Committee: IAASB
Meeting Location: Miami
Meeting Date: September 15–19, 2008

ISA 520, “Analytical Procedures”

Objective of Agenda Item
1. To approve ISA 520 (Redrafted), “Analytical Procedures.”

Task Force
2. The Task Force members are:
   - Ian McPhee (Chair) IAASB Member
   - Susan Jones IAASB Member
3. Redrafting support was provided by Bernard Agulhas and Thinus Peyper of the Standards Department of the Independent Regulatory Board for Auditors (IRBA) in South Africa, the secretariat which supports the Committee for Auditing Standards of the IRBA.

Activities Since Last IAASB Discussion
4. In December 2007, the IAASB approved the exposure draft of proposed ISA 520 (Redrafted) (“ED-ISA 520”). The comment period closed on March 31, 2008. Thirty-five comment letters were received. A list of respondents is included in the Appendix of this Agenda Item.
5. The Task Force held teleconference meetings in June, July and August 2008 to consider the comments received on ED-ISA 520 and to revise the proposed ISA.
6. The IAASB Consultative Advisory Group met in September 2008 to consider significant comments received on ED-ISA 520, the Task Force’s recommendations and the proposed revised draft of ISA 520 (Redrafted).

Significant Comments
7. Overall, most respondents were supportive of the redraft, with many expressing the view that it was an improvement on the extant ISA. The following summarizes significant comments received, and the Task Force’s views and recommendations.
A. Repositioning of Analytical Procedures as Risk Assessment Procedures in ISA 315 (Redrafted)

8. ED-ISA 520 included the proposal to reposition all the guidance in the extant ISA on performing analytical procedures as risk assessment procedures to ISA 315 (Redrafted). This proposal was strongly supported by a significant majority of the respondents (14 out of 18 respondents responded positively).

9. Some respondents\(^1\), however, commented that the repositioning could create confusion and lead to analytical procedures not being undertaken in an integrated manner. The respondents further commented that the extant ISA 520 is weakened and incomplete, while ISA 315 (Redrafted) becomes more unwieldy with the additional guidance.

Task Force Views and Recommendations

10. Due to the strong support received from respondents, and since ISA 315 (Redrafted) contains the requirement and relevant guidance to use analytical procedures as risk assessment procedures, the Task Force believes that it is more appropriate for all guidance on analytical risk assessment procedures to be in ISA 315 (Redrafted) in support of the requirement and, consequently, it decided that the relevant material in extant ISA 520 should be transferred to ISA 315 (Redrafted) as proposed in ED-ISA 520. However, the Task Force has added a footnote in ISA 315 (Redrafted) to cross refer to ISA 520 (Redrafted), paragraphs A1 – A3.

**Action Requested**

The IAASB is asked to consider whether they agree with the task force decision not to reposition.

B. Scope of the ISA

**Paragraph 1 of ED-ISA 520 states:**

“This International Standard on Auditing (ISA) deals with the auditor’s use of analytical procedures as substantive procedures in response to assessed risks, and as procedures that assist in arriving at the auditor’s overall conclusion in an audit of financial statements. The use of analytical procedures as risk assessment procedures is dealt with in ISA 315 (Redrafted).”

11. A respondent\(^2\) recommended that the scope or the objective should state that designing and performing substantive analytical procedures is not a requirement. Another respondent\(^3\) commented that part (a) of the objective should state this fact.

Task Force Views and Recommendations

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\(^1\) FEE, ICAEW, IDW and NAO

\(^2\) ACCA

\(^3\) EFAA
12. Although the Task Force believes that the scope paragraph clearly stated that the ISA only included requirements concerning the use of substantive analytical procedures, the Task Force agreed to include additional wording and a cross-reference to ISA 330 (Redrafted). This emphasises that the requirements and guidance regarding the nature, timing and extent of audit procedures is in ISA 330 (Redrafted).

13. The Task Force proposes that the scope paragraph be refined as follows (see paragraph 1 of Agenda Item 7-A):

“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 an the auditor’s opinion of 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.”

**Action Requested**

**IAASB is asked to consider the proposed re-wording of the scope paragraph.**

**C. OBJECTIVES**

**Paragraph 6 of ED-ISA 520 states:**

“The objectives of the auditor are:

(a) When using 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 in arriving at the overall conclusion in an audit of financial statements.”

14. While most respondents indicated support for the proposed objectives, several respondents were of the view that subparagraphs (a) and (b) are repetitive and could be simplified. These respondents also commented that subparagraph (a) should not focus on procedures that are “effective” in responding to risks of material misstatement, but that the introduction should rather refer to “obtaining audit evidence”.

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6 ACCA, APB, BDO, EC, ICAEW, ICAS, ICJCE, IDW, PwC, FEE
15. Some respondents\(^7\) recommended the deletion of “in response to assessed risk of material misstatement” in part (a) of the objective, as paragraph 20 of ISA 330 (Redrafted) requires the auditor to design and perform substantive procedures for each material class of transactions, account balance and disclosure, irrespective of the assessed risks of material misstatement.

16. A respondent\(^8\) commented that the use of the words “…in arriving at the auditor’s overall conclusion…” in part (b) of the objective is unusual and questioned why the words “audit conclusion” are used instead of “audit opinion”. The respondent recommended that wording similar to paragraph 19 of proposed ISA 200 (Revised and Redrafted) be used namely that, “…the auditor shall obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion…”

**Task Force Views and Recommendations**

17. The Task Force agreed that subparagraph (a) should refer to “obtaining relevant and reliable audit evidence” and agreed not to refer to procedures that are effective. The Task Force simplified subparagraphs (a) and (b) to avoid any repetition.

18. The Task Force agreed to delete the words “in response to assessed risk of material misstatement”, to align the subparagraph with paragraph 20 of ISA 330 (Redrafted).

19. The Task Force agreed to amend subparagraph (b) with similar wording used in paragraph 17 of ISA 200 (Revised and Redrafted) and agreed to ensure alignment of the scope, objective and paragraph 9.

20. The Task Force proposes that the objectives be refined as follows (see paragraph 3 of Agenda Item 7-A):

“The objectives of the auditor are:

(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 arriving at the overall conclusions on which to base the auditor’s opinion in an audit of financial statements.**”

**Action Requested**

IAASB is asked to consider the proposed re-wording of the objective.

**D. Nature of Analytical Procedures**

\(^7\) CNCC, E&Y, FEE and ICJCE

\(^8\) CNCC
21. Some respondents\(^9\) commented that paragraphs 2 - 4 of ED-ISA 520, which provide background information to the nature of analytical procedures, should be relocated to the “Application and Other Explanatory Material” section of the ISA as these paragraphs are guidance in nature.

**Task Force Views and Recommendations**

22. The Task Force agreed to move the paragraphs to the “Application and Other Explanatory Material” section of the ISA since the background information consists of examples only.

**Action Requested**

The IAASB is asked to consider whether the relocation of paragraphs 2-4 to Application and Explanatory Material is appropriate.

**E. Substantive Analytical Procedures in Response to Assessed Risks**

**Paragraph 8 of ED-ISA 520 states:**

“In deciding to use, and when designing and performing, analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with ISA 330 (Redrafted), the auditor shall:

(a) Determine the suitability of using 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;

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

(c) 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;

(d) Evaluate whether the expectation is sufficiently precise to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated; and

(e) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph 10.”

23. A few respondents\(^10\) recommended the deletion of the words “in deciding to use” in paragraph 8 of ED-ISA 520 as it is a change from paragraph 12 of the extant ISA and the decision to use substantive analytical procedures is best dealt with in ISA 330 (Redrafted). Other respondents\(^11\) commented that these words create confusion

\(^{9}\) APB, BDO, EC and IDW

\(^{10}\) CICA, CNCC and EFAA

\(^{11}\) ACCA, EC and NZICA
on where the ISA starts and makes it unclear whether the intention is to restrict requirements to where a decision has already been made to use analytical procedures.

24. Some respondents\textsuperscript{12} recommended that the requirements of paragraph 8 should be separated between the two distinct concepts “deciding to use” and “when using” substantive analytical procedures. This would make it clear at which stage these procedures must be performed.

25. Some respondents\textsuperscript{13} recommended combining requirements in subparagraphs (a) to (e) to create a more logical flow.

\textit{Task Force Views and Recommendations}

26. The Task Force agreed to delete the words ‘in deciding to use’ in paragraph 8 of ED-ISA 520 to eliminate confusion on where the ISA starts and not to contradict the wording of the scope paragraph. In other words, ISA 520 applies once the decision has been made to use analytical procedures as substantive analytical procedures, and as procedures that assist the auditor to draw reasonable conclusions on which to base the auditor’s opinion.

27. The Task Force agreed to some limited reconstruction of the paragraphs in order to improve the flow of the requirements.

28. The Task Force proposes that the paragraph be refined as follows (see paragraph 5 of Agenda Item 7-A):

\begin{quote}
\textquote{In deciding to use, and when designing and performing, \textbf{substantive} analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with ISA 330 (Redrafted),\textsuperscript{14} the auditor shall: (Ref: Para. A\textsuperscript{4}1-A\textsuperscript{5}2)}

(a) Determine the suitability of \textit{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. A\textsuperscript{6}3-A\textsuperscript{11}8)

(b) \textbf{Develop an expectation of recorded amounts or ratios}: (c) 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. A\textsuperscript{12}9-A\textsuperscript{13}4)

(c) \textbf{(d) 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}
\end{quote}

\textsuperscript{12} APB, CICA, DTT, GTI, ICAI, NIVRA
\textsuperscript{13} EC, FEE, ICAEW, IDW, PWC
\textsuperscript{14} ISA 330 (Redrafted), paragraphs 20 and A43 – A47.
the financial statements to be materially misstated, and (Ref: Para. A14)
(d) 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. A15-A16).”

Action requested
The IAASB is asked to consider whether the amended paragraph is appropriate.

F. Considerations Specific to SMEs

29. Several respondents disagreed with the guidance specifically relating to smaller entities provided in paragraph A11 of ED-ISA 520. These respondents commented that the fact that there may be a lack of information or that the information may be unreliable seems discouraging and is not applicable to all smaller entities or smaller entities alone.

Task Force Views and Recommendations

30. The Task Force agreed and deleted the paragraph, but did not provide further guidance given the extent of application material already provided.

Action Requested
The IAASB is asked to consider whether the deletion of the paragraph is appropriate.

G. Consideration of the Need to Re-expose

31. Agenda Item 7-A shows in marked text the changes proposed to ED-ISA 520. The Task Force is of the view that the changes are in response to matters raised by respondents to the exposure draft. They do not introduce new principles or represent other changes of substance when compared with the exposure draft. Accordingly, the Task Force is of the view that re-exposure is not necessary.

16 ACCA, AIA, APB, AUASB, BDO, CIPFA, CNCC, EC, EFAA, FEE, IDW
17 IAASB Working Procedures regarding re-exposure state: “Situations that constitute potential grounds for a decision to re-expose may include, for example: substantial change to a proposal arising from matters not aired in the exposure draft such that commentators have not had an opportunity to make their views known to the IAASB before it reaches a final conclusion; substantial change arising from matters not previously deliberated by the IAASB; or substantial change to the substance of an International Standard or Practice Statement.”

(Revised) Agenda Item 7
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Material Presented

Agenda Item 7-A Proposed ISA 520 (Redrafted), “Analytical Procedures” (Marked from Exposure Draft)
(Pages 1995 – 2004)

Agenda Item 7-B Proposed ISA 520 (Redrafted), “Analytical Procedures” (Clean)
(Pages 2005 – 2014)

Draft to be Discussed at the Meeting

32. The Task Force proposes that the marked version of the revised draft (Agenda Item 7-A) be discussed during the meeting.

Action Requested

The IAASB is asked to consider the matters raised above and to approve the proposed ISA 520 (Redrafted).
## Appendix

### List of Respondents

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<td>ACCA</td>
<td>Association of Chartered Certified Accountants</td>
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<td>Association of International Accountants</td>
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<td>3</td>
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<td>European Federation of Accountants and Auditors for SMEs</td>
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