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Standard on Assurance Engagements (SAE)  
SAE 3400 – The Examination of Prospective Financial Information

CA. Pareen Shah

## □ Purpose

- 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.
- SAE 3400 is not applicable to examination of prospective financial information expressed in general or narrative terms.
- The principles of standards on auditing should be used as much as possible by the auditor in applying this SAE.
- Management is responsible for the preparation of prospective financial information and the auditor is required to validate and report on the same.

- In an engagement to examine prospective financial information, the auditor should obtain sufficient appropriate evidence as to whether:
  - (a) management's best-estimate assumptions on which the prospective financial information is based are not unreasonable and, in the case of hypothetical assumptions, such assumptions are consistent with the purpose of the information;
  - (b) the prospective financial information is properly prepared on the basis of the assumptions;
  - (c) the prospective financial information is properly presented and all material assumptions are adequately disclosed, including a clear indication as to whether they are best-estimate assumptions or hypothetical assumptions; and
  - (d) ) the prospective financial information is prepared on a consistent basis with historical financial statements, using appropriate accounting principles.

## ❑ “Prospective financial information”

- means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It is highly subjective in nature and its preparation requires the exercise of considerable judgment. It can be in the form of a forecast, a projection or a combination of both.

## ❑ “Forecast”

- means prospective financial information prepared on the basis of assumptions as to future events which management expects to take place and the actions management expects to take as of the date the information is prepared (best-estimate assumptions).

## □ “Projection”

- means prospective financial information prepared on the basis of:
- (a) hypothetical assumptions about future events and management actions which are not necessarily expected to take place, such as when some entities are in a start-up phase or are considering a major change in the nature of operations; or
- (b) a mixture of best-estimate and hypothetical assumptions.

# Management's Responsibility

- Management is responsible for :

1

The preparation and presentation of the prospective financial information

2

The identification and disclosure of the sources of information

3

The basis of forecasts and the underlying assumptions.

# The Auditor's Assurance Regarding Prospective Financial Information

- The auditor may be asked to examine and report on Prospective financial information to enhance its credibility
- Prospective financial information relates to events and actions that have not yet occurred and might. Evidences related to same are also generally future oriented, speculative in nature. The Auditor, therefore is not in a position to express an opinion as to whether the results shown in the prospective financial information will be achieved.
- Consequently, in this SAE, when reporting on the reasonableness of management's assumptions, the auditor provides only a moderate level of assurance.

# Acceptance of Engagement

- The auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use.
- In accordance with SA 210, "Terms of Audit Engagement", it is necessary that the auditor and the client should agree on the terms of the engagement.



# Auditor's Considerations

Knowledge of the Business  
to evaluate all significant  
assumptions

Period Covered

# Factors to be considered



- Internal control over systems used to prepare Prospective financial information
- Experience and expertise of team preparing Prospective financial information
- Nature of documentation prepared by the entity to support management's assumptions.
- Extent of statistical, mathematical and computer – assisted techniques are used.
- Methods used to develop and apply assumptions.
- Accuracy of Prospective financial information prepared in prior periods and reason for any significant variation

# Reliance on Historical financial information

- The auditor should consider the extent to which reliance on the entity's historical financial information is justified.
- The auditor requires knowledge of the entity's historical financial information to assess whether the prospective financial information has been prepared on a basis consistent with the historical financial information and to provide a historical yardstick for considering management's assumptions.
- The auditor will need to establish, for example, whether relevant historical information was audited or reviewed and whether acceptable accounting principles were used in its preparation.
- If the audit or review report on prior period historical financial information was other than a clean report or if the entity is in a start-up/expansion phase, the auditor would consider the relevant facts and the effect on the examination of the prospective financial information.

# Nature, timing and extent of examination procedures



- The knowledge obtained by auditor during any previous engagements
- Sources of information and assumptions considered by management based on internal and external sources.
- Whether all significant implications of the assumptions have been taken into consideration
- To focus more on areas that are particularly sensitive to variation and shall have material effect on the results shown in the prospective financial information
- Stability of entity's business.
- Likelihood of material misstatement

# Written Representation from Management Regarding

Intended use of the prospective financial information

The completeness of significant management assumptions

Management's acceptance of its responsibility for the prospective financial information

Management responsible for identification of uncontrollable factors, outstanding litigation, commitments or other material factors

# Presentation and Disclosures

Presentation of prospective financial information is informative

The accounting policies are clearly disclosed in the notes

The assumptions are adequately disclosed in the notes and its need to be clear whether it represents management Best-estimates or are hypothetical

The date as of which the prospective financial information was prepared is disclosed

In case of assumptions subject to high degree of uncertainty, the uncertainty and the resulting sensitivity to be disclosed.

Change in the accounting policy of the entity, and its effect if any

# Documentation



Sources of information

Basis of forecasts and the assumptions made in arriving the forecasts

Hypothetical assumptions, evidence supporting the assumptions;

Management representations regarding the intended use and distribution of the information;

Completeness of material assumptions;

Management's acceptance of its responsibility for the information,

Audit plan, the nature, timing and extent of examination procedures performed

Auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision

# Report on Examination of Prospective Financial Information

(a) Title

(b) Addressee

(c) Identification of the prospective financial information

(d) Reference to the Standards on Auditing applicable to the examination of prospective financial information

(e) Statement that management is responsible for the prospective financial information including the underlying assumptions;

(f) When applicable, a reference to the purpose and/or restricted distribution of the prospective financial information

(g) Statement that the examination procedures included examination, on a test basis, of evidence supporting the assumptions, amounts and other disclosures in the forecast or projection;



# Report on Examination of Prospective Financial Information

(h) Statement of negative assurance as to whether the assumptions provide a reasonable basis for the prospective financial information

(i) Opinion as to whether the prospective financial information is properly prepared on the basis of the assumptions and is presented in accordance with the relevant financial reporting framework

(j) Appropriate caveats concerning the achievability of the results indicated by the prospective financial information

(k) Date of report (which should be the date procedures have been completed)

(l) Place of signature; and

(m) Signature

# Report on Examination of Prospective Financial Information

Presentation and disclosure of the prospective financial information is not adequate



Qualified or  
Adverse opinion

OR

Withdraw from  
the engagement  
as appropriate

One or more significant assumptions do not provide a reasonable basis for the prospective financial information prepared on the basis of best-estimate assumptions or hypothetical assumptions



Express an adverse opinion setting out the reasons in the report on the prospective financial information,

or withdraw from the engagement.

# Report on Examination of Prospective Financial Information



Examination is affected by conditions that preclude application of one or more procedures considered necessary in the circumstances



Auditor should either withdraw from the engagement or disclaim the opinion and describe the scope limitation in the report on the prospective financial information



SAE 3420

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

- This Standard on Assurance Engagements (SAE) deals with reasonable assurance engagements undertaken by a practitioner to report on the responsible party's compilation of pro forma financial information included in a prospectus. The SAE applies where:
- Such reporting is required by securities law or the regulation of the securities exchange ("relevant law or regulation") in the jurisdiction in which the prospectus is to be issued; or
- This reporting is generally accepted practice in such jurisdiction.

# Nature of the Practitioner's Responsibility



- Practitioner has no responsibility to compile the pro forma financial information for the entity; such responsibility rests with the responsible party.
- Practitioner's sole responsibility is to report on whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.
- This SAE does not deal with non-assurance engagements in which the practitioner is engaged by the entity to compile its historical financial statements.

# Purpose of Pro Forma Financial Information Included in a Prospectus

- The purpose of pro forma financial information included in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration.
- Thus, pro forma financial information do not represent the entity's financial position, performance or cash flows.

## □ Compilation of Pro Forma Financial Information

- Identifying the source of the unadjusted financial information to be used in compiling the pro forma financial information;
- Making pro forma adjustments to the unadjusted financial information;
- Presenting the resulting pro forma financial information with accompanying disclosures.

# Nature of Reasonable Assurance Engagement

- A reasonable assurance engagement to report on the compilation of pro forma financial information and to obtain sufficient appropriate evidence about whether:
  - The related pro forma adjustments give appropriate effect to those criteria; and
  - The resulting pro forma column reflects the proper application of those adjustments to the unadjusted financial information.
  
- It does not involve practitioner updating or reissuing any reports or opinions on any historical financial information used in compiling the pro forma financial information or performing an audit or review of the financial information used in compiling the pro forma financial information.



- The objectives of the practitioner are:
  - (a) To obtain reasonable assurance about whether the pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria; and
  - (b) To report in accordance with the practitioner's findings.

## □ Pro forma adjustments :

- In relation to unadjusted financial information, these include :
  - Adjustments to unadjusted financial information that illustrate the impact of a significant event or transaction ("event" or "transaction") as if the event had occurred or the transaction had been undertaken at an earlier date.
  - Adjustments to unadjusted financial information that are necessary for the pro forma financial information to be compiled on a basis consistent with the applicable financial reporting framework of the reporting entity ("entity") and its accounting policies under that framework.

Pro forma adjustments include the relevant financial information of a business that has been, or is to be, acquired ("acquiree"), or a business that has been, or is to be, divested ("divestee"), to the extent that such information is used in compiling the pro forma financial information.

## □ Pro forma financial information :

- Financial information shown together with adjustments to illustrate the impact of an event or transaction on unadjusted financial information as if the event had occurred or the transaction had been undertaken at an earlier date.

## □ Unadjusted financial information :

- Financial information of the entity to which pro forma adjustments are applied by the responsible party.

## □ Applicable criteria :

- The criteria used by the responsible party when compiling the pro forma financial information. Criteria may be established by an authorized or recognized standard-setting organization or by law or regulation. Where established criteria do not exist, they will be developed by the responsible party.

# Engagement Acceptance

- Determine that the practitioner has the capabilities and competence to perform the engagement;
- Determine that the applicable criteria are suitable and that it is unlikely that the pro forma financial information will be misleading;
- determine that the practitioner will likely be able to express the opinion so prescribed by relevant law or regulation, if any,
- Where the sources from which the unadjusted financial information and any acquiree or divestee financial information have been extracted have been audited or reviewed and a modified audit opinion or review conclusion has been expressed, or the report contains an Emphasis of Matter paragraph, consider whether or not the relevant law or regulation permits the use of, or reference in the practitioner's report to, the modified audit opinion or review conclusion or the report containing the Emphasis of Matter paragraph with respect to such sources;
- If historical financial information has never been audited or reviewed, Whether the practitioner can obtain a sufficient understanding of the entity and its accounting and financial reporting practices to perform the engagement.

# Engagement Acceptance

- Obtain the agreement of the responsible party that it acknowledges and understands its responsibility for :
  - i. Adequately disclosing and describing the applicable criteria to the intended users if these are not publicly available
  - ii. Compiling the pro forma financial information on the basis of the applicable criteria; and

# Engagement Acceptance

- Providing the practitioner with:
- Access to all information (including, when needed for purposes of the engagement, information of the acquiree(s) in a business combination), such as records, documentation and other material, relevant to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria.
- Additional information that the practitioner may request from the responsible party for the purpose of the engagement.
- Access to those within the entity and the entity's advisors from whom the practitioner determines it necessary to obtain evidence relating to evaluating whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria; and
- When needed for purposes of the engagement, access to appropriate individuals within the acquiree(s) in a business combination.

# Planning and Performing the Engagement



Assessing the Suitability of the Applicable Criteria

Materiality

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

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

Obtaining Evidence about the Appropriateness of the Pro Forma Adjustments

# Planning and Performing the Engagement



Modified Audit Opinion or Review Conclusion, or Emphasis of Matter Paragraph, with Respect to the Source from Which the Unadjusted Financial Information Has Been Extracted or the Source from Which the Acquiree or Divestee Financial Information Has Been Extracted- the practitioner shall consider the possible effect of the same on his report

When Source from Which the Unadjusted Financial Information Has Been Extracted or Pro Forma Adjustments is Not Appropriate, then the same shall be discussed with responsible party, how to resolve the matter of disagreement and what further action to be taken

Obtaining Evidence about the Calculations within the Pro Forma Financial Information

Evaluating the Presentation of the Pro Forma Financial Information



# Planning and Performing the Engagement



- The Practitioner shall determine whether pro forma adjustments are :
  - i. Directly attributable to the event or transaction
  - ii. Factually supported
  - iii. Consistent with the entity's applicable financial reporting framework and its accounting policies.

# Other Information



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

# Forming of Opinion

- **Unmodified Opinion-** Pro forma financial information has been compiled, in all material respects, by the responsible party on the basis of the applicable criteria.
- **Modified Opinion –**
- The practitioner shall discuss the matter with the responsible party –
- If the responsible party does not agree to make the necessary changes, the practitioner shall:
  - (a) Withdraw from the engagement; or
  - (b) Consider seeking legal advice.



SAE 3402

Assurance Reports on Controls at a Service Organisation

## □ Scope

- It deals with assurance engagements undertaken by service auditor to provide a report for use by user entities and their auditors on the controls at a service organization that provides a service to user entities that is likely to be relevant to user entities internal control as it relates to financials reporting.
- This SAE only deals with assertion – based engagements that convey reasonable assurance, with the assurance conclusion worded directly in terms of the subject matter and the criteria.

- ❑ Objectives :
- ❑ (a) To obtain reasonable assurance about whether, in all material respects, based on suitable criteria
  - The service organization's description of its system **fairly presents the system as designed and implemented** throughout the specified period or specified date.
  - The controls related to the control objectives stated in the service organization's description of its system **were suitably designed** throughout the specified period or specified date.
  - Where included in the scope of the engagement, the controls operated effectively to provide reasonable assurance that the **control objectives stated in the service organization's description of its system were achieved** throughout the specified period or specified date.
- (b) To report on the matters in (a) above in accordance with the service auditor's findings

# Type of Reports

## □ Type of Reports

- Report on the description and design of controls at a service organization (“**Type 1 report**”)
- **A report that comprises:**
- (i) The service organization’s description of its system;
- (ii) A written assertion by the service organization that, in all material respects, and based on suitable criteria:
  - A. The description fairly presents the service organization’s system as designed and implemented as at the **specified date**
  - B. The controls related to the control objectives stated in the service organization’s description of its system were suitably designed as at the **specified date**; and
- (iii) A service auditor’s assurance report that conveys reasonable assurance about the matters in (ii)a.-b. above.

# Type of Reports

## □ Type of Reports

- Report on the description, design and operating effectiveness of controls at a service organization (“Type 2 report”)
- A report that comprises:
  - (i) The service organization’s description of its system;
  - (ii) A written assertion by the service organization that, in all material respects, and based on suitable criteria:
    - A. The description fairly presents the service organization’s system as designed and implemented throughout the **specified period**
    - B. The controls related to the control objectives stated in the service organization’s description of its system were suitably designed throughout the **specified period**; and
    - C. The controls related to the control objectives stated in the service organization’s description of its system operated effectively throughout the **specified period**; and



# Type of Reports

iii) A service auditor's assurance report that:

- a. Conveys reasonable assurance about the matters in (ii)a.-c. above; and
- b. Includes a description of the tests of controls and the results thereof.

# Acceptance and Continuance

- Determine whether:
  - a. The service auditor has the capabilities and competence to perform the engagement
  - b. The criteria to be applied by the service organization to prepare the description of its system
  - c. The scope of the engagement and the service organization's description of its system will not be so limited that they are unlikely to be useful to user entities and their auditors.
  - d. Obtain the agreement of the service organization that it acknowledges and understands its responsibility

# Assessing the Suitability of Criteria

- The service auditor shall assess whether the service organization has used suitable criteria in preparing the description of its system, in evaluating whether controls are suitably designed, and, in the case of a type 2 report, in evaluating whether controls are operating effectively.
- The service auditor shall determine if the criteria encompass, at a minimum:
  - (a) Whether the description presents how the service organization's system was designed and implemented, including
    - ✓ The types of services provided, including, as appropriate, classes of transactions processed
    - ✓ The procedures, within both information technology and manual systems, by which services are provided,
    - ✓ The related records and supporting information, including, as appropriate, accounting records, supporting information and specific accounts

# Assessing the Suitability of Criteria

- ✓ How the service organization's system deals with significant events and conditions, other than transactions.
- ✓ The process used to prepare reports and other information for user entities;
- ✓ The specified control objectives and controls designed to achieve those objectives;
- ✓ Complementary user entity controls contemplated in the design of the controls; and
- ✓ Other aspects of the service organization's control environment, risk assessment process, information system (including the related business processes) and communication, control activities and monitoring controls that are relevant to the services provided.

# Assessing the Suitability of Criteria

- (b) In the case of a type 2 report, whether the description includes relevant details of changes to the service organization's system during the period covered by the description.
- (c) Whether the description omits or distorts information relevant to the scope of the service organization's system being described, while acknowledging that the description is prepared to meet the common needs of a broad range of user entities and their auditors and may not, therefore, include every aspect of the service organization's system that each individual user entity and its auditor may consider important in its particular environment.

# Assessing the Suitability of Criteria to evaluate the operating effectiveness of controls



- The service auditor shall determine if the criteria encompass, at a minimum, whether the controls were consistently applied as designed throughout the specified period. This includes whether manual controls were applied by individuals who have the appropriate competence and authority.

# Other Aspects

Materiality

Obtaining an Understanding of the Service Organization's System

Obtaining Evidence Regarding the Description

Obtaining Evidence Regarding Design of Controls

Obtaining Evidence Regarding Operating Effectiveness of Controls

Sampling

Nature and Cause of Deviations

# The Work of an Internal Audit Function



Obtaining an Understanding of the Internal Audit Function

Determining Whether and to What Extent to Use the Work of the Internal Auditors

Using the Work of the Internal Audit Function

Effect on the Service Auditor's Assurance Report

Written Representations

Other Information

Subsequent Events

Documentation



# Preparing the Service Auditor's Assurance Report

- Content of Service Auditor's Assurance Report
  - i. A title that clearly indicates the report is an independent service auditor's assurance report.
  - ii. An addressee
  - iii. Identification of:
    - The service organization's description of its system, and the service organization's assertion
    - Those parts of the service organization's description of its system, if any, that are not covered by the service auditor's opinion.

# Preparing the Service Auditor's Assurance Report

- If the description refers to the need for complementary user entity controls, a statement that the service auditor has not evaluated the suitability of design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the service organization's description of its system can be achieved only if complementary user entity controls are suitably designed or operating effectively, along with the controls at the service organization.
- If services are performed by a subservice organization, the nature of activities performed by the subservice organization as described in the service organization's description of its system and whether the inclusive method or the carve-out method has been used in relation to them.

# Preparing the Service Auditor's Assurance Report

- iv. Identification of the criteria, and the party specifying the control objectives
- v. A statement that the report and, in the case of a type 2 report, the description of tests of controls are intended only for user entities and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by user entities themselves, when assessing the risks of material misstatements of user entities' financial statements.
- vi. A statement that the service organization is responsible for :
  - Preparing the description of its system, and the accompanying assertion, including the completeness, accuracy and method of presentation of that description and that assertion
  - Providing the services covered by the service organization's description of its system

# Preparing the Service Auditor's Assurance Report

- Stating the control objectives (where not identified by law or regulation, or another party, for example, a user group or a professional body); and
  - Designing and implementing controls to achieve the control objectives stated in the service organization's description of its system.
- vii. A statement that the service auditor's responsibility is to express an opinion on the service organization's description, on the design of controls related to the control objectives stated in that description and, in the case of a type 2 report, on the operating effectiveness of those controls, based on the service auditor's procedures.
- viii. A statement that the engagement was performed in accordance with SAE 3402, "Assurance Reports on Controls at a Service Organization,"

# Preparing the Service Auditor's Assurance Report

- vii. A summary of the service auditor's procedures to obtain reasonable assurance and a statement of the service auditor's belief that the evidence obtained is sufficient and appropriate to provide a basis for the service auditor's opinion, and, in the case of a type 1 report, a statement that the service auditor has not performed any procedures regarding the operating effectiveness of controls and therefore no opinion is expressed thereon.
- viii. A statement of the limitations of controls and, in the case of a type 2 report, of the risk of projecting to future periods any evaluation of the operating effectiveness of controls.
- ix. The service auditor's opinion, expressed in the positive form, on whether, in all material respects, based on suitable criteria:

# Preparing the Service Auditor's Assurance Report

In the case of a type 2 report:

- a) The description fairly presents the service organization's system that had been designed and implemented throughout the specified period;
- b) The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period; and
- c) The controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the specified period.

# Preparing the Service Auditor's Assurance Report

In the case of a type 1 report:

- a) The description fairly presents the service organization's system that had been designed and implemented as at the specified date; and
- b) The controls related to the control objectives stated in the service organization's description of its system were suitably designed as at the specified date.

The date of the service auditor's assurance report, which shall be no earlier than the date on which the service auditor has obtained sufficient appropriate evidence on which to base the opinion.

# Modified Opinion

If the service auditor concludes that :

- a) The service organization's description does not fairly present, in all material respects, the system as designed and implemented;
- b) The controls related to the control objectives stated in the description were not suitably designed, in all material respects;
- c) In the case of a type 2 report, the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved, did not operate effectively, in all material respects; or
- d) The service auditor is unable to obtain sufficient appropriate evidence, the service auditor's opinion shall be modified, and the service auditor's assurance report shall contain a clear description of all the reasons for the modification.



# Other Communication Responsibilities

- If the service auditor becomes aware of non-compliance with laws and regulations, fraud, or uncorrected errors attributable to the service organization that are not clearly trivial and may affect one or more user entities, the service auditor shall determine whether the matter has been communicated appropriately to affected user entities. If the matter has not been so communicated and the service organization is unwilling to do so, the service auditor shall take **appropriate action as below** :
- Obtaining legal advice about the consequences of different courses of action.
- Communicating with those charged with governance of the service organization.
- Communicating with third parties (for example, a regulator) when required to do so.
- Modifying the service auditor's opinion, or adding an Other Matter paragraph.
- Withdrawing from the engagement.

// THANK YOU //