

2.2.11 Advantages and Disadvantages of Audit Programme

■ Advantages

- (i) Provides clear set of instructions to the assistant regarding the work to be done.
- (ii) It focuses on total perspective of the work to be done.
- (iii) Audit programme helps to plan the audit work rationally — enables the auditor to select best assistants dedicated to the work.
- (iv) Under a properly framed audit programme, the work is conducted systematically without ignoring or overlooking important areas.

■ Disadvantages

- (i) There is a possibility that the work may become mechanical without understanding the objects of auditing by the assistants.
- (ii) A strict audit programme may kill the innovativeness of the staff while conducting the audit.
- (iii) Old and repetitive audit programme if followed by the current audit team may be obsolete and useless.

2.2.12 Construction and Developing of an Audit Programme

Following points to be kept in mind while framing an audit programme :

- (a) co-ordinate the procedures to be applied to related items.
- (b) stay within the scope and limitation of the audit assignment.
- (c) consider all possibilities of error and manipulation.
- (d) select best evidence from the basket of evidence available.
- (e) apply only those steps and procedures which are useful for conducting the audit.

2.2.13 Developing an Effective Audit Programme

In order to develop an effective audit programme the auditor should initiate for :

- (a) **Written audit programme :** It is important to have a written audit programme which is to be distributed to the assistants and being useful for a documentary evidence and review mechanism.
- (b) **Audit Planning :** The planning of audit should be incorporated in audit programme. The steps of planning should be reflected in audit programme in order to frame overall audit strategy.
- (c) **Audit Objectives :** The programme should contain audit objectives covering each area of audit and should have sufficient instructions for the assistants in order to conduct the audit fruitfully.
- (d) **Timeframe of audit procedures :** The audit programme may highlight the time frame for conduction of individual and distinct audit areas. This will be helpful for the audit assistants to complete the audit on a time scale.
- (e) **Reliance on Internal Control :** In preparing an audit programme the audit may or may not rely on the accounting system and related internal control mechanism

followed by the entity. The degree of reliance should be reflected in framing the audit programme. Other factors like time limit programme, other factors like time limit, number of assistants, audit fees, clients assistance and cooperation etc. also influence the framing of audit programme.

2.2.14 Periodic Review of the Audit Programme

There should be periodic review of the audit programme to assess whether the programme set before is still effective or not. Otherwise the programme will be obsolete.

2.3 Audit Documentation

SA 230 deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. Audit documentation refers to the working papers prepared and maintained by the auditor to show that the audit work has been done as per the standard on auditing.

2.3.1 Nature, Purpose and Examples of Audit Documentation

Nature :

Audit documentation that meets the requirements of this SA and the specific documentation requirements of other relevant SAs are of following nature :

- (a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor and
- (b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements [Para 2 of SA 230]

Purpose : Audit documentation serves the following purposes

- (i) To assist the engagement team to plan and perform the audit.
- (ii) It acts as an evidence that the auditor was not negligent.
- (iii) Retaining a record of matters of continuing significance to future audits.
- (iv) Enabling the conduct of external inspections in accordance with applicable legal, regulatory and other requirements.
- (v) It can also be used to form conclusions on financial statements. [Para 3 of SA 230]

2.3.2 Examples of Audit Documents

Audit documentation may be recorded on paper or on electronic form. Some examples are :

- (a) Copy of audit programme
- (b) Analysis sheets
- (c) Summaries of significant matters
- (d) Checklists
- (e) Letters of confirmation representation
- (f) Correspondence (including email) concerning significant matters.
- (g) Copies of significant contracts and agreements.

2.3.3 Definition of Audit Documentation

As per SA 230 audit documentation is defined as "the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached".

2.3.4 Form, Content and Extent of Audit Documentation

The auditor shall prepare audit documentation on a timely basis. The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand :

- (i) The nature, timing and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements.
- (ii) The results of the audit procedures performed, and the audit evidence obtained, and
- (iii) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions.

In documenting the nature, timing and extent of audit procedures performed, the auditor shall record :

- (i) The identifying characteristics of the specific items or matters tested
- (ii) Who performed the audit work and the date such work was completed and
- (iii) Who reviewed the audit work performed and the date and extent of such review.

The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

2.3.5 Documentation of Compliance with SAs

In principle, compliance with the requirements of this SA will result in the audit documentation being sufficient and appropriate in the circumstances. Audit documentation provides evidence that the audit complies with SAs. However it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgement made, in an audit. Further, it is unnecessary for the auditor to document compliance with matters for which compliance is demonstrated by documents included within the audit file. For example :

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrated that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.

2.3.6 Audit Working Papers

Definition : As per SA 230 (Revised) "Audit Documentation" Audit working papers are the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditors reached. They are the

- (a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the auditor and

- (b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

2.3.7 Utility of Working Papers

According to SA 230 on "Audit Documentation" working papers helps in planning and performance of the audit, supervision and review of the audit work and provide evidence of the audit work performed to support the auditor's opinion. Besides, audit working papers serve a number of additional purposes such as :

- (i) Helps the audit team to plan and perform the audit.
- (ii) Assists members of the engagement team responsible for supervision to direct and supervise the audit work and to discharge their review responsibilities in accordance with SA 220.
- (iii) Enable the engagement team to be accountable for its work.
- (iv) Retain a record of matters of continuing significance to future audits.

2.3.8 Ownership of Working Papers

Standard on Quality Control (SQC) I, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information and other Assurance and Related Services Engagements" issued by the institute, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed or in the case of assurance engagement the independence of the auditor or of his personnel.

Therefore, working papers are the property of the auditor and he may, at his discretion make portions of or extracts from his working papers to his client.

2.3.9 Custody of Working Papers

The auditor should adopt reasonable care for safe custody and confidentiality of his working papers.

2.3.10 Retention of Working Papers

SA 230 prescribes that audit documentations should be retained for a minimum period of seven years. The Chartered Accountants Act 1949 and regulations made there under, prescribe the minimum period of retention of working papers as seven years.

2.3.11 Audit File

Definition : Audit file refers to one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

Therefore, audit file is maintained for record keeping of specific areas of audits like audit of purchasers, sales or tax audit.

2.3.12 Types of Audit File

Audit files are of two types — permanent audit file and current audit file.

The contents of **permanent audit file** are :

- (i) Information regarding legal and organisational structure of the entity.
 - (ii) Record of the study and evaluation of the internal controls related to the accounting system.
 - (iii) Copies of important legal documents, agreements and minutes relevant to the audit.
 - (iv) Copies of audited financial statements of previous years.
 - (v) Analysis sheets of significant ratios and trends.
 - (vi) Notes regarding significant accounting policies followed by the entity.
 - (vii) Significant audit observations of earlier years.
 - (viii) Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.
- Permanent audit files are to be maintained by the auditor when he/she is conducting audit in the same entity for years or may conduct audit in future year.

2.3.13 Contents of Current Audit File

The current audit file normally includes :

- (i) correspondence relating to acceptance of annual reappointment.
- (ii) Extracts of important matters in the minutes of board meeting.
- (iii) Analysis of transactions related to interested parties.
- (iv) Current planning evidence and audit programme.
- (v) Copies of communications with other auditors, experts and other third parties.
- (vi) A record of the nature, timing and extent of auditing procedures performed and the results of such procedures.
- (vii) Conclusions reached by the auditor concerning significant aspects of the audit.
- (viii) Letters of representation received from the client.
- (ix) Evidence of work performed by the assistants and supervision report.
- (x) Copies of the financial information being reported. Current audit file is mainly concerned with the issues related to current audit assignment.

2.3.14 Advantages of Audit File

- (a) It helps to increase the efficiency of audit procedures.
- (b) It provides ready reference to different items of audit necessary for the purpose of field work in audit engagement.
- (c) It is useful in organising the audit work effectively.

2.3.15 Audit Note Book

It is a physical or electronic diary maintained by the audit staff for the purpose of recording any questionable matter that arises due to course of audit. This note book is an internal arrangement made by the audit staff in order to sought further classification and to investigate those points raised in the minds of the audit staff. It should be noted that audit note book may be considered as integrated part of audit file.

2.3.16 Contents of the Audit Note Book

In general, an audit note book may contain the following items :

- (i) A list of suspected fraud and error found in the books during the course of audit.
- (ii) The structure of financial and administrative organisation.
- (iii) Progress of the audit work.
- (iv) Record of missing vouchers.
- (v) Extracts from correspondence.
- (vi) Information to be needed in future.
- (vii) Audit programme.
- (viii) Details to be included in audit report.
- (ix) Suggestions made by the audit staff for improvement.
- (x) Balance of important ledger accounts.

2.3.17 Advantages of Audit Note Book

- (a) The efficiency of the audit staff can be assessed through this book.
- (b) It enables to prepare audit report.
- (c) It may be placed as documentary evidence before the courts of law.
- (d) This note book will be a great help for a subsequent audit staff who has been replaced in course of audit.
- (e) This note book helps for future reference and guidance and serves as a guide in framing future audit programme.

2.3.18 Audit Memorandum

An audit memorandum is a statement containing all useful information regarding client's business, operations, policies and organisation which are prepared by the auditor for the smooth conduct of the audit work. The objective to prepare this is to record the general information of the business which may help him in conducting the work of audit and to prepare the audit report. Audit memorandum generally include audit manual, audit programme, audit file, internal control questionnaire etc.

The contents of audit memorandum in case the audit made for the first time may include :

- (a) A brief history of the organisation.
- (b) Location of plant and office.
- (c) Principal kinds of products.
- (d) Nature of ownership and control of the business.
- (e) Names of responsible offices and types of their responsibilities.
- (f) Accounting policies and related issues.
- (g) Investment details, tax returns, advertising methods, government reports etc.
- (h) Specific problems raised by the management and their prospective solutions.
- (i) Types of subsidiary companies and their control.

2.4 Audit Evidence

2.4.1 Concept

The concept of audit evidence is based on the explanations given in SA 500 which is named as audit evidence. This standard on auditing explains what constitutes audit evidence in an audit of financial statements and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

2.4.2 Definition of Audit Evidence

As per SA 500 an audit evidence is "the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based." Audit Evidence includes both information contained in the accounting records underlying the financial statements and other information. Other information which the auditor may use as audit evidence includes, for example minutes of the meetings, written confirmation from trade receivables and trade payables, manuals containing details of internal control etc.

2.4.3 Need to obtain Audit Evidence

As auditing is a logical process, the auditor is expected to give an expert opinion about the truth and fairness of the accounts of the client under audit after assessing the actualities of the situation and reviewing the statements of accounts. He is not able to do this unless he obtains appropriate audit evidence for arriving at his judgement. An opinion founded on a rather reckless and negligent examination and evaluation may expose the auditor to legal action with consequential loss of professional reputation and goodwill.

2.4.4 Classification of Audit Evidence

Audit evidences may be classified in two broad categories :

1. Appropriate Audit Evidence
2. Sufficient Audit Evidence

2.4.4.1 Appropriate Audit Evidence

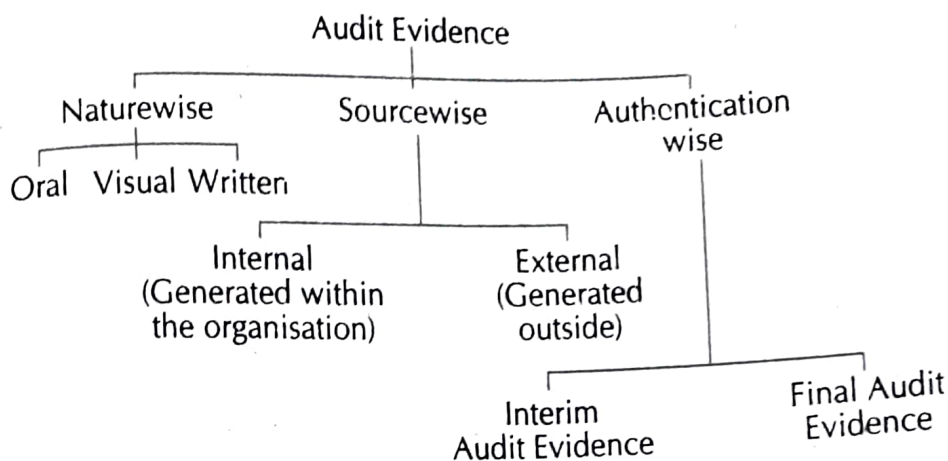
Appropriateness is the measure of the quality of audit evidence; i.e. its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

2.4.4.2 Sufficient Audit Evidence

Sufficiency is the measure of the quantity of audit evidence. Therefore, sufficient audit evidence emphasises what volume or quantity of audit evidence is being obtained by the auditor. The quantity of audit evidence required depends on the auditor's assessment of the risks of misstatement (higher the assessed risks, more audit evidence is required) and also by the quality of such evidence (higher the quality, lesser evidence is required). It can be stated that the concept of sufficiency of audit evidence depends on the auditor's judgement effected by the factors like

- (a) Materiality
- (b) Risk of material misstatement
- (c) Size and characteristics of population

Audit evidence may also be classified in another manner :



2.4.5 Audit Procedures or Techniques to Obtain Audit Evidence

Audit evidence to be obtained by performing

- (a) Risk assessment procedures and
- (b) Further audit procedures.

Risk Assessment procedures refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

Further audit procedures comprise :

- (a) Test of controls, when required by the SAs or when the auditor has chosen to do so, and
- (b) Substantive procedures including tests of details and substantive analytical procedures.

These procedures are based on the following techniques for obtaining audit evidence :

- (i) Inspection
- (ii) Inquiry
- (iii) External Confirmation
- (iv) Recalculation
- (v) Observation
- (vi) Re-performance
- (vii) Analytical Procedure.

■ 2.4.5.1 *Inspection*

Inspection involves examining records or documents, whether internal or external. Inspection of document will show the ownership and value of assets. Inspection of records and documents provides audit evidence of varying degrees of reliability, with respect to their existence.

■ 2.4.5.2 *Inquiry*

Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. It is used extensively throughout the

audit in addition to other audit procedures. Inquiry is conducted to obtain clear understanding about management intension. It may range to formal written inquiries to informal oral inquiries. Evaluating responses to inquiry is an integral part of the inquiry process.

■ 2.4.5.3 External Confirmation

An external confirmation represents audit evidence obtained by the auditor as a direct written response from a third party. External confirmation procedures may be done in paper form or by electronic or other medium. These are relevant when addressing assertions associated with certain account balances and their elements.

■ 2.4.5.4 Recalculation

Recalculation consists of checking the mathematical accuracy of documents or records. It can be performed manually or electronically.

■ 2.4.5.5 Observation

Observation consists of looking at a process performed by others. For example — the auditor's observation of inventory counting by the entity's personnel, or of the performance of the control activities. It provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place.

■ 2.4.5.6 Re-performance

It involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control. For example, reperforming the reconciliation of bank statements.

■ 2.4.5.7 Analytical Procedures

It is comprised of evaluation of financial information using financial and non-financial data. Analytical procedures also include the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate from predicted amount. [Detail of analytical procedures are discussed in latter part of this chapter.]

2.4.6 Routine Checking

Routine checking is the work performed by an auditor in order to see whether the transactions recorded in the books of accounts are proper and whether scientific method has been followed in recording the transactions. It is checking of certain records and books carried on by an auditor as a matter of routine work.

Routine checking involves performance of following functions :

- (i) Checking the posting from the books of original entry to the ledger accounts.
- (ii) To check the correctness of balances and other works relating to the recording of transactions.
- (iii) The posting from the books of original entry to the ledger accounts are checked.
- (iv) Verification is made regarding the principles followed in preparation of trial balance.
- (v) Inspection of various documents in support of specific transactions.

■ 2.4.6.1 Objectives of conducting Routine Checking are :

- (a) Detection of errors and frauds
- (b) Examination of posting of ledger accounts

- (c) Verifying the ledger balances in trial balance
- (d) Examination of correctness of figures.

■ 2.4.6.2 *Advantages and Disadvantages of Routine Checking Advantages :*

- (i) The books and entries can be thoroughly checked and errors and frauds can be easily detected.
- (ii) It is the basis of checking the final accounts.
- (iii) Arithmetical accuracy of the transactions can be checked.
- (iv) It is the simplest form of audit.

Disadvantages

- (i) In modern computerised auditing environment routine checking has lost its relevance. In present days entries are checked by modern auditing software where arithmetical accuracy is automatically confirmed.
- (ii) This audit technique is not capable of detecting sophisticated fraud or errors in principle.

Auditor's Duty

As routine checking is simplest form of audit work, generally it is done by a junior staff. Simple errors and frauds may be detected by applying this technique. Therefore, the auditor should decide the volume of transactions to be checked depending upon time factor and reliability of internal check and internal control in operation in the concern.

2.4.7 Test Checking

■ 2.4.7.1 *Concept and Definition*

In large organisations where voluminous transactions occur during an accounting year, it is not possible for the auditor to go through each and every business transaction in details. It is expensive, time consuming and to some extent not feasible. Therefore, test checking is a substitute for detailed checking. The auditor has to rely on some test checking mechanism which involves selecting and checking only a few transactions for the purpose of arriving at the final judgement. This test checking is traditionally known as selective verification or sampling process. According to Prof. W B Meigs —“Testing and test checking mean to select and examine a representative sample from a large number of similar items.”

It is to be noted that intensive through checking of all transactions does not necessarily eradicate the possibilities of errors and frauds to fullest extent. In other words detailed intensive auditing is not free from any criticism. In contrast, test checking gives almost same results arising from its economy of time and cost of audit. For this reason, the Institute of chartered Accountants of India (ICAI) in statement of Auditing Practices [statement no. 202 (1968)] advocated for adopting test checking mechanism where in the organisation under audit adequate system of internal control is in force.

■ 2.4.7.2 *Advantages and Disadvantages of Test Checking*

Advantages

- (i) Time saving and cost minimisation
- (ii) Ensuring the speed of audit work by minimising the volume of transaction check.

- (iii) If the samples are selected carefully, the audit work will be equally effective like intensive audit.

Disadvantages

- (i) Test checking fails where internal control and check system of the organisation is inoperative or not in force.
- (ii) Test checking is based on selection of representative transactions. Therefore, it is not possible to detect all errors or frauds.
- (iii) Sample selection is most important in order to make test checking successful. Defective sample selection enables failure of test checking.

2.5 Audit Sampling and Auditor's duties

In this respect the standard of Auditing (SA) 530 — Audit sampling may be referred. This SA applies when the auditor has decided to use audit sampling in performing audit procedures. This is a modern technique applied in test checking where the auditor uses statistical and non statistical sampling while selecting the audit sample, performs tests of controls and tests of details and evaluates the results from the sample.

2.5.1 Audit Procedures through Audit Sampling

1. While designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.
2. The auditor shall determine a sample size sufficient to reduce sample risk to an acceptably low level.
3. The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.
4. The auditor shall perform audit procedures, appropriate to the purpose, on each item selected.
5. If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item.
6. If the auditor is unable to apply the designated audit procedures, to a selected item, he shall treat that item as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details.
7. The auditor shall investigate the nature and cause of any deviations or misstatements identified, and evaluate their possible effect on the purpose of the audit procedure and on other areas of audit.

2.5.2 Auditing in Depth

■ 2.5.2.1 Concept and Definition

Auditing in Depth refers to a situation where step by step examination of selected transactions tracing all the links from very beginning to the end takes place. It is an extended form of test checking or selective verification. It assists the auditor in carrying out a test check audit which combines in itself the elements of sampling and procedural check. It is a

method under which a few selective transactions are subjected to a thorough examination for arriving at final judgement – whether the books of accounts exhibit a true and fair view of the state of affairs of the business.

According to Taylor and Perry “Auditing-in-Depth implies the examination of the system applied within a business, entailing the tracing of certain transactions from their origin to their conclusion investigating at each stage the records created and their appropriate authorisation.”

Auditing-in-Depth may be performed through the following steps :

1. Selection of number of transactions to be tested.
2. Actual testing of those selected transactions in depth.
3. Assessment of the testing in order to draw conclusion on the entire transactions.

In order to conduct auditing in depth of a specific transaction, the auditor has to examine thoroughly the different stages of the transaction. The level of efficiency of internal control and check system prevailing in the organisation will be found out through auditing in-depth. The nature, objectives and activities of the business, system of maintenance of records and accounts and internal control and check system should be thoroughly studied before taking up any plan for auditing-in-depth.

■ 2.5.2.2 Advantages & Disadvantages of Auditing-in-Depth

Advantages

1. It is a basis to form an insight into audit
2. It is the best way to study human behaviour in audit organisations.
3. It saves time and cost of audit.
4. Precision in course of audit work can be obtained.

Disadvantages

1. As it depends on selection of specific transactions, it may be fruitless if selection of transaction is wrong.
2. If the conductor of auditing-in-depth is not efficient, the motive of doing this fails.

2.5.3 Analytical Procedure

■ 2.5.3.1 Concept and Definition

As routine checking procedures cannot detect all mistakes or frauds, certain other procedures also have to be applied. In modern times analytical procedures have acquired lot of significance as substantive audit procedure. Standard on Auditing (SA) 520 deals with the analytical Procedures. According to 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.”

To be precise, analytical procedures mean evaluation of financial information through analysis of both financial and non-financial data. Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

■ 2.5.3.2 Purpose of Analytical Procedures

Analytical procedures are used for the following purpose :

1. Helps the auditor to plan his audit.
2. To obtain relevant and reliable audit evidence when using substantive analytical procedures.
3. Enables the auditor to form conclusion or opinion on the financial statements.

■ 2.5.3.3 Timing of Analytical Procedures

Analytical procedures may be applied in the planning phase as well as testing phase and during the completion phase.

Planning Phase < Assist the auditor in understanding clients business
Identifying areas of potential risk

Testing Phase < Test of details
substantive Analytical Procedures > OR Both

Completion Phase → Assist the auditor to form overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

■ 2.5.3.4 Substantive Analytical Procedures

Substantive analytical procedures are based on the auditor's judgement about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk. Substantive Audit Procedures are based on the following factors :

- (a) Availability of data → This will facilitate effective procedures.
- (b) Type of account → The procedures is more useful for certain types of accounts like Income statement accounts tend to be more predictable as they reflect accumulated transactions over a period.
- (c) Predictability → These procedures are more appropriate when an account balance or relationships between items of data are predictable (e.g. sales and cost of sales.)

Following are the **features** of substantive analytical procedures :

- (a) It uses both financial and non-financial information while planning the audit.
- (b) The application of analytical procedures is based on the expectation that relationships among data exist and continue.
- (c) The presence of these relationships provides audit evidence as to the completeness, accuracy and validity of the the data produced by the accounting system.
- (d) Reliance on the results of analytical procedures depends on the auditor's assessment of the risk that it may identify.
- (e) When analytical procedures identify significant fluctuations that are inconsistent with other relevant information or that deviate from predicted amount the auditor should investigate and obtain adequate explanations and appropriate corroborative evidence.

- (f) Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was not aware and may assess the risk of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks.

2.5.4 Techniques / Forms of Substantive Analytical Procedures

Depending on the availability of the reliable data and experience of the audit team, substantive analytical procedures generally take one of the following forms :

Ratio Analysis

It is an useful tool for analysing the relationships between assets and liabilities, revenues and expenses within financial statements. Commonly used ratios include :

- Gross Profit Turnover
- Inventory Turnover
- Accounts Receivable Turnover
- Profitability, leverage and liquidity

Trend Analysis

This is a technique where comparison is made between current data and prior period data or with a trend in two or more prior period balances.

Reasonable Tests

Reasonableness refers to the factor whether the account balances which have relationship with other account balances are acceptable in nature. 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. Examples of accounts that may be reasonably tested are :

- Interest expense against interest bearing obligations
- Sales discounts and commissions against sales volume
- Raw material consumption to production quantity

Comparison Method

This method compares the current year items with previous year's items to find whether there is any significant variation. This variation may measured through any structural modelling like linear regression.

Investigation Results of Analytical Procedures

If analytical procedures performed in accordance with this standard of auditing 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 :

- (a) Inquiry from management and obtaining appropriate audit evidence relevant to management's responses
- (b) Performing other audit procedures as necessary in the circumstances.

Analytical Review

SA 500 on Audit Evidence defines analytical review as those tests of details which consist of studying significant ratios and trends and investigating unusual fluctuation