

SAE 3420**Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus****SAE MAP**

- 1.What do you mean by Pro Forma Financial Information?
- 2.What Factors should be considered before accepting such assignments?
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1.What do you mean by Pro Forma Financial Information?

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. In this SAE, it is presumed that pro forma financial information is presented in columnar format consisting of (a) the unadjusted financial information; (b) the pro forma adjustments; and (c) the resulting pro forma column.

For example, the entity may acquire a number of businesses prior to an initial public offering. In such circumstances, the responsible party may choose to present a pro forma net asset statement to illustrate the impact of the acquisitions on the entity's financial position and key ratios such as debt to equity as if the acquired businesses had been combined with the entity at an earlier date. The responsible party may also choose to present a pro forma income statement to illustrate what the results of operations might have been for the period ended on that date. In such cases, the nature of the pro forma financial information may be described by titles such as "Pro Forma Balance Sheet as at March 31, 20X1" and "Pro Forma Statement of profit and loss for the Year Ended March 31, 20X1"

Key to remember

Suppose Flipkart Ltd acquires Snapdeal Ltd who was biggest on 1st April 2017 and plan IPO in June 2017 for which financial statements of FY 14-15 were supposed to be presented in prospectus, but problem is effect of acquisition will not be reflected in financial statements of FY 14-15, so we will assume that acquisition has taken place on 1st April "2014" and adjust their financial statements.

Example

<i>Particulars</i>	<i>Flipkart Ltd Audited Unadjusted</i>	<i>Snapdeal Ltd Audited Unadjusted</i>	<i>Pro-forma Adjustments Inter Co</i>	<i>Pro-Forma Resulting Financials</i>
<i>Sales</i>	<i>5,000</i>	<i>3,000</i>	<i>(200)</i>	<i>7,800</i>

2. What Factors should be considered before accepting such assignments?

Before agreeing to accept an engagement to report on whether pro forma financial information included in a prospectus has been compiled, in all material respects, on the basis of the applicable criteria, the practitioner shall:

(a) Determine that the practitioner has the capabilities and competence to perform the engagement; *(Eg Whether he has worked in e-commerce business before, whether he has done such assignments before or has he taken training or intensive study on these assignments and expects to get command and as per ICDR 2009 only statutory auditor can do such assignments)*

(b) On the basis of a preliminary knowledge of the engagement circumstances and discussion with the responsible party *(Eg Flipkart)*, determine that the applicable criteria (Eg Issue of Capital & Disclosure Requirements 2009 (ICDR) regulation of SEBI) are suitable and that it is unlikely that the pro forma financial information will be misleading *(Eg It says it is mandatory to merge or demerge only material subsidiaries while preparing pro-forma financial statements)* for the purpose for which it is intended;

(c) Evaluate the wording of the opinion prescribed by the relevant law or regulation, if any, to determine that the practitioner will likely be able to express the opinion so prescribed based on performing the procedures specified in this SAE; *(Eg In India regulations don't provide any wordings do this point is not much use but if they say to give absolute assurance that pro-forma financial statements give true & fair view then that will be unacceptable)*

(d) Where the sources from which the unadjusted financial information and any acquiree or divestee financial information have been extracted have been audited or reviewed and a modified audit opinion or review conclusion has been expressed, or the report contains an Emphasis of Matter paragraph, consider whether or not the relevant law or regulation permits the use of, or reference in the practitioner's report to, the modified audit opinion or review conclusion or the report containing the Emphasis of Matter paragraph with respect to such sources;

(Eg In India regulations are silent about it but if in future they prohibit use of modified audit opinion then we will have to decline such assignments and ensure clean financial statements & report)

(e) If the entity's historical financial information has never been audited or reviewed, consider whether the practitioner can obtain a sufficient understanding of the entity and its accounting and financial reporting practices to perform the engagement;

(Eg This is a rare event in case of company who wants to get listed, we should not accept such assignments)

(f) If the event or transaction includes an acquisition and the acquiree's historical financial information has never been audited or reviewed, consider whether the practitioner can obtain a sufficient understanding of the acquiree and its accounting and financial reporting practices to perform the engagement; and

(Eg Again it seems to be unrealistic situation but if we can go to acquiree and collect info & are satisfied with accounting & financial reporting we may accept the assignment)

(g) Obtain the agreement of the responsible party that it acknowledges and understands its responsibility for:

(i) Adequately disclosing and describing the applicable criteria to the intended users if these are not publicly available;

(ii) Compiling the pro forma financial information on the basis of the applicable criteria; and

(iii) Providing the practitioner with:

a. Access to all information (including, when needed for purposes of the engagement, information of the acquiree(s) in a business combination), such as records, documentation and other material, relevant to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria;

b. Additional information that the practitioner may request from the responsible party for the purpose of the engagement;

c. Access to those within the entity and the entity's advisors from whom the practitioner determines it necessary to obtain evidence relating to evaluating whether the proforma financial information has been compiled, in all material respects, on the basis of the applicable criteria;

and

d. When needed for purposes of the engagement, access to appropriate individuals within the acquiree(s) in a business combination.

Key to remember

Competence & Capabilities → Suitability of Criteria / Is it Misleading? → Audit / Review of Acquiring Company → Audit Review of Subsidiary Company → Modified report of acquiring company → Wordings of opinion prescribed by Criteria → Agreement regarding their responsibility to prepare pro-forma financial statements / follow criteria / disclose criteria if not available publicly / access to information available / prepare additional information as requested / access to people of acquiring company and acquiree company

3.How to plan & perform such assurance engagement?

→Assessing the Suitability of the Applicable Criteria

The practitioner shall assess whether the applicable criteria are suitable, as required by the Framework for Assurance Engagements, and in particular shall determine that they include, at a minimum, that:

(a) The unadjusted financial information be extracted from an appropriate source;

(b) The pro forma adjustments be:

(i) Directly attributable to the event or transaction;

(ii) Factually supportable; and

(iii) Consistent with the entity's applicable financial reporting framework and its accounting policies under that framework; and

(c) Appropriate presentation be made and disclosures be provided to enable the intended users to understand the information conveyed.

In addition, the practitioner shall assess whether the applicable criteria are:

(a) Consistent, and do not conflict, with relevant law or regulation; and

(b) Unlikely to result in pro forma financial information that is misleading.

→Materiality

When planning and performing the engagement, the practitioner shall consider materiality with respect to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.

→Obtaining an Understanding of How the Responsible Party Has Compiled the Pro Forma Financial Information and Other Engagement Circumstances

The practitioner shall obtain an understanding of:

(a) The event or transaction in respect of which the pro forma financial information is being compiled;

(b) How the responsible party has compiled the pro forma financial information;

(c) The nature of the entity and any acquiree or divestee, including:

(i) Their operations;

(ii) Their assets and liabilities; and

(iii) The way they are structured and how they are financed;

(d) Relevant industry, legal and regulatory, and other external factors pertaining to the entity and any acquiree or divestee; and

(e) The applicable financial reporting framework and the accounting and financial reporting practices of the entity and of any acquiree or divestee, including their selection and application of accounting policies.

→Obtaining Evidence about the Appropriateness of the Source from Which the Unadjusted Financial Information Has Been Extracted

The practitioner shall determine whether the responsible party has extracted the unadjusted financial information from an appropriate source.

If there is no audit or review report on the source from which the unadjusted financial information has been extracted, the practitioner shall perform procedures to be satisfied that the source is appropriate.

The practitioner shall determine whether the responsible party has appropriately extracted the unadjusted financial information from the source.

→Obtaining Evidence about the Appropriateness of the Pro Forma Adjustments

In evaluating whether the pro forma adjustments are appropriate, the practitioner shall determine whether the responsible party has identified the proforma adjustments necessary to illustrate the impact of the event or transaction at the date or for the period of the illustration.

In determining whether the pro forma adjustments are in accordance with the applicable criteria, the practitioner shall determine whether they are:

- (a) Directly attributable to the event or transaction;
- (b) Factually supportable.

If acquiree or divestee financial information is included in the pro forma adjustments and there is no audit or review report on the source from which such financial information has been extracted, the practitioner shall perform procedures to be satisfied that the financial information is factually supportable; and

- (c) Consistent with the entity's applicable financial reporting framework and its accounting policies under that framework.

→Modified Audit Opinion or Review Conclusion, or Emphasis of Matter Paragraph, with Respect to the Source from Which the Unadjusted Financial Information Has Been Extracted or the Source from Which the Acquiree or Divestee Financial Information Has Been Extracted

A modified audit opinion or review conclusion may have been expressed with respect to either the source from which the unadjusted financial information has been extracted or the source from which the acquiree or divestee financial information has been extracted, or a report containing an Emphasis of Matter paragraph may have been issued with respect to such source. In such circumstances, if the relevant law or regulation does not prohibit the use of such a source, the practitioner shall evaluate:

- (a) The potential consequence on whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria;
- (b) What further appropriate action to take; and
- (c) Whether there is any effect on the practitioner's ability to report in accordance with the terms of the engagement, including any effect on the practitioner's report.

→Source from Which the Unadjusted Financial Information Has Been Extracted or Pro Forma Adjustments Not Appropriate

If, on the basis of the procedures performed, the practitioner identifies that the responsible party has:

- (a) Used an inappropriate source from which to extract the unadjusted financial information; or
- (b) Omitted a pro forma adjustment that should be included, applied a proforma adjustment that is not in accordance with the applicable criteria or otherwise inappropriately applied a pro forma adjustment, the practitioner shall discuss the matter with the responsible party. If the practitioner is unable to agree with the responsible party as to how the matter should be resolved, the practitioner shall evaluate what further action to take.

→Obtaining Evidence about the Calculations within the Pro Forma Financial Information

The practitioner shall determine whether the calculations within the proforma financial information are arithmetically accurate.

→Evaluating the Presentation of the Pro Forma Financial Information

The practitioner shall evaluate the presentation of the pro forma financial information. This shall include consideration of:

(a) The overall presentation and structure of the pro forma financial information, including whether it is clearly labelled to distinguish it from historical or other financial information;

(b) Whether the pro forma financial information and related explanatory notes illustrate the impact of the event or transaction in a manner that is not misleading;

(c) Whether appropriate disclosures are provided with the pro forma financial information to enable the intended users to understand the information conveyed; and

(d) Whether the practitioner has become aware of any significant events subsequent to the date of the source from which the unadjusted financial information has been extracted that may require reference to, or disclosure in, the pro forma financial information.

The practitioner shall read the other information included in the prospectus containing the pro forma financial information to identify material inconsistencies, if any, with the pro forma financial information. If, on reading the other information, the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact in that other information, the practitioner shall discuss the matter with the responsible party.

If correction of the matter is necessary and the responsible party refuses to do so, the practitioner shall take further appropriate action.

→Written Representations

The practitioner shall request written representations from the responsible party that:

(a) In compiling the pro forma financial information, the responsible party has identified all appropriate pro forma adjustments necessary to illustrate the impact of the event or transaction at the date or for the period of the illustration; and

(b) The pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.

1. *Understand criteria and determine is it conflicting as per FRF of entity or any other regulations → Will it be suitable for the source financial statements / adjustments to made & FRF applicable / will it provide adequate disclosures.*
2. *Determine materiality*
3. *Obtain understanding of the assignment → Understand events (Acquisition / Disinvestment) which are reason behind pro-forma financial statements / Understand*

relevant industry & regulations / Nature of their operations / Understand FRF applicable / Understand nature of income, expense, assets, liabilities

- 4. Obtain source of unadjusted financial statements (If its audited / reviewed take corresponding reports and read them and if not collect additional information to get satisfied) → Consider if they are modified & take suitable action (if source financial statements of any entity are modified / EMP consider impact on pro-forma financial statements and take appropriate action)*
- 5. Obtain evidence about appropriateness of adjustments → Adjustments can be for harmonisation of accounting policy, goodwill / capital reserve arising out of acquisition / adjustment for borrowings or further issue for acquisition / intercompany transactions, balances to be nullified, stock reserve etc. as we see in consolidation → These adjustments should be directly attributable to the event → it should be factually supportable → Adjustments should be consistent with FRF of acquiring company → If information of acquiree company is not audited then we should collect sufficient & appropriate information to be satisfied about its appropriateness*
- 6. Check their arithmetical accuracy (Recalculate figures of adjustments as appearing in working notes provided and also recalculate their effect on unadjusted financial statements)*
- 7. Presentation & Disclosure in Pro-forma financial statements (Pro-Forma Statements should have appropriate title / each column should have proper label to avoid miscommunication / ensure that they are not misleading / for each adjustment suitable notes should be presented which explains rational behind the adjustment / read other information in prospectus and see if there is material inconsistency or material misstatement of fact as explained in SA 720 and take appropriate action)*
- 8. Written Representation (All appropriate adjustments are identified to reflect impact / Criteria followed in all material respects)*
- 9. After performing all above if practitioner comes to know that Source or Adjustment Inappropriate (If source unadjusted financial statements are unreliable or adjustments are not as per criteria then discuss it with client and ask them to change if they don't agree take appropriate action)*

4. Considerations while forming opinion?

The practitioner shall form an opinion 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.

In order to form that opinion, the practitioner shall conclude whether the practitioner has obtained sufficient appropriate evidence about whether the compilation of the pro forma financial information is free from material omissions, or inappropriate use or application of a pro forma adjustment. That conclusion shall include an evaluation of whether the responsible party has adequately disclosed and described the applicable criteria to the extent that these are not publicly available.

→ Form of Opinion

Unmodified Opinion

The practitioner shall express an unmodified opinion when the practitioner concludes that the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.

Modified Opinion

Where the relevant law or regulation precludes (*not allowed*) publication of a prospectus that contains a modified opinion with regard to whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria and the practitioner concludes that a modified opinion is nevertheless appropriate in accordance with the Framework for Assurance Engagements, the practitioner shall discuss the matter with the responsible party.

If the responsible party does not agree to make the necessary changes, the practitioner shall:

- (a) Withdraw from the engagement; or
- (b) Consider seeking legal advice.

Where the relevant law or regulation may not preclude publication of a prospectus that contains a modified opinion with regard to whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria and the practitioner determines that a modified opinion is appropriate in accordance with the Framework for Assurance Engagements, the practitioner shall apply the requirements in the Framework for Assurance Engagements regarding modified opinions.

Emphasis of Matter Paragraph

In some circumstances, the practitioner may consider it necessary to draw users' attention to a matter presented or disclosed in the pro forma financial information or the accompanying explanatory notes. This would be the case when, in the practitioner's opinion, the matter is of such importance that it is fundamental to users' understanding of whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria. In such circumstances, the practitioner shall include an Emphasis

of Matter paragraph in the practitioner's report provided that the practitioner has obtained sufficient appropriate evidence that the matter does not affect whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria. Such a paragraph shall refer only to information presented or disclosed in the pro forma financial information or the accompanying explanatory notes.

5. How to prepare assurance Report?

(Title) INDEPENDENT PRACTITIONER'S ASSURANCE REPORT ON THE COMPILATION OF PRO FORMA FINANCIAL INFORMATION INCLUDED IN A PROSPECTUS

(Addressee) [Appropriate Addressee(s)]

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

(Intro Para) We have completed our assurance engagement to report on the compilation of pro forma financial information of ABC Company by [the responsible party]. The pro forma financial information consists of [the pro forma balance sheet as at [date]], [the pro forma statement of profit and loss for the period ended [date]], [the pro forma cash flow statement for the period ended [date],] and related notes [asset out on pages xx-xx of the prospectus issued by the company]. The applicable criteria on the basis of which [the responsible party] has compiled the pro forma financial information are [specified in [Securities Regulation XX] and described in [Note X]]/[described in [Note X]].

The pro forma financial information has been compiled by [the responsible party] to illustrate the impact of the [event or transaction] [set out in Note X] on the [company's financial position as at specify date] [and] [the company's/its financial performance [and cash flows] for the period ended specify date] as if the [event or transaction] had taken place at [specify date] [and specify date respectively]. As part of this process, information about the company's [financial position], [financial performance] [and cash flows] has been extracted by [the responsible party] from the company's financial statements [for the period ended [date]], on which [[an audit]/[a review] report]/[no audit or review report] has been published.

(Like Management's Responsibility) [The Responsible Party's] Responsibility for the Pro Forma Financial Information [The responsible party] is responsible for compiling the pro forma financial information on the basis of the [applicable criteria]. This responsibility includes the responsibility for designing, implementing and maintaining internal control relevant for compiling the pro forma financial information on the basis of the [applicable criteria] that is free from material misstatement, whether due to fraud or error. The {Responsible party} is also responsible for identifying and ensuring that the Company complies with the laws and regulations applicable to its activities, including

compliance with the provisions of the laws and regulations for the compilation of Pro Forma Financial Information.

(Like Auditor's Responsibility) Practitioner's Responsibilities

Our responsibility is to express an opinion, as required by[Reference to the relevant law or regulation], about whether the pro forma financial information has been compiled, in all material respects, by [the responsible party] on the basis of the[applicable criteria].

We conducted our engagement in accordance with Standard on Assurance Engagements (SAE) 3420, Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus, issued by the Institute of Chartered Accountants of India. This Standard requires that the practitioner comply with ethical requirements and plan and perform procedures to obtain reasonable assurance about whether [the responsible party] has compiled, in all material respects, the pro forma financial information on the basis of the[applicable criteria].

For purposes of this engagement, we are not responsible for updating or reissuing any reports or opinions on any historical financial information used in compiling the pro forma financial information, nor have we, in the course of this engagement, performed an audit or review of the financial information used in compiling the pro forma financial information.

The purpose of pro forma financial information included 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.

Accordingly, we do not provide any assurance that the actual outcome of the event or transaction at[specify date] would have been as presented.

A reasonable assurance engagement to report on whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria involves performing procedures to assess whether the applicable criteria used by [the responsible party] in the compilation of the proforma 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 pro forma financial information reflects the proper application of those adjustments to the unadjusted financial information.

The procedures selected depend on the practitioner's judgment, having regard to the practitioner's understanding of the nature of the company, the event or transaction in respect of which the pro forma financial information has been compiled, and other relevant engagement circumstances.

The engagement also involves evaluating the overall presentation of the proforma financial information.

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

(Opinion)Opinion

In our opinion, [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].

Report on Other Legal or Regulatory Requirements

[Relevant law or regulation may require the practitioner to express an opinion on other matters. The form and content of this section of the practitioner's report will vary with the nature of such other reporting responsibilities.]

Signature / Date / Place

ICDR Requirement**(23) Proforma Financial Statements**

(1) In addition to other requirements laid down in these regulations and subject to the stipulation in sub-para (3) of this para, the issuer shall disclose Proforma Financial Statements in the offer document, if—

(a) an acquisition or divestment is made by the issuer after the end of the latest disclosed annual financial results in the offer document, due to which certain companies become/cease to be direct or indirect subsidiaries of the issuer, and

(b) the financial statements of such acquired or divested entity is material to the financial statements of the issuer company.

Explanation: The financial statements of the acquired or divested entity shall be —materiall to the financial statements of the issuer if:

(i) the total book value of the assets of the acquired/ divested entity amounts to more than 20% of the pre-acquisition/pre-divestment book value of the assets of the issuer;

or

(ii) the total income of the acquired/divested entity amounts to more than 20% of the pre-acquisition/pre-divestment total income of the issuer.

(2) Proforma Financial Statements shall be disclosed in respect of the following, namely: —

i. the last completed accounting year, and

ii. the period beginning from the date of the end of the last completed accounting year and ending on the date on which financial statements of the issuer have been disclosed in the offer document.

(3) Where the said acquisition or divestment does not fulfil the tests of materiality specified in clause 23(1)(b) above, the fact of the acquisition or divestment along with the consideration paid/received and the mode of financing such acquisition shall be disclosed.

(4) The information disclosed as per sub-clause (2) and (3) above shall be certified by the statutory auditor of the issuer