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4 November 2010

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

**Subject Line: Re Proposed International Standard on Assurance Engagements 3420, “Assurance Reports on the Process to Compile Pro Forma Financial Information”**

Dear Mr. Gunn:

The International Organization of Securities Commissions’ (IOSCO) Technical Committee Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the opportunity to comment on the Exposure Draft of the proposed International Standard on Assurance Engagements 3420, *Assurance Reports on the Process Used to Compile Pro forma Financial Information*. As an international organization of securities regulators representing the public interest, IOSCO SC 1 is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing, and professional standards. Members of SC 1 seek to further IOSCO’s mission through thoughtful consideration of accounting, auditing and disclosure concerns and pursuit of improved global financial reporting. As we review proposed standards, our concerns focus on whether the standards are sufficient in scope and adequately cover all relevant aspects of the subject area being addressed, whether the standards are clear and understandable, and whether the standards are written in such a way as to be enforceable.

Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1; however, they are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

**Concern that a Report on “Process” will not be understood**

We appreciate the complexity of the issues the Board has had to deal with in developing this standard and the significant efforts involved in balancing views arising out of different practices in different jurisdictions. While we can see that the Board has addressed many of the issues in a logical and comprehensive fashion, we have concerns that the proposed report “on the process to compile pro forma financial information” will not be well understood by many users.

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We think there is considerable potential for confusion over what it is that the practitioner is giving assurance on, as many readers may not grasp the distinction between “process to prepare” and “properly compiled”, and/or may read “properly compiled” as relating to the “content of” pro forma financial information. At some point, where the process described in the ISAE includes consideration of the appropriate selection of source data for adjustments, and factual support for the adjustments made, the two aspects of pro forma reporting intersect or blend. Some of our members note that there is not always a clear distinction between these two aspects of preparing pro forma information in reality.

We note that the practitioner’s work effort described in the ED goes beyond a pure process focus in a number of instances, which we heartily support. But this does give rise to the question of whether the “assurance on the process to compile” title and characterization of the report is fully descriptive of the additional work involved.

We are concerned that the two wordings of the report offered as alternatives could be subject to significantly different interpretations by readers of the assurance reports, and we therefore urge the Board to reconsider whether it is wise to propose these two wordings for the opinion. In our opinion, the “properly compiled” version of the report more accurately portrays the additional work effort included in this ISAE, work that we believe goes beyond pure “process”. However, there may be a risk that this wording may lead a reader to think that assurance is being given on the financial information itself. For further detailed comment on this matter, please refer to our answer to Question 3 in the Annex to this letter.

Also, because there are engagements where practitioners compile financial statements for entities, i.e., do the compiling themselves as a professional accounting service, and the term compilation is used for these engagements, we believe there is a risk that the use of this term for a separate assurance engagement may confuse financial statement readers about the nature and degree of auditor and practitioner involvement with the information being presented in pro forma reporting.

To ensure that the users of pro forma information understand the meaning of the term “properly compiled” in this assurance engagement context, we think it is very important that the statement of practitioner’s responsibilities in the assurance report make it clear to the reader that the practitioner “has not performed an audit or review of the pro forma financial information” and “is not responsible for updating or reissuing any reports or opinions on any financial information used in compiling the pro forma financial information” when this is the case. In regard to the first statement, we suggest that the Board add the word “itself” to the first statement, so that it would read “we have not performed an audit or review on the pro forma information itself”, to add greater clarity and emphasis to this statement. As to the second “not responsible for” statement, we have a question about whether this statement

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would always be appropriate and believe it needs clarification in any case. For example, if the practitioner providing the assurance report on the process to compile the pro forma information is also the company's auditor for the financial statements that are the source for the unadjusted financial information, why would it be appropriate for that practitioner to make a statement that he or she is not responsible for updating auditor reports relating to the unadjusted financial information? We suggest that the Board include guidance as to when it would be appropriate to include this responsibility statement, and when it should be omitted.

We encourage the Board to explore additional ways to make the nature of the assurance being provided clear to all readers of the pro forma information and the practitioner's report involved, and to be careful that the report cannot be construed as an assurance report on pro forma financial information itself.

### **Concern over understandability of requirements**

The requirements in this proposed standard in paragraphs 17 and 18 are stated in an extremely brief and general manner. We do not think enough detail is included with these requirements to make the requirements clearly understandable on their face and have suggested some additions to the requirements text in the "Additional Comments" section in the Appendix to this letter.

We believe that ISAE 3420 should acknowledge that some jurisdictions permit, and may have requirements or standards for, the provision of assurance on the pro forma information itself and/or provide other forms of a practitioner's report. Additional guidance in this ISAE could give some mention or examples of the considerations which arise in such instances of assurance on pro forma information itself, in terms of preparation, and procedures and types of assurance given in jurisdictions where this occurs. We comment on this further later in this letter.

Some of our members believe that the Board should develop a standard that addresses reviews and examinations/audits of pro forma financial information itself, since such engagements can occur today and some regulators and national audit standard setters have issued standards and/or guidance that address the preparation of pro forma financial information itself as well as positive and/or negative assurance on such information. These members believe that the IAASB at some point will need to consider developing standards or guidance on this subject, if the Board continues to believe that adding content addressing assurance on pro forma information is beyond the scope of the current IASE 3420 Project. However, all of our members do not object to completing the ISAE 3420 project with the present scope, subject to the comments set out in our letter regarding clarifications needed.

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## **The practitioner's report**

We have already noted a concern about whether investors and other users will consistently understand the nature of the practitioner's association with pro forma financial information and the process used to produce that information, under the current structure of this standard. In regard to the form and language of the practitioner's report, we believe it is very important that this report contain a full and complete description of the procedures the practitioner has carried out in the specific engagement. This will form the basis of the reader's understanding of the auditor's association and work, and should be a very good summary of the procedures specific to the engagement and not a standard generic description.

As we reviewed the illustrative report in the ED, we noticed that the description in the report did not completely reflect the procedures and determinations required in the standard. Although the wording shown is illustrative and not mandatory, since some practitioners may use it as a starting point we suggest adding to the description of procedures so it will be a more complete illustration.

We also believe that it would be appropriate to acknowledge in the standard that some jurisdictions may have different or additional practitioner work requirements and/or other options or requirements for the form of report to be given. To elaborate on this fact, we suggest making a statement in the Application Material that the regulatory framework in a jurisdiction may allow or prescribe a different practitioner work effort and report. For example, a jurisdiction may require wording in the assurance report not only that "the information has been compiled on the basis stated" but also that "the information is consistent with the accounting policies of the issuer." (We note that there is a good discussion of the accounting policies criteria in paragraphs 16 c and A15 and A16 - it will be very important to retain this coverage as support for the report.) We also think the Application Material should note as another example that some jurisdictions may permit a negative assurance form of report.

## **Linkage with ISAE 3000 and other IFAC standards and framework**

We believe that it would be helpful for the IAASB to clarify how this ISAE interacts with/links to ISAE 3000 and ISA 200, specifically regarding the obligation attaching to properly meet the ISAE requirements and also whether the practitioner has an obligation to step back and determine whether the objectives of the ISAEs have been met. ISAE 3420 is in the Clarity format, but ISAE 3000 in the pre-Clarity format, which means ISAE 3000 has no explicitly stated objective.



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It may therefore be helpful to include certain key elements of ISAE 3000 in ISAE 3420, including, for example, the requirement to report to those charged with governance. It may also be helpful to include in ISAE 3420 wording similar to that found in paragraph 19 of ISA 200, “The auditor shall have an understanding of the entire text of an ISA, including its application and other explanatory material, to understand its objectives and to apply its requirements properly”. While this is already required for ISAE’s given paragraph 6 and the new paragraph 12(a) of the IAASB “*Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*” (2010 Edition Part I), we believe that it would be helpful for this requirement to be explicit in ISAE 3420 itself.

Attached to this letter is an Appendix in which we answer the questions posed by the Board and provide a number of additional comments that we have.

If you have any questions, please do not hesitate to call me at 202 551 5344, Susan Koski-Grafer at 202 551 5349, or Nigel James at 202 551 5394.

Julie A. Erhardt  
Chair,  
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## Appendix

### Responses to the Questions in the Exposure Draft and Other Detailed Comments from IOSCO SC 1

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).

*The membership of IOSCO SC 1 includes some jurisdictions that require or permit a form of assurance on the process used to produce pro forma information presented in a prospectus and others whose auditing standards would instead address the pro forma information itself with positive or negative assurance approaches. Therefore, not all IOSCO jurisdictions would utilize this proposed standard in its present form. There are also concerns about possible investor confusion as noted earlier in this letter.*

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?

*We would recommend some additional coverage of considerations in determining when a source of adjustments is appropriate and we believe there is a need for more specificity in the requirements section, as we have noted at the end of this letter, under the section "Additional IOSCO SC1 Comments on Text in Proposed ISAE 3420".*

*We note that the work effort already set out in this ED already appears to go beyond a pure process focus in some instances, to address considerations relating to information sources and qualities of the information involved. We think this is a good idea, that it is in the public interest to include the procedures described and further to make the additions that we recommend at the end of this letter, however, please also see our comments on the form of report in question 3 below.*

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



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- Whether the PFI has been properly compiled on the basis stated.

*We can see that the Board is trying to make the scope of the practitioner's work and assurance report clear, but we are not sure that it will be broadly understandable to persons outside the audit profession. We believe the two wordings of the report offered as alternatives could be subject to significantly different interpretations. We don't see these two forms of report as equivalent or the same. We believe the first form of the report is not sufficiently descriptive of the additional procedures involved, as the work effort goes beyond pure process. We believe the second form of report is less explicitly process oriented than the first, but there may be a risk that it could lead some investor readers to believe that the report is covering the pro forma financial information itself as well as the compilation process. Some of our members see the second form of report as preferable to the first form if the potential for misunderstanding can be addressed, because it is more fully descriptive of the practitioner's work effort involved, which is a desirable work effort. As this latter form of reporting may be understood as to go beyond the 'assurance on the process to compile', as mentioned in the title of the ISAE and in the introduction paragraphs, the potential disconnect between "properly compiled" report and the title of the ISAE will need to be clarified.*

*If the "properly compiled" form of report is retained due to its use in EU legislation, it will be especially important to make it clear in the assurance report that the pro forma information itself has not been audited or reviewed.*

*If the assurance "on the process to compile" wording in the ISAE is retained, perhaps it will be helpful to explain in the ISAE that "process" as used in this ISAE includes certain procedures that address the suitability of the source data used for the unadjusted financial information as well as procedures regarding the pro forma adjustments made.*

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?

*Our members have mixed views as to the necessity for a separate standard to be developed that would provide for an examination or review of the PFI itself and assurance report of that type. Some believe this would be very desirable, while others do not view it as necessary. As to the work effort involved, we refer the IAASB to consider the work described in existing national standards on assurance on PFI as a starting point to assess what types of effort would be involved. Some members have also commented that there could be other areas relating to a prospectus that would warrant consideration for standard setting.*



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(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?

*We believe both kinds of assurance should be addressed or at least acknowledged. To differentiate the nature and extent of the work effort for each, the IAASB could begin with national standards that exist today, utilize the content therein, and add whatever guidance would create a comprehensive standard for a global environment. We would include coverage of a principle that the level of assurance on the PFI cannot be higher than the level of assurance on the unadjusted financial information.*



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## **Additional IOSCO SC 1 Comments on Text in Proposed ISAE 3420**

*These comments note the need for some specific text changes in the ISAE. These are in addition to comments we have made earlier in our letter and should be read as a supplement to those earlier comments.*

Paragraph 2 - Footnote 32 – In addition to giving the reader a cross reference to Framework as now written, it would be helpful to repeat the definition of “responsible party” in the footnote. (As is done in Footnote 30 for the definition of “professional accountant.”)

Paragraph 4 – In the first sentence, it would seem more appropriate to the nature of pro forma reporting if the first sentence was revised to state “...*as if* the transaction or event occurred at an earlier date selected for purpose of the illustration”, substituting the words “as if” for “had” (Italics ours, to highlight the primary point we are making”).

Paragraph 5 – We suggest that “and presenting” be added to the actions described in the first sentence. This would be both complete and consistent with what is then described in the bullets in this first sentence.

Paragraph 15 – This paragraph is somewhat vague, stating only that “When planning and performing the engagement, the practitioner shall consider materiality with respect to the process to compile the pro forma financial information”. To strengthen and clarify this statement, we suggest replacing “shall consider” with “shall determine” and add the phrase “giving consideration to both qualitative and quantitative factors” at the end of the sentence.

Paragraphs 17 and 18 – These requirements paragraphs are stated in an extremely brief and general manner. We believe that some additional coverage of what is intended is needed to make them fully understandable on their face. For example, it could be helpful to expand paragraphs 17 and 18 with additional detail as follows:

“The practitioner shall determine whether the responsible party has...

17 a - Used an appropriate source of the unadjusted financial information and adequately disclosed this source, as well as whether the unadjusted information has or has not been audited or reviewed. If the unadjusted information has not been audited or reviewed, the practitioner should determine if additional procedures are needed to support the appropriateness of using this information.

17 b - Appropriately extracted a set of information that is relevant to the purpose of the illustration from the unadjusted financial information



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18 a - The responsible party has appropriately identified the pro forma adjustments and used a reasonable basis of allocation

Paragraph 22 – We would suggest that “evaluation of” replace “consideration of” in the second sentence. We also think it would be helpful to introduce the evaluation of “completeness” of adjustments, i.e., are sufficient adjustments made so that the data is not misleading. Perhaps this is implied by 22 b and c, but stating it explicitly would add clarity and emphasis.

Paragraph 31 – We think it is particularly important that the Assurance Report include a statement on whether the source of the unadjusted financial information was audited or reviewed or unaudited as stated in paragraph 31 c ii . In addition, we think the statement should indicate what type of report was made if it was other than an unmodified opinion. We also think there is a need for some reference to the condition where the practitioner is also the company’s auditor, and therefore would not be able to make a statement of having no responsibility for updating or reissuing opinions on the unadjusted financial information.

We think it would be helpful to add the word “presented” for clarity and emphasis, so that the statement would read “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 presented.”