The South African Institute of Chartered Accountants

Revised Guide on

FORECASTS

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PREFACE

The South African Institute of Chartered Accountants (SAICA) has developed this Guide, in consultation with the JSE Limited (JSE), primarily to assist directors in preparing forecasts, as well as to assist reporting accountants in reporting on such forecasts. The subject of forecasts is specialised and complex.

The Guide endeavours to summarise the important principles involved in preparing, presenting, reviewing and reporting on forecasts in a manner that will be of practical use to members engaged in this type of work. The guide is not meant to be a textbook or an all-embracing procedural programme.

Although Guides do not have the authority of International Standards on Assurance Engagements or South African Statements of Generally Accepted Accounting Practice, in the event of significant deviation from the guidance given, a member may be required to demonstrate that such deviation did not result in failure to comply with appropriate professional requirements.

This Guide replaces the Audit and Accounting Guide on Profit Forecasts issued by SAICA in August 1989, which is hereby withdrawn.

The assurance aspects of this Guide have been noted by the Auditing and Assurance Standards Board of the Public Accountants' and Auditors' Board.

Introduction

.01 A Chartered Accountant can be involved in forecasts in three different roles:

- in his capacity as a director,
- as an adviser to assist the directors in the preparation of the forecast,
- or as the reporting accountant (only if registered with the PAAB).

.02 This Guide does not apply to the examination of forecasts expressed in general or narrative terms, such as that found in an entity's annual report, though much of the guidance provided may be suitable for such an examination.

Definitions

.03 **Prospective financial information**

Prospective financial information means financial information based on assumptions about events that may occur in the future and possible actions by the 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.

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

Projection
A projection means prospective financial information 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.

The Listings Requirements
The Listings Requirements of the JSE

Forecast

.04 A forecast is prepared primarily to inform present and prospective shareholders, and other users on the prospects of the entity. It is usually prepared for a specific purpose, examples of which are:

- raising equity or debt,
- obtaining a listing on a stock exchange, or
- reporting to shareholders.

.05 Such a forecast may be prepared for:

- a current accounting period that has not expired, or
- one or more future accounting periods.

.06 A forecast is usually, but not always, prepared in monetary terms. When no particular figure is mentioned, certain forms of words may constitute a forecast. Examples are "profits will be somewhat higher than last year" and "the profits of the second half year are expected to be similar to those earned in the first half year". It is difficult to generalise but, broadly, whenever a form of words puts a floor under, a ceiling on, or contains the data necessary to ascertain an approximate figure for future profits by an arithmetical process, this is likely to constitute a forecast. The term "forecasts" could therefore include:

- statements made by the chairman in the annual report or at the annual general meeting,
- statements of prospects included in an interim report,
- statements of prospects included in an announcement of annual results whether based on audited or unaudited figures,
- statements of prospects, including expected dividend payments, included in the directors' report, or
- statements of prospects in a take-over statement.

.07 Because the future is unknown, and because forecasts may be affected by many factors both internal and external to the entity, judgment must be used to estimate when and how conditions are likely to change. These judgments may prove subsequently to be unrepresentative of future conditions, with the result that the achievability and reliability of forecasts can never be guaranteed. Moreover, a forecast is less amenable to objective confirmation than historical data, and when working with or using a forecast, it is essential to understand its inherent limitations.

.08 It is important that forecasts should be distinguished from budgets prepared by management and from projections that are essentially part of an entity's strategic planning operations. Care must be taken to ensure that all parties concerned know what is meant by a forecast as opposed to a target or some other form of budget. A forecast reflects the level of profitability that the directors reasonably and honestly expect the entity to achieve, whereas a profit target would probably represent the profit level to which management may be striving.

Requirements to report on a forecast

.09 A forecast is required to be presented in terms of paragraph 3.4 and Sections 13 and Section 21 of the Listings Requirements. Alternatively an entity may voluntarily present a forecast in a circular or announcement. Paragraphs 8.35 to 8.44 of the Listings Requirements contain the regulations for a forecast. Where a forecast is published by a listed/or to be listed entity the Listings Requirements stipulate that the forecast should be accompanied by a reporting accountant's report unless in the case of a trading statement, the alternative as set out in paragraph 3.4(b)(vi)(2) is followed. Paragraph 8.41 of the Listings Requirements states that the accountant’s report must follow the requirements of the guide issued by SAICA. The JSE has advised that the reporting accountant’s report may be provided by any registered accountant and auditor that has sufficient knowledge and experience in the application of the Listings Requirements. However, in practice it would often be provided by the company's auditor.

.10 Where the reporting accountant is required to report on a profit forecast that is to be included in a prospectus, the requirements of Section 151 of the Companies Act places the obligation on him to give his consent to the issue of the document that includes his report, with explicit reference to the form and context in which it is included. Before giving his consent, which should be in writing, to the publication of his report, the reporting accountant would require to see the whole text of the circular, or document, with which it will be published and should be satisfied that it is appropriate, and not misleading, for his report on the profit forecast to appear in the form and context in which it is included. This requirement represents a powerful sanction, which should ensure that no document is issued if it contains anything of a material nature with which the reporting accountant does not wish to be associated.

Responsibility of directors

.11 All parties involved in a forecast should clearly understand that the directors are solely responsible for the forecast and the underlying assumptions. Accordingly, the directors should ensure that the forecast represents their best estimates of the results that they reasonably and honestly believe can and will be achieved. Although an adviser may assist the directors in the preparation of the forecast, the responsibility therefor cannot be delegated. It is considered good practice for the board of directors to approve the forecast formally.

.12 The directors will often delegate the work of compiling the forecast to subordinate management. Whenever they do this they must recognise that the forecast requires the exercise of skill and judgment in projecting future likely events. In delegating the work they should carefully determine how much responsibility each person will be taking, so that the directors know, without a doubt, which individuals will account to them for different parts of the forecast. All personnel involved in the preparation of the information should be properly briefed about the assumptions they are to use in preparing the detailed workings. The directors should also ensure that each person is completely clear on the degree of judgment that they are allowed to exercise.

.13 In a similar way, when members of the management team delegate to staff the preparation of parts of the forecast, they should make sure that the staff concerned are competent and fully understand their duties and responsibilities.

.14 Management should be aware of the fact that, whilst the reporting accountant is carrying out a review of the forecast, management will be required to give of its time in order to explain the procedures adopted in preparing the forecast and the thinking behind any part of the forecast. Members of the board of directors may themselves have to devote time to this.

Preparation

.15 Forecasts may concentrate on projected income as opposed to projected cash flows or balance sheets. Nevertheless, in order to arrive at a meaningful forecast of profits, it may be necessary to develop projected financial statements from which the element of profit can be extracted to form the forecast. It will not usually be possible to make forecasts of profit without considering the prospects of the entity in a broader sense, including cash flows on which projected profits may depend for their sustainability.

Professional behaviour

.16 Because the preparation of forecasts requires the use of judgment, those that prepare forecasts should exercise professional behaviour at all times. This involves making a diligent effort to develop appropriate assumptions and exercising care not to mislead potential users of the forecast. The exercise of professional behaviour precludes preparing a forecast on the basis of undue optimism, pessimism, or in such a way as to arrive at a predetermined profit.

Professional competence and due care

.17 The preparation of a forecast normally involves the extensive use of information and requires many calculations. This information may be processed without the benefits of controls inherent in a historical accounting system, which makes the preparation of a forecast susceptible to clerical errors. Procedures should be established to facilitate the prevention, detection and correction of such errors.

.18 The preparation of a forecast may require skills in addition to those normally required for the preparation of historical financial statements. For example, personnel having competence in marketing, engineering and other technical areas may be needed to provide input. In addition, expertise in sophisticated forecasting techniques and methods may be required.

Accounting policies

.19 The accounting policies applied in the preparation of a forecast should be the same as those that are expected to be applied in recording the transactions or events that may occur. Usually these will be the accounting policies currently applied by the entity. Because a forecast reflects an estimate of the entity's expected results, changes in accounting policies should only be reflected in forecasts if the preparer of the forecast reasonably anticipates that such revised accounting policies will be adopted in the historical financial statements. Attention is drawn to the relevant South African Statement of Generally Accepted Accounting Practice/International Financial Reporting Standard, which requires that a change in accounting policy should not be made unless the new policy is preferable to the one it replaces in order to achieve fair presentation of the results and of the financial position of the business. Such a change in an accounting policy should be appropriately disclosed and should clearly indicate the effect thereof.

Sources of information

.20 Information used for the preparation of a forecast may come from many sources, both within and outside the entity. It should be noted that the different sources of information will provide different degrees of reliability. The process used to develop a forecast should identify the best information that is reasonably available at the time. The cost of acquiring the information should, nevertheless, be commensurate with the anticipated benefits to be derived from the information.

.21 A key consideration in the preparation of a forecast is the use of an appropriate level of detail. In certain circumstances the use of more detail may improve the reliability of the forecast. For example, forecasting sales by product line rather than in aggregate is likely to provide a more accurate forecast, especially where the products are sold in different markets.

Consistency

.22 A forecast should be consistent with the expected financial effects of the anticipated plans and strategies of the entity, including those being planned in response to expected future events and conditions. An indication of such plans can often be found in budgets, strategic plans and statements of goals. In considering these sources of information, the preparer of the forecast should bear in mind that they are often set as targets and may be unduly optimistic or pessimistic. Such plans should also be considered in the context of previous results of operations where relevant.

Assumptions

.23 In determining the assumptions that could affect the entity, factors such as the size and the type of the organisation and the geographical areas in which it operates should be taken into account. For example, political and world economic situations may be vital to the very large entity but relatively remote to the smaller one; industrial disturbances may not apply to a financial institution and interest rates or the general availability of capital may be important to one entity but not to another that has adequate capital.

.24 An understanding of the entity is necessary so that all key factors relating to the entity are identified at the outset of the engagement. Key factors are those significant matters upon which an entity's future results are expected to depend and constitute the areas in which assumptions will have to be made. Key factors vary by entity and by industry.

.25 Once the key factors have been identified, assumptions should be developed in respect of each key factor. For example, if manufacturing labour is identified as a key factor, assumptions may need to be developed for manpower requirements and labour rates.

.26 The quality of the underlying assumptions will largely determine the quality of the forecast. The attention devoted to the appropriateness of a particular assumption should be commensurate with the likely impact of that assumption. All assumptions should be reasonable and suitably supported.

.27 The assumptions on which a forecast is based should not be vague generalities but should constitute a considered forecast of the economic, commercial and financial circumstances that are likely to affect the future profitability of the entity.

.28 Examples of assumptions are:

- interest rates (if the entity is a significant borrower or lender),
- foreign exchange rates (if there is a significant uncovered foreign exchange liability or significant purchases or sales are made in foreign currencies),
- factors affecting fair value calculations for financial instruments,
- taxation rates,
- the likelihood of industrial disputes,
- an inflation factor, or
- new plant brought into use at a certain date.

.29 In developing a forecast, it is necessary to have an understanding of the sensitivity of the forecast results to certain assumptions. Sometimes, forecasts are relatively more sensitive to certain assumptions and less sensitive to others. Changes in certain assumed conditions can result in relatively large variations in forecast results, while changes in other assumptions may cause only minor shifts. Attention should be devoted to those assumptions that are particularly sensitive, and to those with a high probability of variation that may be classified as key factors.

Comparison with actual results

.30 Where forecasts are prepared, they should, where appropriate, be compared with actual results attained. This comparison provides an indication of the probable reliability of future forecasts. Such comparisons should not be limited to overall financial results, but should also include comparisons of the key factors and assumptions, such as sales volumes, prices and production volumes.

Documentation

.31 The preparer of a forecast should adequately document the work that he/she carried out in developing the forecast. Documentation facilitates review and approval of a forecast, and it makes comparison possible between forecasts and actual results. It also provides the discipline necessary for developing reliable forecasts or could serve as evidence in the case of a dispute.

Presentation

.32 A forecast should be clearly described as such to preclude a user from confusing it with historical financial information. This is especially important when a forecast is presented alongside or together with historical information.

.33 The disclosure of key assumptions is essential to the user's understanding of the uncertainties attached to the forecast. In certain circumstances, it may be necessary to disclose the basis or rationale for an assumption to assist the user in understanding the forecast and making an informed judgment about it. However, assumptions stated should relate only to matters that, if they did not occur, would have a significant effect upon the forecast. For example, if an entity exports a significant amount of its products and the entity can estimate, with reasonable accuracy, the volume of export sales, it would not disclose the sales volume as an assumption. On the other hand, if there was a major uncertainty relating to the export sales revenues due to fluctuations in the exchange rate, the exchange rate used in the forecast would be disclosed as an assumption.

.34 It is usually implicit, in the absence of disclosure to the contrary, that certain significant conditions will continue to prevail. Examples of such circumstances are the absence of riots, war conditions or natural disasters.

.35 It should be made clear that the assumptions disclosed are not an exhaustive list and that they are based on what management considers to be significant in the circumstances.

.36 In considering which assumptions to disclose, management should bear in mind the following:

- The user should be able to understand their implications and so be helped in forming a judgment as to the reasonableness of the forecast and the main uncertainties attaching to it.
- Wherever possible, the assumptions should be specific rather than general, definite rather than vague.
- All-embracing assumptions and those relating to the general accuracy of the estimates should be avoided.
- The assumptions should relate only to matters which may have a significant bearing on the forecast.

.37 There is, however, a need for brevity and simplicity. In large and complex entities it may be more appropriate to present the forecast by segment and state the assumptions relating to each segment.

.38 Where, for the reasons discussed in paragraph .19 above, the directors decide to use a different accounting policy from that used in previous annual reports, the effect of such a change should be disclosed in the manner required by the relevant South African Statement of Generally Accepted Accounting Practice/International Financial Reporting Standard.

Responsibility of the reporting accountant

.39 The role of the reporting accountant is to provide users of the forecast with some assurance that it has been properly compiled and presented. It is emphasised that forecasts necessarily depend on subjective judgments and are, to a greater or lesser extent, dependent on the nature of the business and subject to numerous and substantial inherent uncertainties. These uncertainties increase markedly the further forward in time the forecasts are projected. Therefore, it is not possible for the reporting accountant to express any assurance concerning the accuracy of the forecast. The reporting accountant undertakes the assurance engagement in accordance with the International Standard on Assurance Engagements applicable to the *Examination of Prospective Financial Information*.

.40 When called upon to make a report on a forecast, the reporting accountant should be aware of Disciplinary Rule 2 (1) (k) of the Public Accountants' and Auditors' Board, which reads:

2(l) ".....any accountant and auditor registered under the (Public Accountants' and Auditors') Act shall be guilty of improper conduct if he:

(k) permits his name to be used in connection with any estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the estimate."

.41 In terms of this rule, a reporting accountant may not provide or imply any assurance in relation to a forecast that may give the impression that he is confirming or otherwise accepting responsibility for its realisation. However, the reporting accountant can reasonably accept responsibility for examining the accounting bases and calculations and concluding on the reasonableness of the assumptions used.

.42 To avoid misunderstandings from occurring, it is preferable that the reporting accountant should confirm his/her understanding of the responsibilities and terms of the engagement in an engagement letter. This letter should also state that the engagement will be carried out free of material restrictions on the scope of work to be done. The engagement letter should be issued as soon as possible and should be acknowledged by the directors. Examples of matters that could be included in an engagement letter to report on a forecast, are provided in Appendix I.

.43 When completing the engagement, a confirmation from the directors in a representation letter that the forecast represents their best estimate of results and that the assumptions are reasonable should be obtained.

Planning and performing the assurance engagement

.44 It is stressed that the recommended procedures apply to all engagements in which a reporting accountant is required to report on a forecast whether or not the forecast is intended for publication.

.45 The objective in an examination of a forecast is to perform procedures to determine whether or not:

- management's best-estimate assumptions on which the forecast is based are not unreasonable and, in the case of hypothetical assumptions, such assumptions are consistent with the purpose of the information,
- the forecast is properly prepared on the basis of the assumptions,
- the forecast 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 forecast is prepared on a basis consistent with historical financial statements, using appropriate accounting principles.

.46 In undertaking the engagement to provide assurance on the forecast, the reporting accountant applies the requirements contained in the International Standard on Assurance Engagements 3400 applicable to *The Examination of Prospective Financial Information.*

Reporting accountant's report

.47 Once the reporting accountant has completed his/her examination of the forecast, he/she should report to the directors of the entity in terms of the requirements of the International Standard on Assurance Engagements 3400 applicable to *The Examination of Prospective Financial Information*. An illustrative reporting accountant's report on a profit forecast is contained in Appendix II.

APPENDIX I

Illustrative example of matters to be included in an engagement letter for the examination of a forecast

The letter of engagement may include the following:

1. A reference to the meeting at which the respective responsibilities were discussed, such as for example:

   "We refer to our meeting with............................. on................200x when you asked us to examine and report on the forecast of your company for the year ending...............200x proposed to be included in.......

   We explained that we could not express an opinion on whether or not the forecast will be realised. In addition, we will not be carrying out an audit of the financial statements for the months/year ended...............200x proposed to be included in the forecast.

   You understand that, in order for us to carry out an examination, we should need to question directors and senior management regarding the preparation of the forecast, and you agreed that all such personnel would be available."

2. A reference to the directors' responsibility, for example:

   "The directors undertook to assume full responsibility for the forecast, and to ensure that it is properly prepared and updated as necessary to represent their best estimate of the results they reasonably and honestly believe can be achieved. The directors also agreed that they would adopt the forecast formally by resolution of the full board before we report formally on it."

3. A reference to the reporting accountant's scope and responsibility, for example:

   "We undertake to examine the forecast so far as management's best-estimate assumptions on which the forecast is based are not unreasonable and, in the case of hypothetical assumptions, such assumptions are consistent with the purpose of the information, the forecast is properly prepared on the basis of the assumptions, the forecast 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 forecast is prepared on a consistent basis with historical financial statements, using appropriate accounting principles.

   We shall examine the contents of any document in which you propose to publish our report in order to give our consent to the document being issued with our report therein in the form and the context in which our report appears."

4. A reference to any services to be provided to other financial consultants on behalf of the client, for example:

   "We shall provide you and your financial consultants with a report on the preparation of the forecast and the explanations given to us, in such detail as is practicable having regard to any limitation there may be in the time available."

5. A reference to fees, for example:

"Our fees are computed at our scale rates applicable for this type of work on the basis of the time necessarily occupied by our partners and staff of different seniority depending on the degree of responsibility and skill involved in the work."

APPENDIX II

Illustrative example of a reporting accountant's unqualified report on a forecast

INDEPENDENT REPORTING ACCOUNTANT'S ASSURANCE REPORT ON THE FORECAST OF [*COMPANY NAME*]

We have examined the accompanying *[consolidated]* forecast of *[name of company]* for the period … to … set out in the *[circular]* to *[name of company's/companies']* shareholders.

Directors' responsibility
The directors are responsible for the forecast, including the assumptions set out in *Note X*, on which it is based, and for the financial information from which it has been prepared. This responsibility, arising from compliance with the Listings Requirements of the JSE Limited, includes: determining whether the assumptions, barring unforeseen circumstances, provide a reasonable basis for the preparation of the forecast; whether the forecast has been properly compiled on the basis stated; and whether the forecast is presented on a basis consistent with the accounting policies of the company or group in question.

Reporting accountants' responsibility
Our responsibility is to provide a limited assurance report on the forecast prepared for the purpose of complying with the Listings Requirements of the JSE Limited and for inclusion in the *[circular]* to *[name of company's/companies']* shareholders. We conducted our assurance engagement in accordance with the International Standard on Assurance Engagements applicable to the *Examination of Prospective Financial Information.* This standard requires us to obtain sufficient appropriate evidence as to whether or not:

- management's best-estimate assumptions on which the forecast is based are not unreasonable and are consistent with the purpose of the information;
- the forecast is properly prepared on the basis of the assumptions;
- the forecast is properly presented and all material assumptions are adequately disclosed; and
- the forecast is prepared and presented on a basis consistent with the accounting policies of the company or group in question for the period concerned.

In a limited assurance engagement, the evidence – gathering procedures are more limited than for a reasonable assurance engagement and, therefore, less assurance is obtained than in a reasonable assurance engagement. We believe our evidence obtained is sufficient and appropriate to provide a basis for our limited assurance conclusion.

Conclusion
Based on our examination of the evidence obtained, nothing has come to our attention that causes us to believe that:

i) the assumptions, barring unforeseen circumstances, do not provide a reasonable basis for the preparation of the forecast;
ii) the forecast has not been properly compiled on the basis stated;
iii) the forecast has not been properly presented and all material assumptions are not adequately disclosed; and
iv) the forecast, is not presented on a basis consistent with the accounting policies of the company or group in question.

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; accordingly no assurance is expressed regarding the achievability of the forecast.

Name
Registered Accountant and Auditor
Chartered Accountant (SA)
Address
Date

APPENDIX III

Illustrative procedures for an examination of a forecast

The following procedures are listed to assist the reporting accountant in planning an examination of a forecast. The list is neither a complete summary of all possible procedures nor an outline of minimum procedures, but it is intended to aid in the development and selection of procedures for a particular engagement. The reporting accountant may be able to achieve the same objectives by procedures other than those illustrated.

The procedures are divided into four categories:

1. Procedures to determine the scope of the examination
2. Procedures to evaluate the assumptions
3. Procedures to review the preparation and presentation of the forecast
4. Procedures to consider the reasonableness of historical data included in a forecast.

1. **Procedures to determine the scope of the examination**

1.1 Obtain knowledge of the entity's business by:

- interviewing entity personnel and other individuals knowledgeable about the industry
- consulting industry publications, textbooks and periodicals
- analysing financial statements of the entity and of other entities in the industry.

The reporting accountant may have obtained some or all of this knowledge through previous experience with the entity or its industry.

1.2 In obtaining knowledge of the entity's business, consider:

- Resources needed by the entity (availability and cost):
  — Material
  — Labour
  — Capital
  — Fixed assets (for example, capacity of plant and equipment).

- Markets served by the entity (nature and condition):
  — Intermediate markets
  — Final consumer markets
  — Entity's market share
  — Advertising and marketing plans.

- Factors specific to the industry:
  — Competitive conditions
  — Sensitivity to economic conditions
  — Accounting policies
  — Specific regulatory requirements
  — Technology.

- Patterns of past performance for the entity or comparable entities:
  — Trends in revenue and costs
  — Turnover of assets
  — Uses and capabilities of physical facilities
  — Management policies.

1.3 Obtain or assemble the forecast together with a list of the significant assumptions and their descriptions.

1.4 Review the process used in preparing the forecast to obtain an understanding of the rationale by which key factors are identified and assumptions are developed and translated into forecast information. The reporting accountant would look for answers to such questions as:

- is the preparation of the forecast adequately documented to permit tracing through the process? The reporting accountant may decide to prepare a brief outline of the process used to develop forecasts.
- has the process been used in the past to generate forecasts, and, if so, was it effective?
- what procedures provide reasonable assurance that all significant factors are included in the assumptions?
- what procedures provide reasonable assurance that the forecast is based on assumptions approved by a responsible party?
- what are the methods of collecting, calculating and aggregating forecast information?
- what methods identify and quantify the impact of variations in assumptions?
- what are the procedures to effect changes in accounting policies and to reflect them in the forecast?
- if the process used to develop forecasts has been in operation or used in the past, are there procedures to compare the previous forecasts with the historical results for the same period, and analyse the differences where applicable? (For example, differences in forecasts and actual results should be analysed to ascertain that identified causes are considered.) Are the procedures used to adjust the process, where applicable, as a result of such analysis?
- what are the entity's review and approval procedures?
- how are errors prevented or detected?

1.5 Identify any models and techniques that are used. If possible, obtain a description of them.

1.6 Having reviewed the process by which the responsible party develops its forecasts, analyse its strengths and weaknesses by comparing it with the guidelines outlined in this Guide.

1.7 Consider the competence of the entity's personnel involved in the process, including their degree of authority, prior experience with the entity and industry, and understanding of both the entity's plans and the process, in relation to their functions in the process and in entity operations.

1.8 Review documentation of both the forecasts and the process to develop them or otherwise investigate whether there has been:

- review and approval by the responsible party
- determination of the relative effect of variations in major underlying assumptions, and
- use of appropriate accounting practices.

1.9 Test significant elements of the process designed to prevent or detect errors, including clerical errors.

1.10 Where applicable, review the entity's documentation of the comparison of actual results with amounts contained in previous forecasts (if any) for the relevant periods and consider whether or not:

- the comparison was performed using correct, comparable information and whether or not analysed differences were documented and appropriately explained
- the process was adjusted where appropriate
- the procedures to develop forecasts in the past have reflected the entity's plans properly, and
- any consistent bias has been observed.

1.11 Based on the knowledge obtained in the foregoing procedures, design a timetable and the examination procedures for evaluating the assumptions and for the preparation and presentation of the forecast.

2. **Procedures to evaluate the assumptions**

2.1 Evaluate both the assumptions on which the forecast is based and the more detailed information included in the underlying documentation to determine the completeness of the assumptions used. Factors to consider include:

- risks inherent to the business,
- sensitivity to variations, and
- pervasiveness of the impact of particular factors on the various assumptions.

2.2 Obtain forecasts of similar entities, if available, and consider whether or not the key factors covered by the assumptions therein are covered in the client's forecasts.

2.3 Analyse prior period financial results to help identify the principal factors that influenced the results. If any interim historical results are available, consider any significant deviations from historical patterns and investigate the causes.

2.4 Review any public statements, formal plans and the minutes of board of directors' meetings, noting any significant decisions regarding plans, contracts, or legal agreements.

2.5 Question the responsible party regarding possible additional factors or changes in assumptions about factors.

2.6 Using the knowledge of the entity and its industry, investigate any particularly risky or sensitive aspect of the business – market trends, competitive conditions, pending laws and regulations, social economic, political and technological influences, and dependence upon major customers and suppliers.

2.7 Identify and review the support for the assumptions, giving special attention to specific assumptions that are:

- material to the forecast amounts,
- especially sensitive to variations,
- deviations from historical patterns, and/or
- especially uncertain.

2.8 For key assumptions, ascertain the internal and external sources of information that the entity used in formulating the assumptions and, on a test basis, evaluate whether or not the information was correctly considered in formulating the assumptions.

2.9 Trace assumptions about selected key factors in respect of support for the assumptions, to determine whether or not the indicated sources of information were actually used, and evaluate the suitability of the support. If the information is taken from internal analyses, consider the need for testing the supporting information.

2.10 Review any available documentation of the responsible party's plans, such as budgets, spending estimates, policy statements, and contractual agreements, amongst others, and enquire about those plans, goals and objectives - and consider their relationship to the assumptions.

2.11 Investigate alternative sources of support for the assumptions, and evaluate whether the preponderance of available information supports each significant assumption.

2.12 Enquire about and analyse the historical information used in developing the forecast to assess:

- whether or not it is comparable and consistent with the forecast period
- whether or not it is sufficiently reliable for the purpose.

2.13 If historical financial statements have been prepared for an expired part of the period covering the forecast, read the historical financial statements and consider them in relation to the forecast for the same period.

2.14 If the forecast is based on the historical financial results for part of the forecast period and that part is significant to the presentation, make a review of the historical information.

2.15 Consider alternative approaches to the development of the assumptions. For example, if the sales assumption was developed by aggregating individual salesman's estimates, consider comparing the assumptions to historical patterns. Also consider trying other models and techniques.

2.16 Where appropriate, consider confirming with external sources, information supporting the assumptions. (For example, if the backlog of sales orders is significant to the forecast and is not adequately supported by official orders, consider sending written confirmation requests to customers.)

2.17 If the support for key assumptions comes from experts, consider their work in the light of the requirements of the International Standard on Auditing applicable to *Using the Work of an Expert*.

2.18 If the assumptions about the tax treatment of forecast transactions are sensitive, obtain support for their appropriateness by:

- analysing forecast transactions in the context of applicable tax laws, or
- obtaining an opinion from a tax consultant.

2.19 Obtain a representation letter from the responsible party.

2.20 Consider obtaining a letter from the client's legal counsel, as of the reporting date, covering:

- litigation, claims and assessments, and
- the legality of any major changes planned (such as marketing considerations, environmental impact, or patents) and other matters (such as the impact of new laws affecting the industry).

3. **Procedures to review the preparation and presentation of the forecast**

3.1 Test the mathematical accuracy of, or perform, the computations made in translating the assumptions into the forecast amounts.

3.2 Consider whether information has been appropriately aggregated by:

- evaluating the appropriateness of mathematical equations, statistical techniques, or modeling procedures,
- recomputing on a test basis, and
- tracing aggregate amounts to the forecast.

3.3 Determine whether or not the assumptions disclosed are those used in preparing the forecast.

3.4 Determine whether or not the effects of each assumption on all of the related forecast amounts have been reflected in the forecast.

3.5 Determine whether or not any assumption contradicts or is inconsistent with any other assumption.

3.6 Review the relationship between financial and other relevant information using appropriate mathematical or judgmental methods.

3.7 Review adjustments made to the information used, considering whether they arc justified and reasonable in relation to other information, and whether their impact has been properly reflected in the forecast.

3.8 If historical information for part of the forecast period is included in the forecast, trace the amounts from the books, records, and other indicated sources to the forecast.

3.9 Determine whether or not the forecast is in conformity with the presentation guidelines in this Guide, considering the following:

- Are the accounting policies used:

  — consistent with those used in the historical financial statements, if any?

— consistent with those expected to be used in future financial statements (including expected changes in accounting policies)?
— in compliance with generally accepted accounting practice?

- If there has been a change in accounting policy, have the requirements of the relevant Statement on Generally Accepted Accounting Practice been followed?
- Are the assumptions adequately disclosed?
- Are particularly sensitive assumptions identified?
- If the impact of a variation in an assumption is disclosed, is it appropriately stated?
- Is the forecast appropriately distinguished from historical financial statements?

3.10 Read other information in the document containing the forecast to ensure that such information is materially consistent with the forecast.

4. Procedures to consider the reasonableness of historical data included in a forecast

4.1 By means of discussion and enquiry:

- determine the adequacy of the accounting system as a means of generating reliable information,
- determine the reasonableness of accounting estimates such as provisions for obsolescence and doubtful debts,
- consider whether or not the accounting policies are appropriate and have been consistently applied, and
- determine whether or not material liabilities have been raised.

4.2 Carry out analytical review procedures.

4.3 Carry out other procedures as considered necessary.

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