

SAE 3400 "THE EXAMINATION OF PROSPECTIVE FINANCIAL INFORMATION"

Timings Purpose of SAE 3400

- Purpose of SAE 3400 is to establish standards and provide guidance on engagements to examine and report on prospective financial information (PFI) including examination procedures for best-estimate and hypothetical assumptions.
- Principles laid down in the SAs should be used by the auditor, to the extent practicable, in applying this SAE.

NOTE:

Term "auditor" is used throughout this SAE when describing services involving examination of PFI. However, examination of PFI need not necessarily be performed by statutory auditor.

Meaning of Prospective Financial Information (PFI)

- Financial information based on:
 - (1) Assumptions about events that may occur in the future and
 - (2) Possible actions by an entity.
- It is highly subjective in nature & its preparation requires exercise of considerable judgment.
- PFI can be in form of:
 - (1) A forecast or
 - (2) A projection or
 - (3) A combination of both, for example, a 1-year forecast plus a 5-year projection.

(a) Forecast

PFI 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.

NOTE:

Forecast are being based on best estimate assumption, i.e., an assumption that reflects anticipated experience with no provision for risk of adverse deviation.

(b) Projection

PFI is prepared on the basis of:

- 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

- A mixture of best-estimate and hypothetical assumptions.

Nature Of Assurance Regarding PFI

- PFI relates to events & actions that have not yet occurred & might not occur. While evidence may be available to support the assumptions on which PFI is based, such evidence is itself generally future oriented & therefore speculative in nature, as distinct from evidences ordinarily available in examination of historical financial information.
- Auditor, therefore, is not in a position to express an opinion as to whether the results shown in the PFI will be achieved.

Management's Responsibility

Management is responsible for preparation of PFI including:

- Disclosure of PFI;
- Explaining the basis of assumptions;
- Underlying assumptions.

Association of Professional Accountants with PFI

- As per Clause 3 of Part I of the Second Schedule to the Chartered Accountants Act, 1949 a CA in practice shall be deemed to be guilty of professional misconduct, if he permits his name or name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast.
- This clause does not preclude a CA from associating his name with PFI. A CA can participate in preparation of financial forecasts and can review them, provided indicates clearly in his report the sources of information, the basis of forecasts and also the major assumptions made in arriving at the forecasts and so long as he does not vouch for the accuracy of the forecasts.
- Same rule also applies to projections made on basis of hypothetical assumptions about future events and management actions which are not necessarily expected to take place so long as vouching for the accuracy of the projection is not made.

Auditor's duty

While examining PFI, auditor should obtain sufficient appropriate evidence as to whether

- Management's best-estimate assumptions on which the PFI is based are **unreasonable** and, in the case of hypothetical assumptions, such assumptions are consistent with the purpose of the information; not
- The PFI is properly **prepared on the basis of the assumptions**;
- The PFI 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
- The PFI is prepared on a consistent basis with historical F.S., using **appropriate accounting principles**.

Acceptance of Engagement

Before accepting engagement to examine PFI, auditor would consider, amongst other things:

- The intended use of the information;
- Whether the information will be for general or limited distribution;
- The nature of the assumptions, that is, whether they are best-estimates or hypothetical assumptions;
- The elements to be included in the information; and
- The period covered by the information.

Auditor should not accept, or should withdraw from an engagement when the assumptions are clearly unrealistic or when the auditor believes that the PFI will be inappropriate for its intended use.

Examination Procedures

When determining NTE of examination procedures, auditor should consider matters such as:

- The knowledge obtained during any previous engagements;
- Management's competence regarding the preparation of PFI;
- The likelihood of material misstatement;
- The extent to which the PFI is affected by the management's judgment;
- The sources of information considered by the management for the purpose, their adequacy, reliability of the underlying data, including data derived from third parties, such as industry statistics, to support the assumptions;
- The stability of entity's business; and
- The engagement team's experience with the business and the industry in which the entity operates and with reporting on PFI.

Presentation & disclosure of PFI

When assessing the presentation & disclosure of PFI and underlying assumptions, auditor need to consider whether:

- Presentation of PFI is informative and not misleading;
- Accounting policies are clearly disclosed in the notes to the PFI;
- Assumptions are adequately disclosed in the notes to the PFI. It needs to be clear whether assumptions represent management's best-estimates or are hypothetical;
- Date as of which the PFI was prepared is disclosed. Management needs to confirm that the assumptions are appropriate as of this date, even though the underlying information may have been accumulated over a period of time;
- Basis of establishing points in a range is clearly indicated and the range is not selected in a biased or misleading manner when results shown in the PFI are expressed in terms of a range; and
- There is any change in the accounting policy of the entity from that disclosed in the most recent historical F.S. and whether reason for the change and the effect of such change on the PFI has been adequately disclosed.

Documentation

Matters, which are important in providing evidence to support report on examination of PFI, and evidence that such examination was carried out in accordance with this SAE should be documented.

➤ Report on examination of PFI

It should contain the followings:

- Title
- Addressee
- Identification of PFI
- Reference to the SAE applicable to the examination of PFI
- Statement that management is responsible for the PFI including underlying assumptions;
- When applicable, a reference to the purpose and/or restricted distribution of the PFI;
- 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;
- Statement of negative assurance as to whether the assumptions provide a reasonable basis for the PFI;

- Opinion as to whether the PFI is properly prepared on the basis of the assumptions and is presented in accordance with the relevant FRF;
- Appropriate caveats concerning the achievability of the results indicated by the PFI;
- Date of Report;
- Place of Signature; and
- Signature

NOTE:

- Report shall cover the following:
- State whether, based on the examination of the evidence supporting the assumptions, anything has come to auditor's attention, which causes him to believe that the assumptions do not provide a reasonable basis for the PFI.
- Express an opinion as to whether the PFI is properly prepared on the basis of the assumptions and is presented in accordance with the relevant FRF.
- State that:
 - (1) Actual results are likely to be different from the PFI since anticipated events frequently do not occur as expected and the variation could be material; and
 - (2) In the case of a projection, the PFI has been prepared for (intended use), using a set of assumptions that include hypothetical assumptions about future events and management's actions that are not necessarily expected to occur.