



**DISCUSSION PAPER  
ON THE AUDITOR'S INVOLVEMENT  
WITH THE NEW EU PROSPECTUS  
DIRECTIVE**

COMMENTS AND RESPONSES TO THE  
QUESTIONS IN THIS DISCUSSION PAPER ARE  
SOUGHT BY 7 JANUARY 2005 AND SHOULD BE  
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## 1. INTRODUCTION

A new regime for prospectuses will be effective within the EU on 1 July 2005. This paper discusses the role of the auditor in various parts of the prospectus. The Directive and the Regulation<sup>1</sup> deal with the information requirements in a prospectus and place, for some of these, obligations on the auditor to report on them. Certain requirements on the auditor are outside the scope of the statutory audit (for which International Standards on Auditing, ISAs, are applicable) and are not dealt with in the pronouncements of the International Auditing and Assurance Standards Board (IAASB). National auditing standards-setters will therefore need to consider setting or adjusting their own standards. The purpose of this paper is to provide auditing standard setters with a framework within which such standards might be developed, in order to address the new requirements on auditors from the new EU prospectus.

Such standards can be thought of as additions to the auditing standards of the IAASB, as the EU is likely to require the statutory audits in Europe to be performed based on ISAs. Pending the adoption of ISAs, the national auditing standard setters will need to consider the provision of appropriate guidance for their respective market. The due process for a new auditing standard (or change of existing standards) will take time. FEE's discussion paper aims to contribute to the debate on such due process by highlighting areas that should be addressed. It is also written to enable the standard setters to use it as their own document for guidance (with or without translation and further local adaptation), in time for practitioners.

FEE, through its European Capital Markets Reporting Project Group, has actively followed the development of the Prospectus Directive, the Regulation for the implementation measures and CESR's Level 3 guidance, and where possible contributed to it. As part of this process, current practices have been discussed, and valuable insights have been developed on the issues that preparers of prospectuses and their auditors are likely to encounter. Guidance exists on some of the issues for preparers, auditors or both in some countries. This paper discusses the most common issues that may arise in practice, and provides guidance for the reporting by auditors in these situations, which can be considered as best practice.

FEE is conscious that, in some markets, existing practice imposes additional reporting obligations on auditors over and above those set out in the Regulation. This paper is based on the premise that EU Member States will not impose additional obligations on auditors in implementing the Directive. Where this is not the case, national auditing standard setters will need to consider the implications for auditors under their jurisdiction. This paper only addresses the reporting requirements imposed on auditors by the Regulation.

In this discussion paper, the term "auditor" is used to encompass both the statutory auditor and the independent accountant. Chapter 3 explains this issue.

In some countries, issuers, underwriters or others who have responsibility for a prospectus as part of their due diligence process engage auditors to obtain comfort on specific information items in the prospectus. This process, which normally results in a private comfort letter, does not result from any requirement in the Prospectus Directive or the Regulation. This discussion paper does not address this part of the auditor's involvement, as explained in Chapter 4.

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<sup>1</sup> Commission Regulation [EC 809/2004] implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements (further referred to as the Regulation).

The Prospectus Directive and the Regulation require in various places the auditor's involvement. Either previous reports from the auditor are included, or new information is accompanied by a report from the auditor. The prospectus issuer or preparer is responsible for supplying the information required by the Prospectus Directive. FEE's position is that the audit profession can supply the required reports that add trust to the relevant information in the prospectus. FEE acknowledges the importance that stakeholders, particularly investors and regulators, attach to the provision of assurance by auditors on information included in prospectuses.

FEE stresses the importance of the issuer reporting the required information in accordance with a framework for the preparation of such information. FEE's position is that the auditor will then be able to report as to whether or not the information has been prepared in accordance with such a framework. This paper shows that such a framework for the preparation of the required information is not in place at an international or European level for all of the information.

Prospectuses are currently drawn up based on national legislation and stock exchange requirements. From 1 July 2005, the Prospectus Directive will bring about a major change in that a single European prospectus will be available. Protection of investors against misleading information and hence the liability of the issuer and others involved in the prospectus are currently also governed by national law. Liability regimes differ between Member States, and there is no pan-European liability system. This situation will continue for some time, as the issue is not addressed as part of the Financial Services Action Plan. The single prospectus can be used in different countries and both issuers and auditors are exposed to the liability regimes in all countries. The work performed for the prospectus therefore needs to take into account the most onerous liability regime. This is a significant economic consequence that needs further consideration.

According to FEE, the liability regime should not prevent issuers, auditors and others involved from supplying meaningful information to investors. Issuers, auditors and others should be held accountable for the proper fulfilment of their own responsibilities in the information supply chain. More background information on the liability issue is provided in Chapter 4 *Overview of the auditor's involvement*.

As FEE is not a standard setter itself, the enactment of the necessary changes in the relevant auditing standards has to come from the national auditing standard setters or the IAASB. FEE hopes that this discussion paper acts as a stimulant and contributes to the debate. We have therefore widely distributed the report and encourage all who are interested in the proper functioning of European capital markets to respond. Please make your views available to FEE ([secretariat@fee.be](mailto:secretariat@fee.be)) and to the standard setter or regulator in your country by 7 January 2005 at the latest. FEE will summarise all responses<sup>2</sup> received and make a summary available on its website.

Although the issues for preparers and auditors are interlinked, this discussion paper addresses only the issues for the audit profession. Contributions to the debate from outside the profession are however welcome and FEE encourages preparers, users and regulators to comment on this discussion paper.

**Comments on and responses to questions raised in this discussion paper are sought by 7 January 2005 and are to be submitted to the FEE Secretariat ([secretariat@fee.be](mailto:secretariat@fee.be)).**

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<sup>2</sup> Unless advised to the contrary, FEE will assume that respondents accept that their response is a matter of public record.

## 2. THE EU PROSPECTUS DIRECTIVE

The Prospectus Directive is one of the first under the “Lamfalussy” model<sup>3</sup> that sets a framework without the detail necessary for its implementation. It can also be described as a maximum harmonisation directive in that Member States cannot impose additional requirements beyond those prescribed.

It replaces the existing Listing Particulars and Public Offers Directives and provides a common regime that will require a change in practice for many Member States.

The Prospectus Directive requires a prospectus to be prepared wherever securities are offered to the public, or where securities are to be admitted to trading in an EU-regulated market. There are certain exceptions when a prospectus is not required, but these are limited.

The Prospectus Directive also requires a prospectus to be approved by the competent authority in an issuer’s home Member State, which for EU domiciled issuers is their state of incorporation. Once approved, it can be used as a public offer or an admission to trading in any Member State without any further regulatory intervention. There are some language requirements that need to be taken into account.

The Prospectus Directive sets the overarching content requirements, but the detail is being set at “Level 2”, the Regulation. In addition, CESR is expected to issue guidance as to how its members, the Member State regulators, expect the provisions at “Level 2” to be applied. This “Level 3” guidance has been published for consultation in June 2004<sup>4</sup> and is expected to be finalised in late 2004 or early 2005.

One of the practical challenges relating to the Prospectus Directive is its difference in scope compared with the IAS Regulation, 1606/2002, and the impending Transparency Directive, both of which only apply to companies traded on regulated markets. The Prospectus Directive needs to deal with different financial reporting and regular reporting regimes as well as the issue of transition at the time of an initial admission to trading.

A further challenge relating to the Prospectus Directive arises from the fact that both a registration model, similar to that in the US, and the single prospectus model, as currently operated in most of the EU, are allowed. The registration model identifies three elements: the summary, the registration document and the securities note. These are combined in one document to create a single prospectus. The Regulation, however, is based on a registration model.

The Regulation adopts a “building-block” approach to prospectus content, applying a hierarchy to different classes of security, equity, retail debt and wholesale debt as well as separating the registration document from the securities note. The focus of our work has been on the most onerous one of these, the equity regime.

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<sup>3</sup> See Appendix A for an overview of this model applied to the prospectus.

<sup>4</sup> CESR’s recommendations for the consistent application of the European Commission’s Regulation on Prospectuses nr. 809/2004 (CESR/04-225b).

The Prospectus Directive covers other issues, including the incorporation by reference of information into a prospectus. It is unclear how this will operate. While the Regulation refers to such documents as the annual accounts being incorporated by reference, the rules also require any information to be incorporated by reference to have been approved by the relevant regulator.

### 3. AUDITOR OR INDEPENDENT ACCOUNTANT

The terms “independent accountant” and “auditor” are used throughout the Regulation. In this document, “auditor” is used as the encompassing term for both the statutory auditor and audit firm, and the independent accountant and firm of independent accountants, as explained below.

It appears that the reason for referring to independent accountants is: to allow issuers the option not to appoint their statutory auditor to execute the reporting requirements under the Regulation; or to cater for situations where issuers may have changed their statutory auditor and wish to use their new auditor. This option is also available under the current legislation for prospectuses. It allows a flexibility that is used in some Member States to draw the line between the responsibilities and liabilities of accountants with regard to statutory accounts and prospectuses. Such use is current practice in a number of countries.

In its draft recommendations for consistent implementation of the Regulation, CESR explains that an independent accountant is someone qualified to be an auditor or subject to equivalent requirements as applicable to auditors.

To be eligible to act as statutory auditor, as required by EU legislation<sup>5</sup>, that person or firm must meet the requirements, such as in respect of independence, that would be imposed were the individual or firm to be the issuer’s statutory auditor.

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<sup>5</sup> Eighth Council Directive 84/259/EEC of 10 April 1984 on the approval of persons responsible for carrying out the statutory audit of accounting documents, to be replaced by Proposal for a Directive of the European Parliament and of the Council on statutory audit of annual accounts and consolidated accounts and amending Council Directives 78/660/EEC and 83/349/EEC.

## 4. OVERVIEW OF THE AUDITOR'S INVOLVEMENT

### 4.1 Introduction

The auditor's involvement in a prospectus may vary according to individual circumstances. In most countries, the auditor's involvement can be split in two very distinct areas:

- Inclusion of reports from the auditor in the prospectus, and
- Private comfort letter.

For the purpose of this document, we confine ourselves to the reports by the auditor that are required by the Prospectus Directive and the Regulation. The comfort letter is addressed only briefly at the end of this chapter.

The Prospectus Directive and the Regulation mention the auditor in various instances in the text or in the requirements of the different schedules. We refer to the original documents, but for ease of use, we have summarised the relevant text in Appendix B.

The items shown in Appendix B represent the various areas where the involvement of auditors is required for the new EU prospectus. For the purpose of this document, we have grouped all items these as to their subject matter:

- Historical financial information,
- Prospective financial information,
- Interim financial information, and
- Pro forma financial information.

Each subject matter is discussed in a separate chapter in this document. Those chapters discuss the auditor's involvement with the information presented and the issues that may arise in practice. We have chosen to deal with the most common situations that would arise on a share issue, which is the most demanding regime. The chapters discuss the issues and suggest solutions for these common situations.

In developing these solutions, we have chosen:

- a) Not to reinvent the wheel but to consider guidance, where available; and
- b) To deal only with those types of information where the report of the auditor is made available to the users of the prospectus, i.e. where the prospectus includes a written report of the auditor.

There are two important issues that arise when the report of the auditor is included in a prospectus: the issue of auditor responsibility and liability of, and whether the auditor's consent is required for the inclusion of his previous report(s) in the prospectus. Both are interrelated and discussed below. Although the performance of an audit and other engagements by auditors are ruled by international auditing standards and professional firms' global guidance, different legal environments in various countries affect the auditor's responsibilities. This is an important factor that standard setters need to consider. While setting standards for the auditors in their jurisdiction, they should consider the fact that the new prospectus regime will allow the prospectus to be used outside the borders of their national jurisdiction.

## 4.2 *The liability issue*

In determining the roles and responsibilities of auditors in the presentation of (historical) financial information in prospectuses, it is clear that there are a number of fundamental differences between current practice and expectations as regards these roles and responsibilities across the EU.

Article 6 of the Prospective Directive, as presented below, requires the Member States to address the responsibility for the information given. Therefore, national law also governs the liability attached to the responsibility.

1. *Member States shall ensure that responsibility for the information given in a prospectus attaches at least to the issuer or its administrative, management or supervisory bodies, the offeror, the person asking for the admission to trading on a regulated market or the guarantor, as the case may be. The persons responsible shall be clearly identified in the prospectus by their names and functions or, in the case of legal persons, their names and registered offices, as well as declarations by them that, to the best of their knowledge, the information contained in the prospectus is in accordance with the facts and that the prospectus makes no omission likely to affect its import.*
2. *Member States shall ensure that their laws, regulation and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus.*

*However, Member States shall ensure that no civil liability shall attach to any person solely on the basis of the summary, including any translation thereof, unless it is misleading, inaccurate or inconsistent when read together with the other parts of the prospectus.*

The Financial Services Action Plan does not address the liability regime that applies to securities markets in general, nor specifically the issue of prospectus liability.

The question is demonstrated best through the example of the auditor's responsibility when an existing audit report is reproduced in a prospectus. Experience within the EU today is that the auditor's responsibility can range from no additional responsibility accruing, such that the audit report could even be reproduced in a prospectus without the prior knowledge of the auditor, through to full liability to all those who rely on a prospectus in which the auditor's report is included. The issue is further complicated by the fact that the auditor's liability is different in respect of the statutory accounts (the most likely example of previously audited information that goes into a prospectus) in different Member States. As a result, auditors that limit their liability on statutory audits may not wish to undertake further action when the statutory accounts and their report thereon is included in a prospectus. On the other hand, where auditors have to accept full prospectus liability, they may not consent to the inclusion of their report in a prospectus without being able to perform the work necessary to accept this higher risk. For the investor, it would be unclear as to whether or not additional procedures had been performed.

A particular difficulty arises from the requirement for previously published audit reports to be reproduced in a prospectus. This conflicts with prevailing EU Company Law<sup>6</sup>, which prohibits audit reports from being published without the financial statements to which the report applies.

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<sup>6</sup> Article 49 of the Fourth Directive and Article 38 of the Seventh Directive.

This conflict needs to be addressed, as CESR expects the audit report to be reproduced independently of the financial statements to which it relates.

FEE's view is that it is not acceptable to allow the inclusion of the audit reports without previously audited financial statements. In cases where these financial statements are sufficient to comply with the requirements for historical financial information, both the statements and the audit report should be included in the prospectus. In cases where additional information or adjustments to the financial statements are necessary, the adjusted information should be the subject of an auditor's report. In the latter case, the audit reports on the previous non-adjusted financial statements do not serve any purpose. This matter is discussed further in Chapter 6 *Historical financial information*.

The development of consistent pan-EU guidance for auditors is clearly difficult. In those Member States where no prospectus liability applies to audit reports, auditors would not wish to be required to carry out additional procedures, as such procedures might expose the auditor to inadvertent liability. On the contrary, where prospectus liability does exist, the auditor would ordinarily expect to perform appropriate additional procedures in order to mitigate the resultant risk. This may lead to a differentiated approach being applied.

Such a differentiated approach may not be sustainable if the pan-EU nature of a prospectus results in an issuer and its auditor being exposed to the most onerous prospectus liability regime, irrespective of the regime operating in an issuer's Member State. In this event auditors may be advised to carry out the procedures necessary to defend themselves in the most onerous environment.

As long as there is no pan-European regime that clarifies the auditor's responsibility and liability, national law or practice prevail and determine the amount of work that the auditor has to carry out before his previously issued reports are included in a prospectus.

#### Questions

1. Should the prospectus include an audit report without the financial statements? Should the financial statements be included even where they are no longer relevant due to adjustments being necessary, or are there alternative approaches?
2. Is there a need for a pan-European liability regime for those involved in a prospectus (issuers and auditors)?
3. Where prospectus liability differs between countries and restricted circulation of a prospectus is not possible, how should the auditor assess the risks of his work being challenged in other jurisdictions?

### 4.3 Consent

The issue of consent is complex. The complexity arises from the varying practices across EU Member States. For example, in the UK and Ireland, auditors are required to consent to the inclusion of previously published reports; in Germany and Austria, consent is not required, and an auditor's report can be reproduced without the auditor's knowledge. In other countries, auditors issue a public report on the whole of the prospectus or use language that may imply this. It is also unclear whether the competent regulatory authorities will continue this diversity of practice under the new Prospectus Directive regime, as the Prospectus Directive, the Regulation and CESR's recommendations are silent in this issue. Others may believe that consent is not required, as the law (Prospectus Directive and Regulation) require the inclusion.

Giving his consent to include his auditor's report would raise the question of which procedures the auditor has to perform. This would depend on what consent means – whether:

- a) It is merely a representation of a historical document,
- b) The report is still accurate as at the date originally issued, or
- c) The opinion is updated to the date of the prospectus.

The requirement to include previously published audit reports is intended to provide those who rely on a prospectus with assurance as to the quality of the historical financial information. That assurance is provided because of the inclusion of the audit report, rather than because of the auditor's consent to include it. This raises the question whether the auditor's position is any different, with or without consent. However, in exceptional circumstances (for example, where fraud is discovered at a later date), the auditor may need to consider withdrawing his previous opinion. In such a situation, the requirement to consent would give the auditor the opportunity to do this.

Consent would, in general, enable the auditor to control his risk, as the auditor would:

- Know that a report is available in a prospectus;
- Carry out appropriate procedures to ensure that the reproduction of the report is appropriate; and
- Manage the risk of the client's change in status appropriately (for example from unlisted to listed entity).

Given the varying practice described above, there is a great risk that an auditor's responsibility for a report included in a prospectus will be judged against the market expectations where a public offer is made. It is therefore essential that the auditor knows where an offering is being made. However, as there are no regulatory hurdles to overcome, it may prove difficult to impose or enforce constraints from an offering being made in any one environment.

To the extent that the auditor is expected to carry out procedures to ensure that the reproduction of his report is appropriate, FEE considers that the auditor would have regard to ISA720 "Other information in documents containing audited financial statements". FEE believes that these procedures set out in ISA720 should be taken into account when a report on the financial statements is issued. In particular, ISA720 requires that "The auditor should read the other information to identify material inconsistencies with the audited financial statements" (paragraph 2). This obligation however does not introduce a responsibility for the auditor for the prospectus as a whole, as the Regulation is specific as to which parts of the information included the auditor should provide assurance on. Specific consideration of the steps that could

be considered if an auditor is expected to consent to a previously published audit report is discussed in Section 6.3.

#### Questions

4. If the Regulation is understood to require an auditor to consent to a previously published report, what do you think such a consent would imply (see the three options identified above)?
5. When giving consent to the inclusion of a report in a prospectus should the auditor be expected to carry out specific procedures? If so, which procedures?
6. Would the auditor have to carry out procedures in all cases, even where no consent is required?

#### 4.4 *Comfort letters*

Underwriters, regulatory bodies and others may request, for the sale of securities, the listing of securities on a stock exchange, exchanges of securities and business combinations, that auditors perform specified procedures and furnish their findings and certain representations to them in a 'comfort letter'.

In certain jurisdictions, underwriters can be held liable for material omissions and misstatements. The underwriters' defence against this liability is that they exercised due diligence – i.e., after a reasonable investigation, the underwriter had grounds to believe that there were no material omissions or misstatements. Consequently, underwriters perform a "reasonable investigation" of financial and accounting data that is included in the prospectus. One of their investigation procedures is that the underwriter, through the issuer or directly, requests the auditor to perform procedures in relation to financial information that is not already covered by a report of the auditor included in the prospectus (comfort letter).

A comfort letter is a report issued by auditors and prepared on the basis of agreed-upon procedures. The objective of an agreed-upon procedure engagement is for the auditor to carry out procedures of an audit nature to which the auditor, the entity and appropriate third parties have agreed and to report on factual findings. As the auditor simply provides a report of the factual findings, no assurance is expressed. Instead, users of the comfort letter assess for themselves the procedures and findings reported by the auditor, and draw their own conclusions from the auditor's work. The International Standards on Related Services emphasise this and restrict the circulation of the comfort letter to the parties to the agreement.

This request is an engagement between the parties, in contrast to the reports of the auditor included in the prospectus, which are governed by the prospectus law, as there is no contractual relation between the auditor and the investor. Where the comfort letter is the result of a contract, it is the contract law in the jurisdiction that has an important influence on the current practice. For these reasons, the issues surrounding the comfort letter are not discussed in this document. FEE intends, however, to publish a discussion paper on comfort letters at a later date (probably by the end of 2004).

## 5. IAASB STANDARDS

### 5.1 Introduction

There is a wide range of roles and activities that an auditor may be engaged in with respect to prospectuses. This document focuses on the required reporting of historical financial information, prospective financial information, interim financial information and pro forma financial information.

The IAASB has developed standards under various frameworks for several of the activities in which auditors are involved. These are:

- International Framework for Assurance Engagements,
- International Standards on Auditing (ISAs 100-999),
- International Standards on Review Engagements (ISREs 2000-2999),
- International Standards on Assurance Engagements (ISAEs 3000-3999), and
- International Standards on Related Services (ISRSs 4000-4999).

For the purpose of this document, the following standards are of particular interest:

- ISAE 3000, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information;
- ISAE 3400, The Examination of Prospective Financial Information;
- ISRE 2400, Engagements to Review Financial Statements; and
- ISRS 4400, Engagements to Perform Agreed-upon Procedures Regarding Financial Information.

Reference is also made to the draft ISRE Review of Interim Financial Information Performed by the Auditor of the Entity.

The application of the IAASB standards also requires auditors to comply with:

- a) The IFAC *Code of Ethics for Professional Accountants* (the Code), which establishes fundamental ethical principles for professional accountants; and
- b) International Standards on Quality Control (ISQCs), which establish standards and provide guidance on a firm's system of quality control.

Auditing standard setters may have similar requirements in their own standards or, as is the case in some countries, they have accepted the IAASB's standards as their national standards. The European Commission (EC) proposes that the standards of the IAASB are to be complied with for all statutory audits. FEE strongly supports IAASB pronouncements and welcomes this initiative from the EC.

Where a national standard setter adopts the relevant IAASB standards directly, some of the issues addressed in this document will already have been dealt with (for example, the audit of the statutory accounts and the review of interim financial information). Where this is not the case, the following chapters address which issues require specific attention for the information in the prospectus.

Where a national standard setter has its own standards, whether they be general or specific standards in respect of prospectuses, the guidance in this document may serve as a benchmark to ascertain whether it appropriately deals with the new requirements in the Prospectus Directive.

The IAASB distinguishes between audits and other assurance engagements. ISAE 3000 addresses assurance engagements other than audits and reviews of historical financial information. It provides the general principles that auditors should apply where no specific ISAE is developed for non-historical financial information. It is particularly relevant to this document because both prospective and pro forma financial information are types of non-historical financial information. The basic principles of ISAE 3000 are presented in Appendix C.

## ***5.2 Types of assurance engagement***

ISAE 3000 uses the terms “reasonable assurance engagement” and “limited assurance engagement” to distinguish between the two types of assurance engagement that an auditor is permitted to perform.

The objective of a reasonable assurance engagement is the reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement, as the basis for a positive form of expression of the auditor’s conclusion.

The conclusion should be expressed in positive form, for example: “In our opinion *subject matter* is properly compiled, in all material respects, based on *XYZ criteria*” or “In our opinion the *entity’s* assertion that *subject matter* is properly compiled, in all material respects, based on *XYZ criteria*, is fairly stated.”

The objective of a limited assurance engagement is to reduce assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, it should form the basis for a negative form of expression of the auditor’s conclusion.

The conclusion should be expressed in the negative form, for example: “Based on our work described in this report, nothing has come to our attention that causes us to believe that *subject matter* is not properly compiled, in all material respects, based on *XYZ criteria*” or “Based on our work described in this report, nothing has come to our attention that causes us to believe that the *entity’s* assertion that *subject matter* is properly compiled, in all material respects, based on *XYZ criteria*, is not fairly stated.”

Although the required reporting is that the information presented is “properly compiled”, this does not constitute a compilation engagement. The compilation of the information is the responsibility of the issuer. The auditor’s responsibility is to report as to whether the compilation has been done properly.

Both examples of the wording in the opinion paragraph of the report clearly show that criteria are needed for the auditor to judge the compliance. If the issuer reports the required information in accordance with such criteria or with the framework for the preparation of such information, the auditor will be able to report on compliance with that criteria or framework. The following chapters in this paper show that such a framework for the preparation of the required information is not in place at an international or European level for all of the information.

**Questions**

7. The issuer has to compile the relevant information in accordance with a recognised framework for the relevant subject matter or explain the basis of preparation. Should such a framework be followed, or would only the explanation of the basis of preparation be adequate? Please explain the reasons for your preference.
8. Who do you think should prepare such frameworks?

**5.3 Specific issues for prospectuses**

The following are examples, derived from practice, that the auditor should consider when developing his procedures for an engagement with respect to a prospectus.

Although there is no need for the auditor to make oral presentations on his written report or the results of his work, this may happen in practice. In such cases, particular care is taken and the auditor may prepare minutes or a list of key points.

In engagements involving a prospectus, a partner with appropriate experience should be involved in the conduct of the work. Where the auditor is the issuer's statutory auditor, he should consider whether, a partner with experience in prospectuses or listing procedures should be engaged or consulted, even though the auditor will have a thorough knowledge of the entity. For example, an experienced partner may serve as a second or concurring partner.

The auditor obtains, where practicable, written confirmation of certain matters from the issuing entity's directors. Such confirmation usually encompasses representations made by the directors to the auditor in the course of the auditor's work. This may be achieved by the directors' confirmation that they have read a final draft of the report and that to the best of their knowledge and belief:

- They have made available to the auditor all significant information relevant to his engagement in respect of the prospectus of which he has knowledge; and
- The (financial) information included in the prospectus is factually accurate, no material facts have been omitted and the prospectus is not otherwise misleading.

Such a procedure helps to clarify that the auditor is not responsible for the prospectus as a whole.

The date of the report is the date on which the auditor signs the report. This is usually the date on which the issuer's directors authorise the issuance of the prospectus. After the date of his report, the auditor has no obligation to perform procedures or make enquiries regarding the prospectus. However, the auditor has an obligation to act if issues impacting the prospectus come to his knowledge after the date of the prospectus and before the date of the issue.

Where the auditor is to give consent to the inclusion of his report in a prospectus or reference to his name, he should first consider the report in the form and the context in which it appears or is referred to in the document as a whole. ISA 560 includes the following guidance in this respect (paragraph 19):

*Offering of Securities to the Public*

**19. In cases involving the offering of securities to the public, the auditor should consider any legal and related requirements applicable to the auditor in all jurisdictions in which the securities are being offered.** For example, the auditor may be required to carry out additional audit procedures to the date of the final offering document. These procedures would ordinarily include carrying out the audit procedures referred to in paragraphs 4 and 5 up to a date at or near the effective date of the final offering document and reading the offering document to assess whether the other information in the offering document is consistent with the financial information with which the auditor is associated.

When the auditor believes information in the prospectus is inconsistent with their report or misleading, he should withhold his consent (where such a consent is required) until he is satisfied that his concerns are unwarranted or until the prospectus is appropriately amended. The auditor may need to seek legal advice in this situation.

Standard setters may wish to provide illustrative examples of the engagement letter and consent letter.

**Questions**

9. How can the auditor be aware of all the jurisdictions in which securities are offered, given that the Prospectus Directive allows the possible use within the whole of the EU?
10. Should the auditor perform the general procedures outlined above with regard to the information in the prospectus to be reported on?
11. Should these procedures be changed because of the particular legal situation in your jurisdiction?
12. Could the general principles as mentioned in ISAE 3000 (see Appendix C) form an appropriate benchmark for the general procedures that the auditor has to perform on each engagement, other than historical financial information where the auditor is involved with a prospectus?
13. Could the specific procedures mentioned above form an appropriate benchmark for the additional procedures to be performed by the auditor?

## 6. HISTORICAL FINANCIAL INFORMATION

### 6.1 Requirements of the Regulation

Historical information should be included in the prospectus as audited historical financial information for the last three financial years and the audit report for each year. The presumption is that this information would be that previously published by the issuer. However, the Regulation further requires:

- The last two years of the audited historical financial to be presented in a form consistent with the accounting standards to be applied in the issuer's next financial statements; and
- The historical annual financial information to be audited and reported on in order to give a true and fair view for the purposes of the prospectus.

In practice, the following situations, or combinations thereof, may occur.

Either "old" information is recycled through:

1. The inclusion of the published statutory financial statements for the latest three years; and
2. The inclusion of the audit reports of the latest three financial years;

or "new" information is prepared, presented and reported, which may arise in one of the situations identified below:

1. Restated historical financial information is included for the last two or three financial years because of a change in GAAP;
2. Restated historical financial information is included because of previous restatements; or
3. The issuer is a new entity with a pre-existing business, for example as a result of a "carve out"<sup>7</sup> or separation of the business from a larger group.

The principal implications for auditors in these situations arise from the consequences of the audit report being reproduced, and from the level of work required to report any new information.

The key questions that have arisen in considering the implications of the new requirements are whether:

- The reproduction of the audit report in a prospectus gives rise to different liability in different Member States and changes its status so that additional procedures may be necessary for the auditor to accept the higher risk; and
- The form of reporting, for the purposes of a prospectus required by the Regulation, demands an audit to be performed. The extent to which an auditor can rely on work carried out for another purpose (for example, the statutory audit of the underlying statutory financial statements) needs to be addressed.

These issues are explored in more detail below.

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<sup>7</sup> See paragraph 6.7 for an explanation.

## ***6.2 Previously published statutory financial statement information for the latest three years is included***

This will most commonly occur where the entity is issuing a prospectus for the issuance of shares without seeking a listing, or where an issuer that is already traded on a regulated market is making a further issue of shares requiring the production of a prospectus. In this case, the financial statements may be prepared under national GAAP or IFRS, depending on the implementation of the IAS Regulation in the issuer's Member State. Where the financial information is prepared under national GAAP, it must include (a) a balance sheet, (b) an income statement, (c) a statement of changes in equity, (d) a cash flow statement and (e) accounting policies and explanatory notes.

Items (c) and (d) may not be part of the statutory financial statements, depending on national GAAP requirements, and therefore need to be prepared and audited for the purposes of the prospectus. The equity statement would generally not result in any specific issues for the auditor, as it would mainly require a different presentation of previously audited information.

Auditing of the cash flow statement requires the auditor to perform additional procedures, as the information has not been audited before. No special issues arise, as procedures for auditing cash flow statements are well known because they are standard for many audits.

As the issuer has presented new information, such as a cash flow statement, related-party transaction disclosures or segmental reporting, the regulatory expectation is that it has been "audited" or reported on as to whether it shows a true and fair view.

One option would be to consider a multiple-dating approach to reporting by the auditor, with the additional disclosure being reported on the date on which it is first published, i.e., the date in the prospectus being a date later than that on which the audit report on the financial statements was issued. However, ISAs do not address multiple dating.

Alternatively, it will be necessary for the auditor to provide a new opinion on the full financial statements, including the new information. This would mean that the audit report on the previously published information is re-dated as of the date of the prospectus. Detailed discussion of the issues arising from providing a new opinion is discussed in Section 6.4 below.

A third option that reflects current practice in a number of Member States would be to include the additional disclosure(s) in a separate part of the prospectus outside the (financial information extracted directly from the) issuer's statutory financial statements. The additional information would then be reported on separately by the issuer's auditors. However, the opinion could not be termed "true and fair", as International Financial Reporting Standards do not contemplate that "true and fair", or "presents fairly", could apply to a financial statement component<sup>8</sup> in isolation. The opinion can therefore only be in terms of "properly prepared in accordance with relevant accounting principles". It remains to be seen whether competent authorities would be prepared to accept such a solution. An illustrative example of a report giving this opinion is set out in Appendix G.

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<sup>8</sup> The IAASB is currently discussing ISA 800 (revised), *The Auditor's Report on Historical Financial Information Other Than a Complete Set of General Purpose Financial Statements*.

**Question**

14. Which of the three options (a) multiple dating, (b) a new opinion, or (c) a specific opinion on the additional information do you believe should be followed on additional disclosures in order to meet the Regulation's requirements and why?

### ***6.3 The audit reports of the latest three financial years are included***

In principle, the audit reports should be produced together with relevant historical financial information. Issues that require consideration include:

- a) Reproducing audit reports separate from the statutory financial statements, when European Company Law specifically requires that the audit report cannot be published without the financial statements to which it relates, and what this means for the presentation of the historical financial information;
- b) Whether the auditor is re-dating the audit report at the date of the prospectus by assessing whether they are aware of any information that would have affected the opinion expressed at the time it was originally signed had the auditor been aware of it at that time; and
- c) The extent of work necessary for an auditor to allow the inclusion of, or incorporation by reference to, a previously published audit report, including assessment of post-balance sheet events if no "expert" consent is required.

No issue arises if it is concluded, that the European Company Law provision, Article 49 of the Fourth European Company Law Directive, requiring that statutory audit reports cannot be reproduced independently of the financial statements is effectively overridden by the Prospectus Directive implementing measures, as appears to be intended by the drafting of the measures. However, if the relevant European Company Law provision is not overridden, the historical financial information requirements of the implementing measures can only be met by the attachment of, or incorporation by reference to, the issuer's statutory financial statements for each of the last three years. Given this uncertainty, the standard setters could recommend the following solution: when an auditor's report is presented without the previously audited financial statements, steps must be taken to ensure that a prefix is added to the auditor's report, which unequivocally identifies the financial statements to which the report relates, and informs the reader as to where copies of the full text of these financial statements may be obtained.

In its draft recommendations for consistent implementation of the Regulation, CESR advocates the presentation of the three-year financial history in a table extracted from the underlying financial statements accompanied by the audit reports for each year. If there are no changes to amounts and the audit reports are attached, no new issues arise. If the amounts are changed, see Section 6.4.

To determine the implications of the inclusion of previously published audit reports in prospectuses, it is necessary to understand the purposes for which the audit report was required at the time it was issued. Existing views across Europe highlight the diversity of answers to this question. These range from the view that the report is only required under company law to report to the shareholders as to the directors' stewardship of the company's assets, through to the view that the audit report is available for the wider public to use.

Where an auditor is required to consent to the inclusion of a previously published audit report, FEE believes that auditors should undertake certain minimum procedures to assess whether they have become aware of any information that would have affected the opinion expressed at the time it was originally signed, had the auditors been aware of it at that time. Suggestions as to the procedures that would normally be expected to be followed by an auditor are set out below. These procedures, based on those in the UK APB's SIR200, are consistent with those set out in ISA 560 "Subsequent events", which makes specific reference to the inclusion of an audit report in a prospectus<sup>9</sup>. In essence, the effect of the consent is to refresh or re-date the audit report as of the date of the prospectus.

- A partner who is not, or was not, the audit engagement partner when the reports were issued should be involved in the conduct of the work;
- Obtain written representations from the persons responsible for preparing the financial statements that they are not aware of any matter affecting the financial statements that might have a bearing on the validity of the audit report;
- Understand the circumstances in which the audit report requires consent for inclusion in a prospectus;
- Read the completion notes prepared for the purposes of the audit in order to reconsider the basis for the opinion;
- Read the audit committee report, where available;
- Undertake a subsequent events review;
- Consider updating audit procedures in connection with the going-concern assumption where the prospectus is being issued in connection with an offer of securities that materially changes the issuer's financial position;
- Discuss matters arising with a quality review partner;
- Where the auditors are not the auditors in the most recent period for which the financial statements were prepared, obtain written representations from the successor auditors that they are not aware of any matters that affect the financial statements; and
- Obtain documentation of the work performed and conclusions reached.

Where no consent is required, it is argued that the auditor has no responsibility to make any assessment of the impact of any post-balance sheet events. In some Member States it is even possible for the audit report to be reproduced without the knowledge or involvement of the auditor in the prospectus.

However, it is difficult to acknowledge that the auditor does not have some proximity to the prospectus, given that it would be normal for the auditor to be requested to provide some support to the due diligence process in connection with the disclosures in a prospectus. In such cases, we believe that the auditor should consider the extent to which it is appropriate to carry out the procedures outlined above.

#### Question

15. Could the procedures outlined above serve as an appropriate benchmark for the procedures that the auditor has to perform?

<sup>9</sup> ISA 560, paragraph 19.

#### **6.4 Restated historical information because of a change in GAAP**

The approach to disclosure of historical financial information in a prospectus is a compromise between regulators' and investors' need for historical financial information that is not only internally consistent, but also conforms with that to be presented in future periods, and the cost to issuers of preparing that information. Accordingly, the Regulation requires the last two financial years to be presented on the basis of next year's policies. While there has been some confusion as to whether the Regulation referred to a change in GAAP (from national GAAP to IFRS) or a change within GAAP, it is expected that CESR's Level 3 guidance will clarify this<sup>10</sup>. The issues for auditors, however, are the same whichever view is taken.

In addition, it may be necessary for an issuer to present restated or new historical financial information whether through correction of errors, adoption of new accounting policies, or, as noted above, inclusion of additional disclosures.

It is clear from the Regulation that an issuer's auditors should report on any restated accounts as to whether or not, for the purposes of the prospectus, they give a true and fair view.

Issues that require consideration include:

- a) Ensuring that the opinion reports that each of the years gives a true and fair view;
- b) Understanding the extent, in giving an opinion on the restated accounts for the purposes of the prospectus, to which an auditor can rely on audit work performed on the underlying statutory financial statements and whether the answer depends on whether the statutory financial statement audit was performed by the same audit firm or another; and
- c) The possibility that the auditor could be requested to report by providing an "opinion" on the restated or new accounts depends on national legal requirements concerning restatement of financial statements and the interaction with the responsibilities for preparing financial statements, or otherwise, at the choice of the issuer.

In carrying out the work necessary to provide any new opinion on the underlying financial statements where an audit has already been performed, the auditor should consider the following:

- Whether their opinion is supported by work that complies with auditing standards to the extent that they are applicable to the auditor's engagement.
- Where the auditor is also the statutory auditor, a partner who is not, and has not recently been, the audit engagement partner should be involved in the conduct of an engagement involving the expression of an opinion in true and fair terms work.
- Auditors should ensure the financial information on which their opinion is to be expressed is presented in compliance with all relevant requirements.
- Auditors should, unless impracticable, obtain evidence that officials of the entity acknowledge their responsibility for the financial information on which their opinion report is to be expressed.
- The auditors should obtain such knowledge of the entity's business (including its accounting systems) as required to enable them to express their opinion.

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<sup>10</sup> The current Consultation document (CESR/04-225b) recommends that it is the first situation.

- To determine their approach and the supplementary procedures that they perform themselves, the auditors should assess inherent risk in relation to the financial information, taking into account factors relevant to both the entity as a whole and to specific assertions relating to material account balances and classes of transaction.
- The auditors should undertake a general assessment of the entity’s accounting systems, records and control environment in order to determine their influence on the approach to obtaining and assessing evidence. Where reliance is placed on tests of controls, the auditors should also assess control risk in determining the extent of supplementary procedures required to reduce risk to an acceptable level.
- In all opinions on historical financial information in prospectuses, auditors should explain the extent of their responsibility by including in their report:
  - o A statement indicating who was responsible for the financial information on which their opinion is expressed; and
  - o A statement that the contents of the prospectus within which their opinion is reproduced are the responsibility of those responsible for the prospectus.
- Auditors should explain the basis of their opinion by including in their report:
  - o A statement as to their compliance or otherwise with applicable reporting standards or the reasons for any departure from them; and
  - o A statement that they planned and performed their work so as to obtain reasonable assurance that the financial information on which their opinion is given is free from material misstatement.
- The auditor’s report should contain a clear expression of opinion on the financial information and on any further matters required by requirements applicable to the particular engagement.
- The auditors should apply auditing standards relating to qualified opinions, adverse opinions, disclaimers of opinions and fundamental uncertainties. With respect to fundamental uncertainties arising from the adoption of the going-concern basis, the reporting accountants apply specific auditing standards relating thereto.
- Auditors should indicate in their report how the matter was resolved when they conclude that they need not, for the purposes of their report, repeat either:
  - o A previously qualified audit opinion on the underlying statutory financial statements; or
  - o A fundamental uncertainty reported as part of the basis of the auditor’s opinion on the underlying statutory financial statements;
- The auditors should present the financial information on a consistent and comparable basis from period to period and should make necessary presentational changes to the financial information that forms the basis of their report in order to achieve this.

A suggested form of report is appended, Appendix D. This is based on that set out in the IAASB Proposed Final Pronouncements on the Auditor’s Report ISA 700 (Revised), “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements” as presented at the IAASB Board meeting of September 2004, which is a public meeting.

These reports also take account of ISA 710 “comparatives” in reporting on both of the periods presented as if the amounts were “corresponding figures”.

A question arises particularly from the application of IFRS, although it may also arise under Member States' National GAAP, as to the need for comparative information. Specifically, IAS 1 and IAS 8 (2003) require comparative information for a preceding period to be presented fairly or to show a true and fair view. It would therefore be necessary to present an additional previous period to that otherwise required by the Regulation.

This would clearly negate the intended benefit of the provisions in the Regulation that seek to minimise the cost to issuers of adopting new accounting principles for the purposes of preparing a prospectus. In particular, it could be unacceptable to present only one year's information, as envisaged for debt securities prospectuses. As a consequence, the auditor has to qualify the audit report. Whether this is acceptable or not is an issue to be decided by the regulator. A solution to this would have to come from either the regulator or the IASB.

To determine whether an auditor can rely on the work of an auditor, it is necessary to consider the relevant International Standards on Auditing as well as current practices. In some jurisdictions, such as the US, an auditor is not allowed to take into account the work carried out by a predecessor. At the other end of the spectrum, the UK's SIR200 specifically requires an auditor who is not the auditor to rely on the work of another audit firm. Indeed, the SIR200 model is designed to ensure that the independent, or reporting, accountant obtains sufficient evidence irrespective of whether the same firm was the auditor.

Specific guidance is set out below on the procedures that may be followed whenever a new opinion is being given where the underlying financial information has been subject to audit. This guidance, based on that in SIR200, is applicable when the audit firm is the same as the firm that conducted the audits on the underlying financial information and when it is not.

- The prospectus auditors, being those engaged to provide the opinion for the purposes of the prospectus, accept evidence on an audit file as being prima facie truthful and genuine, but in considering that evidence adopt an attitude of professional scepticism, whether the audit file was produced by auditors from the prospectus auditor's firm or by other auditors. However, with respect to audit files obtained from their own firm, prospectus auditors are more familiar with the detailed quality control procedures that will have been applied in the conduct of the audit. The extent to which independent testing of the evidence provided will be necessary is a matter for the prospectus auditor's judgment on the basis of the information available at the time, including their assessment of the risks of misstatement.
- When the company's statutory auditors, or former statutory auditors, are not appointed as the prospectus auditors, they will be aware that those auditors may need access to information contained in the audit files. The statutory auditors or former statutory auditors are normally prepared to make their audit files available in accordance with relevant professional guidance.
- Access may be granted only on the basis that the statutory auditors accept no responsibility or liability to the prospectus auditors for the purposes of the prospectus in connection with the use of their statutory audit files by the prospectus auditor. Such a basis of access has no effect on the validity or otherwise of statutory auditor's working papers as a source of evidence for the prospectus auditor. The prospectus auditors use their own judgment in determining whether they can rely on the working papers as appropriate evidence. The prospectus auditors however, do not use the conclusions recorded in the statutory auditor's working papers as a substitute for their own judgment.

- The matters that are considered in the course of planning what reliance might be placed upon the work of auditors and the degree of independent testing that may be necessary, particularly where the auditors are subject to different regulatory requirements, will normally include:
  - o What is known about the professional qualification and integrity of the statutory auditors?
  - o What auditing standards and requirements apply to the work of the statutory auditors?
  - o Are there any special circumstances concerning the appointment of the statutory auditors, and to whom do they report?
  - o Are the prospectus auditors satisfied that the statutory auditors are independent in all respects?
  - o Has any limitation been placed on the work of the statutory auditors (such as in terms of access, time etc, or because of level of remuneration) or have they been free to decide on the scope and level of their audit tests?
  - o Has the work of the statutory auditors been conducted to an appropriate materiality level?
  - o Have the statutory auditors complied with the basic principles and essential procedures with which auditors are required to comply in the conduct of any audit under applicable auditing standards?
  - o Do corrections or adjustments to subsequent financial statements indicate possible inadequacies in the audits of earlier periods?
  
- Whether or not the auditors have access to the previous auditor's working paper files they seek to obtain, either from the directors or from the auditors, copies of all relevant management letters sent by the auditors to the entity and copies of any responses to such letters made by management. A relevant management letter would, for example, discuss control and other weaknesses.

Particular issues arise where a predecessor audit firm has ceased to exist. Depending on the circumstances, it may be necessary for the auditor to perform a new audit in order to provide the opinion required by the Regulation.

#### **Questions**

16. Is it permissible for the auditor, when reporting for the purposes of a prospectus, to take into account audit work performed in connection with the underlying statutory financial statements?
17. Would your answer to Question 1 change if the auditor reporting for the purpose of the prospectus were not from the same firm that audited the underlying statutory financial statements?

## **6.5 Previous restatements**

Where historical financial information has been restated for changes in accounting policies, ISAs require that by signing the report for the subsequent period with the restated comparatives amounts included, the auditor would have carried out appropriate procedures to assess whether the comparative amounts were appropriately presented. Consequently, with the appropriate disclosures being made by the issuer on the impact of the restatement, it should be acceptable for the audit report to be reproduced for the period in which the amounts were originally presented. Where the restatement affects the opening period, the auditor needs to assess whether the report on that period can be reproduced without the additional presentation of the originally presented amounts.

Where the historical financial information has been restated for the correction of errors, the auditor has to consider whether the impact of those errors is such as to determine that it would not be appropriate to reproduce the previously published audit reports. In such circumstances, the issuer will be preparing restated accounts using the so-called “2+2” disclosure model, and the auditor should report on these restated accounts in line with that model. Whilst CESR’s final advice did not envisage that the “2+2” disclosure and reporting model would have wider application, we believe that it is the most appropriate model for addressing the need for the correction of previously published amounts.

Where a previously published audit report contains a qualification or a reference to a fundamental uncertainty, the auditor should consider the impact on any consent as an “expert” that is required. While additional disclosure in a prospectus that explains the modification and addresses any subsequent developments is essential, the circumstances of the report’s modification may be such that the auditor is unable to agree to the inclusion of the report. The only option available to the issuer may be to request a new opinion prepared on the basis of revised financial information that resolves the impact of the issue giving rise to the previous modified opinion.

## **6.6 Issuers have not operated for a whole financial year**

Specific requirements apply where a company has not operated for a whole financial year. It must prepare financial statements for inclusion in the prospectus, and they must be reported on by the company’s auditors as to whether, for the purposes of the prospectus, they show a true and fair view.

FEE’s view is that issues for auditors are the same as those when considering issuing any new opinion for a prospectus. However, as no audit work will have been performed before, as there will have been no statutory financial statements, it will be necessary for the auditor to perform a full scope audit in order to provide the required opinion.

## **6.7 Carve outs**

The situation can arise where historical financial information in a prospectus presents the financial position and performance of a business that has not hitherto comprised a legal reporting entity. This may arise when a listed company is de-merging to form a separate listed company. Such a situation is commonly described as a “carve out”.

Where it is possible for the financial information to describe the basis on which it has been prepared, the auditor should be able to report on whether that information shows a true and fair view for the purposes of a prospectus. It is anticipated that CESR will provide guidance as to the main principles to be followed in situations such as carve-outs.

The procedures to be undertaken by an auditor when reporting these would be no different from those undertaken in reporting for the purposes of a prospectus. However, particular attention may need to be applied to auditing the application of the basis of preparation.

## 7. PROSPECTIVE FINANCIAL INFORMATION

### 7.1 Requirements of the Regulation

The recital (8) to the Regulation states:

*“Voluntary disclosure of profit forecasts in a share registration document should be presented in a consistent and comparable manner and accompanied by a statement prepared by independent accountants or auditors. This information should not be confused with the disclosure of known trends or other factual data with material impact on the issuers’ prospects. Moreover, they should provide an explanation of any changes in disclosure policy relating to profit forecasts when supplementing a prospectus or drafting a new prospectus.”*

The Regulation allows issuers the choice of whether to include profit forecasts or estimates. However, where they are included, issuers have to adhere to the following requirements, including a report by the auditor (Annex I item 13):

*“13.1 A statement setting out the principal assumptions upon which the issuer has based its forecast, or estimate.*

There must be a clear distinction between assumptions about factors that the members of the administrative, management or supervisory bodies can influence, and assumptions about factors that are exclusively outside the influence of the members of the administrative, management or supervisory bodies; the assumptions must be readily understandable by investors, be specific and precise and not relate to the general accuracy of the estimates underlying the forecast.

*13.2 A report prepared by independent accountants or auditors stating that in the opinion of the independent accountants or auditors the forecast or estimate has been properly compiled on the basis stated and that the basis of accounting used for the profit forecast or estimate is consistent with the accounting policies of the issuer.*

*13.3 The profit forecast or estimate must be prepared on a basis comparable with the historical financial information.*

*13.4 If a profit forecast in a prospectus has been published which is still outstanding, then provide a statement setting out whether or not that forecast is still correct as at the time of the registration document, and an explanation of why such forecast is no longer valid if that is the case.”*

FEE’s position is that auditor’s reports on profit forecasts or estimates should only be included in a prospectus if preparers have used a recognised framework for preparing profit forecasts or estimates. The basic principles for such a framework are proposed in CESR’s proposed Level 3 guidance. This framework is necessary to clarify the respective responsibilities of the issuer and the auditor.

### *Definition of profit forecast and estimate*

Article 2 (10) of the Regulation defines the term profit forecast as follows:

*“Profit forecast” means a form of words which expressly states or by implication indicates a figure or a minimum or maximum figure for the likely level of profits or losses for the current financial period and/or financial periods subsequent to that period, or contains data from which a calculation of such a figure for future profits or losses may be made, even if no particular figure is mentioned and the word “profit” is not used.*

Article 2 (11) of the Regulation defines the term “profit estimate” as follows:

*“Profit estimate” means a profit forecast for a financial period which has expired and for which results have not yet been published.*

FEE notes that the basis on which profit forecast and estimates are compiled by issuers will vary depending on the period for which the forecast or estimate has been completed. The level of certainty will depend on the period expired as well as on the sensitivity of the issuer’s results to particular events and circumstances, whether as result of the issuer’s normal business cycle or of events outside its control.

## **7.2 IAASB standards**

The Commission recognises that a key element to support a consistently high level of audit quality throughout the EU is the use of common auditing standards. The Commission is therefore working on having a binding requirement for EU auditors to apply ISAs.

The following IAASB standards are of particular interest for the independent accountant or auditor’s report on profit forecasts or estimates in prospectuses:

- *ISAE 3400, The Examination of Prospective Financial Information (previously ISA 810)*
- *ISAE 3000, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information.*

### *ISAE 3400*

The purpose of this ISAE is to establish standards and provide guidance on engagements to examine, and report on prospective financial information, including examination procedures for best-estimate and hypothetical assumptions. This ISAE states that “it does not apply to the examination of prospective financial information expressed in general or narrative terms, though many of the procedures outlined in this standard may be suitable for such an examination”. The requirements in the Regulation are directed at general or narrative profit forecast statements.

FEE believes that the level of work required for auditors to express an opinion on whether profit forecasts or estimates are properly compiled should be independent of whether such profit forecasts or estimates are presented in any form of narrative words or in the form of a full profit and loss statement.

The scope of ISAE 3400 is wider than the reporting requirements contained in the Regulation. According to the Regulation, the auditor should report on whether the forecast or estimate has been properly compiled on the basis stated and that the basis of accounting used for the profit forecast or estimate is consistent with the accounting policies of the issuer. There is no requirement for the auditor to provide a statement of negative assurance as to whether the assumptions provide a reasonable basis for the profit forecast or estimate.

The Regulation defines profit forecast or estimate as including any form of words that expressly states or by implication indicates a figure, or a minimum or maximum figure, for the likely level of profits or losses for the current financial period and/or financial periods subsequent to that period, or contains data from which a calculation of such a figure for future profits or losses may be made, even if no particular figure is mentioned and the word “profit” is not used. This type of profit forecast or estimate is not within the scope of this ISAE.

### *ISAE 3000*

ISAE 3000 provides the general principles that auditors should apply to assurance engagements other than audits or reviews of historical financial information where no specific ISAE is developed. The basic principles of ISAE 3000 are outlined in Appendix C of this document.

This ISAE is to be read in the context of the “International Framework for Assurance Engagements” (the Framework), which defines and describes the elements and objectives of an assurance engagement, and identifies those engagements to which ISAEs apply. This ISAE has been written for general application to assurance engagements other than audits or reviews of historical financial information covered by ISAs or ISREs.

ISAE 3000 should be used in the absence of an ISAE dealing specifically with auditor’s reports on profit forecasts or estimates to be included in a prospectus. However, ISAE 3000 requires the suitable criteria on which to provide assurance.

### **Questions**

18. Do you agree with the conclusion that the scope of ISAE 3400 should be disregarded?
19. To what extent do you believe that there are suitable criteria on which to provide assurance on profit forecasts?

### **7.3 Reporting principles**

The form of opinion required by the Regulation has two components: proper compilation and consistent accounting policies.

In understanding what is intended by “proper compilation”, it is important to understand the current practice. This shows that there are different interpretations.

One interpretation would limit the auditor’s role to checking that the forecast has been compiled on the basis stated. This assumes that there is no expectation that the auditor has any obligation to assess the assumptions on which the forecast has been compiled.

Another view is that the auditor is expected to at least consider whether the assumptions are complete and that they are not, to the best of the auditor’s knowledge and belief, unreasonable.

It could even be argued that the auditors should assess whether the assumptions are reasonable and that effectively the forecast is achievable, although that is not currently accepted as a public reporting model, nor is that required by the Regulation.

The challenge of designing a reporting model for auditors engaged to report on profit forecasts is managing expectations as to the proper description of the auditor's responsibilities. This may be particularly difficult, given the diversity of expectation in those markets where profit forecast reporting is currently required, and the absence of experience in those markets where reporting is not currently required.

As for consistency of accounting policies, while the Regulation requires that "the profit forecast must be prepared on a basis comparable with the historical financial information", the basis of preparation must be expected to take account of the policies that a company knows it will be applying when preparing the financial statements for the period to which the profit forecast relates. If there is any uncertainty as to the policies likely to be required for a future period, it should be acceptable for an issuer to state an assumption, making it clear which policies have been applied and identifying any areas where policy change may have an impact.

Assessing the consistency of policies should therefore be, FEE believes, a reasonably straightforward exercise to design reporting engagement procedures.

An illustrative example for the auditor's report on profit forecasts as required by the Regulation is set out in Appendix E. As the Regulation does not impose any reporting obligation on the auditor with regard to the assumptions underlying the prospective information, the auditor's report should be silent in that respect.

**Question**

20. What do you understand when an auditor reports that a profit forecast is properly compiled?

## 8. INTERIM FINANCIAL INFORMATION

### 8.1 Requirements of the Regulation

The various annexes in the Regulation<sup>11</sup> state that the issuer has to include interim financial information when published, together with any report by the auditor thereon, if any, and requires (unaudited) interim financial information to be included after a certain lapse of time:

*“If the issuer has published quarterly or half yearly financial information since the date of its last audited financial statements, these must be included in the registration document. If the quarterly or half yearly financial information has been reviewed or audited, the audit or review report must also be included. If the quarterly or half yearly financial information is unaudited or has not been reviewed state that fact.*

*If the registration document is dated more than nine months after the end of the last audited financial year, it must contain interim financial information, which may be unaudited (in which case that fact should be stated) covering at least the first six months of the financial year.*

*The interim financial information should include comparative statements for the same period in the prior financial year, except that the requirements for comparative balance sheet information may be satisfied by presenting the years end balance sheet.”*

The Regulation also sets limits as to the time elapsed since the latest audited financial information (Annex I, item 20.5) by requiring (audited) interim financial statements.

As stated above, if the interim financial information is reviewed or audited, the audit or review report must also be included. If unaudited, this fact must be stated. For a review the ISRE 2400 (previously ISA 910), Engagements to Review Financial Statements provides the auditor with the necessary guidance and support. There are no specific issues around the prospectus.

In Addition to the ISRE 2400, the IAASB has drafted a proposal “Review of Interim Financial Information Performed by the Auditor of the Entity”. In future this document may become more definite.

The Regulation refers to interim financial information and interim financial statements, neither of which are defined. FEE believes that both need to be defined in CESR’s Level 3 guidance. For the purpose of this document, we distinguish:

- Full financial statements,
- Condensed financial statements, and
- Other interim financial information.

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<sup>11</sup> 20.6, Annex I, Share Registration Document, 13.5, Annex III, Share Securities Note, 20.5, Annex X, Depository Receipts issued over shares.

## **8.2 Full financial statements**

Where the Regulation refers to interim financial statements (Annex I, item 20.5), interim financial statements should be read as full financial statements for an interim period. Interim period means a period other than a full financial year.

In the situation addressed in Annex I item 20.5, the financial statements and the audit report are most likely produced for inclusion in the prospectus. In all other situations, the auditor's report, if any, is likely to have been published before.

The audit of (full) financial statements is covered by ISAs. The auditor, if requested, could also perform a review on full financial statements. ISRE 2400 Engagements to Review Financial Statements and the proposed ISRE Review of Interim Financial Information performed by the Auditor of the Entity provide the necessary guidance for the work to be performed on such engagements. The applicable GAAP, whether it is IFRS or national GAAP, will normally provide the criteria to evaluate the subject matter.

The auditor's report resulting from an audit provides reasonable assurance. The auditor's report resulting from a review only provides limited assurance.

Apart from the liability issue that may or may not arise on the inclusion of an earlier published auditor's report, as discussed in Chapter 4, no specific issues arise.

## **8.3 Condensed financial statements**

In practice, most interim financial information takes the form of condensed financial statements. Condensed financial statements are described in IAS 34.

The IAASB states in the proposed ISRE "*Review of Interim Financial Information*"

*"If the interim financial information is comprised of a condensed set of financial statements, a statement about whether the auditor is aware of any material modification that should be made to the interim financial information for it to be in accordance with the identified financial reporting framework (including identifying the country of origin of the financial reporting framework when the framework used is not International Financial Reporting Standards)."*

The auditor could carry out an assurance engagement or a review. The assurance engagement results in an auditor's report expressing reasonable assurance, whereas a review results in limited assurance. For both types of engagement, there is guidance for the auditor. Apart from the liability issue that may or may not arise on the inclusion of an earlier published auditor's report, as discussed in Chapter 4, no specific issues arise.

## **8.4 "Other" interim financial information**

For the purpose of this document, we define all interim information that is less than condensed financial statements as "other interim financial information". As there is no framework for the preparation of such other information, a variety of information may exist. If published earlier, such information needs to be included in the prospectus. This information is, however, not normally accompanied by an auditor's report.

The sponsor or bank can state specific requirements regarding such other interim financial information. The auditor cannot provide any public assurance, but only comfort based on “agreed-upon procedures”. Guidance for such engagements is available in ISRS 4400 Engagements to Perform Agreed-upon Procedures Regarding Financial Information. As explained in the ISRS, the parties to the contract have to agree on which activities the auditor has to execute and the report is restricted to those parties. In practice, the required comfort is therefore provided in the comfort letter.

## Summary

This position can be summarised in the following table:

Level of information	Level of assurance
Full financial statements	Reasonable assurance (audit) or limited assurance (review)
Condensed financial statements	Reasonable assurance or limited assurance (review)
“Other” financial information (selective information, less than condensed financial statements)	None (letter of comfort: agreed-upon procedures)

## Question

21. The Prospectus Directive and Regulation do not define a “review for the purposes of requiring disclosure in a prospectus”. Should “review” be defined as in ISAE 2400?

## 9. PRO FORMA FINANCIAL INFORMATION

### 9.1 Requirements of the Regulation

The European Prospectus Directive (2003/71/EC) provides for minimum information on the presentation of pro forma financial information in prospectuses. The detailed requirements regarding pro forma financial information are set out in the Regulation.

According to Recital (9) of the Regulation “pro forma financial information is needed in case of significant gross change, i.e. a variation of more than 25% relative to one or more indicators of the size of the issuer’s business, in the situation of an issuer due to a particular transaction, with the exception of those situations where merger accounting is required”.

For many EU issuers, the Regulation will require them for the first time to present pro forma financial information in prospectuses according to minimum requirements.

The Regulation (Annex I item 20.2) also requires the disclosure of an independent report made by an auditor or independent accountant on the pro forma financial information as follows:

*“Pro forma financial information must be accompanied by a report prepared by independent accountants or auditors.”*

This is supplemented with a specific requirement in Annex II item 7 as follows:

*“The report prepared by the independent accountants or auditors must state that in their opinion:*

*The pro forma financial information has been properly compiled on the basis stated;  
That basis is consistent with the accounting policies of the issuer.”*

Regarding an auditor’s association with the reporting of non-GAAP measures in a prospectus, it requires the detailed definition of the “level of comfort” and of the corresponding auditor’s/accountant’s work to be performed. This work would be covered by any comfort letter that an auditor might agree to provide in connection with the issue of a prospectus. Although the implementation measures seem to define the content of the auditor’s report, there is the need to consider these minimum requirements against the structure of International Engagement Standards issued by IAASB (cf. IFAC Handbook 2004, December 2003). While there is currently no accepted international framework for preparing pro forma financial information, the rules in Annex II to the Regulation are quite detailed and provide the backbone of a framework. CESR has consulted on guidance elaborating on some of the terms used in the Annex. Together these should form a sufficient basis on which auditors can reasonably be expected to report.

Issues for auditors that require consideration include:

- a) How to report on pro forma financial information (kind of assurance?), and
- b) The extent of work necessary for an auditor to allow public reporting in accordance with International Engagement Standards issued by IAASB.

## 9.2 *Current practice*

In specific circumstances, issuers are used to publishing results or other financial data on the basis of methodologies different from those required by national GAAP. These types of statements are often referred to as “pro-forma” financial information. The release of non-GAAP financial information raises obvious investor protection concerns. Seeking to improve investor protection, some EU Member States, the competent authorities (for example, stock exchanges) or accounting and/or auditing standard setters provide standards and/or recommendations to impose restrictions on the presentation of pro forma financial information within prospectuses.

The requirements for the preparation and presentation of pro forma financial information differ around Europe. The competent authorities of some Member States (for example, France, Italy and the UK) require pro forma financial information within prospectuses or other deal-related documents. Similar requirements exist in the US. In other countries (for example, Germany), pro forma financial information in prospectuses is not a matter of statutory law. Nevertheless, the Deutsche Börse AG, Frankfurt am Main, makes recommendations for the conduct and actions of issuers (Going Public Principles, 2 September 2002), including recommendations on pro forma financial information.

## 9.3 *Kind of assurance*

The major issue for auditors is the kind of assurance the auditor should provide. The difficulty for auditors is that the pro forma financial information has to be qualified as specifically non-GAAP financial information. In the light of user expectations and due to the risk of misunderstanding the auditor’s involvement, the minimum requirements of the Regulation must be measured against the International Engagement Standards issued by IAASB.

Against the background of the International Framework for Assurance engagements Annex II item 7, FEE believes that the report is as “Assurance Engagements other than Audits or Reviews of Historical Financial Information”.

The key question is whether the report can constitute “reasonable assurance” or whether it can only be of “limited assurance”.

However, the form of opinion is quite explicitly provided by the Regulation. In addition, there is no scope limitation in relation to the subject matter, as this is also described by the Regulation. Combined with the existence of anticipated guidance, FEE believes that there will be a sufficiently robust framework to conclude that the report can be a reasonable assurance engagement.

This approach is stressed by the fact that the Regulation introduced mandatory disclosure of pro forma financial information in the prospectus for share issuers in case of a significant gross change accompanied by an auditor’s statement.

#### ***9.4 Performance of the engagement***

The objective of an engagement to report on pro forma financial information is to obtain a reasonable level of assurance as to whether:

- 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.

In considering whether the pro forma financial has been properly compiled, the auditor should ascertain whether:

- The auditor is able to become familiar with the business activities and accounting policies applied by the entities whose data are contained in the pro forma information. The auditor would obtain such an understanding by having audited or reviewed all the material historical financial statements. When an entity's financial statements have been audited or reviewed by other auditors, the auditor has to decide in the specific case how to obtain the knowledge necessary for the review of pro forma information;
- The pro forma financial information has been compiled in the manner prescribed by Annex II of EU Regulation 2004-809;
- The pro forma financial information has been presented as required by Annex II of EU Regulation 2004-809;
- The assumptions underlying the pro forma information appropriately reflect the material effects of the transaction on the financial statements;
- The pro forma adjustments have been derived properly on the basis of these assumptions;
- The pro forma adjustments have been accurately reflected in the pro forma balance sheet and the pro forma income statement; and
- The pro forma adjustments have been presented clearly and comprehensively in the pro forma notes.

As regards the consistency of accounting policies, it is clear that the pro forma financial information is hypothetical, and thus if a significant gross change involving another undertaking is, or will be, accounted for as an acquisition in the issuer's statutory financial statements, that is how it is presented in the pro forma financial information.

Complexity arises where financial information of an acquired undertaking, or an undertaking to be acquired, has been prepared on a different accounting basis. In these circumstances, it will be necessary for the management of the preparer of the pro forma financial information to make adjustments that conform with the policies. CESR may provide some guidance as to how this particular issue is to be addressed.

In carrying out the engagement, the following procedures should be followed:

- Obtain an understanding of the transactions underlying the pro forma information by, for instance, reading the relevant contracts and enquiring of management;
- Obtain an understanding of the entities/parts of entities involved;
- Obtain an understanding of the accounting policies used by the entities involved;
- Inquire of management as to the adjustments made about the effects of the transactions on the financial statements;

- Assess whether the pro forma adjustments cover the significant effects of the transactions on the financial statements;
- Consider whether the party responsible for the pro forma financial information has appropriate support for the pro forma adjustments. This may include, for example, agreements for the purchase of entities or mergers of entities, valuation reports or financing documents;
- Assess whether the pro forma adjustments are consistent and logical;
- Check the computation of pro forma adjustments and the application of the pro forma adjustments to the unadjusted financial information;
- Assess whether the transactions and the pro forma adjustments, the underlying assumptions and the material uncertainties associated with these assumptions have been described appropriately in the pro forma notes;
- Obtain a management representation letter, to include in particular the following:
  - o Management’s responsibility for the underlying assumptions and the computation of the pro forma financial information.
  - o A statement that the assumptions underlying the pro forma information appropriately reflect the material effects of the transactions on the financial statements, that the pro forma adjustments have been derived properly on the basis of these assumptions, and that the pro forma adjustments have been accurately reflected in the pro forma balance sheet and the pro forma income statement.
  - o A statement that all relevant transactions and the material effects of such transactions on the financial statements have been discussed appropriately in the pro forma notes.

In providing the opinion as required by the Regulation, there should be no expectation that the auditor is refreshing or re-addressing any opinions provided on any of the financial information that may comprise part of the pro forma financial information. It is merely necessary for the auditor to assess whether the information meets the criteria for inclusion in the pro forma.

An illustrative example of the auditor’s report based on the principles in ISAE 3000 (Revised) is set out in Appendix F.

#### Questions

22. Should the report on pro forma financial information required by the Regulation be considered as a reasonable assurance engagement?
23. Does the Regulation, as supported by CESR’s Level 3 guidance, provide a sufficient basis against which auditors can report, as required by the Regulation?
24. Could the procedures outlined above serve as an appropriate benchmark for the procedures that the auditor has to perform to provide a “properly compiled” opinion?
25. Do you agree that the auditor’s opinion that pro forma financial information is properly compiled does not include any restatement of the opinions provided on any of the underlying financial information?

## APPENDIX A: THE EUROPEAN LEGISLATIVE MODEL – THE “LAMFALUSSY” PROCESS

Four Level Approach to Law Making Process		Brief Description of application of approach to Prospectuses
<b>Level 1</b> <b>European Parliament and the Council of the European Union</b> <i>(Conceptual Legislative Framework)</i>		<b>Prospectus Directive (2003/71/EC)</b> Conceptual legislative framework of essential principles to harmonise requirements for the drawing up, approval and distribution of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market situated or operating within a Member State
<b>Level 2</b> <b>The Commission of the European Communities (European Securities Committee based on technical advice of CESR)</b> <i>(Technical Implementing Measures of Level 1)</i>		<b>Commission Regulation (EC) No 809/2004</b> <ul style="list-style-type: none"> <li>• Format of prospectus</li> <li>• Minimum information requirements to be included in prospectus</li> <li>• Method of publication</li> <li>• Incorporation by reference</li> <li>• Publication methods to ensure a prospectus is publicly available</li> <li>• Dissemination of advertisements</li> </ul>
<b>Level 3</b> <b>(CESR)</b> <ul style="list-style-type: none"> <li>• <i>Coordinated implementation of EU law</i></li> <li>• <i>Regulatory convergence (the process of creating common rules)</i></li> <li>• <i>Supervisory convergence</i></li> </ul>		<b>CESR guidance (exposed over Summer 2004) for level 3 issues</b> These consist of a higher level of detail or a common implementation of the legislative measures under the Prospectus Directive in delivering the guidelines to issuers on how best to complete a prospectus. The recommendations are expected to be followed by all competent authorities when approving a prospectus.
<b>Level 4</b> <b>European Commission</b> <i>(Strengthened Enforcement of Community Rules)</i>		European Commission checks Member State compliance with EU legislation and may take legal action against Member State suspected of breach of Community law. Member States, regulators, and the market participants have an important role in supplying information to the European Commission about any potential infringement of Community Rules

### Standard setting process for auditors

<b>Guidance to auditors on meeting their obligations under Levels 1, 2 and 3 falls outside of the Lamfalussy process.</b>		<b>Standards and guidance for auditors is not dealt with directly by levels 1, 2, 3 or 4. It therefore falls to national standard setters to provide the guidance they consider necessary. This discussion paper represents FEE’s contribution to coordinating the efforts of the national standard setters in providing such standards and guidance.</b>
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## APPENDIX B: REQUIREMENTS FROM THE REGULATION

The quotations below are derived from Annexes on Shares. Similar requirements can be found in the annexes for other instruments.

The Regulation goes into more detail as the following table demonstrates. The following text is derived from the Regulation No 809/2004 of 29 April 2004:

<b>Reference</b>	<b>Text</b>
Paragraph 8	Voluntary disclosure of profit forecasts in a share registration document should be presented in a consistent and comparable manner and accompanied by a statement prepared by independent accountants or auditors.
Annex I, Share Registration 2.1.	Names and addresses of the issuer's auditors for the period covered by the historical financial information (together with their membership in a professional body).
Annex I, Share Registration 2.2.	If auditors have resigned, been removed or not been re-appointed during the period covered by the historical financial information, indicate details if material.
Annex I, Share Registration 13.2.	A report prepared by independent accountants or auditors stating that in the opinion of the independent accountants or auditors the forecast or estimate has been properly compiled on the basis stated and that the basis of accounting used for the profit forecast or estimate is consistent with the accounting policies of the issuer.
Annex I, Share Registration 20.1.	The historical annual financial information must be independently audited or reported on as to whether or not, for the purposes of the registration document, it gives a true and fair view, in accordance with auditing standards applicable in a Member State or an equivalent standard.
Annex I, Share Registration 20.2.	Pro forma financial information must be accompanied by a report prepared by independent accountants or auditors.
Annex I Share Registration 20.4.1.	A statement that the historical financial information has been audited. If audit reports on the historical financial information have been refused by the statutory auditors or if they contain qualifications or disclaimers, such refusal or such qualifications or disclaimers must be reproduced in full and the reasons given.
Annex I Share Registration 20.4.2.	Indication of other information in the registration document which has been audited by the auditors.

Annex III Share Securities Note 10.2. An indication of other information in the Securities Note which has been audited or reviewed by statutory auditors and where auditors have produced a report. Reproduction of the report or, with permission of the competent authority, a summary of the report.

Annex XVI, Securities issued by Member States, third countries and their regional and local authorities  
4 Description of any auditing or independent review procedures on the accounts of the issuer.

## APPENDIX C: BASIC PRINCIPLES OF ISAE 3000 FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OR REVIEWS OF HISTORICAL FINANCIAL INFORMATION

The auditor should comply with ISAE 3000 and other relevant ISAEs when performing an assurance engagement other than an audit or review of historical financial information covered by ISAs or ISREs. An ISAE is to be read in the context of the “International Framework for Assurance Engagements” (the Framework), which defines and describes the elements and objectives of an assurance engagement, and identifies those engagements to which ISAEs apply. Other ISAEs may relate to topics that apply to all subject matters or be subject matter specific. Although ISAs and ISREs do not apply to engagements covered by ISAEs, they may nevertheless provide guidance to auditors.

The auditor should:

- Comply with the requirements of Parts A and B of the IFAC *Code of Ethics for Professional Accountants*.
- Implement quality control procedures that are applicable to the individual engagement.
- Accept (or continue where applicable) an assurance engagement only if the subject matter is the responsibility of a party other than the intended users or the auditor.
- Accept (or continue where applicable) an assurance engagement only if, on the basis of a preliminary knowledge of the engagement circumstances, nothing comes to the attention of the auditor to indicate that the requirements of the Code of Ethics or of the ISAEs will not be satisfied.
- Accept (or continue where applicable) an assurance engagement only if the auditor is satisfied that those persons who are to perform the engagement collectively possess the necessary professional competencies.
- Agree on the terms of the engagement with the engaging party.
- Consider the appropriateness of a request, made before the completion of an assurance engagement, to change the engagement to a non-assurance engagement or from a reasonable assurance engagement to a limited assurance engagement, and should not agree to a change without reasonable justification.
- Plan the engagement so that it will be performed effectively.
- Plan and perform an engagement with an attitude of professional scepticism recognizing that circumstances may exist that cause the subject matter information to be materially misstated.
- Obtain an understanding of the subject matter and other engagement circumstances, sufficient to identify and assess the risks of the subject matter information being materially misstated, and sufficient to design and perform further evidence-gathering procedures.
- Assess the appropriateness of the subject matter.

As may be clear both from current practice and from the requirements in the Prospectus Directive and the Regulation, the subject matter is not the prospectus as such but rather the relevant information included in the prospectus, such as historical financial information, prospective financial information, interim financial information and pro forma financial information.

- Assess the suitability of the criteria to evaluate or measure the subject matter.
- Consider materiality and assurance engagement risk when planning and performing an assurance engagement.

- Reduce assurance engagement risk to an acceptably low level in the circumstances of the engagement.
- When the work of an expert is used in the collection and evaluation of evidence, on a combined basis with the expert, possess adequate skill and knowledge regarding the subject matter and the criteria for the auditor to determine that sufficient appropriate evidence has been obtained.
- Be involved in the engagement and understand the work for which an expert is used, to an extent that is sufficient to enable the auditor to accept responsibility for the conclusion on the subject matter information.
- Obtain sufficient appropriate evidence that the expert's work is adequate for the purposes of the assurance engagement.
- Obtain sufficient appropriate evidence on which to base the conclusion.
- Obtain representations from the responsible party, as appropriate.
- Consider the effect on the subject matter information and on the assurance report of events up to the date of the assurance report.
- Document matters that are significant in providing evidence that supports the assurance report and that the engagement was performed in accordance with ISAEs.
- Conclude whether sufficient appropriate evidence has been obtained to support the conclusion expressed in the assurance report
- Issue an assurance report.

The assurance report should be in writing and should contain a clear expression of the auditor's conclusion about the subject matter information. The assurance report should include the following basic elements:

- a) A title that clearly indicates the report is an independent assurance report.
- b) An addressee
- c) An identification and description of the subject matter information and, when appropriate, the subject matter
- d) Identification of the criteria
- e) Where appropriate, a description of any significant, inherent limitation associated with the evaluation or measurement of the subject matter against the criteria
- f) When the criteria used to evaluate or measure the subject matter are available only to specific intended users, or are relevant only to a specific purpose, a statement restricting the use of the assurance report to those intended users or that purpose.
- g) A statement to identify the responsible party and to describe the responsible party's and the auditor's responsibilities
- h) A statement that the engagement was performed in accordance with ISAEs
- i) A summary of the work performed
- j) The auditor's conclusion
- k) The assurance report date
- l) The name of the firm or the auditor, and a specific location, which ordinarily is the city where the auditor maintains the office that has responsibility for the engagement.

With regard to the auditor's conclusion, the auditor should:

- Not express an unqualified conclusion when the following circumstances exist and, in the auditor's judgment, the effect of the matter is or may be material:
  - a) There is a limitation on the scope of the auditor's work, that is, circumstances prevent, or the responsible party or the engaging party imposes a restriction that prevents, the auditor from obtaining evidence required to reduce assurance engagement risk to the

appropriate level. The auditor should express a qualified conclusion or a disclaimer of conclusion;

- b) In those cases where:
    - (i) The auditor's conclusion is worded in terms of the responsible party's assertion, and that assertion is not fairly stated, in all material respects; or
    - (ii) The auditor's conclusion is worded directly in terms of the subject matter and the criteria, and the subject matter information is materially misstated, the auditor should express a qualified or adverse conclusion; or
  - c) When it is discovered, after the engagement has been accepted, that the criteria are unsuitable or the subject matter is not appropriate for an assurance engagement. The auditor should express:
    - (iii) A qualified conclusion or adverse conclusion when the unsuitable criteria or inappropriate subject matter is likely to mislead the intended users; or
    - (iv) A qualified conclusion or a disclaimer of conclusion in other cases.
- Express a qualified conclusion when the effect of a matter is not so material or pervasive as to require an adverse conclusion or a disclaimer of conclusion. A qualified conclusion is expressed as being "except for" the effects of the matter to which the qualification relates.
  - Consider other reporting responsibilities, including the appropriateness of communicating relevant matters of governance interest arising from the assurance engagement with those charged with governance.

The principles summarised above are accompanied by more detailed guidance in ISAE 3000. The auditor should, when performing an engagement in respect of a prospectus, consider the guidance in ISAE 3000 as a whole.

## **APPENDIX D: ILLUSTRATIVE EXAMPLE OF AN AUDITOR'S OPINION ON NEW OR RESTATED FINANCIAL INFORMATION**

The illustrative opinion included below is based on that set out in the IAASB Proposed Final Pronouncements on the Auditor's Report ISA 700 (Revised), "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" as presented at the IAASB Board meeting of September 2004, which is a public meeting ([www.ifac.org/IAASB/Meeting-FileDL.php?FID=0774](http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=0774)).

### INDEPENDENT AUDITOR'S OPINION

*[Appropriate Addressee]*

#### **Report on the [prospectus accounts]**

We have audited the accompanying [prospectus accounts] of [Europe PLC], which comprise the balance sheet as at 31 December 20X1 [31 December 20X2 and 31 December 20X3], and the income statement, statement of changes in equity and cash flow statement for the years then ended, and a summary of significant accounting policies and other explanatory notes.

*Management's responsibility for the [prospectus accounts]*

Management is responsible for the preparation and the fair presentation of these [prospectus accounts] in accordance with International Financial Reporting Standards [or appropriate accounting framework] [and with the requirements of the Prospectus Directive implementing Regulation EU 2004-809]. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of [prospectus accounts] that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies that are consistent with International Financial Reporting Standards [or appropriate accounting framework]; and making accounting estimates that are reasonable in the circumstances.

*Auditor's responsibility*

Our responsibility is to express an opinion on these [prospectus accounts] based on our audit. We conducted our audit in accordance with International Standards on Auditing [or applicable auditing standards]. Those standards require, that we comply with the applicable ethical requirements and plan and perform the audit to obtain reasonable assurance whether the [prospectus accounts] are free from material misstatement.

An audit conducted in accordance with International Standards on Auditing [or applicable auditing standards] involves performing procedures to obtain audit evidence about the amounts and disclosures in the [prospectus accounts]. The audit procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement in the [prospectus accounts]. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the [prospectus accounts] as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall [prospectus accounts] presentation.

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We believe that the audit evidence that we have obtained is sufficient and appropriate to draw reasonable conclusions on which to base our audit opinion.

*Opinion*

In our opinion, the [prospectus accounts] give a true and fair view of (or, “*present fairly, in all material respects*”) the financial position of [Europe PLC] as of 31 December 20X1 [31 December 20X2 and 31 December 20X3], and of its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

**Report on Other Legal and Regulatory Requirements**

*[Form and content of this section of the auditor’s report will vary depending on the nature of the auditor’s other reporting responsibilities.]*

*[Auditor’s signature]*

*[Date of the auditor’s report]*

*[Auditor’s address]*

## APPENDIX E: ILLUSTRATIVE EXAMPLE OF AN AUDITOR’S REPORT ON PROSPECTIVE FINANCIAL INFORMATION

### *Auditor’s Assurance Report on prospective financial information*

*[Addressee]*

We report on the profit forecast set out in Part [ ] of the Europe PLC’s prospectus dated [ ] (the “Profit Forecast”).

#### *Management’s responsibility*

It is management’s responsibility to prepare the profit forecast, together with the material assumptions upon which it is based, in accordance with the requirements of EU Regulation 2004-809 and [CESR’s Level 3 guidance – reference].

#### *Auditor’s responsibility*

It is our responsibility to provide the opinion required by Annex I item 13.3 of EU Regulation 2004-809. We are not required nor do we express an opinion on the possibility of achievement of result or on the assumptions underlining the profit forecast. We do not accept any responsibility for any financial information previously reported on and used in the compilation of the Profit Forecast beyond that owed to those to whom any reports on that financial information were addressed by us at the date[s] of their issue.

#### *Work performed*

We performed our work in accordance with [specify relevant auditing standards]. Our work included an evaluation of the procedures undertaken by the Directors in compiling the Profit Forecast and the consistency of the Profit Forecast with the accounting policies normally adopted by Europe PLC.

We planned and performed our work so as to obtain all the information and explanations we considered necessary in order to provide us with reasonable assurance that the Profit Forecast has been properly compiled on the basis stated. Since the Profit Forecast and the assumptions on which it is based relate to the future and may therefore be affected by unforeseen events, we can express no opinion as to whether the actual results reported will correspond to those shown in the Profit Forecast and differences may be material.

#### *Opinion*

In our opinion:

- a) The profit forecast has been properly compiled on the basis stated; and
- b) That basis of accounting is consistent with the accounting policies of the issuer.

*[Place]*

*[Date]*

*[Signature]*

## APPENDIX F: ILLUSTRATIVE EXAMPLE OF AN AUDITOR'S REPORT ON PRO FORMA FINANCIAL INFORMATION

### *Auditor's Assurance Report on Pro Forma Financial Information*

*[Addressee]*

We report on the pro forma financial information set out in Part [ ] of the Europe PLC's prospectus dated [ ].

The pro forma financial information has been prepared, for illustrative purposes only, to provide information about how the [describe the significant gross change event] might have affected the [unaudited] [consolidated] [balance sheet of Europe PLC as at [date] [and]/[or] [profit and loss account of the Company for the year ended [date] and because of its nature addresses a hypothetical situation and, therefore, does not represent the company's actual financial position or results.

#### *Management's responsibility*

It is management's responsibility to prepare the pro forma financial information in accordance with the requirements of EU Regulation 2004-809 and [CESR's Level 3 guidance – reference].

#### *Auditor's responsibility*

It is our responsibility to provide the opinion required by Annex II item 7 of EU Regulation 2004-809. We are not responsible for expressing any other opinion on the pro forma financial information or on any of its constituent elements. In particular, we do not accept any responsibility for any financial information previously reported on and used in the compilation of the pro forma financial information beyond that owed to those to whom any reports on that financial information were addressed by us at the date[s] of their issue.

#### *Work performed*

We performed our work in accordance with [specify relevant auditing standards]. Our work, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the pro forma financial information with the directors of the Company.

We planned and performed our work so as to obtain all the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro Forma Financial Information has been properly compiled on the basis stated.

#### *Opinion*

In our 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.

*[Place]*

*[Date]*

*[Signature]*

## APPENDIX G: ILLUSTRATIVE EXAMPLE OF AN AUDITOR'S REPORT ON ADDITIONAL DISCLOSURES

### *Auditor's Assurance Report on additional disclosures*

*[Addressee]*

We report on the accompanying additional disclosures of [Europe PLC], which comprise the {specify information and periods concerned e.g. [statement of changes in equity] [cash flows statements] for the three years ended 31 December 20X2, and [the related notes]} that have been prepared for the purposes of inclusion in a prospectus dated [date] (“the additional disclosures”).

The additional disclosures have been prepared in order to complement the financial statements of [Europe PLC] to the extent necessary to meet the disclosure requirements of EU Regulation 2004-809.

#### *Management's responsibility*

It is management's responsibility to prepare the additional disclosures in accordance with the requirements of applicable {specify GAAP}, EU Regulation 2004-809 and [CESR's Level 3 guidance – reference].

#### *Auditor's responsibility*

It is our responsibility to provide the opinion required by Annex I item 20.1 of EU Regulation 2004-809. We do not accept any responsibility for any information derived from financial statements previously reported on and used in the compilation of the additional disclosures beyond that owed to those to whom any reports on those financial statements were addressed by us at the date[s] of their issue.

#### *Work performed*

We performed our work in accordance with [specify relevant auditing standards]. Our work consisted primarily of considering the evidence supporting the additional disclosures and discussing the additional disclosures with the directors of the Company.

We planned and performed our work to obtain all the information and explanations we “considered necessary to provide us with reasonable assurance that the additional disclosure has been properly prepared on the basis stated.

#### *Opinion*

In our opinion:

- a) The additional disclosures have been properly prepared; and
- b) The additional disclosures are consistent with the applicable accounting principles.

*[Place]*

*[Date]*

*[Signature]*