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CHAPTER 8 STANDARDS ON ASSURANCE ENGAGEMENTS (SAEs 3000-3699)

1. SRE 3400 THE EXAMINATION PROSPECTIVE FINANCIAL INFORMATION

Prospective Financial Information (PFI)

1. It means financial information based on the assumptions about the events that may occur in future and possible action by management.
2. It is, thus, a subjective concept requiring **judgment**.
3. It may be of two types.
 - 1) **Forecast** - It is based upon assumptions which management expects to take place. (Best estimate assumptions)
 - 2) **Projection** - It is based on
 - a. Hypothetical assumptions which are not necessarily expected to take place; or
 - b. Mixture of best estimate and hypothetical assumptions.

Management's Responsibility

Management is responsible for preparation of PFI including:

- ✚ Identification and disclosure of PFI;
- ✚ The basis of forecast:
- ✚ Underlying assumptions.

AUDITOR'S DUTY

1. Auditor may be asked to examine and report **on** it to enhance its credibility.
2. It relates to events and actions that have not yet occurred and might not occur.
3. Evidence is future oriented and thus speculative.
4. Auditor is not in a position to express opinion as to whether the results shown in prospective financial information will be achieved.
5. He can provide only moderate assurance (Negative assurance).

ACCEPTANCE OF ENGAGEMENT

1. He should not accept or should withdraw from engagement when assumptions are clearly unrealistic or when he believes that it will be inappropriate for its intended use.
2. Auditor and client should agree on the terms of the engagement.

KNOWLEDGE OF BUSINESS

1. Auditor should obtain knowledge of the business so that he can be able to evaluate whether all required assumption have been identified,
2. He should consider the extent of reliance that can be placed on entity's historical financial information (whether it was audited/reviewed, etc.)

PERIOD COVERED

1. Auditor should consider the time period covered by prospective financial information.
2. Assumption becomes more speculative if length of period covered increases.

EXAMINATION PROCEDURES

While determining NTE of Audit procedure, he should consider -

1. Knowledge obtained during any previous engagement

2. Management's competence
3. Likelihood of material misstatement
4. Extent to which PFI is affected by management's judgment
5. Source of information and their reliability
6. Stability of entity's business
7. The experience of engagement team in this connection

DOCUMENTATION

1. He should keep proper documentation to support his report and to have evidence that he has followed this standard.
2. If report is modified, he should document the reasons also.

REPORT ON EXAMINATION OF PFI

1. Title
2. Addressee
3. Identification of PFI
4. Reference to this standard
5. Statement that management is responsible for its preparation.
6. When applicable, a reference to the purpose and for restricted distribution of PFI.
7. Statement that examination procedure included examination, on a test basis of evidences supporting the assumptions, amounts and other disclosures in PFI.
8. Statement of negative assurance as to whether assumptions provide a reasonable basis for PFI.
9. Opinion as to whether PFI is properly prepared on the basis of assumptions and presented as per relevant financial reporting framework.
10. Appropriate caveats w.r.t. achievability of results indicated by PFI.
11. Date
12. Place
13. Signature

CONSIDERATIONS

1. If presentation and disclosures are not adequate - resign or provide qualified report.
2. If significant assumptions don't provide reasonable basis - either resign/adverse report.
3. If he can't perform necessary procedures - either resign or disclaimer.

2. SRE 3402 ASSURANCE REPORTS ON CONTROLS AT SERVICE ORGANIZATION

OBJECTIVES

The objectives of the service auditor are:

1. To **obtain reasonable assurance** about whether, in all material respects, based on suitable criteria:
 - a. The service organization's description of its system fairly presents the system as designed and implemented throughout the specified period (or in the case of a type 1 report, as at a specified date);
 - 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 (or in the case of a type 1 report, as at a specified date);
 - c. 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.
2. To **report** on the matters in (1.) above in accordance with the service auditor's findings.

FRAMEWORK FOR ASSURANCE ENGAGEMENTS

The service auditor shall not represent compliance with this SAE unless the service auditor has complied with the requirements of this SAE and the requirements of the Framework for Assurance Engagements.

ETHICAL REQUIREMENTS

The service auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to assurance engagements.

MANAGEMENT AND THOSE CHARGED WITH GOVERNANCE

The service auditor shall determine the appropriate person(s) within the service organization's management or governance structure with whom to interact.

ACCEPTANCE AND CONTINUANCE

Before agreeing to accept, or continue, an engagement the service auditor shall:

1. **Determine** whether:

- ✚ The service auditor has the **capabilities and competence** to perform the engagement;
- ✚ The **criteria** to be applied by the service organization to prepare the description of its system will be suitable and available to user entities and their auditors; and
- ✚ 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.

2. **Obtain the agreement** of the service organization that it acknowledges and understands its **responsibility**

ACCEPTANCE of A CHANGE IN THE TERMS OF ENGAGEMENT

If the service organization requests a change in the scope of the engagement before the completion of the engagement, the service auditor shall be satisfied that there is a reasonable justification for the change.

ASSESSING THE SUITABILITY OF THE CRITERIA

In assessing the suitability of the criteria to evaluate the service organization's description of its system, the service auditor shall determine if the criteria encompass, at a minimum:

1. Whether the description presents how the service organization's system was designed and implemented,
2. 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.
3. 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

MATERIALITY

When planning and performing the engagement, the service auditor shall consider materiality with respect to the fair presentation of the description, the suitability of the design of controls and, in the case of type 2 reports, the operating effectiveness of controls.

OBTAINING AN UNDERSTANDING OF THE SERVICE ORGANIZATION'S SYSTEM

The service auditor shall obtain an understanding of the service organization's system, including controls that are included in the scope of the engagement.

OBTAINING EVIDENCE REGARDING THE DESCRIPTION

The service auditor shall obtain and read the service organization's description of its system, and shall evaluate whether those aspects of the description included in the scope of the engagement are fairly presented,

OBTAINING EVIDENCE REGARDING DESIGN OF CONTROLS

The service auditor shall determine which of the controls at the service organization are necessary to achieve the control objectives stated in the service organization's description of its system, and shall assess whether those

controls were suitably designed.

OBTAINING EVIDENCE REGARDING OPERATING EFFECTIVENESS OF CONTROLS

- ✚ When providing a type 2 report, the service auditor shall test those controls that the service auditor has determined are necessary to achieve the control objectives
- ✚ When designing and performing test of controls, the service auditor shall:
 - a. Perform other procedures in combination with inquiry to obtain evidence about:
 - ✚ How the control was applied;
 - ✚ The consistency with which the control was applied; and
 - ✚ By whom or by what means the control was applied;
 - b. Determine whether controls to be tested depend upon other control
 - c. Determine means of selecting items for testing that are effective in meeting the objective of the procedure.

SAMPLING

When the service auditor uses sampling, the service auditor shall:

1. Consider the purpose of the procedure and the characteristics of the population from which the sample will be drawn when designing the sample;
2. Determine a sample size sufficient to reduce sampling risk to an appropriately low level;
3. Select items for the sample in such a way that each sampling unit in the population has a chance of selection;
4. If a designed procedure is not applicable to a selected item, perform the procedure on a replacement item; and
5. If unable to apply the designed procedures, or suitable alternative procedures, to a selected item, treat that item as a deviation.

NATURE AND CAUSE OF DEVIATIONS

The service auditor shall investigate the nature and cause of any deviations identified and shall determine whether Identified deviations are within the expected rate of deviation and are acceptable, Additional testing of the control or of other controls is necessary to reach a conclusion.

THE WORK OF AN INTERNAL AUDIT FUNCTION

1. Obtaining an Understanding of the Internal Audit Function
2. Determining Whether and to What Extent to Use the Work of the Internal Auditors
3. Using the Work of the Internal Audit Function
4. Effect on the Service Auditor's Assurance Report

1. Obtaining an Understanding of the Internal Audit Function:

If the service organization has an internal audit function, the service auditor shall obtain an understanding of the nature of the responsibilities of the internal audit function and of the activities performed in order to determine whether the internal audit function is likely to be relevant to the engagement.

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

The service auditor shall determine:

- ✚ Whether the work of the internal auditors is likely to be adequate for purposes of the engagement; and
- ✚ If so, the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures.

3. Using the Work of the Internal Audit Function:

In order for the service auditor to use specific work of the internal auditors, the service auditor shall evaluate and perform procedures on that work to determine its adequacy for the service auditor's purposes.

4. Effect on the Service Auditor's Assurance Report:

- ✚ If the work of the internal audit function has been used, the service auditor shall make no reference to that work in the section of the service auditor's assurance report that contains the service auditor's opinion.
- ✚ In the case of a type 2 report, if the work of the internal audit function has been used in performing tests of controls, that part of the service auditor's assurance report that describes the service auditor's tests of

controls and the results thereof shall include a description of the internal auditor's work and of the service auditor's procedures with respect to that work.

WRITTEN REPRESENTATIONS

The service auditor shall request the service organization to provide written representations:

1. That re-affirms the assertion accompanying the description of the system;
2. That it has provided the service auditor with all relevant information
3. That it has disclosed to the service auditor any of the following of which it is aware:

OTHER INFORMATION

1. The service auditor shall read the other information, if any, included in a document containing the service organization's description of its system and the service auditor's assurance report, to identify material inconsistencies, if any, with that description.
2. While reading the other information for the purpose of identifying material inconsistencies, the service auditor may become aware of an apparent misstatement of fact in that other information.
3. If the service auditor becomes aware of a material inconsistency or an apparent misstatement of fact in the other information, the service auditor shall discuss the matter with the service organization.
4. If the service auditor concludes that there is a material inconsistency or a misstatement of fact in other information that the service organization refuses to correct, the service auditor shall take further appropriate action.

SUBSEQUENT EVENTS

1. If the service auditor is aware of such an event, and information about that event is not disclosed by the service organization, the service auditor shall disclose it in the service auditor's assurance report.
2. The service auditor has no obligation to perform any procedures regarding the description of the service organization's system, or the suitability of design or operating effectiveness of controls, after the date of the service auditor's assurance report.

DOCUMENTATION

The service auditor shall prepare documentation that is sufficient to enable an experienced service auditor, having no previous connection with the engagement, to **understand**:

1. The **nature, timing, and extent of the procedures performed** to comply with this SAE and applicable legal and regulatory requirements;
2. The **results** of the procedures performed, and the evidence obtained; and
3. **Significant matters arising** during the engagement, and the **conclusions** reached thereon and **significant professional judgments** made in reaching those conclusions.

PREPARING THE SERVICE AUDITOR'S ASSURANCE REPORT

1. Content of the Service Auditor's Assurance Report:

The service auditor's assurance report shall include the following basic elements:

- 1) **A title** that clearly indicates the report is an independent service auditor's assurance report.
- 2) An **addressee**.
- 3) **Identification** of:
 - a. The service organization's **description of its system**, and the service organization's assertion
 - b. Those parts of the service organization's description of its system, if any, that **are not covered** by the service auditor's opinion.
 - c. 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,
 - d. 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.

- 4) Identification of the **criteria**, and the party specifying the control objectives.
- 5) 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,
- 6) A statement that the service organization is responsible for:
 - a. Preparing the description of its system, and the accompanying assertion, including the completeness, accuracy and method of presentation of that description and that assertion;
 - b. Providing the services covered by the service organization's description of its system;
 - c. Stating the control objectives (where not identified by law or regulation, or another party, for example, a user group or a professional body); and
 - d. Designing and implementing controls to achieve the control objectives stated in the service organization's description of its system.
- 7) 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.
- 8) A statement that the engagement was performed in accordance with SAE 3402,
- 9) A summary of the service auditor's procedures to obtain reasonable assurance
- 10) 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.
- 11) The service auditor's opinion, expressed in the positive form, on whether, in all material respects, based on suitable criteria:
 - a. In the case of a type 2 report:
 - ✚ The description fairly presents the service organization's system that had been designed and implemented throughout the specified period;
 - ✚ 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
 - ✚ 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.
 - b. In the case of a type 1 report:
 - ✚ The description fairly presents the service organization's system that had been designed and implemented as at the specified date; and
 - ✚ 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.
- 12) 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.
- 13) Practitioner's Signature-The report should be signed by the practitioner in his personal name. Where the firm is appointed, the report should be signed in the personal name of the engagement partner and in the name of the firm. He shall mention the membership number the registration number of the firm.
- 14) The place of signature – the report should name specific location, which is ordinarily the city where the report is signed.

2. Modified Opinions:

If the service auditor concludes that:

1. The service organization's description does not fairly present, in all material respects, the system as designed and implemented;
2. The controls related to the control objectives stated in the description were not suitably designed, in all material respects;
3. In the case of a type 2 report, the controls tested, which were those necessary to provide reasonable assurance that control objectives stated in the service organization's description of system were achieved, did not operate effectively, in all material respects; or
4. 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

1. 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.

2. If the matter has not been so communicated and the service organization is unwilling to do so, the service auditor shall take appropriate action.