

Chapter 8 : Analytical Procedures
Compilation of Important ICAI Question Answers
As discussed in Revision class:
<https://www.youtube.com/watch?v=UuDgvSTlbs>

Question

Discuss the techniques available as Substantive Analytical Procedures.(5 Marks) (May 2018) (Jan,21)

Answer: 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 — A 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. We evaluate 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.

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).

Question : 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. (Nov., 2019) (3 Marks)

Answer : The following are the relevant points while 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 specialized 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.
- 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.

Question : 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. (Nov. 2020) 3 Marks)

Answer

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.

Question 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? **(July 2021) (3 Marks)**

Answer

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:

- (i) 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.
- (ii) 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 present case CA Raj identifies certain inconsistencies while applying analytical procedure to financial or non-financial data of ABC Ltd. CA Raj should inquire the management of ABC Ltd, and obtain sufficient and appropriate audit evidences relevant to the management response. Further CA Raj should also perform other audit procedures, if required in the circumstances of the case to obtain further sufficient and appropriate evidence.

Question

Define Analytical Procedures.

Answers

- 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.
- Thus, analytical procedures include the consideration of comparisons of the entity's financial information with as well as consideration of relationships.
- Analytical Procedures may be segregated into the following major types:
 - ◆ as comparison of client and industry data,
 - ◆ comparison of client data with similar prior period data,
 - ◆ comparison of client data with client-determined expected results,
 - ◆ comparison of client data with auditor-determined expected results and
 - ◆ comparison of client data with expected results, using non financial data.

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Question : Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit.

Answer

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.

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.

Question: What are the objectives of Auditor as per SA 520?

Answer: The objectives of the auditor are:

- (a) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
- (b) 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.

Question: DISCUSS HOW AUDITOR SHALL DETERMINE SUITABILITY OF PARTICULAR ANALYTICAL PROCEDURES FOR GIVEN ASSERTIONS

Answer:

- ◆ 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

Question: What are 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?

Answer: EVALUATION OF WHETHER THE EXPECTATION IS SUFFICIENTLY PRECISE:

(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.