

## AR-C Section 120

# Compilation of Pro Forma Financial Information

(Supersedes SSARS No. 14)

Source: SSARS No. 22

Effective for compilation reports on pro forma financial information dated on or after May 1, 2017.

## Introduction

### Scope of This Section

.01 This section contains performance and reporting requirements and application guidance for accountants engaged to perform a compilation engagement on pro forma financial information. (Ref: par. .A1)

### Effective Date

.02 This section is effective for compilation reports on pro forma financial information dated on or after May 1, 2017.

## Objective

.03 The objective of the accountant in a compilation of pro forma financial information is to apply accounting and financial reporting expertise to assist management in the presentation of pro forma financial information and report in accordance with this section without undertaking to obtain or provide any assurance on the pro forma financial information.

## Definition

.04 For purposes of this section, the following term has the meaning attributed as follows:

**Pro forma financial information.** A presentation that shows what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. (Ref: par. .A2–.A5)

## Requirements

### General Principles for Compilations of Pro Forma Financial Information

.05 In addition to complying with this section, an accountant is required to comply with section 60A, *General Principles for Engagements Performed in*

*Accordance With Statements on Standards for Accounting and Review Services, adapted as necessary.*

## **Independence**

**.06** In a compilation of pro forma financial information, the accountant must determine whether the accountant is independent of the entity. (Ref: par. .A6)

## **Acceptance and Continuance of Client Relationships**

**.07** As a condition for accepting an engagement to perform a compilation on pro forma financial information, in addition to the requirements in paragraph .25 of section 60A, adapted as necessary, the accountant should obtain the agreement of management that it acknowledges and understands its responsibility for the following: (Ref: par. .A7)

- a. The preparation and fair presentation of pro forma financial information in accordance with the applicable financial reporting framework (Ref: par. .A8)
- b. To include the following in any document that contains the pro forma financial information:
  - i. The complete financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) or such financial statements are readily available (Ref: par. .A9)
  - ii. If pro forma financial information is presented for an interim period, either historical interim financial information for that period (which may be in condensed form) or that such interim information is readily available (Ref: par. .A10)
  - iii. In the case of a business combination, the relevant historical financial information for the significant constituent parts of the combined entity
- c. To ensure that the financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based have been subjected to a compilation, review, or an audit engagement
- d. To include the accountant's compilation or review report or the auditor's report on the financial statements (or to have readily available) in any document containing the pro forma financial information
- e. To present a summary of significant assumptions with the pro forma financial information
- f. To obtain the accountant's permission prior to including the accountant's compilation report in any document containing the pro forma financial information that indicates that the entity's accountant has performed a compilation engagement on such pro forma financial information

**.08** If the accountant is not satisfied about any of the matters set out in paragraph .25 of section 60A or paragraph .07 of this section as preconditions for accepting a compilation engagement with respect to pro forma financial

information, the accountant should discuss the matter with management. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed compilation engagement.

## Agreement on Engagement Terms

**.09** The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A11–.A16)

- a.* The objectives of the engagement
- b.* The responsibilities of management set forth in paragraph .25c of section 60A and paragraph .07 of this section
- c.* The responsibilities of the accountant
- d.* The limitations of the compilation engagement
- e.* Identification of the applicable financial reporting framework for the preparation of the pro forma financial information
- f.* The expected form and content of the accountant's compilation report and a statement that there may be circumstances in which the report may differ from its expected form and content

**.10** The engagement letter or other suitable form of written agreement should be signed by

- a.* the accountant or the accountant's firm, and
- b.* management or those charged with governance, as appropriate. (Ref: par. .A12)

## The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework

**.11** The accountant should obtain an understanding of the applicable financial reporting framework and the significant accounting policies intended to be used in the preparation of the pro forma financial information. If the entity is a combined entity, the accountant should obtain an understanding of the significant accounting policies adopted by management of each significant constituent part of the combined entity that would have been required to have been obtained by the accountant performing a compilation engagement with respect to the financial statements of each entity for the most recent annual or interim period for which the pro forma financial information is presented. (Ref: par. .A17–.A18)

## Compilation Procedures

**.12** In performing a compilation of pro forma financial information, the accountant should do the following:

- a.* Comply with the requirements set forth in paragraphs .13–.16 of section 80A, adapted as necessary. (Ref: par. .A19)
- b.* Obtain an understanding of the underlying transaction or event.
- c.* Ascertain that management has fulfilled its agreement pursuant to paragraph .07b of this section to include the following in any document that contains the pro forma financial information:

- i. The complete financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) or such financial statements are readily available
  - ii. If pro forma financial information is presented for an interim period, either historical interim financial information for that period (which may be in condensed form) or that such interim information is readily available
  - iii. In the case of a business combination, the relevant financial information for the significant constituent parts of the combined entity
- d. Ascertain that management has fulfilled its agreement pursuant to paragraph .07c of this section to ensure that the financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based have been subjected to a compilation, review, or an audit engagement.
- e. Ascertain that management has fulfilled its agreement pursuant to paragraph .07d of this section to include the accountant's compilation or review report or the auditor's report on the financial statements (or have readily available) in any document containing the pro forma financial information.

## The Accountant's Compilation Report on Pro Forma Financial Information

**.13** The accountant's compilation report should be in writing and comply with the requirements set forth in paragraphs .17–.31 of section 80A (Ref: par. .A20–.A22)

**.14** In addition to the report elements required by paragraph .17 of section 80A, an accountant's compilation report on pro forma financial information should include the following:

- a. A reference to the financial statements from which the historical financial information is derived and a statement as to whether such financial statements were subjected to an audit, a review, or a compilation engagement
- b. A reference to any modification of the audit, review, or compilation report on the historical financial information
- c. A description of the nature and limitations of pro forma financial information

## Documentation

**.15** The accountant should prepare documentation in connection with each compilation of pro forma financial information in sufficient detail to provide a clear understanding of the work performed, which, at a minimum, includes the following: (Ref: par. .A23)

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .09–.10
- b. The results of procedures performed in accordance with paragraph .12

- c. A copy of the pro forma financial information
- d. A copy of the accountant's compilation report

## Application and Other Explanatory Material

### Scope of This Section (Ref: par. .01)

**.A1** A compilation engagement on pro forma financial information may be undertaken as a separate engagement or in conjunction with a compilation, a review, or an audit of financial statements.

### Definition (Ref: par. .04)

**.A2** Pro forma financial information is developed by applying pro forma adjustments to historical financial information. Appropriate pro forma adjustments are based on management's assumptions, give effect to all significant effects directly attributable to the transaction (or event), and are stated on a basis consistent with the financial reporting framework of the reporting entity and its accounting policies under that framework.

**.A3** Pro forma financial information is commonly used to show the effects of a transaction (or event) such as the following:

- Business combination
- Change in capitalization
- Disposition of a significant portion of the business
- Change in the form of business organization or status as an autonomous entity
- Proposed sale of securities and the application of the proceeds

**.A4** Adequately disclosed pro forma financial information is labeled as such to distinguish it from other historical financial information. In addition, adequately disclosed financial information

- describes the transaction (or event) that is reflected in the pro forma financial information, the date on which the transaction (or event) is assumed to occur, the financial reporting framework of the financial statements, the source of the historical financial information on which it is based, the significant assumptions used to develop the pro forma adjustments, and any significant uncertainties about those assumptions.
- indicates that the pro forma financial information should be read in conjunction with the related historical financial information and that the pro forma financial information is not necessarily indicative of the results (such as financial position, results of operations, and cash flows, as applicable) that would have been attained had the transaction (or event) actually taken place earlier.

**.A5** Article 11 of Regulation S-X provides further guidance on the presentation of pro forma financial information included in filings with the SEC.

### Independence (Ref: par. .06)

**.A6** The interpretations of the "Independence Rule", (ET sec. 1.200.001) of the AICPA Code of Professional Conduct provide authoritative guidance on independence. It is in the public interest and, therefore, required by this section,

that the accountant modify the accountant's compilation report when the accountant is not independent of the entity whose pro forma financial information is the subject of the compilation engagement. The AICPA Code of Professional Conduct also defines *independence* as consisting of two elements, independence of mind and independence in appearance. Independence enhances the accountant's ability to act with integrity and be objective. Independence implies an impartiality that recognizes an obligation to be fair not only to the responsible party but also to users of the pro forma financial information who may rely upon the accountant's compilation report. In the absence of an interpretation of the "Independence Rule" that addresses a particular relationship or circumstance, a member should apply the "Conceptual Framework for Independence" interpretation (ET sec. 1.210.010).

## Acceptance and Continuance of Client Relationships (Ref: par. .07)

**.A7** Financial statements and historical interim financial information are deemed to be *readily available* if they are obtainable by a third-party user without any further action by the entity. For example, historical interim financial information on an entity's website may be considered readily available; however being available upon request is not considered readily available.

**.A8** A compilation in accordance with SSARs is conducted on the premise that management has acknowledged and understands that it has the responsibility set out in paragraph .25c of section 60A. The preparation of pro forma financial information, in whole or in part, is a nonattest service subject to the provisions of the "Nonattest Services" subtopic (ET section 1.295) of the "Independence Rule." To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the compilation engagement as required by paragraphs .13–.15.

**.A9** For purposes of this standard, *complete financial statements* means the financial statement or financial statements, including related notes if presented, that have been subjected to a compilation, a review, or an audit engagement. For example, if a balance sheet, income statement, statement of cash flows, and related notes were subjected to a compilation, a review, or an audit engagement, all are presented. If only a single financial statement is subjected to a compilation, a review, or an audit engagement or financial statements that omit all or substantially all disclosures are subjected to a compilation engagement, only that financial statement is (or those statements are) presented.

**.A10** Interim historical financial information may be presented as a column in the pro forma financial information.

## Agreement on Engagement Terms (Ref: par. .09–.10)

**.A11** Both management and the accountant have an interest in documenting the terms of the compilation engagement before the commencement of the engagement to help avoid misunderstandings about the engagement. For example, it reduces the risk that management may inappropriately rely on or expect the accountant to protect management against certain risks or perform certain functions, including those that are management's responsibility.

**.A12** The roles of management and those charged with governance in agreeing upon the terms of the compilation engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management,

those charged with governance, or both. Nonetheless, when the agreement on the terms of engagement is with only those charged with governance, in accordance with paragraph .25c of section 60A, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities.

**.A13** When a third party has contracted for a compilation of the entity's pro forma financial information, agreeing on the terms of the compilation with management of the entity is necessary in order to establish that the preconditions for a compilation are present.

**.A14** The understanding with management regarding the services to be performed for compilation engagements is required by paragraph .09 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common and usually the most convenient method for documenting the understanding with management regarding the services to be performed for compilation engagements.

**.A15** Although the accountant may prepare the pro forma financial information, in whole or in part, the pro forma financial information is a representation of management, and the fairness of its presentation in accordance with the applicable financial reporting framework is management's responsibility.

**.A16** Exhibit A, "Illustrative Engagement Letter," provides an example of an engagement letter for a compilation of pro forma financial information.

## **The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .11)**

**.A17** The requirement that the accountant obtain an understanding of the applicable financial reporting framework intended to be used in the preparation of the pro forma financial information and the significant accounting policies adopted by management does not prevent the accountant from accepting a compilation engagement for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such understanding by, for example, consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the framework or the industry.

**.A18** If another accountant has performed a compilation engagement on the financial statements of a significant constituent part of the combined entity, the need for the accountant to obtain an understanding of the significant accounting policies adopted by management is not diminished.

## **Compilation Procedures (Ref: par. .12)**

**.A19** The requirement in paragraph .13 of section 80A that the accountant read the financial statements in light of the accountant's understanding of the applicable financial reporting framework and the significant accounting policies adopted by management and consider whether such financial statements appear to be appropriate in form and free from obvious material misstatements requires the accountant to also read the pro forma financial information and consider the following:

- Whether the underlying transaction (or event), the pro forma adjustments, the significant assumptions, and the significant uncertainties, if any, about those assumptions have been appropriately described

- Whether the source of the historical financial information on which the pro forma financial information is based has been appropriately identified

### **The Accountant's Compilation Report on Pro Forma Financial Information (Ref: par. .13)**

**.A20** The accountant's compilation report on pro forma financial information may be added to the accountant's report on financial statements or it may appear separately.

**.A21** An uncertainty about whether the underlying transaction (or event) will be consummated would not require a report modification.

**.A22** Exhibit B, "Illustrative Accountant's Compilation Report on Pro Forma Financial Information," provides an example of an accountant's compilation report on pro forma financial information.

### **Documentation (Ref: par. .15)**

**.A23** Documentation may include significant consultations or significant professional judgments made throughout the engagement.

.A24

## Exhibit A—Illustrative Engagement Letter (Ref: par. .A16)

The illustrative engagement letter in this exhibit is intended as an illustration that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances. The accountant may seek legal advice about whether a proposed letter is suitable.

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the pro forma financial information and perform a compilation on the pro forma financial information the accountant prepared.
- The pro forma financial information is presented in accordance with accounting principles generally accepted in the United States of America.
- The accountant expects that his or her independence will not be impaired.

To the appropriate representative of management of ABC Company:<sup>1</sup>

You<sup>2</sup> have requested that we prepare the pro forma financial information of ABC Company (the Company) and perform a compilation engagement with respect to that pro forma financial information. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

Pro forma financial information is a presentation that shows what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date.

### Our Responsibilities

The objective of our engagement is to

- a. prepare the pro forma financial information in accordance with accounting principles generally accepted in the United States of America, and
- b. perform a compilation engagement on the pro forma financial information we prepared in which we will apply accounting and financial reporting expertise to assist you in the presentation of the pro forma financial information and report without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information in order for it to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public

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<sup>1</sup> The addresses and references in the engagement letter will be those that are appropriate in the circumstances of the compilation of pro forma financial information, including the relevant jurisdiction. It is important to refer to the appropriate persons.

<sup>2</sup> Throughout this engagement letter, references to *you, we, us, management, and accountant* will be used or amended as appropriate in the circumstances.

Accountants (AICPA) and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or provide any assurance on the pro forma financial information.

Our engagement cannot be relied upon to identify or disclose any pro forma financial information misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the Company or noncompliance with laws and regulations.

### **Management Responsibilities**

The engagement to be performed is conducted on the basis that management acknowledges and understands that our role is to prepare the pro forma financial information in accordance with accounting principles generally accepted in the United States of America and perform a compilation engagement on the pro forma financial information we prepared. Management has the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARSs:

- a. For the preparation and fair presentation of the pro forma financial information in accordance with accounting principles generally accepted in the United States of America and for the selection of accounting principles generally accepted in the United States of America as the applicable financial reporting framework
- b. To include the following in any document that contains the pro forma financial information:
  - i. The complete financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) or such financial statements are readily available
  - ii. If pro forma financial information is presented for an interim period, either historical interim financial information for that period (which may be in condensed form) or that such interim information is readily available
  - iii. In the case of a business combination, the relevant historical financial information for the significant constituent parts of the combined entity
- c. To ensure that the financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based have been subjected to a compilation, review, or an audit engagement.
- d. To include the accountant's compilation or review report or the auditor's report on the financial statements (or make readily available) in any document containing the pro forma financial information
- e. To present a summary of significant assumptions with the pro forma financial information
- f. To obtain the accountant's permission prior to including the accountant's compilation report in any document containing the pro

forma financial information that indicates that the entity's accountant has performed a compilation engagement on such pro forma financial information

- g.* To prevent and detect fraud
- h.* To ensure that the Company complies with the laws and regulations applicable to its activities
- i.* For the accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- j.* To provide us with the following:
  - i.* Assumptions that provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event)
  - ii.* Documentation and other related information that is relevant to the preparation and presentation of the pro forma financial information
  - iii.* Additional information that may be requested for the purpose of the preparation of the pro forma financial information
  - iv.* Unrestricted access to persons within the Company of whom we determine necessary to communicate

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and expertise to oversee our preparation of your pro forma financial information. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

### **Our Report**

As part of our engagement, we will issue a report that will state that we did not examine or review the pro forma financial information and that, accordingly, we do not express an opinion nor provide any assurance on it. There may be circumstances in which the report differs from the expected form and content.

We have no responsibility to update our report for events and circumstances occurring after the date of such report.

If management intends to reproduce and publish the pro forma financial information and our report thereon, they must be reproduced in their entirety, and both the first and subsequent corrected drafts of the document containing the pro forma financial information and any accompanying material must be submitted to us for approval.

### **Other Relevant Information**

Our fees for these services . . .

*[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):*

*You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the pro forma financial information described herein except for our own intentional wrongdoing.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the pro forma financial information described herein and to perform a compilation engagement with respect to that same pro forma financial information, and our respective responsibilities.

Sincerely yours,

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*[Signature of accountant or accountant's firm]*

Acknowledged and agreed on behalf of ABC Company by:

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*[Signed]*

*[Name and title]*

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*[Date]*

.A25

**Exhibit B—Illustrative Accountant's Compilation Report on Pro Forma Financial Information (Ref: par. .A22)**

Management is responsible for the accompanying pro forma condensed balance sheet of XYZ Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended (pro forma financial information), based on the criteria in Note 1. The historical condensed financial statements are derived from the financial statements of XYZ Company, on which I (we) performed a compilation engagement, and of ABC Company, on which other accountants performed a compilation engagement. The pro forma adjustments are based on management's assumptions described in Note 1. (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (we) did not examine or review the pro forma financial information nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on the pro forma financial information.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the underlying transaction (or event) occurred at an earlier date. However, the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the above mentioned transaction (or event) actually occurred at such earlier date.

[Additional paragraph(s) may be added to emphasize certain matters relating to the compilation engagement or the subject matter.]

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant's city and state]*

*[Date of the accountant's report]*

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