

Lry

Ch-8 (SA 520)

Analytical Procedures

1) Meaning! Analytical Procedures means evaluation of financial information through analysis of expected relationships among both financial & non financial data.

Analytical Procedures also encompass (covers) such investigation as is necessary for identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

2) Nature of analytical Procedures

- Information for prior period
 - Anticipated results of entity - budget, forecast etc.
 - Similar industry information - entity's ratio of sales to A/cs rel. with industry avg.
- } AP having consideration of comparison
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- Expected to confirm a predictable pattern
Eg: Gross Margin %
 - B/w financial information & relevant non financial information
Eg: Payroll cost, no. of employees
- } AP having consideration of relationship

3) Purposes & timings of AP

AP uses comparisons & relationships to assess whether account balances or other data appear reasonable.

Objectives of Auditor

- 1) To obtain relevant & reliable Audit evidence when using substantive AP (enumeration stage)
- 2) To design & perform AP near the end of audit that assist overall conclusion as to whether FS are consistent of auditor's understanding of entity (reporting stage)

4) Timings of Analytical Procedure

At Planning Stage	While performing Audit	Near the end of audit
<ul style="list-style-type: none">→ Auditor's obtain understanding about client client business & identifies Risk (ROMM)→ Helps in determining the N.T.E of procedure	<ul style="list-style-type: none">→ Assertion level may be TOB, substantive AP or both.→ Based on auditor's judgement expected effectiveness & efficiency→ Reduce audit risk at the assertion level to an acceptably low level.→ Inquiry of mgt. as to reliability & info.	<ul style="list-style-type: none">→ Forming an overall conclusion as to whether FS are consistent with understanding of audit.

5) Analytical procedure that assist when forming an overall conclusion

- Intended to corroborate conclusions
- Assist reasonable conclusions base to auditor's opinion
- Results may identify a previously unrecognized ROMM
- SA 3315 require to revise auditor's assessment of ROMM & materiality as per SA 320
- Modify further planned audit procedures
- May be similar to those that would be used as risk assessment procedures

6) Factors to be considered for substantive analytical audit procedure

i) Availability of data:

Reliable & relevant data will facilitate effective procedures

ii) Disaggregation:

Degree of disagreement directly affect degree of usefulness in data

iii) Account type:

More useful for certain types of accounts than others.

Income statement A/c's → more predictable (reflect accumulated transaction over a period)

Balance sheet A/c's → Net effect of transactions (greater mgt. judgement)

Eg: Payroll, Rent, Dep. = ✓
PP&E = X

iv) Nature of Assertion:

Substantive AP → may be more effective in providing evidences

Predictive AP → Used to address completeness, valuation & occurrence.

v) Predictability:

More appropriate → account balance or relationship b/w items of data are predictable.
Predictable relationship → Reasonably expected to exist or continue over time.

vi) Source:

Similar transactions (through routine process) → more predictable

Non-routine transactions or estimations → Difficult to predict

vii) Inherent risk or "what can go wrong":

Nature of ROMM is considered in order to determine if SAP can be used to obtain audit evidence.

Inherent Risk ↑ - design TOB to address higher IR

- When significant risk is identified, audit evidence obtained solely from SAP is unlikely to be sufficient.

7) Techniques available as SAP (Substantive Audit Procedures)

Design of SAP is limited only by the availability of relative data of experience & certainty.

Trend Analysis	Ratio Analysis	Reasonableness Tests	Structural Modelling
<ul style="list-style-type: none"> - Comparison of current data with prior period data. - Current bal. A/c within line with trend establishment with previous bal. A/c. 	<ul style="list-style-type: none"> - Analysis of assets & liab. A/c as well as revenue & Expense A/c - Individual B/S difficult to predict but relationship to another A/c often more predictable 	<ul style="list-style-type: none"> - Does not rely on events of prior period but upon non financial data audit period under consideration. - Tests generally more applicable to Income Statement A/cs & certain Accrual & Prepayment A/c 	<ul style="list-style-type: none"> - Modelling tool construct a statistical model from financial / non-financial data of - Prior A/c period to predict current A/c balances. (eg. linear regression) <p style="border: 1px solid black; display: inline-block; padding: 2px;">Not effective</p>

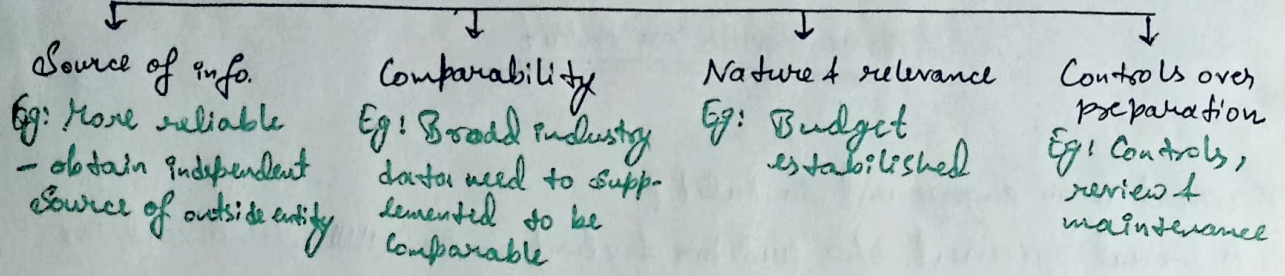
8) Analytical Procedures used as substantive test

- 1) Determine the suitability of particular substantive AP for given assertions taking A/c of assessed ROMM & TOB.
- 2) Evaluate Reliability of data, taking source, comparability & nature & relevance of info available & control over preparation which the auditor's expectation to record amounts.
- 3) Develop & ~~expectation~~ expectation of recorded amounts & ratios, evaluate whether expectation is sufficiently precise to identify a misstatement.
- 4) Determine amount of any difference of recorded amounts from expected values that is acceptable without further statement.

9) Suitability of Particular AP for given assertions: (Imp. for CIA)

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|---|--|--|
| <ul style="list-style-type: none"> - Large volume transactions tend to be predictable over time. - Continue in absence of known condition of contrary as data expectation exists. | <ul style="list-style-type: none"> - Unsophisticated records predictive mode may be effective as an AP | <ul style="list-style-type: none"> - Different AP provide different level of assurance. <p>Eg: Rent rates, no. of apartment & vacancy rates</p> |
|---|--|--|

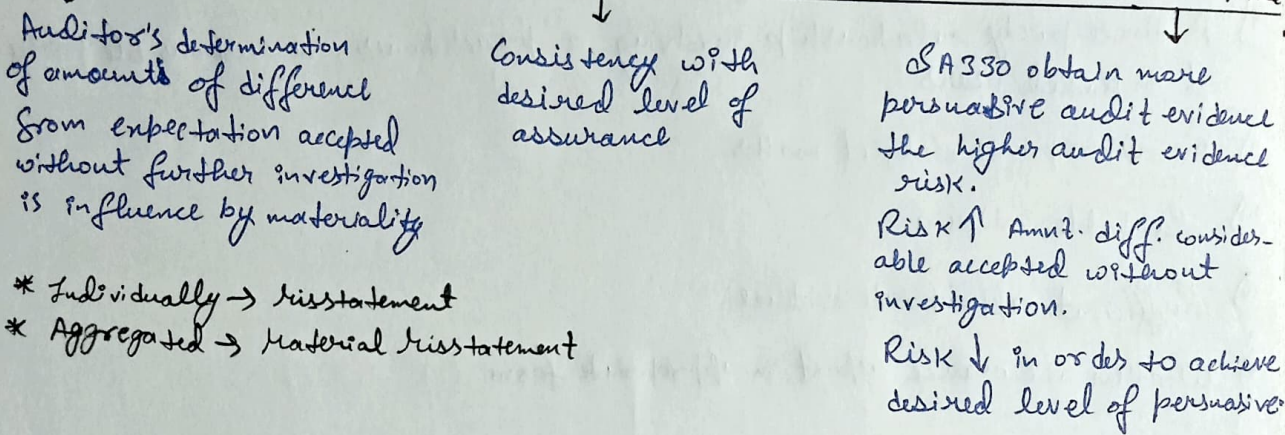
10) Extent of reliance on AP



11) Evaluation on whether the expectation is sufficiently precise

- i) Accuracy with which the expected results SAP can be predicted
Eg: Rent / Payroll - better vs PPE
- ii) The availability of information, both financial & non financial
- iii) The degree to which information can be disaggregated.

12) Amount of diff. of recorded amount from expected values that is acceptable



13) Investigating results of AP

- i) Inquiry of mgmt. to obtain appropriate audit evidence relevant to mgmt. responses.
- ii) Performing other audit procedures as necessary in the circumstances