



COMMITTEE OF EUROPEAN SECURITIES REGULATORS
THE CHAIRMAN

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Date: 22 October 2010
Ref.: CESR/10-1158

RE: Consultation on the Exposure Draft on ISAE 3420, Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus

The Committee of European Securities Regulators (CESR), through its Corporate Reporting Standing Committee, has considered the consultation document issued by the IAASB on the Exposure Draft (ED) on ISAE 3420 “Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus”.

With regard to pro forma financial information, the EU Prospectus Regulation (Commission Regulation (EC) No 809/2004) requires that the report prepared by the independent accountants or auditors must state that in their opinion (a) the pro forma financial information has been properly compiled on the basis stated and (b) that basis is consistent with the accounting policies of the issuer. CESR believes that in order to give this opinion, the practitioner will be required to perform procedures that go beyond the mere assessment of the compilation process.

This said, CESR does not believe that the focus on mere process in some parts of the ED (and indeed very prominently in its title) is actually in accordance with the work effort that the ED, including the application material within it, requires overall. In other words, CESR believes that the requirements and application material set out in the ED reflect more than just a focus on mere process and that as a result, and subject to the comments set out in this letter, the resulting work effort is likely to be appropriate to support an opinion that is in accordance with the requirements of the EU Prospectus Regulation.

On the basis of the above, CESR would like to highlight some key observations as set out below and in greater detail in appendix 1.

Proper compilation and consistency with the issuer’s accounting policies

As noted above, subject to the comments in this letter, CESR believes that the work effort set out in the ED as a whole is likely to be appropriate to support an opinion that the pro forma financial information has been properly compiled on the basis stated and is consistent with the accounting policies of the issuer. As such, CESR believes that:

- (i) The objectives of the standard (as set out in paragraph 9 of the ED) should not focus only on the process, but should also encompass proper compilation and the consistency with the accounting policies of the issuer.
- (ii) The practitioner’s opinion should explicitly state whether, in the practitioner’s view, the pro forma financial information has been properly compiled on the basis stated (which, in the EU, would be the Prospectus Regulation) and is in accordance with the issuer’s



accounting policies. In other words, the illustrative opinion as set out in the ED should contain a single option stating that the pro forma financial information is properly compiled on the basis stated and that the basis is consistent with the accounting policies of the issuer.

- (iii) The title of the practitioner's report should remove the reference to process and the wording in the report should be amended accordingly.

With regard to item (ii) above, CESR is not persuaded that the two alternatives for the opinion suggested in the ED (being "*the process to compile the pro forma financial information has ... been applied in accordance with the applicable criteria*" and "*the pro forma financial information has been properly compiled on the basis stated*") are equivalent, as seems to be suggested on page 6 of the ED. The first mentioned wording focuses inappropriately on process and thus does not reflect the work effort set out in the ED.

Status of application guidance

CESR believes that there may be a need for some of the application material to be reflected in the requirements section of the standard itself, so that it has greater prominence and status. In the answer to question 2 in Appendix 1, we have highlighted parts of the guidance that could be worth considering for this aim, including some specific suggestions.

In addition to further strengthen the importance of the application material and to clarify the interactions amongst objectives, requirements and application material CESR is of the view that it would be helpful to include in the final standard an explicit reference that the standard is to be interpreted in the same way as is explained in the context of ISAs in ISA 200.

Our detailed comments are set out in the Appendix to this letter.

We hope that you find our comments helpful and would be happy to discuss all or any of these issues further with you.

Yours sincerely,

Carlos Tavares



Appendix 1 – CESR’s detailed responses to the questions asked in the exposure draft

Question 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).

CESR is not in the position to address this matter, due to the nature of its organization. As securities regulators we would be bound to accept any style of engagement that led to an appropriate opinion being given by an accountant that complied with the Prospectus Directive. Nevertheless, as a forum of the European Securities Regulators, CESR is considering the impact that this ED might have on the entities which securities are listed on European markets. Subject to the observations set out in this letter, CESR is supportive of the use of the second alternative proposed for the assurance opinion, as long as it complies with the requirements under the EU Prospectus Regulation (i.e. that it also makes reference to consistency with the issuers accounting policies).

Question 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?

In Europe, with regard to pro forma financial information, the EU Prospectus Regulation (Commission Regulation (EC) No 809/2004) requires that the report prepared by the independent accountants or auditors must state that in their opinion (a) the pro forma financial information has been properly compiled on the basis stated and (b) that basis is consistent with the accounting policies of the issuer. CESR believes that this regulation requires the practitioner to perform work that goes beyond concentrating merely on the compilation “process” and to express an opinion accordingly.

In the ED, the practitioner is asked to report on the process to compile pro forma financial information, and this focus on process is emphasized throughout the standard: in its title, in the objectives set out in paragraph 9 which require the practitioner to obtain reasonable assurance on the fact that the process of compilation has been applied in accordance with the applicable criteria and in the wording used in the assurance report proposed in the Appendix to the ED.

This said, CESR does not believe that the apparent focus on process in the ED is actually in accordance with the work effort that the ED requires overall (as included in the requirements . and in the application material). The work effort indeed seems to reflect more than just work on the compilation process.

For example, the practitioner is required to assess the suitability of the applicable criteria, and, as part of this assessment, the practitioner is required, amongst other procedures, (as set out in paragraph 13 (b) and then under paragraph 18 (b)), to determine whether the pro forma adjustments are directly attributable to the transaction, factually supportable and consistent with the entity’s applicable financial reporting framework and its accounting policies. These procedures are further explained in the relevant application material. Overall the nature of work to be performed by the practitioner (which requires specific knowledge of the transaction and its context, consideration of the relevant accounting policies, exercise of judgement in evaluation matters, etc.) clearly suggests to us that the ED requires the work effort of the reporting accountant or auditor to go beyond the mere assessment of the compilation process. Specifically in our view the requirement to determine the consistency of the pro forma adjustments with the entity’s accounting policies goes beyond the compilation process.



This mismatch between the work effort that has to be undertaken by the practitioner and the apparent focus on process can also be found with respect to other requirements and related application material included in the ED (e.g. requirements in paragraphs 17, 18, 20, 21 and 22). The ED should be clearer in stating that the work effort encompasses work on the process and work on other substantive aspects related, for example, to the accounting policies applied, the evaluations made, the appropriateness of the unadjusted financial information, the presentation of the pro forma financial information, etc.

CESR believes that this mismatch should be eliminated from the ED because it could lead to inconsistent practices and it could create the risk of misinterpretations on requirements among practitioners. The mismatch is also reflected in the wording used in the assurance report proposed in the appendix, which refers to the process to compile, and could convey the wrong message to the readers of the report. As far as the wording of this assurance report is concerned please see our answer under question n.3.

Moreover, CESR believes that the objectives of the practitioner should be to obtain reasonable assurance about whether the pro forma financial information has been properly compiled by the responsible party in accordance with the applicable criteria and to report in accordance with the practitioner's findings, including on the consistency with the accounting policies of the issuer.

With respect to the specific requirements and Application Material related to the work effort to be undertaken by the practitioner, we also believe that in order to report on the proper compilation of the pro forma financial information in accordance to the EU regulation, some of the guidance from the application material could be brought into the requirements section of the standard, strengthening some of the current requirements and bringing clarity to the objectives and work undertaken.

In this regard, we refer particularly to the procedures to be followed as part of evaluation of the compilation process of the pro forma financial information as indicated in paragraphs 17 and 18 of the ED, that are further explained in the application material (A 29 to A35) which provides guidance on :

- Obtaining evidence on the factors to be considered in assessing whether the source represents a reliable starting point and is clearly identifiable (paragraph A29).
- Performing procedures that may be appropriate where the unadjusted financial information is not audited or reviewed (paragraph A31 – A33), including, to the extent that may be necessary, inquiries of management, high-level analytical review, reconciliation to ledgers/source documents, and corroboration of management explanations
- Assessing the appropriateness of the pro-forma adjustments by performing specific procedures on the nature of those adjustments, and the way they were determined (paragraph A34).

We believe that, for example, in order to determine whether a source of the unadjusted financial information is appropriate, the practitioner should be required to determine whether he has sufficient knowledge on the source and whether it would be necessary to perform procedures in order to support the credibility of the source. Furthermore, in order to determine the appropriateness of the pro forma adjustments, the practitioner should be required to evaluate the reasonableness of the responsible party's approach to identifying the adjustments.

Finally we believe that guidance in A21 could be expanded in order to include the possible need for the practitioner to obtain an understanding of internal controls concerning information sources relevant to the pro forma financial adjustments.



Status of application guidance

With regard to all these requirements and application material included, CESR is of the view that it would be helpful to include in the final standard 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*”. This requirement should effectively already exist with regard to this ISAE given paragraph 6 and 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). However, CESR believes that it is necessary for this requirement to be explicit in ISAE 3420 itself.

Linkage to other standards

The linkage to ISAE 3000 in paragraph 11 of the ED is not fully clear. Whereas this ED of ISAE 3420 is in the clarified format, and the practitioner as such should be required to comply with the obligations set in ISA 200 (as clarified above), ISAE 3000 is still in the pre-clarity format, which only consists of bold lettered and grey lettered requirements the exact nature of which is unclear. This makes it difficult to fully understand the linkage between these two standards. We believe that for the sake of clarity, this standard on pro forma should be a standalone standard. This would imply the inclusion in ISAE 3420 of some parts of ISAE 3000 (in the clarity format) relevant to the assurance engagement on pro-forma financial information.

Question 3

Do respondents believe that it is clear from the illustrative practitioner’s report in the Appendix to the proposed ISAE that the practitioner is reporting on the process to compile the PFI and not on the PFI itself? Paragraph A52 of the proposed ISAE, in particular, provides two alternatives for the opinion in relation to the process, i.e.

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

While CESR believes that the compilation is reflected in the opinion and that it is clear that the practitioner is not reporting on the PFI, CESR is not persuaded that the two alternatives for the opinion suggested in the ED (being “*the process to compile the pro forma financial information has ... been applied in accordance with the applicable criteria*” and “*the pro forma financial information has been properly compiled on the basis stated*”) are equivalent, as seems to be suggested on page 6 of the explanatory memorandum introducing the ED.

The wording of the first alternative focuses inappropriately on process and, as explained in our answer to question 2, we believe it does not reflect the work effort set out in the ED, giving rise to possible misunderstandings among the readers of the assurance report.

In addition to this, the focus on process in the assurance report could be read as being not in line with the EU Prospectus Regulation which requires that the report prepared by the independent accountants or auditors must state that in their opinion (a) the pro forma financial information has been properly compiled on the basis stated and (b) that basis is consistent with the accounting policies of the issuer.

The second alternative seems to be more in line with the work effort but does not refer to the consistency with the accounting policies as explicitly required by the EU regulation.

In order to have an assurance report more in line with the European regulation, CESR believes that:

- the heading of the assurance report should refer to the “*compilation*” of the pro forma financial information and not to the “*process to compile*” and that the wording throughout the report should be amended accordingly;



- the illustrative opinion as set out in the appendix of the ED should contain a single option stating that the pro forma financial information is properly compiled on the basis stated and that the basis is consistent with the accounting policies of the issuer.

For the avoidance of doubt we would specifically like it understood that although supportive of the work set out in the ED as a basis for producing the practitioner's report on pro forma financial information, as securities regulators we would find ourselves unable to accept an opinion in a prospectus that did not fully comply with that set out in the Directive itself. .

Question 4

As the proposed ISAE is designed to convey assurance on the process to compile the PFI, do respondents believe that it would be desirable for the IAASB to also develop a separate standard on reporting on the PFI itself? If yes:

As indicated above, we believe that the work undertaken by the practitioner, as required under the ED, amounts to more than simply focusing on the process. As long as the objectives, the requirements and the opinion are adjusted in the final standard such that it reflects the position proposed in our comments to question 2 and 3, we believe that no expectation gap should arise regarding the assurance provided by a pro forma opinion.

We believe that that in those cases where an issuer's financial history is more complex, pro forma financial information will need to be supplemented by other more complex financial information in order to meet the requirements of the Prospectus Directive, and as such, we would not expect the IAASB to develop a standard on reporting on the pro forma financial information itself.

(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?

As mentioned above, we do not believe that a new standard on PFI should be developed.

(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?

As mentioned above, we do not believe that a new standard on PFI should be developed.

Comments required on other matters

(a) The content of the illustrative practitioner's report

No comment.

(b) Whether the proposed ISAE will contribute to enhancing user confidence in how the PFI is produced.

No comment

(c) Effective date

No comment