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BHUBANESWAR BRANCH OF EASTERN INDIA REGIONAL COUNCIL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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EDITORIAL



Dear Esteemed Members,

As we reflect on the month of **August**, it is truly encouraging to see the remarkable enthusiasm, participation, and commitment demonstrated by the members and students of the ICAI Bhubaneswar Branch. The month witnessed a meaningful blend of learning, knowledge-sharing, professional interaction, and engagement, further strengthening our collective pursuit of excellence and continuous growth.

In today's rapidly evolving professional landscape, staying informed, adaptable, and future-ready is no longer an option but a necessity. Keeping this in mind, our Branch remains committed to creating meaningful platforms that encourage continuous learning, enhance professional skills, and foster collaboration and knowledge exchange among our members and students.

As we look ahead, we are determined to introduce more initiatives centred around **practical learning, leadership, innovation, professional development, and active participation**. The progress of our Branch is a reflection of the collective contribution of our members, students, faculty, volunteers, and Managing Committee. I encourage each one of you to participate wholeheartedly in our upcoming programmes and contribute towards building a vibrant, progressive, and inclusive professional community.

I take this opportunity to express my heartfelt appreciation to our **Managing Committee Members, esteemed faculty, dedicated volunteers, and all our members and students** whose valuable support and active involvement have contributed immensely to the successful execution of our initiatives. Your continued cooperation inspires us to strive for greater heights and create more meaningful opportunities for professional advancement.

With a shared vision, collective effort, and unwavering commitment to the values of our profession, I am confident that together we will continue to create new milestones and strengthen the legacy of our profession.

As we move forward, I extend my warmest wishes to each one of you for **continued success, good health, meaningful learning, and new opportunities for personal and professional growth**.

Warm regards,

CA (Dr.) Goutam Lenka
Chairman, ICAI Bhubaneswar Branch

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Members' area of Interest

Observations related to SA 450, Evaluation of Misstatements Identified During the Audit.

Observation 2:

Misstatements were found during audit, but neither the differences were corrected at the time of finalization of accounts nor audit comment was found by the firm.

What is the issue?	AASB Suggested Guidance	Technical Literature
What steps should an audit firm take in response to uncorrected misstatements that are below the materiality level, according to SA 450?	If uncorrected misstatements are below the materiality level, the audit firm should: **1. Document the misstatements:** Record the details of all uncorrected misstatements, including their nature and amount, in the audit working papers. **2. Assess cumulative impact:** Evaluate the combined effect of all uncorrected misstatements to ensure that their total impact remains below the materiality threshold. Determine whether the overall audit strategy and audit plan needs to be revisited. **3. Communicate with management and those charged with governance:** Inform management and those charged with governance about the uncorrected misstatements, regardless of their immateriality and obtain written representation that they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. **4. Re-evaluate materiality:** Reassess the materiality level to confirm that the uncorrected misstatements do not aggregate to a material amount that could affect the financial statements.	**Para 6 of SA 450:** The auditor shall determine whether the overall audit strategy and audit plan need to be revised if: a. The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or (Ref: Para. A4) b. The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with SA 320. (Ref: Para. A5) **Para 8 of SA 450:** The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. The auditor shall request management to correct those misstatements (Ref: Para. A7 A9) **Para 10 of SA 450:** Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results. (Ref: Para. A11-A12) **Para 14 of SA 450:** The auditor shall request a written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation. (Ref: Para. A24)

	5. Review financial statements: Ensure that the financial statements are presented fairly despite the presence of these uncorrected misstatements.	**Para 15 of SA 450:** The audit documentation shall include: (Ref: Para. A25) a) The amount below which misstatements would be regarded as clearly trivial (paragraph 5); b) All misstatements accumulated during the audit and whether they have been corrected (paragraphs 5, 8 and 12); and c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion. (paragraph 11)
What factors should be considered by the audit firm when determining if uncorrected misstatements are material?	When determining if uncorrected misstatements are material, the audit firm should consider the following factors: **1. Nature of the misstatements:** Assess the type of misstatement and its potential impact on the financial statements. Certain types of misstatements, such as those involving fraud or violations of laws, may be material regardless of their size. **2. Effect on financial statements:** Evaluate how the misstatements affect the financial statements as a whole. Consider whether they distort the overall financial picture, affect the decisions of financial statements users or undermine the reliability of financial statements. **3. Aggregate impact:** Consider the cumulative effect of all uncorrected misstatements. Even if individual misstatements are below materiality thresholds, their combined impact might be material. **4. Trends or patterns:** Determine if there is a trend or pattern in the misstatements that could suggest ongoing issues with the entity's financial reporting or internal controls. **5. Potential to indicate other misstatements:** Assess whether the uncorrected misstatements could indicate that other areas of the financial statements might be materially misstated or that systemic issues exist.	**Para 11 of SA 450:** The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider: a) The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and (Ref: Para. A13-A17, A19-A20) b) The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. (Ref: Para. A18)

	6. Quantitative and qualitative factors: Evaluate both quantitative aspects (size of misstatements relative to financial statements amounts) and qualitative aspects (such as the nature and context of the misstatements). By considering these factors, the audit firm ensures a comprehensive evaluation of the materiality of uncorrected misstatements and their potential impact on the financial statements.	

Article on-

Analytical Procedures: Audit Evidence

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"The analysis of significant ratios and trends including the resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or which deviate from predicted amounts". Analytical Procedures may include:

I. Comparison of financial information:

a. Trend Analysis:

Trend analysis involves comparing financial data from one period to another to identify trends or changes over time. This can help auditors and analysts to identify areas of concern or to assess the reasonableness of financial statement balances.

b. Ratio Analysis:

Ratio analysis involves the comparison of financial ratios to industry benchmarks, prior year results, or other relevant factors. This can help auditors and analysts evaluate an organization's financial health and identify potential risk areas.

c. Regression Analysis:

Regression analysis involves using statistical techniques to identify relationships between different financial variables. This can help auditors and analysts to identify potential areas of concern or to develop predictive models.

d. Variance Analysis:

Variance analysis involves comparing actual financial results to budgeted or expected results to identify areas of variance. This can help auditors and analysts identify areas of concern or assess internal controls' effectiveness.

e. Reasonableness Analysis:

Reasonableness analysis involves comparing financial information to external data sources, such as industry averages or publicly available financial information. This can help auditors and analysts to evaluate the reasonableness of financial statement balances and to identify potential areas of risk.

II. Consideration of relationships between financial information and non- financial information:

A study of plausible relationships among both financial and nonfinancial data. A basic premise underlying the application of analytical procedures is that plausible relationships among data may reasonably be expected to exist and continue in the absence of known conditions to the contrary. Particular conditions that can cause variations in these relationships include, for example, specific unusual transactions or events, accounting changes, business changes, random fluctuations, or misstatements.

Analytical Procedures as an Audit Evidence:

It may provide auditor an-evidence as to the completeness, accuracy and validity of the data. For example, where the production process is standardized, the ratio of various elements of manufacturing inputs to total manufacturing inputs are expected to remain stable over the years. Similarly, where the client follows an established policy of granting one month credit to the buyers, the relationship between outstanding debtors and creditors is a logical relationship. Thus, analytical procedures involve understanding the relationship between data and examining whether the actual data are consistent with this understanding.

How much we can rely on Analytical Procedures as an-evidence:

Where it is expected that logical relationships among data exist, the auditor can rely on the results of analytical. The extent to which the auditor can rely on the results of analytical procedures depends on the following factors:

A. Materiality of the items involved:

Analytical procedures normally provide a lower level of assurance that the tests of the details of transactions and balances. Therefore, in respect of material items, the auditor may use analytical procedures in conjunction with tests in details.

B. Nature of Assertion:

Analytical procedures may be effective tests for those assertions in which potential misstatement is not likely to be detected by an examination of detailed evidence or in which detailed evidence is not readily available.

C. Predictability of relationships among data:

For application of analytical procedures, it is essential that relationships among items of financial information are predictable so that any deviation there from can be taken as being indicative of potential misstatements. Relationship involving items of the profit and loss account are generally more predictable than relationship involving only balance sheets accounts, since items of the profit and loss account represent items over a period of time whereas the balance sheet items represent transactions amount as of a point of time. Auditor can expect a greater consistency in comparing gross profit margins from one period to another than in comparing the ratio of cash and bank balance to total current assets.

D. Evaluation of Internal Control System:

Analytical procedures may not provide to the auditors the desired level of assurance in areas where the internal controls are weak. This is because, in such cases, data used by the auditor for developing relationships may themselves be misstated. For example. Where the auditor concludes that internal controls over sales are weak, he may decide to rely more on tests of details of transactions and balances than on analytical procedures in drawing his conclusions on sales.

There are four elements that comprise distinct steps that are inherent in the process to using substantial analytical procedures:

STEP 1: Develop an independent expectation:

The development of an appropriately precise, objective expectation is the most important step in effectively using substantive analytical procedures. An expectation is a prediction of a recorded amount or ratio. The prediction can be a specific number, a percentage, a direction or an approximation, depending on the desired precision.

The auditor should have an independent expectation whenever s/he uses substantive analytical procedures (ISA 520). The auditor develops expectations by identifying plausible relationships (eg between store square footage and retail sales, market trends and client revenues) that are reasonably expected to exist based on his knowledge of the business, industry, trends, or other accounts.

STEP 2: Define a significant difference (or threshold):

While designing and performing substantive analytical procedures the auditor should consider the amount of difference from the expectation that can be accepted without further investigation (ISA 520). The maximum acceptable difference is commonly called the 'threshold'.

Thresholds may be defined either as numerical values or as percentages of the items being tested. Establishing an appropriate threshold is particularly critical to the effective use of substantive analytical procedures. To prevent bias in judgment, the auditor should determine the threshold while planning the substantive analytical procedures, i.e. before Step 3, in which the difference between the expectation and the recorded amount are computed.

The threshold is the acceptable amount of potential misstatement and therefore should not exceed planning materiality and must be sufficiently small to enable the auditor to identify misstatements that could be material either individually or when aggregated with misstatements in other disaggregated portions of the account balance or in other account balances.

STEP 3: Compute difference:

The third step is the comparison of the expected value with the recorded amounts and the identification of significant differences, if any. This should be simply a mechanical calculation.

It is important to note that the computation of differences should be done after the consideration of an expectation and threshold. In applying substantive analytical procedures, it is not appropriate to first compute differences from prior-period balances and then let the results influence the 'expected' difference and the acceptable threshold.

STEP 4: Investigate significant differences and draw conclusions:

The fourth step is the investigation of significant differences and formation of conclusions (ISA 520). Differences indicate an increased likelihood of misstatements; the greater the degree of precision, the greater the likelihood that the difference is a misstatement.

Explanations should be sought for the full amount of the difference, not just the part that exceeds the threshold. There is a chance that the unexplained difference may indicate an increased risk of material misstatement. The auditor should consider whether the differences were caused by factors previously overlooked when developing the expectation in Step 1, such as unexpected changes in the business or changes in accounting treatments.

If the difference is caused by factors previously overlooked, it is important to verify the new data, to show what impact this would have on the original expectations as if this data had been considered in the first place, and to understand any accounting or auditing ramifications of the new data.

The expectation should be precise enough to provide the desired level of assurance that differences that may be potential material misstatements, individually or when aggregated with other misstatements, would be identified for the auditor to investigate (see paragraph .20). As expectations become more precise, the range of expected differences becomes narrower and, accordingly, the likelihood increases that significant differences from the expectations are due to misstatements. The precision of the expectation depends on, among other things, the auditor's identification and consideration of factors that significantly affect the amount being audited and the level of detail of data used to develop the expectation.

There are four key factors that affect the precision of analytical procedures:

1. **Disaggregation:**

   The more detailed the level at which analytical procedures are performed, the greater the potential precision of the procedures. Analytical procedures performed at a high level may mask significant, but offsetting, differences that are more likely to come to the auditor's attention when procedures are performed on disaggregated data.

   The objective of the audit procedure will determine whether data for an analytical procedure should be disaggregated and to what degree it should be disaggregated. Disaggregated analytical procedures can be best thought of as looking at the composition of a balance(s) based on time (e.g. by month or by week) and the source(s) (e.g. by geographic region or by product) of the underlying data elements. The reliability of the data is also influenced by the comparability of the information available and the relevance of the information available.

2. **Data reliability:**

   The more reliable the data is, the more precise the expectation. The data used to form an expectation in an analytical procedure may consist of external industry and economic data gathered through independent research. The source of the information available is particularly important. Internal data produced from systems and records that are covered by the audit, or that are not subject to manipulation by persons in a position to influence accounting activities, are generally considered more reliable.

3. **Predictability:**

   There is a direct correlation between the predictability of the data and the quality of the expectation derived from the data. Generally, the more precise an expectation is for an analytical procedure, the greater will be the potential reliability of that procedure. The use of non-financial data (eg number of employees, occupancy rates, units produced) in developing an expectation may increase the auditor's ability to predict account relationships. However, the information is subject to data reliability considerations mentioned above.

4. **Type of analytical procedures:**

   There are several types of analytical procedures (As discussed above) commonly used as substantive procedures and will influence the precision of the expectation. The auditor chooses among these procedures based on his objectives for the procedures (ie purpose of the test, desired level of assurance).

Stages at which analytical procedures are used to gather Audit Evidences:

Analytical procedures are used for the following purposes:

a) To assist the auditor in planning the nature, timing, and extent of other auditing procedures
b) As a substantive test to obtain evidential matter about particular assertions related to account balances or classes of transactions
c) As an overall review of the financial information in the final review stage of the audit

Analytical procedures should be applied to some extent for the purposes referred to in (*a*) and (*c*) above for all audits of financial statements made in accordance with generally accepted auditing standards. In addition, in some cases, analytical procedures can be more effective or efficient than tests of details for achieving particular substantive testing objectives.

There are numerous benefits of uses of analytical procedures out of them Some are below.

1. **Enhanced Efficiency:**

   It helps auditors and analysts quickly identify potential financial statement issues. By identifying potential risks early in the audit or analysis process, auditors and analysts can plan their work more effectively, improving overall efficiency.

2. **Improved Quality of Financial Reporting:**

   It can help identify errors, omissions, or other irregularities in financial statements. By identifying these issues, auditors and analysts can help to ensure that the financial statements are accurate and complete.

3. **Enhanced Risk Assessment:**

   It helps auditors and analysts to assess the risk of material misstatements in the financial statements. By identifying potential risk areas, auditors and analysts can develop appropriate audit or analysis procedures to mitigate those risks.

4. **Better Decision Making:**

   It provides valuable information to management, investors, and other stakeholders.

Similarly, there are various shortcomings of using Analytical Procedures in auditing which can be understood in the following ways.

1. **Data Availability and Quality:**

   It requires reliable and accurate financial data. If the data is available and of good quality, the results of the analytical methods may be reliable.

2. **Subjectivity:**

   It requires judgment and interpretation, which can introduce subjectivity. The results of analytical methods may result from the auditor or analyst's personal biases or assumptions.

3. **Limitations of the Techniques:**

   It has restrictions, such as the inability to detect fraud or errors that are difficult to detect.

4. **Industry-Specific Challenges:**

   It may be more difficult in specific industries, such as the technology industry, where the underlying data may be more complex or difficult to interpret.

5. **Interpretation of Results:**

   The results of it can be challenging, mainly if they are unusual. Auditors and analysts must be able to analyze the results of the analytical methods and determine whether further investigation is necessary.

Glimpses of Events

Celebrating Freedom, Unity & Nationhood: ICAI Bhubaneswar Branch Observes Independence Day









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