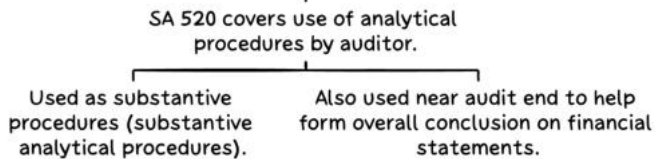


Analytical Procedures (SA 520)

Scope of SA 520

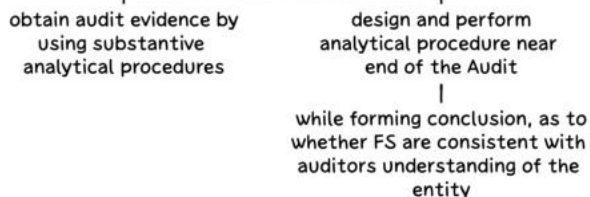


The auditor compares the monthly sales figures with the previous year's figures to identify any significant variances that might indicate misstatements in revenue.

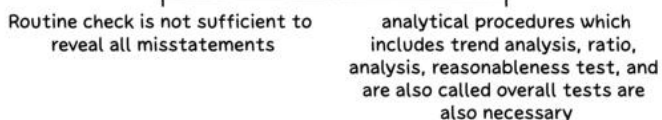
At the end of an audit, the auditor has gathered a substantial amount of evidence about individual accounts and transactions. However, to form an overall opinion on whether the financial statements present a true and fair view, they need to step back and look at the big picture.

Example - Profitability Trends: Are profits increasing, decreasing, or remaining stable? Does this align with industry trends or the company's own strategic initiatives?

Objective of auditor as per SA 520

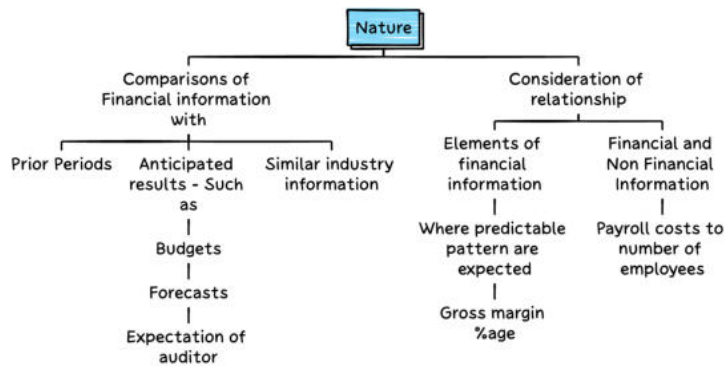
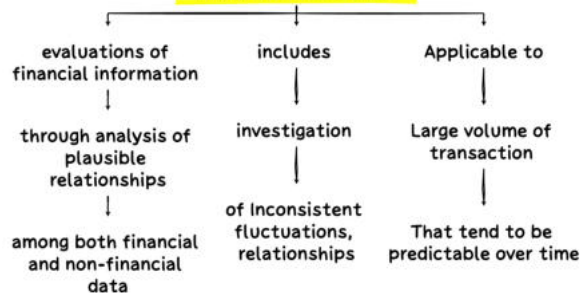


Need for analytical procedures

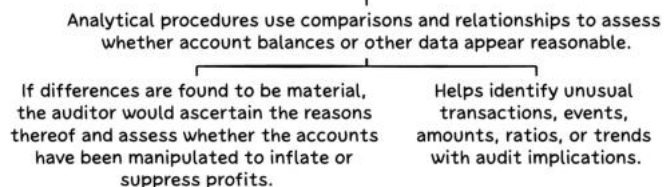


What is the meaning of Analytical Procedures?

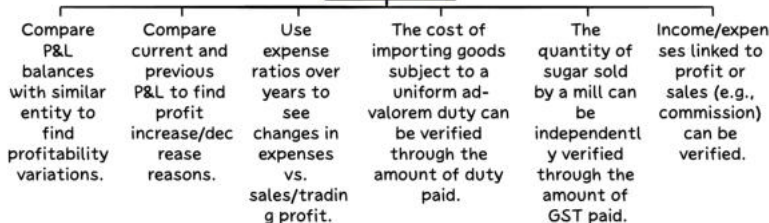
Analytical Procedures



Purpose of AnPro

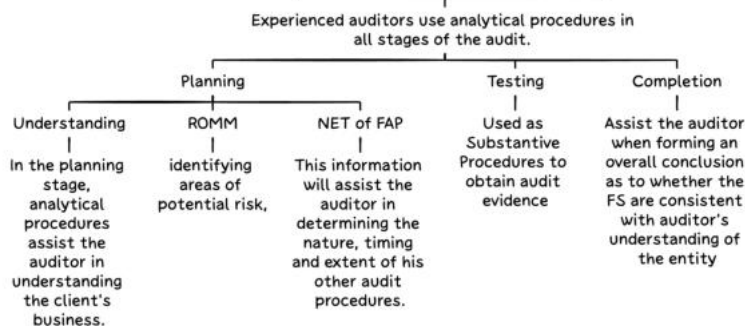


Few Examples



The process of calculating ratios, trends, and comparisons is also known as analytical review.

Timing of Analytical Procedures



Substantive Analytical Procedures

Auditor's substantive procedures at the assertion level may include:

- Tests of details
- Substantive analytical procedures
- A combination of both

Procedure choice: Based on effectiveness and efficiency in reducing audit risk.

Management data: Auditors may inquire about and use management's analytical data if reliable.

Factors to be considered for using Analytical Procedures as Substantive Audit Procedures

The auditor should consider the following factors for Substantive Audit Procedures:

Availability of Data

The availability of reliable and relevant data will facilitate effective analytical procedures.

Disaggregation

The degree of disaggregation in available data can directly affect the degree of its usefulness in detecting misstatements.

Account Type

- Substantive analytical procedures – more useful for certain account types.
- Income statement accounts – more predictable – reflect accumulated transactions over a period.
- Balance sheet accounts – less predictable – show net effect at a point in time or involve more management judgement.

Source – Type of class of transactions

Some transaction classes more predictable – consist of numerous, similar transactions. Non-routine and estimation SCOTs (Significant Classes of Transactions) involve management judgement – harder to predict.

- Example: Daily retail sales transactions that follow consistent patterns, like grocery store purchases which are high volume and regular
- Example: One-time business restructuring costs that management decides how to classify and when to record
- Example: Warranty liability provisions where management must estimate future claims based on assumptions about failure rates and repair costs

Predictability

- Substantive analytical procedures suit predictable account balances or data relationships.
- Examples: sales vs. cost of sales, trade receivables vs. cash receipts.
- Predictable relationship: reasonably expected to exist and continue over time.

Example: Sales and cost of sales usually increase or decrease together – this makes the relationship predictable.

Nature of Assertion

- Substantive analytical procedures are more effective for completeness or valuation than rights and obligations.
- Predictive analytical procedures (using data analytics) help check completeness, valuation/measurement, and occurrence.
- Completeness – helps check if all sales are recorded.
- Valuation – shows unusual fluctuations in asset/liability values affecting other items.

Nature of Assertion – Explained with Examples

- Example: Easier to check if all sales are recorded (completeness) than to check ownership of assets (rights).
- Example: Using trends to confirm if all expenses occurred or were recorded correctly.
- Example – if sales trend shows ₹10 lakhs monthly but only ₹6 lakhs recorded – indicates missing sales.
- Example: Sudden drop in inventory value may affect cost of sales or profits – needs investigation.

Inherent Risk or "What Can Go Wrong"

- While designing procedures for inherent risk or "what can go wrong", assess the nature of risk.
- If suitable, use substantive analytical procedures for audit evidence.
- Higher inherent risk → design tests of details.
- For significant risks, analytical procedures alone are not sufficient.
- Example (Nature of Risk): If management bonuses are linked to profit, there's a risk they may overstate revenue – assess this risk before using analytical procedures.
- Example: Rent expense is fixed monthly – trend analysis can give sufficient evidence.
- Example: For inventory prone to theft, verify physical stock instead of relying on trends.
- Example: For revenue fraud risk, also check invoices and contracts, not just sales trends.

DPQ – CA M, auditor of a company, has planned to use substantive analytical procedures during course of audit. In this regard, he has decided to use such procedures in following areas: –
For testing relationship between sales and cost of sales
For testing rights over certain assets forming part of account balances
Comment upon his approach along with reasons
(ICAI MTP 2 Sep 24 – 4 Marks)