



28 September 2010

Our ref: ICAEW Rep 97/10

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

Dear James

**PROPOSED ISAE 3420 ASSURANCE REPORTS ON THE PROCESS TO COMPILE PRO FORMA FINANCIAL INFORMATION INCLUDED IN A PROSPECTUS**

The ICAEW welcomes the opportunity to comment on the proposed ISAE 3420 *Assurance Reports on the Process to Compile Pro Forma Financial Information Included in a Prospectus* published by the IAASB in April 2010.

The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

We welcome the issue of this exposure draft and believe that it will contribute to a level playing field for the capital markets in the EU. SIR 4000 in the UK covers this area and we hope that there will be broad consistency between the final ISAE 3420 and SIR 4000. While we have reservations about IAASB issuing standards and guidance where application is likely to be restricted to certain jurisdictions, we believe that this standard will be helpful to jurisdictions outside the EU as well as those within it.

Our main comments, comments in response to the IAASB's specific questions and other comments are set out below; please contact me should you wish to discuss any of them.

Yours sincerely

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## MAIN COMMENTS

1. We acknowledge problems with the wording of the opinion required by the EU Prospectus Directive; it requires the independent accountants or auditors to state that in their opinion, the pro-forma financial information has been properly compiled on the basis stated, and that that basis is consistent with the accounting policies of the issuer. There is no reference to materiality, there is some lack of clarity as to whether the report is required on the compilation, the compilation process, or the PFI itself, and the reference to the *basis stated* is awkward. Nevertheless, neither of the two alternative sets of wording proposed in the exposure draft corresponds exactly to the Directive's wording and we suggest that in the interests of clarity and simplicity, a single opinion to the effect that the information *has been properly compiled on the basis stated* is adopted. No solution is perfect but multiple (supposedly equivalent) options will not promote consistency of thought or in the application of the standard. This wording, which is extracted from the Directive, is appropriately high level and flexible.
2. There appears to be a general consensus that independent accountants or auditors report on the compilation of the PFI, rather than the PFI itself<sup>1</sup>. We agree with this approach because reporting on the PFI itself, which is hypothetical information, is problematic and we think it impracticable to develop standards on how to report on output unless and until there is a far more comprehensive and generally accepted framework for preparation of pro-forma financial information. Nevertheless, the distinction between process and output is far from hard - reporting on process involves a great deal of work on output - and the exposure draft as it stands focuses excessively on process in an unsuccessful attempt at embedding that distinction. The exposure draft is a difficult read - indeed at times it appears internally inconsistent - because of this unnecessarily narrow focus on the compilation process, rather than the compilation as a whole. For example, many of the paragraph 13 criteria<sup>2</sup> clearly appertain (or can easily be construed as appertaining) to the PFI rather than the process to compile it, and the wording of the example report in the appendix dealing with procedures, makes it very clear that the independent accountant or auditor is required to take a view on the PFI itself<sup>3</sup>, for the purposes of forming a view on process. These problems might be ameliorated by clearer inclusion of references to the overall view that the process creates in the PFI itself. Does the process result in an illustration of the position as required? The hard and awkward distinction drawn in the explanatory memorandum on p7 between criteria for process and disclosure criteria in a financial reporting framework might not be necessary if IAASB were to take a less conservative approach by making it clear that one part of reporting on the compilation as a whole (including the process) involves examining or evaluating the PFI itself, which in practice it does, and as the exposure draft requires.
3. The implications of A23 (absence of controls) warrant further development.
4. The proposals suffer from very complex cross-referencing to the application material.

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<sup>1</sup> This is the view of, among others, the Committee for European Securities Regulators

<sup>2</sup> Such as *...applicable criteria shall encompass as a minimum that...appropriate presentation be made and disclosures provided...*

<sup>3</sup> Such as *...Evaluating the overall presentation and disclosure of the pro-forma financial information...*

## ANSWERS TO IAASB's SPECIFIC QUESTIONS

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 UK's Auditing Practices Board (APB) has not yet determined how the document might be used in the UK and there are elements of the draft that may still present difficulties. For example, UK practices are moving away from boilerplate disclosure of procedures in assurance reports. Furthermore, operationalising the standard depends on compliance with ISAE 3000 which itself is in the process of revision and which has not been adopted by the APB in the UK. We hope that the final standard will enable APB to form a positive view of the alignment of SIR 4000 and ISAE 3420, and such a view will be more easily facilitated if the standard stands alone, without reference to ISAE 3000, but we think it unlikely that ISAE 3420 will be adopted by APB in the UK.

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?*

While the work effort set out in the proposed ISAE is sufficient and appropriate to enable the practitioner to express the opinion set out in the proposed report, the report itself does not make this clear in two ways. Firstly, in our main comments above we note the apparent misalignment between the work proposed and the opinion required resulting from excessive focus on the process to compile in the PFI at the expense of the compilation as a whole. Secondly, the summary of procedures included in the report does not sit comfortably with the opinion below it because it is not comprehensive and should be shortened to a summary statement (as proposed in IAASB's Greenhouses Gasses working papers) rather than the current *include* statement (which begs the question as to what has been left out). Alternatively, a simple statement of compliance with the requirements of the standard (as required by SIR 4000) might be required.

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.*

See our main comments above. The wording of the proposed opinions are not aligned with the EU Prospectus Directive and can easily be read as referring to the PFI rather than the compilation or compilation process. The wording of the opinion should either be aligned with the Directive's requirements - that the PFI has been *properly compiled on the basis stated* - or it should be shortened to a simple reference to the PFI being *properly compiled*. In order to prevent misunderstanding, it would be helpful to have the cautionary wording in the report closer to the opinion itself and for references to be made to *management's process* to compile PFI. If the proposed wording is retained, it would be important to state clearly, within the definitions perhaps, that the criteria refer to the compilation or the compilation process and not to the PFI *per se*.

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:*

*(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?*

There is no demand in the UK for such a standard. We believe it would be very difficult to obtain the required level of assurance on what is effectively hypothetical information. If IAASB were to decide that standards and guidance were needed however, there would likely be a substantial base level of work that is common to engagements to obtain assurance on process and engagements to report on the PFI itself. Any such standard would be duplicative to a large extent and, if it were considered necessary, it would be preferable to develop a standard that dealt with both types of assurance.

*(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?*

It would not be helpful to address limited assurance because it would be very difficult to draw a distinction between the procedures required for the two types of engagement. There is in any case no call for such assurance in the UK.

#### *Developing Nations*

*Recognising that many developing nations have adopted or are in the process of adopting the International Standards, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed ISAE in a developing nation environment.*

We have no comment to make on this subject.

#### *Translations*

*Recognizing that many respondents may intend to translate the final ISAE for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents may note in reviewing the proposed ISAE.*

We have no comment to make on this subject.

#### *Effective Date*

*Recognising that the proposals in the proposed ISAE do not establish fundamentally new assurance principles and that the subject matter of the proposed ISAE does not represent a fundamentally new area of practice for the profession, and given the public interest need to harmonize inconsistent practice internationally as soon as practicable, the IAASB believes that an appropriate effective date for the standard would be 18 months after the date of final approval of the standard. The IAASB welcomes comment on whether this lead time relative to the effective date would provide a sufficient period to support effective implementation of the standard.*

A lead time of 18 months after the date of final approval of the standard would provide a sufficient period to support effective implementation of the standard.

## **OTHER COMMENTS**

1. Paragraph A41 on disclosures is effectively guidance on management's presentation of the PFI and only applies absent relevant law or regulation. It may be helpful to point this out.
2. While it is unlikely that historical information on which the PFI is based will often be unaudited or unreviewed, where such circumstances arise, the process risks may be greater than normal and it may be helpful to point this out in A33.
3. A modified opinion on process may be difficult to justify in any circumstances and it may be helpful to suggest that the requirements of paragraph 28 – auditors withhold the report, withdraw or take legal advice when management refuse to make changes necessary to achieve an unmodified opinion where modified opinions are prohibited – may equally be applicable where law and regulation are silent on the issue of modified opinions.