## PROPOSED INTERNATIONAL STANDARD ON AUDITING 520 (REDRAFTED)

**ANALYTICAL PROCEDURES**

(Effective for audits of financial statements for periods beginning on or after [December 15, 2009])

### CONTENTS

<table>
<thead>
<tr>
<th>Paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Introduction</strong></td>
</tr>
<tr>
<td>Scope of this ISA</td>
</tr>
<tr>
<td>Nature of Analytical Procedures</td>
</tr>
<tr>
<td>Effective Date</td>
</tr>
<tr>
<td>Objectives</td>
</tr>
<tr>
<td>Definition</td>
</tr>
<tr>
<td><strong>Requirements</strong></td>
</tr>
<tr>
<td>Substantive Analytical Procedures as Substantive Procedures in Response to Assessed Risks</td>
</tr>
<tr>
<td>Analytical Procedures that Assist in Drawing Reasonable Conclusions Arriving at the Auditor’s Overall Conclusion in an Audit of Financial Statements</td>
</tr>
<tr>
<td>Investigating Results of Analytical Procedures</td>
</tr>
<tr>
<td><strong>Application and Other Explanatory Material</strong></td>
</tr>
<tr>
<td>Nature of Analytical Procedures</td>
</tr>
<tr>
<td>Substantive Analytical Procedures as Substantive Procedures in Response to Assessed Risks</td>
</tr>
<tr>
<td>Analytical Procedures that Assist in Drawing Reasonable Conclusions Arriving at the Auditor’s Overall Conclusion in an Audit of Financial Statements</td>
</tr>
<tr>
<td>Investigating Results of Analytical Procedures</td>
</tr>
</tbody>
</table>

---


---

Prepared by: Bernard Agulhas (August 2008)

Page 1 of 10
Introduction
Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor’s use of analytical procedures as substantive procedures (“substantive analytical procedures”) in response to assessed risks, and as procedures that assist in arriving at the auditor’s overall in drawing reasonable conclusions on which to base in the auditor’s opinion on the financial statements. The use of analytical procedures as risk assessment procedures is dealt with in ISA 315 (Redrafted). ISA 330 (Redrafted) includes requirements and guidance regarding the nature, timing and extent of audit procedures in response to assessed risks; these audit procedures may include substantive analytical procedures.

Nature of Analytical Procedures [ISSUE D]

2. Analytical procedures include the consideration of comparisons of the entity’s financial information with, for example:
   - Comparable information for prior periods.
   - Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
   - Similar industry information, such as a comparison of the entity’s ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

3. Analytical procedures also include consideration of relationships, for example:
   - Among elements of financial information that would be expected to conform to a predictable pattern based on the entity’s experience, such as gross margin percentages.
   - Between financial information and relevant non-financial information, such as payroll costs to number of employees.

4. Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, financial statements of components (such as subsidiaries, divisions, branches or segments) and individual elements of financial information.

---

Effective Date

5.2. This ISA is effective for audits of financial statements for periods beginning on or after [December 15, 2009].

Objectives

6.3. The objectives of the auditor are: [ISSUE C]

(a) To obtain relevant and reliable audit evidence when using substantive analytical procedures as substantive procedures in response to assessed risks, to design and perform such analytical procedures so that they are effective in responding to assessed risks of material misstatement in the financial statements at the assertion level; and

(b) To design and perform analytical procedures that assist the auditor in drawing reasonable conclusions on which to base the auditor’s opinion in an audit of financial statements.

Definition

7.4. For the purposes of the ISAs, the term “analytical procedures” means evaluations of financial information made by a study through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the such investigation, as is necessary, of identified fluctuations and relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. (Ref: Para. A1-A3)

Requirements

Substantive Analytical Procedures as Substantive Procedures in Response to Assessed Risks

8.5. In deciding to use, and when designing and performing, substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with ISA 330 (Redrafted), the auditor shall: (Ref: Para. A4-A52) [ISSUE E]

(a) Determine the suitability of using the planned substantive analytical procedures given the assertions, taking account of the assessed risks of material misstatement and tests of details, if any, directed towards the same assertion; (Ref: Para. A63-A118)

(b) Develop an expectation of recorded amounts or ratios;

(e)(b) Evaluate the reliability of data, whether internal or external, from which the auditor’s expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation; (Ref: Para. A129-A134)

---

Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated;\(^4\) and (Ref: Para. A142)

Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph 740. (Ref: Para. A153-A164).

Analytical Procedures that Assist in Drawing Reasonable Conclusions Arriving at the Auditor’s Overall Conclusion in an Audit of Financial Statements

The auditor shall design and perform analytical procedures that assist in drawing reasonable conclusions on which to base as to whether the financial statements as a whole are consistent with the auditor’s understanding of the entity opinion. (Ref: Para. A175-A197)

Investigating Results of Analytical Procedures

If analytical procedures performed in accordance with paragraphs 5 and 6 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) Inquiring of management and obtaining appropriate audit evidence relevant to management’s responses; and

(b) Performing other audit procedures as necessary in the circumstances. (Ref: Para. A2018-A219)

Application and Other Explanatory Material

Nature of Analytical Procedures (Ref: Para. 4)

Analytical procedures include the consideration of comparisons of the entity’s financial information with, for example:

- Comparable information for prior periods.
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.

Proposed ISA 520 (Redrafted) (Marked from ED)

IAASB Main Agenda (September 2008) Page 2008·1999

- Similar industry information, such as a comparison of the entity’s ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

A2. Analytical procedures also include consideration of relationships, for example:
- Among elements of financial information that would be expected to conform to a predictable pattern based on the entity’s experience, such as gross margin percentages.
- Between financial information and relevant non-financial information, such as payroll costs to number of employees.

A1-A3. Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, financial statements of components (such as subsidiaries, divisions, branches or segments) and individual elements of financial information.

Substantive Analytical Procedures as Substantive Procedures in Response to Assessed Risks (Ref: Para. 58)

A2-A4. The auditor’s substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to use, perform, including whether to use substantive analytical procedures, is based on the auditor’s judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.

A3-A5. The auditor may inquire of management as to the availability and reliability of information needed to apply substantive analytical procedures as substantive procedures, and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided the auditor is satisfied that such data is properly prepared.

Suitability of Using Planned Analytical Procedures Given the Assertions (Ref: Para. 58(a))

A4-A6. Substantive analytical procedures as substantive procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. The presence of these relationships provides audit evidence as to the completeness, accuracy and occurrence of transactions captured in the information produced by the entity’s information system relevant to financial reporting. However, the suitability of a particular analytical procedure will depend upon the auditor’s assessment of how effective it will be in detecting a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated.
A5. In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has employed a known number of staff at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognized trade ratios (such as profit margins for different types of retail entities) can often be used effectively in analytical procedures to provide evidence to support the reasonableness of recorded items amounts.

A6. Different types of analytical procedures provide different levels of assurance. Analytical procedures involving, for example, the prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the components 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.

A7. The determination of the suitability of planned substantive analytical procedures as substantive procedures is influenced by the nature of the assertion and the auditor’s assessment of the risk of material misstatement. For example, if controls over sales order processing are weak, the auditor may place more reliance on tests of details rather than on analytical procedures for assertions related to receivables; or if inventory balances are material, the auditor may decide not to rely only on analytical procedures when performing audit procedures on the existence assertion.

A8. Planned substantive analytical procedures as substantive procedures may also be considered appropriate suitable when tests of details are performed on the same assertion. For example, when obtaining audit evidence regarding the valuation assertion for accounts receivable balances, the auditor may apply analytical procedures to an aging of customers’ accounts in addition to performing tests of details on subsequent cash receipts to determine the collectability of the receivables.

Considerations Specific to Public Sector Entities

A9. The relationships between individual financial statement items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities; for example, in many public sector entities there may be little direct relationship between revenue and expenditure. In addition, because expenditure on the acquisition of assets may not be capitalized, there may be no relationship between expenditures on, for example, inventories and fixed assets and the amount of those assets reported in the financial statements. Also, industry data or statistics for comparative purposes may not be available in the public sector. However,
other relationships may be relevant, for example, variations in the cost per kilometer of road construction or the number of vehicles acquired compared with vehicles retired.

The Reliability of the Data (Ref: Para. 58(bc))

A10. The reliability of data is influenced by its source and by its nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures as substantive procedures:

(a) Source of the information available. For example, information may be more reliable when it is obtained from independent sources with an established reputation outside the entity;

(b) Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products;

(c) Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and

(d) Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

A11. The auditor may consider testing the operating effectiveness of controls, if any, over the entity’s preparation of information used by the auditor in performing substantive analytical procedures as substantive procedures in response to assessed risks. When such controls are effective, the auditor generally has greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The operating effectiveness of controls over non-financial information may often be tested in conjunction with other tests of controls. For example, in establishing controls over the processing of sales invoices, an entity may include controls over the recording of unit sales. In these circumstances, the auditor could may test the operating effectiveness of controls over the recording of unit sales in conjunction with tests of the operating effectiveness of controls over the processing of sales invoices. Alternatively, the auditor may consider whether the information was subjected to audit testing. [Proposed] ISA 500 (Redrafted) establishes requirements and provides guidance in determining the audit procedures to be performed on the information to be used for substantive analytical procedures as substantive procedures.6

---

6 [Proposed] ISA 500 (Redrafted), paragraph [12].
Considerations Specific to Smaller Entities [ISSUE F]

A12. The extent of use of analytical procedures as substantive procedures in response to assessed risks in the audit of a smaller entity may be limited because of the unreliability, or lack, of information on which the analytical procedures are based.

Evaluation whether the Expectation is Sufficiently Precise (Ref: Para. 58(c4))

A13-A14. Matters relevant to the auditor’s evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, the auditor may consider matters such as the following include:

- The accuracy with which the expected results of substantive analytical procedures can be predicted. For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.
- The degree to which information can be disaggregated. For example, analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole.
- The availability of the information, both financial and non-financial. For example, the auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures. If the information is available, the auditor may also consider the reliability of the information as discussed in paragraphs A129 and A130 above.

Amount of Difference of Recorded Amounts from Expected Values that is Acceptable (Ref: Para. 58(d))

A14-A15. The auditor’s determination of the amount of difference from expectation that can be accepted without further investigation is influenced by materiality and the consistency with the desired level of assurance, taking account of the possibility that a misstatement, when aggregated with other misstatements, may cause the financial statements to be materially misstated. ISA 330 (Redrafted) requires the auditor to obtain more persuasive audit evidence the higher the auditor’s assessment of risk. Accordingly, as the assessed risk increases, the a smaller amount of difference that would be considered acceptable without investigation decreases in order is needed to achieve the desired level of assurance as the assessed risk increases persuasive evidence.

7 ISA 320 (Revised and Redrafted), “Materiality in Planning and Performing an Audit,” paragraph A13.
8 ISA 330 (Redrafted), paragraph 7(b).
A15-A16. The matters discussed in paragraphs A12(a)–A12(d) are relevant irrespective of whether the auditor performs substantive analytical procedures—substantive procedures on the entity’s period end financial statements, or at an interim date and plans to perform substantive analytical procedures—substantive procedures with respect to the intervening period as part of the period end. ISA 330 (Redrafted) establishes requirements and provides guidance on substantive procedures performed at an interim date.

Analytical Procedures that Assist in Drawing Reasonable Conclusions

Arriving at the Auditor’s Overall Conclusion in an Audit of Financial Statements (Ref: Para. 6)

A16-A17. The conclusions drawn from the results of analytical procedures—during the overall review stage of the audit designed and performed in accordance with paragraph 6—are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements, and this assists in arriving at the auditor’s overall conclusions on whether which to base the auditor’s opinion financial statements as a whole are free from material misstatements.

A17-A18. The results of such analytical procedures may identify a previously unrecognized risk of material misstatement. In such circumstances, ISA 315 (Redrafted) requires the auditor to revise the auditor’s assessment of the risks of material misstatement and modify the further planned audit procedures accordingly.10

A18-A19. The analytical procedures performed as part of the auditor’s overall review of the financial statements are often in accordance with paragraph 6 may be similar to those that would be used as risk assessment procedures.

Investigating Results of Analytical Procedures (Ref: Para. 7)

A19-A20. Audit evidence relevant to management’s responses may be obtained by considering how evaluating those responses compare with taking into account the auditor’s understanding of the entity and its environment, or and with other audit evidence obtained during the course of the audit.

A20-A21. The need to apply perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management’s response, is not considered adequate.

9 ISA 330 (Redrafted), paragraphs 23-24.
10 ISA 315 (Redrafted), paragraph 30.
CONFORMING AMENDMENTS TO OTHER ISAs

ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment”

Analytical Procedures

A7. Analytical procedures performed during as risk assessment procedures of the entity may indicate identify aspects of the entity of which the auditor was unaware and will assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold. [ISSUE A]

A8. Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

A9. However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures. ISA 520, “Analytical Procedures,” establishes requirements and provides guidance on the use of analytical procedures.

Considerations Specific to Smaller Entities

A10. The availability of information to perform analytical procedures as risk assessment procedures in the audit of a smaller entity may be limited by the timeliness of processing of transactions and preparation of reliable financial information by the entity. Further, some smaller entities may not have interim or monthly financial information that can be used for purposes of analytical procedures. Accordingly, in these circumstances, although the auditor may be able to perform limited analytical procedures for purposes of planning the audit or obtain some information through inquiry, the auditor may need to plan to perform analytical procedures to identify and assess the risks of material misstatement when an early draft of the entity’s financial statements is available.

---