it was pointed out that the over-emphasis on the process may result in users underestimating the applicability and usefulness of the standard, and the level of assurance that the work effort actually supports. These respondents felt that the work effort proposed would be more appropriate in the context of an engagement to report on the proper compilation of the PFI as a whole.
15. Given that the proposed work effort extended beyond the process, some of the respondents questioned whether it was appropriate to focus the title of the ISAE and the report on the “process” to compile PFI. It was therefore suggested that the title of, and proposals in, ED-ISAE 3420 be re-characterized in terms of assurance on the *proper compilation* of the PFI, without changing the intended scope of the standard. This re-characterization was strongly supported by respondents from the regulatory community.

IAASB Decisions

16. The IAASB accepted that, in trying to emphasize that the practitioner is not providing assurance *on the PFI*, the ED had perhaps overly emphasized the process. The IAASB also recognized that while a substantial part of the work effort set out in the ED did indeed relate to the steps involved in the responsible party’s compilation of the pro forma financial information, such work effort also extended beyond a pure process focus. However, the work effort did not go so far as to amount to an “audit of the PFI” in the same way as an audit of financial statements would be understood. The IAASB agreed with those respondents who argued that the level of work effort proposed in the ED would be in the public interest for this type of engagement.
17. Accordingly, the IAASB determined that the following changes should be made to more accurately reflect the nature of the engagement and the focus of the practitioner’s work under the standard:
 - (a) Changing the title of the standard from:

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

to:

Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus
 - (b) Rephrasing references to “process to compile pro forma financial information” in terms of “the compilation of pro forma financial information” or “whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria,” as appropriate, throughout the standard. This includes the practitioner’s opinion (see Reporting section below for discussion regarding the wording of the opinion).

- (c) Clarifying the definition of “pro forma financial information” to indicate that such information is presumed to be presented in columnar format consisting of (i) the unadjusted financial information; (ii) the pro forma adjustments; and (iii) the resulting pro forma column (see paragraph 11(c)).⁶ This is to emphasize that the PFI refers to the overall presentation of the financial information in a columnar format and not just the final pro forma numbers as reflected in the pro forma column.
- (d) Explaining how the practitioner’s work effort goes beyond pure process, i.e., that the engagement involves performing the procedures set out in this ISAE to assess whether the applicable criteria used by the responsible party in the compilation of the pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction, and to obtain sufficient appropriate evidence about whether:
- The related pro forma adjustments give appropriate effect to those criteria; and
 - The resulting pro forma column (as referred to in the definition of pro forma financial information in paragraph 11(c)) reflects the proper application of those adjustments to the unadjusted financial information.
- (See paragraph 6.)
- (e) Emphasizing in the report the illustrative nature of PFI and making clear that the practitioner is not providing any assurance that the actual outcome of the event or transaction at the date of the illustration would have been as presented (see paragraph 35(e)(iii) and the illustrative report).

18. The IAASB believes that these changes clarify the focus of the practitioner’s work in performing this type of engagement and better reflect the essence of the standard without changing its scope.

Work Effort on Unadjusted Financial Information or Acquiree or Divestee Financial Information

19. ED-ISAE 3420 included a requirement for the practitioner to determine whether the responsible party has used an appropriate source from which the unadjusted financial information has been extracted. It then provided guidance on factors to consider that may affect the appropriateness of the source. It also provided guidance on procedures the practitioner may perform when there is no published audit or review report on the source, and when the entity’s financial information has never been audited or reviewed. Finally, it provided guidance when a published audit or review report has been issued by another practitioner. ED-ISAE 3420 directed the practitioner to refer to such guidance when determining whether the acquiree or divestee financial information is factually supportable.
20. A few respondents expressed concern about the absence of any requirement for specific procedures to be performed regarding the appropriateness of the source from which the unadjusted financial information or the acquiree or divestee financial information has been extracted when that source has not been audited or reviewed. They questioned the

⁶ Paragraph numbers refer to the final ISAE 3420 unless otherwise noted.

sufficiency of the indicative work effort in the application material (paragraphs A29–A33 of the ED), noting that the practitioner could decide not to perform any of the listed procedures. The respondents were of the view that the practitioner should be required to perform additional procedures in all circumstances when the source has not been audited or reviewed. They also suggested that it would be helpful to clarify the minimum extent of inquiries and analytical (or other) procedures expected.

21. A few respondents commented on the lack of clarity regarding the proposed guidance on the work effort when the source from which the unadjusted financial information or the acquiree or divestee information has been extracted has not been audited or reviewed. One of the respondents felt that the approach to describing the practitioner's responsibilities regarding the credibility of the acquiree or divestee financial information was unclear compared with the description of such responsibilities relative to the unadjusted financial information in the same circumstances. Another respondent was of the view that the procedures suggested in the application material appeared close to a review of the source from which the unadjusted financial information has been extracted.
22. There was also a view that whether the source from which the unadjusted financial information has been extracted should be audited or reviewed should be a decision for regulators to make, rather than the IAASB. Nevertheless, given the differences in regulatory requirements around the world, there was strong support for the proposed requirements and guidance regarding the source from which the unadjusted financial information has been extracted.

IAASB Decisions

23. The IAASB agreed that more clarity was needed on the guidance in the ED regarding whether the source from which the unadjusted financial information has been extracted is appropriate, and whether the acquiree or divestee financial information is factually supportable.
24. As a preliminary matter, the IAASB reaffirmed its guidance addressing 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 the practitioner. In those circumstances, as the practitioner will have audited or reviewed the source, there will be a basis for the practitioner to determine whether the source from which the unadjusted financial information has been extracted is appropriate (see paragraph A27), or whether the acquiree financial information is factually supportable (see paragraph A35).
25. The IAASB then amended ED-ISAE 3420 to clarify the guidance addressing the following other circumstances that may arise.

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

26. The explanatory memorandum to ED-ISAE 3420 had explained that when an audit or review has been performed on the source from which the unadjusted financial information

has been extracted, the IAASB's view is that the appropriateness of such 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 would not obviate the need for the practitioner reporting under the ISAE to obtain a sufficient understanding of the entity and its accounting and financial reporting practices in order to perform the engagement. This explanation was incorporated in the form of guidance in paragraph A30 of the ED.

27. The IAASB reaffirmed this guidance. That is, the reporting practitioner will need to consider whether it would be possible to acquire a sufficient understanding of the entity and its accounting and financial reporting practices to perform the procedures necessary to report under the ISAE. However, the IAASB agreed to further clarify that the reporting practitioner would acquire knowledge of such matters pursuant to the requirements of paragraphs 17(c) and (e) of the standard (see paragraph A30). In addition, the IAASB has emphasized in the same guidance that the reporting practitioner would still need to be satisfied that the source from which the unadjusted financial information has been extracted is appropriate. It will be a matter of the reporting practitioner's judgment in the circumstances whether it is necessary for the reporting practitioner to perform additional procedures to determine the appropriateness of the source.
28. The IAASB also introduced similar guidance in paragraph A36 to address circumstances where the source from which the acquiree financial information has been extracted has been audited or reviewed by another practitioner.

Source from which the Unadjusted Financial Information has been Extracted, or Source from which the Acquiree Financial Information Has Been Extracted, Not Audited or Reviewed

29. The IAASB accepted the concerns raised regarding the lack of any required work effort when no audit or review has been performed on the source from which the unadjusted financial information or the acquiree financial information has been extracted. The IAASB decided that greater rigor was needed in these circumstances.
30. Accordingly, the IAASB determined that a requirement should be established for the practitioner to perform procedures to be satisfied that the source from which the unadjusted financial information has been extracted is appropriate, or that the acquiree financial information is factually supportable (see paragraphs 19 and 22(b), respectively).
31. With respect to the source from which the unadjusted financial information has been extracted, the nature and extent of procedures that the practitioner may perform on 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 A29). Paragraph A30 sets out a number of procedures the practitioner may consider when 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. The IAASB has clarified and enhanced this guidance in response to respondents' comments.
32. Similar considerations apply to the source from which the acquiree financial information has been extracted. For the avoidance of doubt, the IAASB has introduced specific guidance in this regard in paragraphs A37–A38.

Factual Support for Divestee Financial Information

33. 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. The IAASB determined that guidance should be provided to that effect (see paragraph A33).
34. The IAASB also decided that the practitioner should be referred to the guidance in paragraphs A29-A30 where the divestee financial information is derived from a source of unadjusted financial information that has not been audited or reviewed (see paragraph A34).

Historical Financial Information of the Entity or of the Acquiree Never Audited or Reviewed

35. Given that it is unlikely that law or regulation will permit an entity to issue a prospectus if its historical financial information has never been audited or reviewed, the IAASB determined that the guidance in paragraph A33 of ED-ISA 3420, which listed examples of procedures the practitioner may perform in these circumstances, was unnecessary. Accordingly, this guidance has been deleted.
36. Instead, the IAASB determined that a general requirement should be established as part of engagement acceptance for the practitioner to consider, where the entity's historical financial information has never been audited or reviewed, whether the practitioner can obtain a sufficient understanding of the entity and its accounting and financial reporting practices to perform the engagement (see paragraph 13(e)). The IAASB believes that this requirement adds rigor to the practitioner's consideration of engagement acceptance should such circumstances arise. Guidance has been provided in paragraph A31 explaining that with the exception of an entity formed for purposes of the transaction and that has never had any trading activity, it is unlikely that relevant law or regulation will permit an entity to issue a prospectus if its historical financial information has never been audited or reviewed.
37. A similar requirement has been added to engagement acceptance where, in the case of an acquisition, the acquiree's historical financial information has never been audited or reviewed (see paragraph 13(f)).

Reporting**Proposed Alternative Opinion Wordings**

38. ED-ISA 3420 proposed the following two alternative wordings for the practitioner's opinion:
 - 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.
39. Many respondents were of the view that these two alternative wordings for the opinion had the potential to confuse users. In particular, it was noted that the second alternative wording

did not include the word “process” even though the ED focused on the process of compilation.

40. Also, the ED proposed to require the practitioner to include disclaimer language in the report to the effect that the practitioner is not providing any assurance on the PFI itself. Notwithstanding this, however, most of those same respondents felt that users could interpret the second alternative as providing such assurance, especially in jurisdictions that do not have a legal or regulatory requirement for assurance to be provided on the proper compilation of PFI.
41. Additionally, it was suggested that users might misunderstand the two alternatives as implying that the practitioner is reporting on *both* the process and the PFI, notwithstanding the disclaimer in the report. It was highlighted that there would be a challenge in clearly distinguishing the two forms of reporting as it was felt that some of the work effort dealing with the appropriate selection of source data and factual support for the pro forma adjustments could apply to reporting on both the process and the PFI.
42. A few respondents objected to the ED providing two alternative wordings for the opinion, believing that they were not equivalent. In particular, because a “properly compiled” opinion in their jurisdictions deals with more than the process, they felt that associating that form of opinion with reporting on just the process (as the ED appeared to do) would be misleading in their jurisdictions. Some also were of the view that the first wording did not appropriately reflect the work effort set out in the ED.
43. A few further respondents suggested that if the second wording were to be retained, it should be restricted to only those jurisdictions where such wording is mandated by law or regulation. There was also a suggestion to retain only the first wording as the other wording did not reflect the ED’s focus on process.
44. Several respondents expressed support for the opinion actually specified in the EU Prospectus Directive⁷ to be used, some in favor of it being the sole option and others as a third option.

IAASB Decision

45. The IAASB noted that the first alternative wording of the opinion was provided in the ED because of the ED’s focus on reporting on the process of compilation. Given that the work effort set out in the ED extends beyond the process (see discussion on the focus of the practitioner’s work above), the IAASB decided to replace this alternative with the following wording to move away from a strict focus on process:

Whether the pro forma financial information has been compiled, in all material respects, on the basis of the [*applicable criteria*].

(See the illustrative report.)

46. The IAASB also decided to retain the second alternative wording of the opinion as proposed but to do so through establishing an equivalency with the first alternative wording

⁷ That is, that “the pro forma financial information is properly compiled on the basis stated, and that basis is consistent with the accounting policies of the issuer.”

(see paragraph 35(h)). This adopts a duality approach to the opinion similar to that in ISA 700,⁸ which establishes equivalency between the phrases:

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

47. The IAASB believes that it is in the public interest for the second alternative wording in the ED to be provided in the ISAE. This is because the standard would likely have the greatest application and fulfill the greatest market need in jurisdictions⁹ where the opinion is prescribed by law or regulation, or has become accepted through market practice, in terms of whether “the pro forma financial information has been properly compiled on the basis stated.” This alternative enables the standard to be relevant and of practical use in these jurisdictions, where the wording of the opinion will not likely be misunderstood. At the same time, this does not preclude the use of the other alternative wording by practitioners in jurisdictions where the wording of the opinion is not mandated by law or regulation.

Distinction between Applicable Criteria and Basis Stated

48. ED-ISAE 3420 proposed that the practitioner’s opinion be phrased in terms of 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.” A view was expressed that there may be confusion in the ED between the “applicable criteria” and what is generally referred to as “the basis of compilation.” It was argued that these two concepts are different. It was noted in particular that, in the EU context, the applicable criteria are the generic criteria for the compilation of the PFI in accordance with the Prospectus Directive; by contrast, the basis of compilation would be tailor-made to the entity’s circumstances. It was also felt that the term “basis stated” in the ED refers as much to the basis of compilation as to the applicable criteria.
49. For this reason, it was argued that the two alternative wordings for the opinion in the ED are not equivalent. It was therefore suggested that, to clarify the concept of “basis stated,” a definition of the term “basis of compilation” be provided in the standard.

IAASB Decision

50. The IAASB determined that “basis stated” is in fact part of the suitability of the applicable criteria. In particular, for the criteria to be deemed suitable, ED-ISAE 3420 proposed that they include as a condition that appropriate disclosures be provided to enable the *intended users to understand the information conveyed* (see paragraph 14(c) in the final standard). In this regard, paragraph A42 of ISAE 3420 specifies a number of disclosures that would typically be provided to enable users to obtain such understanding, in particular:

⁸ ISA 700, *Forming an Opinion and Reporting on Financial Statements*

⁹ Including, but not limited to, the EU in the context of the Prospectus Directive and Prospectus Regulation

- The nature of the event or transaction, and the date at which such event is assumed to have occurred or transaction been undertaken.
- The pro forma adjustments, including a *description and explanation* of each adjustment.

51. Accordingly, the IAASB determined that no separate definition of “basis stated” or “basis of compilation” was necessary.

Level of Description of Work Effort in the Illustrative Report

52. To provide transparency about the work performed in the engagement, ED-ISAE 3420 proposed a requirement that the practitioner’s report include a summary of the procedures performed. The illustrative report in the ED listed several procedures as an example of how the practitioner could set out such a summary.

53. Several respondents objected to this proposal. They commented that the description of the procedures in the illustrative report amounted to excessive detail, appearing to be like a “recipe” for the engagement or even making the engagement appear to be an agreed-upon procedures engagement. They contrasted this approach with that taken in other IAASB assurance standards, in which illustrative reports provide a more summarized description of work performed. Some of the respondents also highlighted inconsistency between the description of the procedures in the report and the requirements in the ED. They were therefore of the view that a more summarized approach to describing the work performed would be appropriate, including emphasizing that the work effort depends on the practitioner’s professional judgment.

54. A few respondents, however, took an opposite view, arguing that it would be important for the report to contain a full and complete description of the procedures performed rather than a generic description. They felt that this would facilitate readers’ understanding of the nature of the assurance conveyed, the work performed, and the auditor’s association with the pro forma financial information. A view was also expressed that the description in the illustrative report did not completely reflect the procedures required in the ED. Accordingly, it was suggested that this description be expanded to provide a more complete illustration.

IAASB Decision

55. The IAASB accepted the arguments put forth by those respondents who expressed preference for a more summarized description of the work performed. In particular, the IAASB concluded that the argument that a comprehensive description would help users better understand the nature of the assurance conveyed could equally be applied to audits and reviews of financial statements. The IAASB also noted that the longer the list of procedures in the report, the more complete it would appear to be, which could be misleading as the list may never capture the entire breadth of procedures the practitioner may perform in the engagement circumstances.

56. In addition, the IAASB noted that it had already taken a summarized approach to describing the nature of the practitioner’s work for assurance engagements to be addressed

by the proposed ISAE 3410 and proposed ISRE 2400 (Revised).¹⁰ The explanatory memoranda for the exposure drafts of these two proposed standards explained the following in particular:

- *Proposed ISAE 3410*: “The practitioner’s report in a reasonable assurance engagement is ordinarily in the short-form, that is, it follows a standard wording and only briefly describes procedures performed. This is because describing in detail the specific procedures performed would not assist users to understand that, in all reasonable assurance engagements where an unmodified report is issued, sufficient appropriate evidence has been obtained to enable the practitioner to express a conclusion in the positive form.”
- *Proposed ISRE 2400 (Revised)*: “Under the proposed ISRE, the practitioner’s report describes the work undertaken in a review with reference to the primary types of procedures performed ... The IAASB understands that it is in the public interest for users of the financial statements to have a clear understanding of the limited assurance obtained by the practitioner in a review engagement. The IAASB has considered whether the practitioner’s report should set out a more detailed articulation of the procedures performed. Arguably, doing so might enable users to understand more fully the work effort applied in the engagement. The IAASB believes, however, that, in a review where specified *types* of procedures are required (that is, primarily inquiry and analytical review), there is no need to provide that level of detail. Indeed it is recognized that doing so might introduce the potential for misunderstanding, as readers of the report may infer from the level of detail a higher level of assurance than is actually the case.”

57. The IAASB therefore determined that the description of the work effort in the illustrative report should be more summarized than was proposed in ED-ISAE 3420, mirroring, with the exception below, the description in paragraph 6 regarding the nature of a reasonable assurance engagement under the standard (see paragraph 35(g)(i) and the illustrative report).
58. Whereas paragraph 6 includes the statement that “the resulting *pro forma column* (see paragraph 11(c)) reflects the proper application of those adjustments to the unadjusted financial information,” the IAASB decided that the report should include the statement that “the *pro forma financial information* reflects the proper application of those adjustments to the unadjusted financial information.” The IAASB noted that there is a potential for the term “pro forma column” to not be understood by readers of the report without the context of the definition of the term “pro forma financial information” in paragraph 11(c). Accordingly, the IAASB agreed that the description of this particular aspect of the work effort in the report should instead refer to pro forma financial information. See the illustrative report.

¹⁰ Proposed ISAE 3410, *Assurance Engagements on Greenhouse Gas Statements*, and proposed ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*

Restriction on Distribution or Use of the Report

59. A few respondents to ED-ISAE 3420 suggested that the distribution or use of the practitioner’s report be restricted. One of the respondents argued that doing so could help minimize the risk of misunderstanding of the report in jurisdictions where there is no regulatory requirement for reporting on the compilation of pro forma financial information. Another respondent commented that pro forma financial information is by nature special purpose information that is prepared in a specific context, i.e., for the filing of a prospectus with a securities regulator. It was suggested that wording similar to that provided in ISA 800¹¹ be used:

Restriction on Use

Without modifying our opinion, we draw attention to Note X to the pro forma financial information, which explains that the pro forma financial information is issued for the purpose of inclusion in the prospectus filed with [Securities Commission XX] and may not be suitable for another purpose.

IAASB Decision

60. The IAASB did not agree that it would be appropriate to limit the distribution or use of the practitioner’s report given that the prospectus in which the report is to be included is itself a public document. Accordingly, the IAASB determined that no change was necessary.

Other Matters

Terminology

61. Paragraphs 2 and 3 of ED-ISAE 3420 sought to distinguish the practitioner’s responsibilities when the practitioner is engaged to report under ISAE 3420 from those when the practitioner is engaged to compile an entity’s financial information.
62. A few respondents were of the view that the risk of misunderstanding would persist despite the provision of this explanatory material. They therefore suggested that more detailed explanations be provided. A few other respondents, however, took a completely opposite view. They indicated no difficulty with the use of the terms “compile” and “compilation” in the ED. Instead, they were of the view that the explanatory material in paragraphs 2 and 3 of the ED could introduce uncertainty amongst readers where none was present. Accordingly, they suggested that this material be deleted.
63. Also, paragraph A29 of ED-ISAE 3420 indicated that one of the factors that may affect the appropriateness of the source of the unadjusted financial information is whether the source is “credible.”
64. A concern was raised regarding the appropriateness of using the term “credible” in this context. It was argued that this term is generally associated in the auditing literature with the “assurance taken” by users of assurance reports. It was therefore suggested that the term be replaced by the phrase “prepared in accordance with the applicable financial reporting framework.”

¹¹ ISA 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*, paragraph 14

IAASB Decisions

65. The IAASB intended that through the inclusion of the essential explanatory material in paragraphs 2 and 3 in the ED, the risk that readers would be confused as to the nature and degree of the practitioner’s involvement in the actual compilation of the PFI would be minimized. The IAASB was not persuaded that there would be confusion regarding the use of the “compilation” terminology given that this type of assurance engagement to report on the compilation of PFI included in a prospectus is well understood in jurisdictions where it is required or it is market practice. Importantly, the IAASB believes that the reference to “non-assurance engagements” in paragraph 3 of the final standard helps to address any confusion between an assurance engagement to report on the compilation of PFI and a compilation of historical financial statements.
66. The IAASB therefore concluded that this explanatory material should remain in the standard and that additional explanatory material was unnecessary. The IAASB has, however, deleted the reference to ISRS 4410¹² in paragraph 3 of ED-ISAE 3420 to avoid any potential inadvertent confusion given potential changes to the scope of ISRS 4410 in the project to revise that standard.
67. With regard to the use of the term “credible,” the IAASB accepted that this term may introduce ambiguity. Accordingly, the IAASB has redrafted the guidance to avoid the use of this term, focusing more on whether there is an audit or review report on the source from which the unadjusted financial information has been extracted. See paragraph A27 of the ISAE.

“Published” vs. Audited Source from which the Unadjusted Financial Information Has Been Extracted

68. ED-ISAE 3420 included a number of references in the requirements and application material to a published audit or review report on the source from which the unadjusted financial information has been extracted. A few respondents questioned this focus on the publication of the audit or review report on the source. They were of the view that what matters most is whether or not the source has been audited or reviewed, not whether or not the audit or review report on the source has been “published.” It was suggested that there is in fact no difference in the assurance conveyed between a published and an unpublished audit or review report.

IAASB Decision

69. The IAASB accepted that, for purposes of the practitioner’s work effort, the overriding consideration should be whether the source from which the unadjusted financial information has been extracted has been audited or reviewed. Accordingly, with the exceptions below, the IAASB has replaced all references to “published audit or review reports” in ED-ISAE 3420 with, where appropriate, references to whether there is an audit or review report on the financial information, or whether such a report has been issued.

¹² ISRS 4410, *Engagements to Compile Financial Statements*

70. However, concerning the practitioner's report (paragraph 35(c)(ii)) and in the disclosures accompanying the PFI (paragraph A42), the IAASB does not believe that it would be appropriate to replace such references with whether an audit or review report has been issued. In particular, the IAASB believes that disclosing that a review report on the source has been issued would de facto render such a review public, thereby turning what is a private engagement in some jurisdictions into a public engagement.
71. Accordingly, the requirement for the practitioner to state in the practitioner's report whether or not an audit or review report on the source has been published remains unchanged. Equally, regarding the list of disclosures that may appropriately accompany the PFI, the reference to whether or not an audit or review report on the source has been published remains unchanged.

Use of Profit Forecasts as the Basis for the Unadjusted Financial Information

72. Paragraph A8 of the ED explained the following regarding the unadjusted financial information:

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.

73. Several respondents highlighted ambiguity in this guidance. Some suggested that the apparent consequence of the circumstance described should be explicitly stated, i.e., that the practitioner will not be able to report in accordance with the ISAE. Others were of the view that the standard should make clear that it would not be appropriate for the practitioner to accept the engagement when profit forecasts are used as the basis for the unadjusted financial information.

IAASB Decision

74. The IAASB agreed that there was a lack of clarity in the proposed guidance. Nevertheless, the IAASB does not believe that it would be appropriate for it to impose a restriction on the use of profit forecasts as the unadjusted financial information, as this is a matter for law or regulation to determine. Accordingly, to avoid inadvertently introducing ambiguity in the standard, the IAASB has deleted the guidance.

Relationship with ISAE 3000¹³

75. Many respondents noted that ED-ISAE 3420 was developed on the basis of extant ISAE 3000 and that the IAASB had already started a project to revise that standard. They therefore highlighted the need for the IAASB to align the proposed ISAE 3420 with the proposed revised ISAE 3000.

¹³ ISAE 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

IAASB Decision

76. The IAASB accepted these comments. However, given the pressing market need to harmonize diverse practices regarding reporting on the compilation of pro forma financial information included in prospectuses, the IAASB concluded that it would not be in the public interest to withhold the finalization of ISAE 3420 pending the completion of the project to revise ISAE 3000. Consistent with its approach to ISAE 3402,¹⁴ which was issued in 2009 based on the extant ISAE 3000, the IAASB determined that it would be appropriate to issue ISAE 3420 based on the extant ISAE 3000.
77. The IAASB agreed that once the revision of ISAE 3000 is finalized, appropriate conforming amendments, if any, should be made to ISAE 3420 in due course.
78. During its deliberations in finalizing ISAE 3420, the IAASB reaffirmed that the practitioner will need to comply with the requirements of this ISAE and the overarching requirements of ISAE 3000 (including with regard to risk assessment) to be able to represent compliance with ISAE 3420 (see paragraph 12).

Nature of Subject Matter, Criteria and Subject Matter Information

79. During the finalization of ISAE 3420, the IAASB deliberated the nature of the subject matter, criteria, and subject matter information as described in the *International Framework for Assurance Engagements* in an engagement performed in accordance with ISAE 3420.
80. The IAASB concluded that in a reasonable assurance engagement to report on the compilation of pro forma financial information included in a prospectus, the subject matter, criteria, and the subject matter information are as follows:
- *Subject matter:* The steps involved in the compilation of the pro forma financial information as described in paragraph 5 of ISAE 3420.
 - *Criteria:* See paragraph 11(a) of the standard.
 - *Subject matter information:* An assertion by the responsible party as to the proper application of the criteria to the subject matter, as reflected in the presentation of the pro forma financial information (see paragraph 11(c) of the standard).
81. To be consistent with this interpretation of subject matter information, the IAASB decided to require the practitioner to obtain a written representation from the responsible party that the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria (see paragraph 28(b)).

¹⁴ ISAE 3402, *Assurance Reports on Controls at a Service Organization*

Consideration of Whether to Develop a Standard on Reporting on PFI

82. The explanatory memorandum to ED-ISAE 3420 asked for respondents' views on the following question:

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?

83. The majority of respondents did not support the development of a standard on reporting on PFI. Amongst the reasons they provided were the following:

- There is no internationally recognized and accepted framework for the preparation of PFI.
- There are considerable conceptual problems associated with the provision of assurance on hypothetical figures given that the PFI does not represent actual financial outcomes for the entity on which a "true and fair" or "present fairly" opinion might be rendered.
- There is little evidence of significant demand internationally for such a standard.
- Such a standard would not be compatible with local regulation or market practice.
- Such a standard could create a greater divide internationally.

84. Some respondents suggested, instead, that national auditing standard setters should take responsibility to develop standards to meet any such legal or regulatory needs for assurance on PFI that may exist nationally.

85. A small number of respondents were in favor of the IAASB developing a standard on reporting on PFI, mainly because this would better meet their market needs.

86. A third group of respondents suggested that the IAASB should first survey stakeholder demand before deciding whether to develop a standard on reporting on PFI. Notwithstanding this suggestion, it was noted that a reasonable assurance engagement on PFI, if it were to require full audits of all the underlying financial information, may not be a practicable and viable option given the overriding need for timely delivery of the report in the context of securities offerings.

IAASB Decision

87. Notwithstanding the conceptual issues associated with reporting on PFI, the IAASB decided that there is insufficient support and evidence of demand currently to justify a project to develop a standard on reporting on PFI. Accordingly, the IAASB will not pursue such a project at this time.