

## Financial Model Auditing Determining the Scope of Work

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As the need for a financial model audit becomes more prevalent in the securing of debt funding, we are increasingly being asked to offer quotations where there is uncertainty over the scope of work.

Our intention here is to provide clarity on the three common forms of review we offer:

- **High Level Review**
  - **Due Diligence Review**
  - **Formal Model Audit**
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## High Level Review

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For this scope of work, Operis would offer to:

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Areas to consider in determining the agreed scope of work include:

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Ballpark fee: £10,000 - £15,000

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## Scope of Work - Financial Model Auditing

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A High Level Review is generally sought in instances where project investors are seeking comfort that their model is producing output results as intended and that there are no obvious material flaws in the model.

We always make clear this form of review does not attempt to check every part of the model. Instead it focuses on areas which in our experience typically contain the most problems. For this reason we do not offer an amount of liability in connection with the final deliverable, a Letter of Support.

The review process involves reporting on the issues uncovered after reviewing the original model, followed by the review of a further iteration to ensure the detected errors have been corrected.

The same analytical resource and audit techniques are applied to those in a Formal Model Audit, although the senior quality control review undertaken in the closing stages of a full audit is not required given the absence of formal liability.

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1. review the logic and integrity of selected areas of the model to consider whether the calculations are reasonable and consistent with the operational, financial, and economic assumptions contained within the model;
  2. review whether the model achieves its objective of generating consistent profit and loss, cash flow and balance sheet projections for the project;
  3. review whether the composition of key financial indicators is reasonable in the model;
  4. review whether the model implements reasonable accounting and tax treatments;
  5. produce a report which summarises and discusses issues that have arisen during the course of the review;
  6. review one further version of the model to check changes made in response to issues raised; and
  7. provide a Letter of Support.

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Is a tax and accounting review required? Some financial models do not contain tax and/or accounting treatments.

A High Level Review generally only looks at two model versions, although further iterations can always be reviewed if greater certainty is required.

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Estimated time for completion: 1 - 2 weeks

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## Due Diligence Review

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For this scope of work, Operis would offer to:

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Areas to consider in determining the agreed scope of work include:

## Scope of Work - Financial Model Auditing

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This form of review is typically sought by equity investors to confirm the accuracy of a financial model being relied upon for the purpose of acquiring a share in an asset. This review offers an accelerated timetable compared to a formal model audit, while still providing a level of liability cover.

The process involves reviewing three iterations of the model with a focus on a pre-agreed threshold of materiality, to allow you to concentrate on the changes that really matter.

Such a review is often conducted in the weeks leading to the acquisition bid submission or financial close, with two to three weeks generally required for completion.

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1. review the logic and integrity of the model to ensure that the calculations are arithmetically correct and that the results are reliable, accurate, complete and consistent with the assumptions contained within the model;
  2. review whether the model's stated assumptions are consistent with and agree with the supporting information contained in English-language extracts of the project and financing documents;
  3. review whether the model materially achieves its objective of generating profit and loss, cash flow and balance sheet projections, and key financial ratios and investors' returns for the project on the basis of the set of operational, financial and economic assumptions set out in the base case;
  4. review whether the assumptions and logic of the model are reasonable with regards to local GAAP or IFRS;
  5. review whether the assumptions and logic of the model are reasonable with regards to local tax legislation;
  6. produce draft and final reports which summarise and discuss the issues set out above, highlighting any material errors;
  7. review a number of iterations of the model as it evolves; and
  8. provide a due diligence letter for bid or acquisition.

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We typically suggest focussing on issues that have an impact of more than 1% on the acquisition price, and we would be happy to adapt this threshold to your requirements.

The number of model iterations reviewed is generally set at three, but naturally subject to transaction demands.

Similarly, some thought should be given to which documents are required to be reviewed against the model, in an attempt to streamline the review timetable.

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Estimated time for completion: 2 - 3 weeks

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## Formal Model Audit

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For this scope of work, Operis would offer to:

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Areas to consider in determining the agreed scope of work include:

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Ballpark fee: Around £35,000

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## Scope of Work - Financial Model Auditing

This form of review is typically required by banks to confirm the accuracy of a financial model being relied on for the purpose of lending. The key attribute is an agreed cap of liability, offered in conjunction with the Formal Opinion Letter. The liability cap we offer can be as high as £20 million, however is more often in the range of £5 million - £10 million.

The process involves reviewing 3 - 4 iterations of the model to confirm the base case, followed by reviewing a set of lender-prescribed sensitivities. The audit usually involves confirming the model's tax and accounting treatments, which may comprise working with a local advisor or using existing reports or advice which the sponsor has provided.

Such an audit is often conducted in the weeks leading to bid submission or a financial close, with 4 - 5 weeks generally required for completion.

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1. review the logic and integrity of the model to ensure that the calculations are arithmetically correct and that the results are reliable, accurate, complete and consistent with the assumptions contained within the model;
  2. ensure the model's standard assumptions are consistent with and agree with the supporting information contained in English-language extracts of the projects and financing documents;
  3. ensure the model materially achieves its objective of generating profit and loss, cash flow and balance sheet projections, and key financial ratios and investors' returns for the project on the basis of the set of operational, financial and economic assumptions set out in the base case;
  4. review the model's output to identify any unexplainable trends or variations in key financial indicators. This will include a detailed review of the cover ratios and confirmation that the stated definitions of these are correctly interpreted in the model's formulae;
  5. review the assumptions and outputs contained in or produced by the model to ensure that the model conforms with our current understanding of local GAAP or International Finance Reporting Standards;
  6. review the assumptions and outputs contained in or produced by the model to ensure that the model conforms with our current understanding of local tax legislation and ensure that the tax treatment in the model is consistent with the accounting treatment in the model;
  7. understand and review a range of sensitivity runs (run by the model author) of the model to ensure that changes to results accurately reflect changes to input data;
  8. produce draft and final reports which summarise and discuss the issues set out above;
  9. review a number of iterations of the model as it evolves toward completion; and
  10. attend financial close, if required.

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A model's tax and accounting treatments can be reviewed by the Operis team irrespective of location or jurisdiction. The approach taken may involve checking to existing tax and accounting advice, or consulting with local tax and accounting experts.

The number of model iterations and lender sensitivities reviewed is generally set at four and 10 respectively, but naturally subject to transaction demands.

We will generally enquire in advance on the likelihood of the documents requiring checking.

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Estimated time for completion: 4 - 5 weeks

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## In summary:

Scope	High Level Review	Due Diligence Review	Formal Model Audit
Purpose of review	To provide investor comfort	To provide investor comfort	To satisfy lender requirements
Model logic & arithmetic	Review of selected areas	Complete review	Complete review
Review of Documents	Optional	Complete review	Complete review
Checking ratios	Check back to docs and assumptions	Check back to docs and assumptions	Check back to docs and assumptions
Model outputs	Check back to docs and assumptions	Check back to docs and assumptions	Check back to docs and assumptions
Tax & Accounting	Check treatments are reasonable	Check to modeller's advice, typically	Full T&A review
Reports	Issues reports	Issues reports	Issues reports, sensitivities reports
No. of models	2 (original plus 1 update)	3 (original plus 2 updates)	4 (original plus 3 updates)
Lender sensitivities	No	No	10 as standard
Final deliverable	Letter of Support	Due Diligence Letter	Formal Opinion Letter
Liability Cover	No liability cover	£100k	£5m or £10m typically
Duration	1 - 2 weeks	2 - 3 weeks	4 - 5 weeks
<b>Ballpark fee</b>	<b>£10,000 - £15,000</b>		<b>Around £35,000</b>

The pricing described above is based on the review of a typical project finance model with the conventional size and complexity which we are used to seeing.

## Contact a member of the team to discuss your requirements

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## Coverage

- Financial Advisory
- Financial Model Auditing
- Financial Model Development
- Tax & Accounting Advice
- Financial Modelling Training
- Financial Modelling Software

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