Chapter 8

Question Bank

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Q1. Which of the following is not an analytical procedure?

a) Tracing of purchases recurred in the purchase book to purchase invoices.
b) Comparing aggregate wages paid to number of employees
c) Comparing the actual costs with standard costs
d) All of them are analytical procedure

(Sample MCQs) (MTP1, Nov 2019, 1 Mark)

Correct answer: (a) Tracing of purchases recurred in the purchase book to purchase invoices.

Q2. What are analytical procedures?

a) Substantive tests designed to assess control risk
b) Substantive tests designed to evaluate the validity of management's representation letter
c) Substantive tests designed to study relationships between financial and non-financial data
d) All of the above

(Sample MCQs)

Correct answer: (c) Substantive tests designed to study relationships between financial and non-financial data

Q3. Analytical procedures issued in the planning stage of an audit, generally:

a) helps to determine the nature, timing and extent of other audit procedures
b) directs attention to potential risk areas
c) indicates important aspects of business
d) All of the above

(Sample MCQs)

Correct answer: (d) All of the above

Q4. Which of the following statement is correct :

a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time
b) Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time
c) Substantive analytical procedures are generally more applicable to small volumes of transactions that tend to be predictable over time
d) All statements are correct

	(Sample MCQs)
	Correct answer: (a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time
Q5.	Marvin Ltd. is a renowned food chain supplier in a posh area providing restaurant facility along with food delivering. CA. Felix was appointed as an auditor of the company for the Financial Year 2017-18. While examining the books of account of the company, CA. Felix came to know about one of the major expenses of the company i.e. rent expense of Rs. 1,20,000 per month, for which he applied substantive analytical procedure for verification purpose. Explain, how would CA. Felix perform substantive analytical procedure in the given scenario? a) CA. Felix would inspect every single rent invoice per month of Rs 1,20,000 and verify other elements appropriately. b) CA. Felix would compare the rental expense of the company with that of another nearby company having corresponding dimensions, for high degree of accuracy. c) CA. Felix would select the first month rent invoice of Rs 1,20,000 and appropriately verifying other elements would predict that the rent for the whole year would be Rs 14,40,000 (i.e. Rs 1,20,000 * 12). Thereafter, he would compare the actuals with his prediction and follow-up for any fluctuation. d) (a) and (b), both. **(Sample MCQs) (RTP, May 2019, NA)**
	Correct answer: (c) CA. Felix would select the first month rent invoice of Rs 1,20,000 and appropriately verifying other elements would predict that the rent for the whole year would be Rs 14,40,000 (i.e. Rs 1,20,000 * 12). Thereafter, he would compare the actuals with his prediction and follow-up for any fluctuation.
Q6.	Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Explain stating the purpose of analytical procedures with examples. **(RTP, May 2018, NA)**
	SA 520 “Analytical Procedures” deals with the auditor’s use of analytical procedures as substantive procedures **<u>Meaning of analytical procedures</u>** Analytical procedures means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. It also encompasses such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount **<u>Purpose of Analytical Procedures</u>** Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes: ● To obtain relevant and reliable audit evidence when using substantive analytical procedures; and ● To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor’s understanding of the entity. For instance, establishing the relationship that exists between certain balances included in the Balance Sheet and the Statement of Profit and Loss and comparing them with those that existed between the same set of balances in the previous year’s reconciling the physical balances of assets with the relevant financial record; obtaining of account from the bankers, account receivables and account payables and reconciling with relevant balances in books of account; confirming amounts of outstanding income and

expenses by preparing reconciliation statements, etc. These are helpful in the detection of unusual state of affairs and mistakes in accounts.

Example:

The auditor of the company has discovered a fall in the GP ratio while comparing the gross profit ratio of the current year with that of the previous year. Hence, it became necessary for the auditor to make further enquiries as it may be due to pilferage of inventories/ misappropriation of a part of the sale proceeds/ a change in the cost of sales without a corresponding increase in the sales price.

Likewise, on examining the balances of sundry account receivables and account payables by obtaining the confirmation of their statements of account, it will be possible for the auditor to find out whether the discrepancy in the balance of an account receivable is due to the failure to debit his account with the cost of goods supplied to him or is the result of non-adjustment of a remittance received from him.

Also whether in the case of account payable, the discrepancy is due to failure to afford him credit for one or more consignments of goods supplied by him or failure to debit him with an amount of remittance.

Similarly, by taking inventories of raw materials and stores at the end of the year any excesses or shortages therein shall be detected. The investigation of their causes might disclose that the shortages were the result of a misappropriation of inventory or that the excess were due to requisitions having been entered before the inventories were issued.

In the same way, by reconciling the amounts of interest and dividends collected with the amounts which had accrued due and that which are outstanding for payment, the mistake, if any, in the adjustment of such an income would be detected.

The overall tests can be extended for making inter-firm and intra-firm comparison of trading results.

For example, if balances included in the Statement of Profit and Loss of an entity are compared with those contained in the Statement of Profit and Loss for the same period of another entity engaged in the same trade and working under similar circumstances, it would be possible to find out the cause of the variation in the rate of profitability that exists.

Similarly, it would also be possible to compare the balances on the Statement of Profit and Loss with that of the previous period, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years. By setting up certain expenses ratios on the basis of balances included in the Statement of Profit and Loss, for the year under audit, comparing them with the same ratios for the previous year, it is possible to ascertain the extent of increase or decrease in various items of expenditure in relation to sales and that of trading profit in relation to sales. If differences are found to be material, the auditor would ascertain the reasons thereof and assess whether the accounts have been manipulated to inflate or suppress profits.

An abnormal fall in the cost of manufacture or that in the administrative cost, apart from economy in expenses, there could be no provision or less provision for expenses incurred in the year. When it is suspected, the auditor should compare the entries in the outstanding book with those in the previous year. He must also check the vouchers for one month immediately before the close of the following years. To verify that none of the expenses in the accounts under audit have been charged to the accounts of the following years.

Often it is possible to independently verify the correctness of some of the items of expenses included in the Statement of Profit and Loss.

For instance the cost of importing goods which are subjected to an ad valorem duty at uniform rate can be verified from the amount of duty paid. Similarly, a quantity of sugar sold by a sugar mill can be verified independently from the amount of excise duty paid.

Similarly, the amount of any income or expenses which has a direct relationship with the amount of profits or that of sales can be verified independently, e.g., commission paid to a manager calculated on the basis of net profits, commission paid to a selling agent as percentage of sales, etc. Such calculation of ratios, trends and comparisons is also termed as analytical review.

	Thus, it is important to note that Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.
Q7.	Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Explain stating the techniques available as substantive analytical procedures **(RTP, May 2018, NA) (MTP1, Nov 2019, 3 Marks)** **OR** Explain techniques available as substantive analytical procedures. **(SA, May 2018, 5 Marks) (RTP, May 2019, NA) (SA, Jan 2021, 3 Marks)** **OR** The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Explain clearly stating the techniques available as substantive analytical procedures. **(MTP1, Nov 2018, 5 Marks)** **OR** The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. In this context, discuss the techniques available as Substantive Analytical Procedures. **(RTP, May 2021, NA)** **OR** While applying the Substantive Analytical Procedures what techniques can be used by the statutory auditor of a company to obtain sufficient and appropriate audit evidence? **(MTP1, May 2022, 4 marks)**
	Techniques available as substantive analytical procedures: The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Substantive analytical procedures generally take one of the following forms: ● **Trend analysis:** Trend analysis is the most commonly used technique which involves comparison of current data with the prior period balance or with a trend in two or more prior period balances. The auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change. ● **Ratio analysis:** Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry. For example, Financial ratios may include: ➢ Trade receivables or inventory turnover ➢ Freight expense as a percentage of sales revenue ● **Reasonableness tests:** Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts. ● **Structural modelling:** A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear

	regression). The statutory auditor may use any of the above mentioned techniques while applying substantive analytical procedures depending upon the availability of data and requirements of the case.
Q8.	CORRECT/INCORRECT A modelling tool constructs a statistical model from financial data only of prior accounting periods to predict current account balances. **(MTP1, May 2018, 2 marks) (MTP1, May 2019, 2 marks)**
	Incorrect: A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).
Q9.	CORRECT/INCORRECT When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. **(MTP1, May 2018, 2 marks) (MTP1, May 2019, 2 marks)** **OR** When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement. **(RTP, Nov 2020, NA)**
	Correct: When we are designing audit procedures to address an inherent risk or "what can go wrong", we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. When inherent risk is higher, we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.
Q10.	The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, explain the factors that are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures. **(MTP1, May 2018, 5 marks) (MTP2, Nov 2018, 5 marks)**
	The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures: i) **Source of the information available.** For example, information may be more reliable when it is obtained from independent sources outside the entity; ii) **Comparability of the information available**. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products; iii) **Nature and relevance of the information available.** For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and iv) **Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity.** For example, controls over the preparation, review and maintenance of budgets.

	The auditor may consider testing the operating effectiveness of controls, if any, over the entity's preparation of information used by the auditor in performing substantive analytical procedures in response to assessed risks. When such controls are effective, the auditor generally has greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The operating effectiveness of controls over non-financial information may often be tested in conjunction with other tests of controls. For example, in establishing controls over the processing of sales invoices, an entity may include controls over the recording of unit sales. In these circumstances, the auditor may test the operating effectiveness of controls over the recording of unit sales in conjunction with tests of the operating effectiveness of controls over the processing of sales invoices. Alternatively, the auditor may consider whether the information was subjected to audit testing. SA 500 (Revised) establishes requirements and provides guidance in determining the audit procedures to be performed on the information to be used for substantive analytical procedures.
Q11.	While performing analytical procedures on financial statements of ABC Ltd., auditor identifies fluctuations or relationships that are inconsistent with other relevant information and also that differs from expected values by a significant amount, the auditor seeks your advise as to how should he proceed **(MTP2, May 2018, 5 marks)** **OR** If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, explain how would the auditor investigate such differences. **(RTP, May 2019, NA) (RTP, May 2022, NA)** **OR** The statutory auditor of ABC Ltd., CA Raj identifies certain inconsistencies while applying analytical procedures to the financial and non-financial data of ABC Ltd. With reference to SA 520 on "Analytical Procedures", how CA Raj shall investigate such differences? **(SA, July 21, 3 Marks)**
	If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by: ● **Inquiring of management and obtaining appropriate audit evidence relevant to management's responses:** Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit. ● **Performing other audit procedures as necessary in the circumstances:** The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate. **Conclusion:** In the given question, the auditor identifies certain inconsistencies while applying analytical procedure to financial or non financial data of the company. The auditor should inquire the management of the company and obtain sufficient and appropriate audit evidences relevant to the management response. Further the auditor should also perform other audit procedures, if required in the circumstances of the case to obtain further sufficient and appropriate evidence.
Q12.	Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Explain **(RTP, Nov 2018, NA) (MTP2, May 2019, 4 Marks)**

	Substantive Analytical Procedure: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated. In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.
Q13.	The relationships between individual financial statements items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities. Analyse and Explain **(RTP, Nov 2018, NA)**
	The relationships between individual financial statements items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities; for example, in many public sector entities there may be little direct relationship between revenue and expenditure. In addition, because expenditure on the acquisition of assets may not be capitalized, there may be no relationship between expenditures on, for example, inventories and fixed assets and the amount of those assets reported in the financial statements. Also, industry data or statistics for comparative purposes may not be available in the public sector. However, other relationships may be relevant, for example, variations in the cost per kilometer of road construction or the number of vehicles acquired compared with vehicles retired.
Q14.	CORRECT/INCORRECT Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time **(MTP1, Nov 2018, 2 marks)**
	Incorrect: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. SA 520, "Analytical Procedures" establishes requirements and provides guidance on the application of analytical procedures during an audit
Q15.	CORRECT/INCORRECT Ratio analysis is a commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances. **(MTP2, Nov 2018, 2 marks)**
	Incorrect: Trend analysis is the most commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances. The auditor evaluates whether the

	current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change. Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts.
Q16.	CORRECT/INCORRECT When we are designing audit procedures to address an inherent risk or “what can go wrong”, we do not consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. **(MTP2, Nov 2018, 2 marks)**
	Incorrect: When we are designing audit procedures to address an inherent risk or “what can go wrong”, we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. When inherent risk is higher, we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.
Q17.	Which of the following is correct : a) As per the Standard on Auditing (SA) 520 “Analytical Procedure” ‘the term “analytical procedures” means evaluations of financial information through analysis of financial data. b) As per the Standard on Auditing (SA) 520 “Analytical Procedure” ‘the term “analytical procedures” means evaluations of financial information through analysis of non-financial data. c) As per the Standard on Auditing (SA) 520 “Analytical Procedure” ‘the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. d) As per the Standard on Auditing (SA) 520 “Analytical Procedure” ‘the term “analytical procedures” means evaluations of financial information through ratio analysis. **(MTP1, May 2019, 1 Mark)**
	Correct answer: (c) As per the Standard on Auditing (SA) 520 “Analytical Procedure” ‘the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.
Q18.	Which of the following statement is correct : a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time b) Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time c) Substantive analytical procedures are generally more applicable to small volumes of transactions that tend to be predictable over time d) None of the above **(RTP, Nov 2019, NA)**
	Correct answer: (a)Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time
Q19.	Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis. Analyse and Explain stating clearly the meaning of analytical procedures

(RTP, Nov 2019, NA)

Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis in addition to reasonable tests. These collectively are known as overall tests.

With the passage of tests, analytical procedures have acquired a lot of significance as substantive audit procedures. SA-520 on Analytical Procedures discusses the application of analytical procedures during an audit.

Meaning of Analytical Procedures.

As per the Standard on Auditing (SA) 520 "Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Q20. Give examples of Analytical Procedures having consideration of comparisons of the entity's financial information

(RTP, Nov 2019, NA)

Examples of Analytical Procedures having consideration of comparisons of the entity's financial information with are:

- Comparable information for prior periods.
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
- Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry

Q21. which of the following is correct :

a) Different types of analytical procedures provide different levels of assurance.
b) Different types of analytical procedures provide similar levels of assurance.
c) Similar type of analytical procedures provide different levels of assurance.
d) All are correct

(MTP1, Nov 2019, 2 Marks)

Correct answer: (a) Different types of analytical procedures provide different levels of assurance.

Q22. CORRECT/INCORRECT

The auditor's substantive procedure at the assertion level means substantive analytical procedures only.

(SA, Nov 2019, 2 Marks)

Incorrect:

The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedure, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.

Q23. CA A, auditor of ABC Ltd. wants to design substantive analytical procedure and for that he wants to check whether the data is reliable or not. Mention the relevant points which he has to consider whether data is

	reliable for purpose of designing the substantive analytical procedures. **(SA, Nov 2019, 3 Marks)**
	The following are the relevant points while determining whether data is reliable for purposes of designing substantive analytical procedures: ● **Source of the information available.** For example, information may be more reliable when it is obtained from independent sources outside the entity. ● **Comparability of the information available.** For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products. ● **Nature and relevance of the information available.** For example, whether budgets have been established as results to be expected rather than as goals to be achieved. ● **Controls over the preparation of the information** that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.
Q24.	Statement I As per the Standard on Auditing (SA) 520 “Analytical Procedures”, the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among financial data. Statement II Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. a) Only Statement I is correct b) Only Statement II is correct c) Both statements are correct d) Both Statements are incorrect **(RTP, May 2020, NA)**
	Correct answer: (b) Only Statement II is correct
Q25.	Which of the following is not an example of Analytical Procedures having consideration of comparisons of the entity’s financial information: a) Comparable information for prior periods. b) Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation. c) Similar industry information, such as a comparison of the entity’s ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry. d) Among elements of financial information that would be expected to conform to a predictable pattern based on the entity’s experience, such as gross margin percentages. **(RTP, May 2020, NA)**
	Correct answer: (d) Among elements of financial information that would be expected to conform to a predictable pattern based on the entity’s experience, such as gross margin percentages.
Q26.	CORRECT/INCORRECT In the planning stage, analytical procedures would not in any way assist the auditor. **(RTP, May 2020, NA)**
	The statement is incorrect. In the planning stage, analytical procedures assist the auditor in understanding the client’s business and in

	identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.
Q27.	Explain the commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances. **(RTP, May 2020, NA)**
	<u>Trend analysis</u> Trend analysis is the most commonly used technique is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. The auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change. Trend analysis implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years. For example, the auditor may compare the rent paid by the company during the year under audit with the rent paid by the company for several earlier years. There may be some percentage increase in the rent expense over the years. However, an unusual increase in such expense amounts may indicate that fraudulent payments are being made.
Q28.	When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Explain the other relevant points in this context. **(RTP, May 2020, NA)**
	When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall: ● Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions; ● Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation; ● Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and ● Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.
Q29.	Auditor Compares Gross Profit Ratio with that of Previous year and it is discovered that there has been a fall in the ratio. This is an example of : a) Analytical Procedure b) Test of Controls c) Walk Through Test

	d) Audit Sampling **(RTP, Nov 2020, NA)**
	Correct answer: (a) Analytical Procedure
Q30.	CORRECT/INCORRECT If an entity has a known number of employees at fixed rates of pay throughout the period, there would be more need to perform tests of details on the payroll. **(RTP, Nov 2020, NA)**
	Incorrect. If an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll.
Q31.	In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk. Explain **(RTP, Nov 2020, NA)** **OR** Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit. **(MTP2, Nov 2021, 3 Marks)**
	Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase. **Analytical Procedures in Planning the Audit** In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information. For example, analytical procedures may help the auditor during the planning stage to determine the nature, timing and extent of audit procedures that will be used to obtain audit evidence for specific account balances or classes of transactions
Q32.	The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment. Explain **(RTP, Nov 2020, NA)**
	Use of substantive analytical procedures: The substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level. The auditor may inquire of management as to the availability and reliability of information needed to apply substantive analytical procedures, and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided the auditor is satisfied

	that such data is properly prepared.
Q33.	With respect to SA 520 "Analytical procedures", explain the following factors to be considered by the auditor for substantive audit procedures. (i) Account type (ii) Predictability (iii) Nature of Assertion **(SA, Nov 2020, 3 Marks)**
	The auditor should consider the following factors for Substantive Audit Procedures: ● **Account Type** – Substantive analytical procedures are more useful for certain types of accounts than for others. Income statement accounts tend to be more predictable because they reflect accumulated transactions over a period, whereas balance sheet accounts represent the net effect of transactions at a point in time or are subject to greater management judgment. ● **Predictability** – Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable (e.g., between sales and cost of sales or between trade receivables and cash receipts). A predictable relationship is one that may reasonably be expected to exist and continue over time. ● **Nature of Assertion** – Substantive analytical procedures may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations). Predictive analytical procedures using data analytics can be used to address completeness, valuation/ measurement and occurrence.
Q34.	Mention the Analytical Review procedures that may be useful as a means of obtaining audit evidence regarding various assertions relating to Trade receivables, loans and advances. **(RTP, May 2021, NA) (MTP1, Nov 2021, 4 Marks)**
	Analytical Review Procedures: The following analytical review procedures may often be helpful as a means of obtaining audit evidence regarding the various assertions relating to trade receivables, loans and advances- ● comparison of closing balances of trade receivables, loans and advances with the corresponding figures for the previous year; ● comparison of the relationship between current year trade receivable balances and the current year sales with the corresponding budgeted figures, if available; ● comparison of actual closing balances of trade receivables, loans and advances with the corresponding budgeted figures, if available; ● comparison of current year's ageing schedule with the corresponding figures for the previous year; ● comparison of significant ratios relating to trade receivables, loans and advances with similar ratios for other firms in the same industry, if available; ● comparison of significant ratios relating to trade receivables, loans and advances with the industry norms, if available
Q35.	CA Amar wants to verify the payments made by XYZ Ltd. on account of building rent during the FY 2020-21. The rent amounts to Rs.50,000/- per month for the year. The monthly rent payments are consistent with the rent agreement. However, the other companies in the similar industry are paying rent of Rs. 10,000/- per month for a similar location. How will applying the analytical procedures impact the verification process of such rental payments by XYZ Ltd.? **(MTP2, May 2021, 3 Marks)**
	If CA Amar checks in detail the monthly rent payments, he may find that such payments are consistent with the rent agreement i.e. XYZ Ltd. paid Rs. 50,000/- per month as rent and the same is getting reflected in the rent agreement. Here, CA Amar may not be able to find out the inconsistency in the rent payment

with respect to rent payment prevalent in the similar industry for rent of the similar location.

If CA Amar applies analytical procedure i.e. compares the rent payment by XYZ Ltd. with the similar payments made by companies in similar industry and similar area, he will notice an inconsistency in such rent payments as the other companies are paying a very less monthly rent in similar industry for similar area.

However, if CA Amar does not make such comparison and only checks the monthly payments and rent agreement of XYZ Ltd., he would not have found such inconsistency and as such the misstatement may remain undetected.

Q36. For the purposes of the SAs, the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Explain giving examples of both.

(RTP, Nov 2021, NA)

Analytical procedures include the consideration of comparisons of the entity’s financial information with, for example:

- Comparable information for prior periods.
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
- Similar industry information, such as a comparison of the entity’s ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

Analytical procedures also include consideration of relationships, for example:

- Among elements of financial information that would be expected to conform to a predictable pattern based on the entity’s experience, such as gross margin percentages.
- Between financial information and relevant non-financial information, such as payroll costs to number of employees.

Q37. Analysis by computation of ratios includes the study of relationships between financial statement amounts. State Commonly used ratios.

(RTP, Nov 2021, NA)

Analysis by computation of ratios includes the study of relationships between financial statement amounts. Commonly used ratios include:

- Elements of income or loss as a percentage of sales
- Gross profit turnover
- Accounts receivable turnover
- Inventory turnover
- Profitability, leverage, and liquidity

Q38. Whether it is possible to independently verify the correctness of some of the items of expenses included in the statement of profit and loss? Explain with the help of some examples.

(SA, Dec 2021, 3 Marks)

Often it is possible to independently verify the correctness of some of the items of expenses included in the Statement of Profit and Loss.

For instance, the cost of importing goods which are subjected to an ad-valorem duty at uniform rate can be verified from the amount of duty paid.

Similarly, a quantity of sugar sold by a sugar mill can be verified independently from the amount of excise duty/ GST paid. Similarly, the amount of any income or expenses which has a direct relationship with the

	amount of profits or that of sales can be verified independently, e.g., commission paid to a manager calculated on the basis of net profits, commission paid to a selling agent as percentage of sales, etc. Such calculation of ratios, trends and comparisons is also termed as analytical review. Thus, it is important to note that Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.
Q39.	Discuss the matters relevant to the auditor’s evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated. **(RTP, May 2022, NA)**
	Matters relevant to the auditor’s evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include: (i) **The accuracy with which the expected results of substantive analytical procedures can be predicted.** For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising. (ii) **The degree to which information can be disaggregated.** For example, substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole. (iii) **The availability of the information, both financial and non-financial.** For example, the auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures. If the information is available, the auditor may also consider the reliability of the information.
Q40.	_____________ implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years. (a) Trend analysis (b) Ratio analysis (c) Structural modelling (d) Account fluctuations analysis **(MTP1, May 2022, 1 mark)**
	Correct answer: (a) Trend analysis