

## AR Section 120

# Compilation of Pro Forma Financial Information

Issue date, unless otherwise indicated: July 2005

Source: SSARS No. 14; SSARS No. 17

**.01** Statements on Standards for Accounting and Review Services (SSARSs) provide guidance concerning the standards and procedures applicable when an accountant is engaged to report on compiled financial statements or submits financial statements to his or her client or third parties. By definition, presentations of pro forma financial information are not financial statements. This statement expands SSARSs to apply when an accountant is engaged to report or issues a report on compiled pro forma financial information. If, however, the pro forma financial information is included as supplementary information, the accountant should refer to paragraph .53 of section 80, *Compilation of Financial Statements*. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.02** A compilation of pro forma financial information is limited to assisting management (owners) in presenting financial information without undertaking to obtain or provide any assurance that there are no material modifications that should be made to that information. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.03** The objective of pro forma financial information is to show what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. Pro forma financial information is commonly used to show the effects of transactions such as the following:

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

**.04** This objective is achieved primarily by applying pro forma adjustments to historical financial information. Pro forma adjustments should be based on management's assumptions and give effect to all significant effects directly attributable to the transaction (or event).

**.05** Pro forma financial information should be labeled as such to distinguish it from historical financial information. This presentation should describe the transaction (or event) that is reflected in the pro forma financial information, the source of the historical financial information on which it is based, the significant assumptions used in developing the pro forma adjustments, and any significant uncertainties about those assumptions. The presentation should

also indicate that the pro forma financial information should be read in conjunction with the related historical financial information and that the pro forma financial information is not necessarily indicative of the results (such as financial position and results of operations, as applicable) that would have been attained had the transaction (or event) actually taken place earlier.

## **Conditions for Compiling Pro Forma Financial Information**

**.06** Nothing in this statement is intended to preclude an accountant from assisting management (owners) in presenting pro forma financial information and submitting such pro forma financial information to the client or to third parties without the issuance of a compilation report, unless the accountant has been engaged to report on such compiled pro forma financial information. If an accountant assists management (owners) in presenting pro forma financial information,<sup>[1]</sup> the accountant should consider how such a presentation of pro forma financial information will be used. The accountant should consider the potential of being associated with pro forma financial information and the likelihood that the user may inappropriately infer, through that association, an unintended level of reliance on the information. If the accountant believes that he or she will be associated with the information, the accountant should consider issuing a compilation report so a user will not infer an unintended level of reliance on the information. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.07** An engagement to report on compiled pro forma financial information may be undertaken as a separate engagement or in conjunction with a compilation of financial statements. The accountant may agree to compile pro forma financial information only if the document that contains the pro forma financial information includes (or incorporates by reference) the historical financial statements of the entity on which the pro forma financial information is based. Historical interim financial information may be presented in condensed form. In the case of a business combination, the document should include (or incorporate by reference) the appropriate historical financial information for the significant constituent parts of the combined entity. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.08** Additionally, the historical financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based must have been compiled, reviewed, or audited. The accountant's compilation or review report or the auditor's report on the historical financial statements should be included (or incorporated by reference) in the document containing the pro forma financial information.

## **Understanding With the Entity**

**.09** When an accountant is engaged to report on compiled pro forma financial information, the accountant should establish an understanding with

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<sup>[1]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services (SSARS) No. 19.]

management regarding the services to be performed and should document the understanding through a written communication with management. Such an understanding reduces the risks that either the accountant or management may misinterpret the needs or expectations of the other party. For example, it reduces the risk that management may inappropriately rely on the accountant to protect the entity against certain risks or perform certain functions that are management's responsibility. The accountant should ensure that the understanding includes the objectives of the engagement, management's responsibilities, the accountant's responsibilities, and the limitations of the engagement. In some cases, the accountant may establish such understanding with those charged with governance. An understanding with management and, if applicable, those charged with governance regarding a compilation of pro forma financial information should include the following matters:

- The objective of a compilation of pro forma information is to assist management in presenting such financial information.
- The accountant utilizes information that is the representation of management (owners) without undertaking to obtain any assurance that there are no material modifications that should be made to the pro forma financial information in order for the pro forma financial information to be in conformity with the applicable financial reporting framework.
- Management is responsible for the preparation and fair presentation of the pro forma financial information in accordance with the applicable financial reporting framework.
- Management is responsible for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.
- Management is responsible for the prevention and detection of fraud.
- Management is responsible for identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- Management is responsible for making all financial records and related information available to the accountant.
- The accountant is responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.
- A compilation differs significantly from a review or an audit of pro forma financial information. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, the accountant will not express an opinion or provide any assurance regarding the pro forma financial information.

- The engagement cannot be relied upon to disclose errors, fraud,<sup>2</sup> or illegal acts.<sup>3</sup>
- The accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the performance of compilation procedures<sup>4</sup> that fraud or an illegal act may have occurred.<sup>5</sup> The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.
- The effect of any independence impairments on the expected form of the accountant's compilation report, if applicable.

[Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

.10 When the accountant is engaged to report on compiled pro forma financial information and evidence or information comes to his or her attention during the engagement that fraud or an illegal act may have occurred, the accountant should adhere to the communication requirements contained in paragraphs .54–.55 of section 80. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Performance Requirements

.11 When the accountant is engaged to report on compiled pro forma financial information, he or she should adhere to the compilation performance requirements contained in paragraphs .06–.13 of section 80. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

.12 Before issuance of a compilation report on pro forma financial information, the accountant should read such compiled pro forma financial information, including the summary of significant assumptions,<sup>6</sup> and consider whether the information appears to be appropriate in form and free of obvious material errors. In this context, the term *error* refers to mistakes in the compilation of the pro forma financial information, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate

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<sup>2</sup> For purposes of this statement, *fraud* is an intentional act that results in a misstatement in compiled pro forma financial information.

<sup>3</sup> For purposes of this statement, *illegal acts* are violations of laws or government regulations, excluding fraud.

<sup>4</sup> Performance requirements with respect to an engagement to compile pro forma financial information are contained in paragraphs .11–.12.

<sup>5</sup> Whether the act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on pro forma financial information, presents himself or herself as one who is proficient in accounting and compilation services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal. However, the determination about whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

<sup>6</sup> The accountant may not report on compiled pro forma financial information if the summary of significant assumptions is not presented. Nothing in this statement should be interpreted to preclude the accountant from reporting on compiled pro forma financial information when management elects to omit substantially all disclosures. In that situation, the accountant should follow the guidance in paragraph .20 of section 80, *Compilation of Financial Statements*. [Footnote revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

disclosures. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Documentation Requirements

.13 When the accountant is engaged to report on compiled pro forma financial information, he or she should adhere to the documentation requirements contained in paragraphs .14–.15 of section 80. [Paragraph added, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Reporting Requirements

.14 The accountant's objective in reporting on compiled pro forma financial information is to prevent misunderstanding of the degree of responsibility the accountant is assuming when his or her name is associated with the pro forma financial information. When the accountant issues a compilation report on pro forma financial information, the basic elements of the report are as follows:

- a. *Title.* The accountant's compilation report should have a title that clearly indicates that it is the accountant's compilation report. The accountant may indicate that he or she is independent in the title, if applicable. Appropriate titles would be "Accountant's Compilation Report" or "Independent Accountant's Compilation Report."
- b. *Addressee.* The accountant's report should be addressed as appropriate in the circumstances of the engagement.
- c. *Introductory paragraph.* The introductory paragraph in the accountant's report should
  - i. identify the entity whose pro forma financial information has been compiled.
  - ii. state that the pro forma financial information has been compiled.
  - iii. identify the pro forma financial information that has been compiled.
  - iv. specify the date or period covered by the pro forma financial information.
  - v. reference the financial statements from which the historical financial information is derived and include a statement on whether such financial statements were compiled, reviewed, or audited. (The report on pro forma financial information should refer to any modifications in the accountant's or auditor's report on historical financial statements.)
  - vi. include a statement that the accountant has not audited or reviewed the pro forma financial information and, accordingly, does not express an opinion or provide any assurance about whether pro forma financial information is in accordance with the applicable financial reporting framework.
  - vii. if the compilation was performed in conjunction with a compilation of the entity's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on

those statements should also be disclosed if considered relevant to the presentation of the pro forma financial information.

- d. *Management's responsibility for the pro forma financial information and for internal control over financial reporting.* A statement that management (owners) is (are) responsible for the preparation and fair presentation of the pro forma financial information in accordance with the applicable financial reporting framework and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.
- e. *Accountant's responsibility.* A statement that the accountant's responsibility is to conduct the compilation in accordance with SSARSs issued by the AICPA.
- f. A statement that the objective of a compilation is to assist management in presenting financial information in the form of pro forma financial information without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information.
- g. A separate paragraph explaining the objective of pro forma financial information and its limitations.
- h. *Signature of the accountant.* The manual or printed signature of the accounting firm or the accountant, as appropriate.
- i. *Date of the accountant's report.* The date of the compilation report (the date of completion of the compilation should be used as the date of the accountant's report).

Procedures that the accountant might have performed as part of the compilation engagement should not be described in the report.

See exhibit B, "Illustrative Accountant's Compilation Report on Pro Forma Financial Information," for an illustrative compilation report.

[Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.15** Each page of the pro forma financial information compiled by the accountant should include a reference, such as "See accountant's compilation report" or "See independent accountant's compilation report." [Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**[.16]** [Paragraph renumbered and deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]<sup>[7-8]</sup>

## Reporting When the Accountant Is Not Independent

**.17** When the accountant is issuing a report with respect to a compilation of pro forma financial information for an entity, with respect to which the accountant is not independent, the accountant's report should be modified. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA Code of Professional Conduct. The accountant

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<sup>[7-8]</sup> [Footnotes deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

should indicate his or her lack of independence in a final paragraph of the accountant's compilation report. An example of such a disclosure would be<sup>[9]</sup> If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

I am (we are) not independent with respect to XYZ Company.

The accountant is not precluded from disclosing a description about the reason(s) that his or her independence is impaired. The following are examples of descriptions the accountant may use:

- a. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company.
- b. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company.
- c. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

If the accountant elects to disclose a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description.

[Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

**.18** This section is effective for engagements entered into after December 15, 2005. Early application is permitted. [Paragraph renumbered, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

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<sup>[9]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Exhibit A

### Illustrative Engagement Letter for a Compilation of Pro Forma Financial Information

*[Appropriate Salutation]*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the pro forma financial information of XYZ Company as of December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

The objective of a compilation is to assist you in presenting financial information in the form of pro forma financial information. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information in order for the pro forma financial information to be in conformity with *[the applicable financial accounting framework (for example, accounting principles generally accepted in the United States of America)]*.

You are responsible for

- a. the preparation and fair presentation of the pro forma financial information in accordance with *[the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]*.
- b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.
- c. preventing and detecting fraud.
- d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with SSARs issued by the AICPA.

A compilation differs significantly from a review or an audit of financial information. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the pro forma financial information being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material



errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures, that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:

We are not independent with respect to XYZ Company. We will disclose that we are not independent in our compilation report.

If, for any reason, we are unable to complete the compilation of your pro forma financial information, we will not issue a report on such schedule as a result of this engagement.

Our fees for these services . . . .

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.<sup>[\*]</sup>

Sincerely yours,

\_\_\_\_\_  
[Signature of accountant]

Acknowledged:

XYZ Company

\_\_\_\_\_  
President

\_\_\_\_\_  
Date

[As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17. Paragraph renumbered and revised, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

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<sup>[\*]</sup> [Footnote deleted, December 2010, to reflect conforming changes necessary due to the issuance of SSARS No. 19.]

## Exhibit B

# Illustrative Compilation Report on Pro Forma Financial Information

Compilation report on pro forma financial information reflecting a business combination prepared in accordance with accounting principles generally accepted in the United States of America

### Accountant's Compilation Report

*[Appropriate Salutation]*

I (we) have compiled the accompanying pro forma financial information of XYZ Company as of December 31, 20XX, reflecting the business combination of the Company and ABC Company. The historical condensed financial statements are derived from the historical unaudited financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were compiled by another (other) accountant(s).<sup>1</sup> I (we) have not audited or reviewed the accompanying pro forma financial information and, accordingly, do not express an opinion or provide any assurance about whether the pro forma financial information is in accordance with accounting principles generally accepted in the United States of America.

Management (owners) is (are) responsible for the preparation and fair presentation of the pro forma financial information in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of pro forma financial information without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information.

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

*Paragraph the accountant may add after the previous paragraph when management has elected to omit substantially all disclosures, but the pro forma financial*

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<sup>1</sup> When one set of historical financial statements is audited or reviewed and the other is audited, reviewed, or compiled, wording similar to the following would be appropriate:

The historical condensed financial statements are derived from the historical financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were reviewed by another (other) accountant(s), appearing elsewhere herein (or incorporated by reference).

If either accountant's review report or auditor's report includes an explanatory paragraph or is modified, that fact should be referred to within the report.

*information is otherwise in conformity with accounting principles generally accepted in the United States of America.*

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

*[Date]*

[Paragraph added, December 2010, to reflect the presentation style and conforming changes necessary due to the issuance of SSARS No. 19.]

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