

SA 520 "Analytical Procedures"

Analytical Procedures" means

- **evaluation of financial information**
- through **analysis of relationships** among both financial & non-financial data

Objective

- To obtain **relevant & reliable AE** when using SAP; &
- To **design & perform AP** near end of audit that assist auditor when forming an overall conclusion as to whether F.S. are consistent with auditor's understanding of entity.

Substantive Analytical Procedures (SAP)

When designing & performing SAP, either alone or in combination with tests of details, as substantive procedures as per SA 330, auditor shall:

- Determine suitability** of particular SAP for given assertions, taking account of assessed ROMM & tests of details, for these assertions;
- Evaluate reliability** of data from which auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, & nature & relevance of info. available, & controls over preparation;
- Develop expectation** of recorded amounts or ratios & evaluate whether expectation is sufficiently precise to identify misstatement that, may cause FS to be materially misstated; and
- Determine amount of any difference of recorded amt. from expected values** that is acceptable without further investigation.

Suitability of Particular AP for Given Assertions

- SAP are **more applicable to large volumes of transactions** that tend to be predictable over time.
- In some cases, **unsophisticated predictive model** may be effective as AP.

For ex: where an entity has known no. of employees at fixed rates of pay throughout period, it may be possible for auditor to use this data to estimate total payroll costs for period with a high degree of accuracy, thereby providing AE for a significant item in FS & reducing need to perform tests of details on payroll.

- Different types of analytical procedures** provide different levels of assurance.

For ex: prediction of total rental income on building divided into apartments, taking rental rates, no. of apartments & vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified. In contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may provide less persuasive evidence, but may provide useful corroboration if used in combination with other audit procedures.

4. Determination of **suitability of SAP is influenced by -**

- ❖ **nature of assertion &**
- ❖ **auditor's assessment of ROMM**

For ex: if controls over sales order processing are weak, auditor may place more reliance on tests of details rather than on SAP for assertions related to receivables.

5. **Particular SAP may be considered suitable** when tests of details are performed on same assertion.

For ex: when obtaining AE regarding valuation assertion for accounts receivable balances, auditor may apply AP to aging of customers' accounts in addition to performing tests of details on subsequent cash receipts to determine collectability of receivables.

Following factors affects the Reliability of Data

- ❑ **Source of info. available:** For ex: info. may be more reliable when it is obtained from independent sources outside entity;
- ❑ **Comparability of info. available:** For ex: broad industry data may need to be supplemented to be comparable to that of entity that produces & sells specialised products;
- ❑ **Nature & relevance of info. available:** For ex: whether budgets have been established as results to be expected rather than as goals to be achieved; &
- ❑ **Controls over preparation of info:** That are designed to ensure its completeness, accuracy & validity. For ex: controls over preparation, review & maintenance of budgets.

AP that Assist When Forming Overall Conclusion

Conclusions drawn from results of AP designed and performed in accordance with, are intended to corroborate conclusions formed during audit of individual components or elements of FS. This assists auditor to draw reasonable conclusions on which to base auditor's opinion. Results of such AP may identify a previously unrecognised ROMM. In such circumstances, SA 315 requires auditor to revise auditor's assessment of ROMM & modify planned FAP.

Investigating

If the auditor identifies fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by significant amt., he shall investigate such differences by:

- Inquiring of Mgt. & obtaining appropriate AE relevant to Mgt. responses:** AE relevant to Mgt. responses may be obtained by **evaluating those responses** taking into account auditor's understanding of entity & its environment, & with other AE obtained during course of audit.
- Performing other AP as necessary in circumstances:** Need to perform other AP may arise when,
 - Mgt. is unable to provide explanation, or
 - explanation, together with AE obtained w.r.t Mgt. response, is not considered adequate.

Techniques for AP

- Trends
- Ratios
- Reasonableness of amounts
- Structural modelling - to predict current a/c balances