

CA FINAL

**HANDWRITTEN NOTES
ADVANCED AUDITING**

For MAY 24 & onwards

BY DHRUVIKA KOTHARI

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CHAPTER - 11

PROSPECTIVE FINANCIAL INFORMATION AND OTHER ASSURANCE SERVICES

★ Overview of chapter :

- ▶ Introduction : Traditionally, CA in practice past events पर ही audit or review perform करते थे But growing and dynamic society में future पर भी करते हैं।
Why? - Preparation of projected cash flow & profitability statements by intended borrowers or investees for the purpose of making an appropriate appraisal of their loan application and Equity proposals.
Who require? - Banks, financial institutions & prospective investors.
 These future oriented FS are generally known as Prospective financial statements.

▶ Standards on Assurance Engagements (SAE) :

An ass. Eng. may relate to Examination of subject matters other than Examination of FS of Historical FS.

In this Eng., Examination relate to prospective fin. info. or to provide assurance regarding non-financial matters like - design & operation of IC in Entity.

The level of assurance provided by these std. on Assurance Eng. is MODERATE.

▶ SAE, which are covered in this chapter :

- SAE 3400 : Examination of Prospective Fin. Info. (PFI)
- SAE 3402 : Assurance reports on controls at a service orgⁿ?
- SAE 3420 : Assurance Eng. to report on Compilation of pro forma financial info. included in prospectus

★ What is Projection ?

PFI prepared on the basis of :

- Hypothetical assumptions about future events and
- Mgt. actions which are not necessarily expected to take place
- More risky & usually by start up entities or entities considering a major change in nature of operations.
- Can be mixture of best estimate and hypothetical assumption (Imagined or suggested)

Concept 2 Scope of SAE 3400 & Nature of Assurance

Scope :→ Purpose is to establish standard and provide guidance to Examine & report on PFI including procedures for best estimate & hypothetical assumptions.

- This SAE does not apply to Examination of PFI expressed in general or narrative terms.
- Principles in other SAs (issued by ICAI) should be used by auditor, to extent practicable in applying SAE.

Note : SAE में 'auditor' word use हुआ है Examination के लिए भी
But इसका ये मतलब नहीं है कि वो stat. auditor वैसे काम करेगा।

Nature of Assurance :→ PFI relates to Events & actions which have not yet occurred & might not occur.

- Evidences are itself generally future oriented which support assumptions and therefore speculative in nature. and distinct from ordinary evidence available in historical fin. info.
- Therefore, opinion can not be expressed.

Concept 3 Responsibility of Preparation & Presentation of PFI

Management is responsible for prep. & pres. of PFI including

- Identification & Disclosure of PFI
- Explaining basis of forecast.
- underlying assumptions.

★ Can Professional Accountants be associated with PFI ?

- clause 3 of IInd schedule to CA Act, 1949 states that CA in practice deemed to be guilty of professional misconduct if उसका या उसकी firm का नाम use होगा Earning की Estimation

के future transactions में जिससे ऐसा लगे कि he vouches for accuracy of forecast.

But above clause किसी CA को PFI में associate होने से मना नहीं करता है।

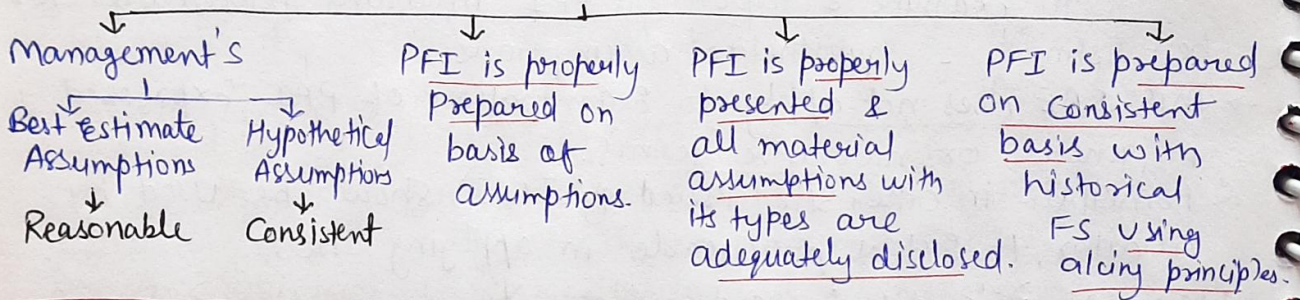
CA can participate in ① Preparation of profit or ② Fin. forecast and can review them provided he clearly indicate in report → Sources of info. → basis of forecast → Assumptions for forecast

AND he does not vouch for accuracy of forecasts.

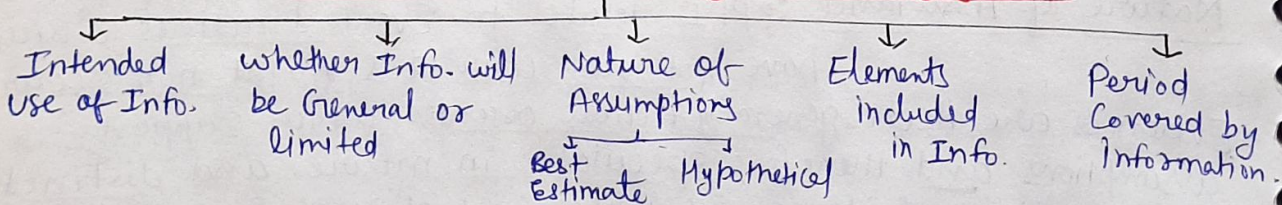
Same is applies to Projections on basis of hypothetical-assumptions.

Concept 4) Duties of Member who is Examining PFI

Auditor should obtain suff. App. Evidence as to whether :



Concept 5) Acceptance of Eng. : Precautions to be taken by Auditor before accepting such Engagement



* Auditor should not accept [or] should withdraw from Eng. if assumptions are unrealistic or auditor believes that PFI will be inappropriate for-intended use.

* Like other Eng., it is necessary that Terms of Eng. should be agreed by client by sending Eng. letter.

Concept 6) Examination Procedures * Imp

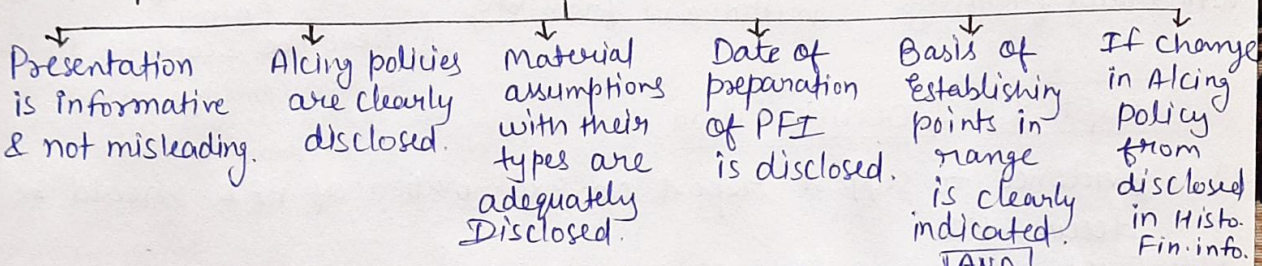
Determining NTE of procedures, following matters should be considered such as :

- (i) Knowledge obtained in previous Eng.
- (ii) Mgt.'s Competence in preparation of PFI.
- (iii) Likelihood of Material Misstatements

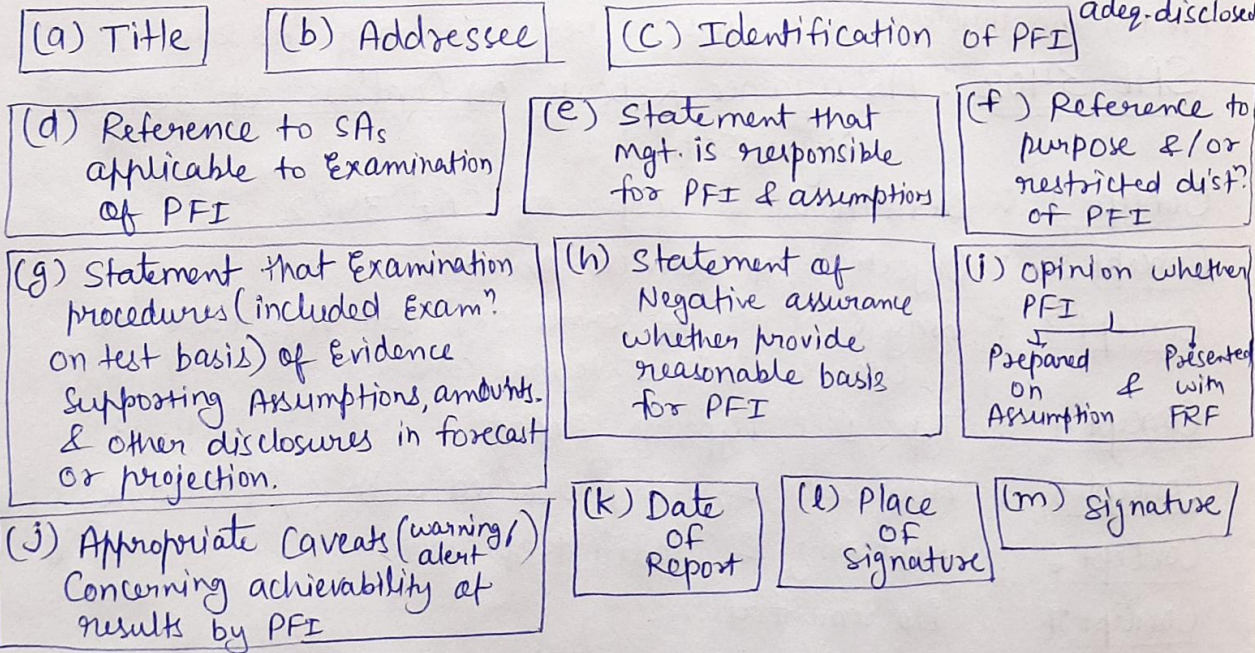
- (iv) Extent to which PFI is affected by Mgt.'s judgement.
- (v) Sources of information for the purpose : → Their adequacy, → reliability of data (data derived from 3rd parties)
- (vi) Stability of Business.
- (vii) Eng. Team's Experience.

Concept 7 Presentation & Disclosure

When assessing presentation & disclosure of PFI & underlying assumptions, in addition to specific req., it needs to consider :-



Concept 8 Report on Examination of PFI



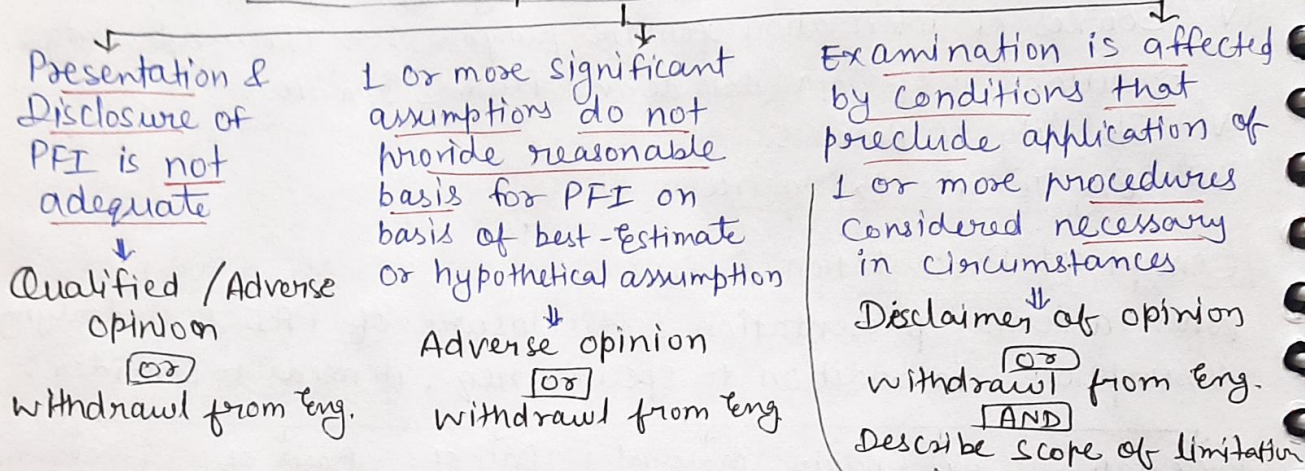
Such a report would

State that after assumptions Examination of ~~the~~ Evidence do not provide reasonable ~~assess~~ basis.

Express an opinion whether PFI Prepared on basis of Assumption & Presented with FRF.

state that Actual result, PFI is different & there is no assurance that actual result will fall within range. Reader to take Caution ~~stn~~ PFI above mentioned use of असाधारण Use of ~~असाधारण~~

Situations & opinion (Qualified / Adverse / Disclaimer)



→ किसी Condition की वजह से कोई Procedure apply नहीं कर पाए है तो Examination में जरूरी है।

Concept 9 Documentation

- (i) Evidence to support report on examination of PFI should be documented.
- (ii) Evidence that such examination was carried out with SAE should be documented.

(Firstly Go through with SA 402 before starting SAE 3402)

SAE 3402 : Assurance Reports on Controls at Service Organisations

- Concept 1 : Definitions & Scope of SAE 3402
- Concept 2 : Objectives of Service Auditor
- Concept 3 : why controls of service org? are important to User Entity's Internal Control
- Concept 4 : Type 1 & Type 2 Report
- Concept 5 : How such Eng. is proceeded with? / Procedures of Eng.
- Concept 6 : Reporting & Modified opinion
- Concept 7 : Documentation.

Concept 1 Definitions & Scope of SAE 3402

Service organisation : It refers to 3rd party organisation that provides services to User Entities for Internal Control as it relates to financial reporting.

User Entity : An Entity that uses a service org?

User auditor: An auditor who audits & reports on FS of User Entity.

Service auditor: At request of service orgⁿ, a professional accountant in public practice provides an assurance report on controls of service orgⁿ.

Scope of SAE 3402: SAE 3402 applies only when service orgⁿ is responsible for [OR] able to make assertion about the suitable design of controls.

It does not deal with assurance Eng.:

- (a) To report only on whether controls at service orgⁿ operated as described [OR]
- (b) To report only on controls at service orgⁿ other than ~~other~~ those related to user entities Internal Control.
(E.g. Controls that affect user entities production or quality ctrl)

Concept 2 Objectives of Service auditor

(a) To obtain reasonable assurance about whether in all material respect

↓
Service orgⁿ's description of its system's design & implementation.

↓
Controls related to Control objectives were suitably designed.

↓
Controls operated effectively to provide reasonable assurance that control obj. were achieved.

(b) To report on matter in (a) with service auditor's findings.

Concept 3 Why controls of service orgⁿ are imp. to user entities Internal Control

→ Controls related to service orgⁿ's operations & Compliance objectives may be relevant to user entity's IC as it relates to fin. rep.

→ Such Controls may pertain

- To assertions about presentation & disclosure relating to a/c bal., classes of txn.
- To Evidence that user auditor Evaluate or use in auditing procedure

→ Controls at service orgⁿ includes

↓
Aspects of user entities Info. System maintained by service orgⁿ

↓
May also include aspect of 1 or more other component of IC

→ It does not includes Control that are not related to achievement of Control obj.

→ Determination of Controls related to operations & Compliance is matter of Prof. judgement.

Concept 4 Type 1 & Type 2 Report

Type 1 report Comprises :

- (i) Service org's description of its system.
- (ii) Written assertion by service org. -
 - Description presents system's design & implementation fairly.
 - Controls related to control obj. were suitably designed.
 - (यह Assertion specified date पर होगा)
- (iii) Service auditor's assurance report conveys reasonable assurance for matter in (ii) above.

Conclusion : Type 1 report is report on description & design of controls at service org.

Type 2 report Comprises :

Type 1 report

+

Written assertion about controls related to control obj. operated effectively.

(यहाँ यही assertion specified period के लिए होगा)

Service auditor's assurance report includes description of test of control & results thereof.

Type 2 report on description, design & operating effectiveness of controls at service org.

Concept 5 How such engagement is proceeded with ?

- 1) Service auditor shall comply with relevant ethical requirements.
- 2) Service auditor shall inquire of, request representation from, communicate/interact with appropriate persons within org's Mgt. & TCWG.
- 3) Acceptance & changes in terms of Eng. : Before accepting Eng., service auditor ensure about capabilities & competence to carry out. Also ensure that system description prepare करने का criteria suitable & available है या नहीं for users entities & their auditor and scope of Eng. limited भी नहीं है।
If service org. request for change in scope before completion of Eng., service auditor satisfy होगा - यानी कि reasonable justification है change का।

4) service auditor shall assess suitability of criteria :

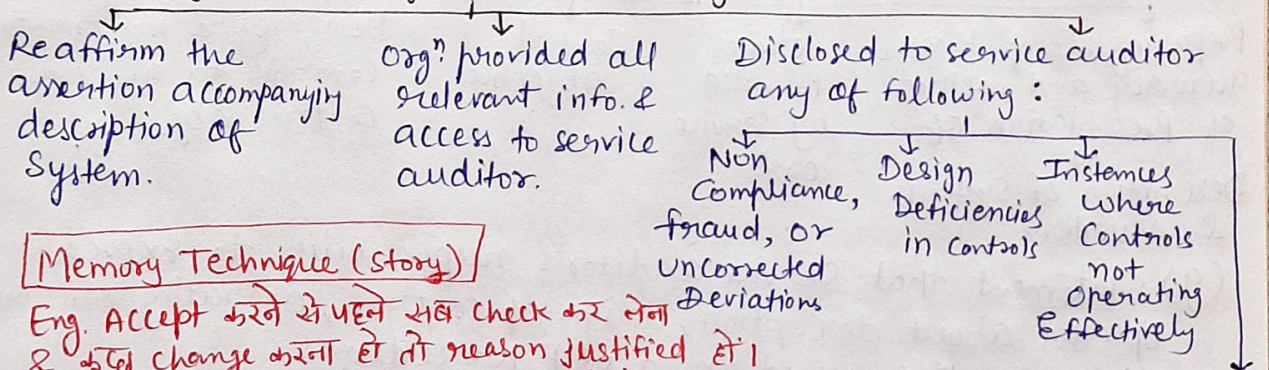
In preparing description of its system

In evaluating that controls are suitably designed

In evaluating controls operating effectively in Type 2 report.

5) when planning & performing Eng., service auditor shall consider Materiality for above 3

- 6) Service auditor shall obtain an understanding of org's system including controls.
- 7) Obtain & read description of system & Evaluate those aspects are fairly presented.
- 8) Service auditor shall determine which control is necessary to achieve control obj. and assess whether controls suitably designed.
- 9) Service auditor shall test those controls and assess operating Effectiveness.
- 10) Service auditor shall obtain understanding of Nature of responsibilities of internal audit function and understanding of activities performed to determine whether internal audit function is relevant for service auditor to use specific work of internal auditors.
- 11) Service auditor shall inquire whether service org is aware of any Event subsequent to date of auditor's assurance report that could have significant effect on report.
- 12) Asking for WR from service org that :



Memory Technique (story)

Eng. Accept करने से पहले सब check कर लेना & कुछ change करना हो तो reason justified हो। फिर then Ethical req. Comply करनी है फिर criteria suitable है या नहीं तो देखना है for description of system, design of Control & its Effectiveness. and इनकी materiality भी Consider करनी है। Then Understand and Evaluate/Assess then check करना है कोई Subs. Events तो नहीं है जिनका sign. Effect हो & above discussed लगभग हर चीज का Written Repres. लेना है Service org. से and Mgt./TCWG से कुछ भी inquire, Communicate या Interact कर सकते हैं।

- Description of System
- Controls design
- operating Effectiveness of Controls
- Internal audit funct.

Concept 6 Reporting & Modified opinion

- (a) Title (b) Addressee
(c) Identification of :

↓ Description of system and assertion which include Type 1 & 2 report matters.
↓ Those parts of description of system not covered by service auditor's opinion
↓ If description refers to need for complementary user entity controls
↓ Nature of activities performed by Subservice Orgⁿ

- (d) Identification of criteria and party specifying control objectives.

↓ Statement that service auditor has not evaluated
↓ Statement that control Obj. can be achieved only if controls are suitably designed & operating effectively.
↓ Suitability of design, op. effectiveness } of Controls

- (e) Statement that report and description of test of controls are intended only for user entities & their auditors.

- (f) Statement that service orgⁿ is responsible for :

↓ Preparing, Completeness, accuracy and method of presentation of Description of system & Assertions.
↓ Services provided by service orgⁿ
↓ Control objectives
↓ Designing & implementing Controls to achieve control obj.

- (g) Statement that service auditor's responsibility to express opinion about description, design of control, operating effectiveness of control etc based on audit procedures.

- (h) Statement that Eng. was performed with SAE 3402, Comply Ethical req. and obtain reasonable assurance about description, design & operating effectiveness of controls.

- (i) A summary of audit procedures and a statement that evidence obtained is suff. & App. to provide basis for opinion, and in case of type 1 report a statement that auditor has not performed procedures for operating effectiveness of control & no opinion on this.

- (j) Statement of limitation of controls and in case of type 2 report Statement of risk of projecting to future period Evaluation of operating effectiveness of controls.

(k) Service auditor's opinion expressed in positive form :-

In Type 1 report

- Description of system designed & implemented on specified date.
- Control related to control obj. suitably designed at specified date.

In Type 2 report

- & b) Same as type 1 report But it is for specified period.
- Controls tested to achieve control obj. are operated effectively for specified period.

(l) Date of service auditor's assurance report.

(m) Signature - by practitioner.

(n) Place of signature - specified location (ordinarily the city where report is signed)

★ Additional Matters requiring reporting in Type 2 report :-

→ Service auditor's assurance report shall include that describe Test of Control performed & results thereof. ↗ Separate Section
OR
↘ Attachment

→ In describing Test of Control, auditor shall clearly state :-

- Which controls were tested
- Identify items tested represent all or selected item in population.
- Indicate nature of tests to Enable use auditor to determine Effect of test on risk Assessment.

→ If deviations identified then service auditor include extent of testing performed that led to identification of deviations, No. & nature of deviations noted.

Note : Service auditor shall report deviations Even if control obj. was achieved on basis of test performed.

★ Modified opinion : If service auditor concludes that :

- | | | | |
|---|--|---|---|
| (a) Description does not fairly present system as designed and implemented. | (b) Controls related to control obj. not suitably designed as stated in description. | (c) Controls did not operate effectively. | (d) Service auditor is unable to obtain suff. App. Evidence. |
|---|--|---|---|

Concept 7 | Documentation

Service auditor shall prepare documentation to Enable Experienced auditor having no previous connection with Eng. to understand :

- | | | |
|--|--|--|
| (a) NTE of procedures to comply with SAE and legal & reg. req. | (b) Results of procedures & Evidence obtained. | (c) Significant matters & conclusions & significant Prof. judgement. |
|--|--|--|

SAE 3420 : Assurance Eng. to Report On Compilation of Pro Forma Fin. Info. [PFFI] included in a Prospectus

V.V. Impl

Concept 1 : Scope and objective of SAE 3420

Concept 2 : What is Pro Forma Financial Information (PFFI)

Concept 3 : Compilation of PFFI and steps thereof

Concept 4 : Nature of Practitioner's Responsibility

Concept 5 : Steps involved in such Engagement

- Impl (i) Eng. Acceptance (ii) Planning & Performing Eng. (iii) written Representation (iv) Forming opinion (v) Preparing assurance report

Concept 6 : Documentation

Concept 1 Scope and objective of SAE 3420

Scope : → SAE 3420 deals with reasonable assurance Engagement undertaken by practitioner to report on responsible party's Compilation of PFFI which included in prospectus.

→ It applies where such reporting is required by :

Security law or reg. of Security Exchange in which prospectus is to be issued.

OR

This reporting is generally accepted practice in such jurisdiction.

Objective : → To obtain reasonable assurance → whether PFFI compiled → in all material respect → by responsible Party
→ to report with Practitioner's findings.

Impl

Concept 2 What is Pro Forma Financial Information [PFFI]?

31/3/23

Unadjusted Fin. Info. (Normal fin. stat.)

01/06/23

Occur a Event or txn. (Like - Mergers/Demergers/Bus. Acq.)

01/06/23

IPO/FPO

Issue Prospectus

[Unadj. FS की date & IPO/FPO की date के बीच में कोई भी significant Event/txn. हुआ है तो उसको adjust करके new FS prepare करेंगे & इसको Pro forma Fin. Info. कहेंगे]

Need to adjust those Event or txn. & prepare adjusted FS called Pro forma fin. Info.

- PFFI refers to fin. info. shown together with adjustments to illustrate impact of an event or transaction on unadj. fin. info. as if event occurred at an earlier date.
- PFFI normally used in offer documents to demonstrate effect of txn. on FS.
- PFFI does not represent entity's actual financial position, financial performance or cash flows.

Purpose: Purpose of PFFI included in Prospectus is solely to illustrate impact of event/txn. on unadj. fin. info. as if event/txn. occurred at an earlier date and this is achieved by applying pro forma adj. to unadj. fin. info.

Concept 3 Compilation of PFFI and Steps of Compilation

Compilation: Compilation of PFFI involves

Steps of Compilation includes:

Identifying source of unadj. fin. info. and extracting unadj. fin. info. from that source → Making proforma adjustments to unadj. fin. info. → Presenting the resulting pro forma fin. info. with disclosures.

Grathering
Classifying
Summarising
Presenting } Fin. Info. by responsible party

Concept 4 Nature of Practitioner's Responsibility

- Practitioner has no responsibility to compile PFFI for Entity. Such responsibility rests with responsible party.
- Practitioner's sole responsibility is to report on whether PFFI has been compiled in all material respect by responsible party on basis of applicable criteria.

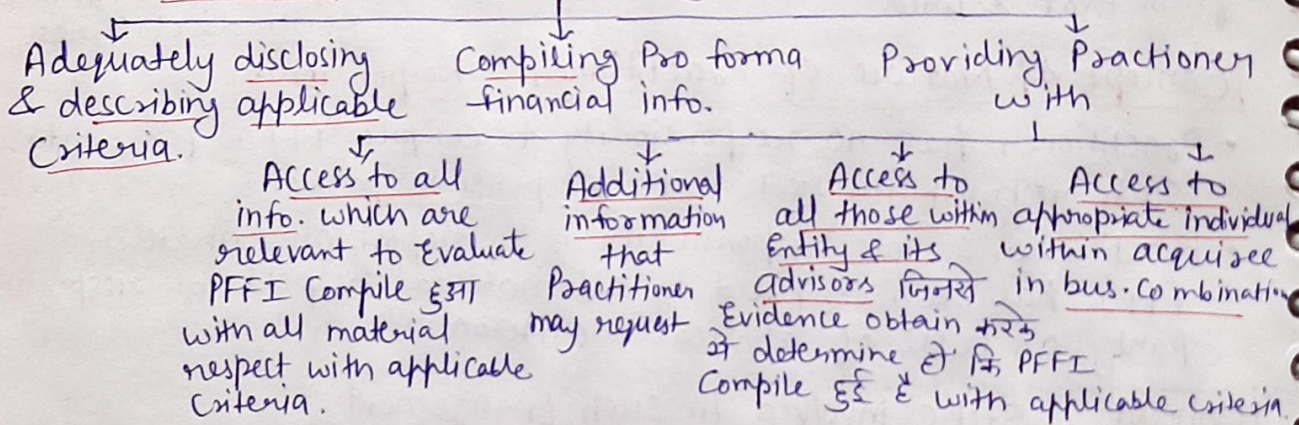
Concept 5 Steps involved in such Engagement

Step 1: Engagement Acceptance

'Applicable criteria' are criteria used by responsible party to compile PFFI. Criteria may established by authorized or recognized std. setting org. or by law or reg. & where establish criteria doesn't exist, they will be developed by responsible party.

Before agreeing to accept an Engagement, Practitioner shall consider matter / Factors to be considered before accepting an engagement :-

- (a) Determine Capabilities and Competence to perform.
- (b) Determine Applicable criteria are suitable and not misleading PFFI for which it is intended.
- (c) Evaluate wording of opinion based on procedures in SAE.
- (d) Where sources from which unadj. fin. info. OR fin. info. of any acquiree or divestee → have been audited or reviewed and → Modified opinion or review expressed OR report contain EOM Para THEN → Consider करें कि उन sources के respect में law or regn. permit करते हैं या नहीं उन modified opinion या review या EOM को use करने के लिए या report में reference देने के लिए।
- (e) If Entity's Historical fin. info. never been audited or reviewed THEN → Consider whether practitioner obtain suff. understanding of Entity.
- (f) If Event or txn. includes an acquisition AND Acquiree's historical fin. info. never been audited or reviewed THEN → Consider practitioner obtain suff. understanding of Entity.
- (g) Obtain agreement of Responsible party that acknowledges & understands its responsibility for :



Step 2 : Planning & Performing the Engagement

- | | |
|--|---|
| <ul style="list-style-type: none"> → Assess applicable criteria suitable → Consider materiality to evaluate compilation of PFFI with criteria. → Understand how responsible party compile PFFI → Obtain evidence about appropriateness of sources → If there is no audit/review report on source <u>THEN</u> → Perform procedures for appropriateness of source | <ul style="list-style-type: none"> → Determine responsible party extracted unadj. fin. info. from source → Obtain evidence about appropriateness of pro forma adj. → Evaluate presentation of PFFI. → Read other info. included in prospectus to identify material inconsistencies, if any. |
|--|---|

Step 3 : Written Representation

- Practitioner shall request WR from Responsible party that :
- a) Responsible party has identified all appropriate pro forma adj. in compiling PFFI.
 - b) PFFI has been compiled in all material respect with applicable criteria.

Step 4 : Forming Opinion

★ Unmodified opinion : Practitioner Express unmodified opinion

↓ WHEN

★ Modified opinion : Concludes that PFFI compiled with applicable criteria

If prospectus includes modified opinion related to PFFI and practitioner को लगता है कि वो modified opinion appropriate है

BUT |

Relevant Law or Reg. Precludes Practitioner shall discuss the matter with responsible party.

Relevant Law or Reg may not Preclude

Practitioner shall apply requirements regarding modified opinions.

But responsible party doesn't agree to make necessary changes then

Withdraw from Eng. Consider seeking legal advice.

★ EOM Para : ऐसे ऐसे matters जो PFFI या Explanatory notes में Presented / Disclosed हैं जो Practitioner Consider necessary to draw user's attention to user's Understanding

Practitioner उसकी report में Eom para include करेगा & इस Para में वही चीजे आएगी जो PFFI या Explanatory notes में हैं

Step 5 : Preparing Assurance Report

- (a) Title
- (b) Addressee
- (c) Introductory paragraph that identify
- (d) Statement of responsibility of responsible party to compile PFFI.
- (e) Statement of Practitioner's responsibilities:

- PFFI
- Sources and audit/review report on sources
- Period/Date of PFFI
- Reference to applicable criteria.

To Express opinion Practitioner is not responsible for updating or reissuing report or opinion on Historical FS [AND] not performed audit/review of Fin. info. used in compilation.

Practitioner does not provide assurance that actual outcome of event or txn. would have been as presented.

(f) statement that Eng. was performed in accordance with SAE 3420 which requires to comply with ethical req. and plan & perform procedures.

(g) Statement that :

(i) Reasonable assurance Eng. involves performing procedures to assess whether applicable criteria in compilation of PFFI provide reasonable basis for presenting significant effect to event or txn. **AND** obtain suff. App. Evidence about whether :

Related pro forma adj. give appropriate effect to those criteria **AND** PFFI reflects proper application of those adj. to unadj. fin. info.

(ii) Procedures selected depend on practitioner's judgement.

(iii) Eng. also involves evaluating overall presentation of PFFI.

(h) Unless otherwise req. by Law or Reg., Practitioner's opinion using 1 of following phrases :

→ PFFI has been compiled, in all material respect on basis of applicable criteria **OR**

→ PFFI has been properly compiled on basis stated.

(i) Practitioner's Signature

(j) Date of Report

(k) Place of Signature.

Concept 6 Documentation

As in case of all assurance Eng., Documentation has to be ensured by practitioner while performing Engagement Under SAE 3420.