

December 2011

International Standard on Assurance Engagements (ISAE) 3420

Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus

This summary provides an overview of ISAE 3420, *Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus*

Project Objective:

The objective of the project was to develop a standard to deal with reasonable assurance engagements undertaken by professional accountants to report on the compilation of pro forma financial information by entities for inclusion in their prospectuses.

The project was undertaken in the context of the increasing globalization of the capital markets that has 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. In developing this standard, the IAASB has sought to fulfill a significant market need for harmonized practice internationally regarding reporting on the compilation of pro forma financial information included in a prospectus.

Effective Date:

Assurance reports dated on or after March 31, 2013

For More Information:

Visit the project history at www.ifac.org/auditing-assurance/projects/assurance-engagements-report-compilation-pro-forma-financial-information.

What is pro forma financial information included in a prospectus, and what purpose does such financial information serve?

Different types of pro forma financial information can be used in different contexts. Pro forma financial information included in a prospectus is a specific type of such information.

Also, a prospectus can include different types of financial information that serve different purposes. Pro forma financial information included in a prospectus serves a specific purpose.

Meaning of pro forma financial information for purposes of the standard

ISAE 3420 defines pro forma financial information covered within the scope of the standard as financial information shown together with adjustments to illustrate the impact of an event or transaction on unadjusted financial information as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration.

The standard presumes that the pro forma financial information is presented in columnar format consisting of:

- The unadjusted financial information;
- The pro forma adjustments; and
- The resulting pro forma column.

Purpose of pro forma financial information

ISAE 3420 explains that the purpose for which an entity provides pro forma financial information in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration.

The standard notes that this is achieved by applying pro forma adjustments to the unadjusted financial information.

The standard also makes clear that pro forma financial information does not represent the entity's actual financial position, financial performance, or cash flows.

When does the ISAE apply and what is the nature of the professional accountant's responsibility under the ISAE?

Given differences in legal and regulatory frameworks around the world regarding the provision of, and reporting on, pro forma financial information included in a prospectus, the ISAE specifies the circumstances in which it applies.

The ISAE also makes clear the professional accountant's responsibility regarding the compilation of the pro forma financial information.

Circumstances in which the ISAE applies

The ISAE recognizes that the nature of assurance engagements it covers will most clearly be understood in jurisdictions where law or regulation requires professional accountants to report on the compilation of pro forma financial information included in a prospectus, or where it is common market practice for entities to engage professional accountants to provide such reports.

Accordingly, the ISAE seeks to limit its application to those circumstances where:

- Reporting on the compilation of the pro forma financial information is required by securities law or the regulation of the securities exchange in the jurisdiction in which the prospectus is to be issued; or
- Such reporting is generally accepted practice in such jurisdiction.

Nature of the professional accountant's responsibility

The ISAE explains that the professional accountant's sole responsibility under the standard is to report on whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.

The standard emphasizes that in an engagement performed under the ISAE, the practitioner has no responsibility to compile the pro forma financial information for the entity and that such responsibility rests with the responsible party.

The standard also makes clear that it does not deal with non-assurance engagements in which the practitioner is engaged by the entity to compile its historical financial statements.

What does a compilation of pro forma financial information included a prospectus entail, and what is the nature of the work performed by the professional accountant?

A compilation of pro forma financial information for inclusion in a prospectus can be characterized in terms of specific steps taken by the responsible party to put the information together.

The work performed by the professional accountant focuses on whether the responsible party has appropriately followed those steps.

Compilation of pro forma financial information

ISAE 3420 explains that a compilation of pro forma financial information involves the responsible party gathering, classifying, summarizing and presenting financial information that illustrates the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at the selected date.

The standard describes the steps involved in this process as including:

- 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.

Nature of work performed by the professional accountant

The standard explains that the professional accountant performs procedures 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 reflects the proper application of those adjustments to the unadjusted financial information.

The standard explains that this work also involves evaluating the overall presentation of the pro forma financial information.

What specific issues does ISAE 3420 address?

Among other matters, ISAE 3420 establishes minimum benchmarks for criteria under which engagements can be performed under the standard; addresses the nature and extent of work effort on the unadjusted financial information of the reporting entity and on the financial information of acquirees or divestees; and deals with reporting considerations.

What minimum criteria does the ISAE specify?

ISAE 3420 requires that the criteria used to compile the pro forma financial information meet the following at a minimum:

- The unadjusted financial information is extracted from an appropriate source.
- The pro forma adjustments are directly attributable to the event or transaction, factually supportable, and consistent with the entity's applicable financial reporting framework and its accounting policies under that framework.
- Appropriate presentation is made and disclosures are provided to enable the intended users to understand the information conveyed.

Work effort on unadjusted financial information or acquiree or divestee financial information

The standard deals with various scenarios in relation to obtaining evidence regarding the appropriateness or factual support for such information, including where:

- The source from which the unadjusted or acquiree financial information has been extracted has been audited or reviewed by another practitioner.
- The source from which the unadjusted or acquiree financial information has been extracted has not been audited or reviewed.
- The historical financial information of the entity or of the acquiree has never been audited or reviewed.

Reporting considerations

To maximize its applicability globally, and ensure compatibility with law or regulation in jurisdictions that have already prescribed the wording of the opinion, ISAE 3420 allows for two alternative forms of the opinion in the professional accountant's report, i.e.:

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