

**INTERNATIONAL STANDARD ON  
ASSURANCE ENGAGEMENTS 3400**

(Previously ISA 810)

**THE EXAMINATION OF PROSPECTIVE  
FINANCIAL INFORMATION**

(This Standard is effective)

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International Standard on Assurance Engagements (ISAE) 3400, “The Examination of Prospective Financial Information” should be read in the context of the “Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services,” which sets out the application and authority of ISAEs.

## Introduction

1. The purpose of this International Standard on Assurance Engagements (ISAE) is to establish standards and provide guidance on engagements to examine and report on prospective financial information including examination procedures for best-estimate and hypothetical assumptions. This ISAE does not apply to the examination of prospective financial information expressed in general or narrative terms, such as that found in management's discussion and analysis in an entity's annual report, though many of the procedures outlined herein may be suitable for such an examination.
2. **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.**
3. "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. Prospective financial information can be in the form of a forecast, a projection or a combination of both, for example, a one year forecast plus a five year projection.
4. A "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).
5. A "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.

Such information illustrates the possible consequences as of the date the information is prepared if the events and actions were to occur (a “what-if” scenario).

6. Prospective financial information can include financial statements or one or more elements of financial statements and may be prepared:
  - (a) As an internal management tool, for example, to assist in evaluating a possible capital investment; or
  - (b) For distribution to third parties in, for example:
    - A prospectus to provide potential investors with information about future expectations.
    - An annual report to provide information to shareholders, regulatory bodies and other interested parties.
    - A document for the information of lenders which may include, for example, cash flow forecasts.
7. Management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the assumptions on which it is based. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility whether it is intended for use by third parties or for internal purposes.

### **The Auditor’s Assurance Regarding Prospective Financial Information**

8. Prospective financial information relates to events and actions that have not yet occurred and may not occur. While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future oriented and, therefore, speculative in nature, as distinct from the evidence ordinarily available in the audit of historical financial information. The auditor is, therefore, not in a position to express an opinion as to whether the results shown in the prospective financial information will be achieved.
9. Further, given the types of evidence available in assessing the assumptions on which the prospective financial information is based, it may be difficult for the auditor to obtain a level of satisfaction sufficient to provide a positive expression of opinion that the assumptions are free of material misstatement. Consequently, in this ISAE, when reporting on the reasonableness of management’s assumptions the auditor provides only a moderate level of assurance. However, when in the auditor’s judgment an appropriate level of satisfaction has been obtained, the auditor is not precluded from expressing positive assurance regarding the assumptions.

## Acceptance of Engagement

10. Before accepting an engagement to examine prospective financial information, the 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-estimate or hypothetical assumptions;
  - The elements to be included in the information; and
  - The period covered by the information.
11. **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.**
12. **The auditor and the client should agree on the terms of the engagement.** It is in the interests of both entity and auditor that the auditor sends an engagement letter to help in avoiding misunderstandings regarding the engagement. An engagement letter would address the matters in paragraph 10 and set out management's responsibilities for the assumptions and for providing the auditor with all relevant information and source data used in developing the assumptions.

## Knowledge of the Business

13. **The auditor should obtain a sufficient level of knowledge of the business to be able to evaluate whether all significant assumptions required for the preparation of the prospective financial information have been identified.** The auditor would also need to become familiar with the entity's process for preparing prospective financial information, for example, by considering the following:
  - The internal controls over the system used to prepare prospective financial information and the expertise and experience of those persons preparing the prospective financial information.
  - The nature of the documentation prepared by the entity supporting management's assumptions.
  - The extent to which statistical, mathematical and computer-assisted techniques are used.
  - The methods used to develop and apply assumptions.
  - The accuracy of prospective financial information prepared in prior periods and the reasons for significant variances.

14. **The auditor should consider the extent to which reliance on the entity's historical financial information is justified.** The auditor requires a 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.
15. If the audit or review report on prior period historical financial information was other than unmodified or if the entity is in a start-up phase, the auditor would consider the surrounding facts and the effect on the examination of the prospective financial information.

### Period Covered

16. **The auditor should consider the period of time covered by the prospective financial information.** Since assumptions become more speculative as the length of the period covered increases, as that period lengthens, the ability of management to make best-estimate assumptions decreases. The period would not extend beyond the time for which management has a reasonable basis for the assumptions. The following are some of the factors that are relevant to the auditor's consideration of the period of time covered by the prospective financial information:
  - Operating cycle, for example, in the case of a major construction project the time required to complete the project may dictate the period covered.
  - The degree of reliability of assumptions, for example, if the entity is introducing a new product the prospective period covered could be short and broken into small segments, such as weeks or months. Alternatively, if the entity's sole business is owning a property under long-term lease, a relatively long prospective period might be reasonable.
  - The needs of users, for example, prospective financial information may be prepared in connection with an application for a loan for the period of time required to generate sufficient funds for repayment. Alternatively, the information may be prepared for investors in connection with the sale of debentures to illustrate the intended use of the proceeds in the subsequent period.

### Examination Procedures

17. **When determining the nature, timing and extent of examination procedures, the auditor's considerations should include:**
  - (a) **The likelihood of material misstatement;**
  - (b) **The knowledge obtained during any previous engagements;**

- (c) **Management's competence regarding the preparation of prospective financial information;**
  - (d) **The extent to which the prospective financial information is affected by the management's judgment; and**
  - (e) **The adequacy and reliability of the underlying data.**
18. The auditor would assess the source and reliability of the evidence supporting management's best-estimate assumptions. Sufficient appropriate evidence supporting such assumptions would be obtained from internal and external sources including consideration of the assumptions in the light of historical information and an evaluation of whether they are based on plans that are within the entity's capacity.
  19. The auditor would consider whether, when hypothetical assumptions are used, all significant implications of such assumptions have been taken into consideration. For example, if sales are assumed to grow beyond the entity's current plant capacity, the prospective financial information will need to include the necessary investment in the additional plant capacity or the costs of alternative means of meeting the anticipated sales, such as subcontracting production.
  20. Although evidence supporting hypothetical assumptions need not be obtained, the auditor would need to be satisfied that they are consistent with the purpose of the prospective financial information and that there is no reason to believe they are clearly unrealistic.
  21. The auditor will need to be satisfied that the prospective financial information is properly prepared from management's assumptions by, for example, making clerical checks such as recomputation and reviewing internal consistency, that is, the actions management intends to take are compatible with each other and there are no inconsistencies in the determination of the amounts that are based on common variables such as interest rates.
  22. The auditor would focus on the extent to which those areas that are particularly sensitive to variation will have a material effect on the results shown in the prospective financial information. This will influence the extent to which the auditor will seek appropriate evidence. It will also influence the auditor's evaluation of the appropriateness and adequacy of disclosure.
  23. When engaged to examine one or more elements of prospective financial information, such as an individual financial statement, it is important that the auditor consider the interrelationship of other components in the financial statements.
  24. When any elapsed portion of the current period is included in the prospective financial information, the auditor would consider the extent to which procedures need to be applied to the historical information. Procedures will

vary depending on the circumstances, for example, how much of the prospective period has elapsed.

25. **The auditor should obtain written representations from management regarding the intended use of the prospective financial information, the completeness of significant management assumptions and management's acceptance of its responsibility for the prospective financial information.**

### **Presentation and Disclosure**

26. When assessing the presentation and disclosure of the prospective financial information, in addition to the specific requirements of any relevant statutes, regulations or professional standards, the auditor will need to consider whether:
- (a) The presentation of prospective financial information is informative and not misleading;
  - (b) The accounting policies are clearly disclosed in the notes to the prospective financial information;
  - (c) The assumptions are adequately disclosed in the notes to the prospective financial information. It needs to be clear whether assumptions represent management's best-estimates or are hypothetical and, when assumptions are made in areas that are material and are subject to a high degree of uncertainty, this uncertainty and the resulting sensitivity of results needs to be adequately disclosed;
  - (d) The date as of which the prospective financial information 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;
  - (e) The 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 prospective financial information are expressed in terms of a range; and
  - (f) Any change in accounting policy since the most recent historical financial statements is disclosed, along with the reason for the change and its effect on the prospective financial information.

### **Report on Examination of Prospective Financial Information**

27. **The report by an auditor on an examination of prospective financial information should contain the following:**
- (a) **Title;**
  - (b) **Addressee;**

- (c) **Identification of the prospective financial information;**
  - (d) **A reference to the ISAE or relevant national standards or practices applicable to the examination of prospective financial information;**
  - (e) **A statement that management is responsible for the prospective financial information including the assumptions on which it is based;**
  - (f) **When applicable, a reference to the purpose and/or restricted distribution of the prospective financial information;**
  - (g) **A statement of negative assurance as to whether the assumptions provide a reasonable basis for the prospective financial information;**
  - (h) **An 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;**
  - (i) **Appropriate caveats concerning the achievability of the results indicated by the prospective financial information;**
  - (j) **Date of the report which should be the date procedures have been completed;**
  - (k) **Auditor's address; and**
  - (l) **Signature.**
28. Such a report would:
- State whether, based on the examination of the evidence supporting the assumptions, anything has come to the auditor's attention which causes the auditor to believe that the assumptions do not provide a reasonable basis for the prospective financial information.
  - Express an 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.
  - State that:
    - Actual results are likely to be different from the prospective financial information since anticipated events frequently do not occur as expected and the variation could be material. Likewise, when the prospective financial information is expressed as a range, it would be stated that there can be no assurance that actual results will fall within the range; and

- In the case of a projection, the prospective financial information has been prepared for (state purpose), using a set of assumptions that include hypothetical assumptions about future events and management's actions that are not necessarily expected to occur. Consequently, readers are cautioned that the prospective financial information is not used for purposes other than that described.

29. The following is an example of an extract from an unmodified report on a forecast:

We have examined the forecast<sup>1</sup> in accordance with the International Standard on Assurance Engagements applicable to the examination of prospective financial information. Management is responsible for the forecast including the assumptions set out in Note Xn which it is based.

Based on our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe that these assumptions do not provide a reasonable basis for the forecast. Further, in our opinion the forecast is properly prepared on the basis of the assumptions and is presented in accordance with ....<sup>2</sup>

Actual results are likely to be different from the forecast since anticipated events frequently do not occur as expected and the variation may be material.

30. The following is an example of an extract from an unmodified report on a projection:

We have examined the projection<sup>3</sup> in accordance with the International Standard on Assurance Engagements applicable to the examination of prospective financial information. Management is responsible for the projection including the assumptions set out in Note Xn which it is based.

This projection has been prepared for (describe purpose). As the entity is in a start-up phase the projection has been prepared using a set of assumptions that include hypothetical assumptions about future events and management's actions that are not necessarily expected to occur. Consequently, readers are cautioned that this

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<sup>1</sup> Include name of the entity, the period covered by the forecast and provide suitable identification, such as by reference to page numbers or by identifying the individual statements.

<sup>2</sup> Indicate the relevant financial reporting framework.

<sup>3</sup> Include name of the entity, the period covered by the projection and provide suitable identification, such as by reference to page numbers or by identifying the individual statements.

projection may not be appropriate for purposes other than that described above.

Based on our examination of the evidence supporting the assumptions, nothing has come to our attention which causes us to believe that these assumptions do not provide a reasonable basis for the projection, assuming that (state or refer to the hypothetical assumptions). Further, in our opinion the projection is properly prepared on the basis of the assumptions and is presented in accordance with ....<sup>4</sup>

Even if the events anticipated under the hypothetical assumptions described above occur, actual results are still likely to be different from the projection since other anticipated events frequently do not occur as expected and the variation may be material.

31. **When the auditor believes that the presentation and disclosure of the prospective financial information is not adequate, the auditor should express a qualified or adverse opinion in the report on the prospective financial information, or withdraw from the engagement as appropriate.** An example would be where financial information fails to disclose adequately the consequences of any assumptions which are highly sensitive.
32. **When the auditor believes that 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 that one or more significant assumptions do not provide a reasonable basis for the prospective financial information given the hypothetical assumptions, the auditor should either express an adverse opinion in the report on the prospective financial information, or withdraw from the engagement.**
33. **When the examination is affected by conditions that preclude application of one or more procedures considered necessary in the circumstances, the auditor should either withdraw from the engagement or disclaim the opinion and describe the scope limitation in the report on the prospective financial information.**

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<sup>4</sup> See footnote 2.