

Basis for Conclusions: ISA 520 (Redrafted), Analytical Procedures

*Prepared by the Staff of the International Auditing and
Assurance Standards Board*



**International Federation
of Accountants**

BASIS FOR CONCLUSIONS:
ISA 520 (REDRAFTED), ANALYTICAL PROCEDURES

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, ISA 520 (Redrafted), “Analytical Procedures,” which was approved by the IAASB in September 2008.¹

Background

1. In September 2006, the IAASB agreed the conventions to be used in drafting future International Standards on Auditing (ISAs). These conventions are commonly referred to as the IAASB’s Clarity conventions.²
2. The IAASB has undertaken to redraft all of its ISAs in accordance with the Clarity conventions. This approach responds to the desire for all ISAs to be consistently drafted, and subject to a single statement of their authority and effect. The IAASB has agreed, in response to the general call for the Clarity project to be completed within a reasonable time, that while a significant number of the ISAs are under substantive revision as well as redrafting to reflect the new conventions, others will be subject to a limited redrafting to reflect only the conventions and matters of clarity generally. ISA 520 is in the latter category.
3. In December 2007, the IAASB issued an exposure draft of proposed ISA 520 (Redrafted) (ED-ISA 520). The comment period for ED-ISA 520 closed on March 31, 2008. The IAASB received thirty-five comment letters from various respondents, including regulators and oversight authorities, IFAC member bodies, national auditing standard setters, audit firms, preparers and users of financial statements, and professional and public sector organizations. Input was also received from IFAC’s Small and Medium Practices Committee. The IAASB made changes to ED-ISA 520 in response to these comments. Respondents to ED-ISA 520 generally supported the proposed ISA. A significant majority supported the IAASB’s conclusion to reposition guidance pertaining to the performance of analytical procedures as risk assessment procedures in the extant ISA 520 to ISA 315 (Redrafted).³
4. In addition, the IAASB discussed significant issues in the development of ED-ISA 520, and the finalization of ISA 520 (Redrafted), with its Consultative Advisory Group (CAG). The CAG raised no significant concerns about the proposed treatment of these issues with the IAASB.
5. This Basis for Conclusions explains the more significant issues raised by respondents on ED-ISA 520, and how the IAASB has addressed them. In general, ED-ISA 520 received

¹ See minutes of the September 15-19, 2008 IAASB meeting at <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4426>.

² The IAASB’s Clarity conventions, and the authority and obligation attaching to them, are established in ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing.”

³ ISA 530 (Redrafted), “Audit Sampling.”

support from respondents in terms of how the extant ISA had been redrafted in accordance with the IAASB's Clarity conventions.

Scope and Objective of the ISA

6. Paragraph 1 of ED-ISA 520 stated:

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).

7. Paragraph 6 of ED-ISA 520 stated:

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.

8. A few respondents were of the view that although ED-ISA 520 deals with the auditor's use of analytical procedures as substantive procedures, the requirement for the auditor to design and perform these procedures are contained in ISA 330 (Redrafted).⁴ The respondents felt that it is important for the relationship between the two ISAs to be specified in the scope or objective of ED-ISA 520 in order to avoid confusion.
9. Several respondents were of the further view that reference to the performance of *effective* procedures in responding to assessed risks of material misstatement in the objective of ED-ISA 520 creates the impression that analytical procedures alone constitute sufficient audit evidence (which is not the case, for example, in response to a significant risk). The respondents commented that the objective of the ISA is more appropriately focused on the obtaining of audit evidence by the auditor.
10. Some respondents provided drafting suggestions to better align the scope and objective of the ISA to other relevant ISAs. In particular, it was suggested that the words "in response to assessed risk of material misstatement" be deleted as analytical procedures may be performed in meeting the requirement of ISA 330 (Redrafted) that 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. A respondent also commented that the words in the scope of ED-ISA 520, "arriving at the auditor's overall conclusions" is inconsistent with ISA 200 (Revised and Redrafted) which refers to "draw[ing] reasonable conclusions on which to base the audit opinion."

⁴ ISA 330 (Redrafted), "The Auditor's Responses to Assessed Risks."

IAASB Decision

11. The scope of ED-ISA 520 stated that the ISA addressed the auditor's use of analytical procedures as substantive audit procedures which implied that the determination to perform substantive analytical procedures had been made earlier by the auditor. Nevertheless, to respond to comments made by respondents, the IAASB agreed to redraft the scope paragraph by including a cross-reference to ISA 330 (Redrafted) in order to avoid potential misinterpretation of the auditor's objectives under the ISA. See paragraphs 1 and 3 of ISA 520 (Redrafted).
12. The IAASB considered the other comments made by respondents and agreed that the clarity of ISA could be improved by the following:
 - Redrafting the objective of ED-ISA 520 to focus on the obtaining of relevant and reliable audit evidence by the auditor in place of the auditor performing *effective* procedures in response to assessed risks of material misstatement. This is so as to avoid inappropriately creating the impression that performance of analytical procedures alone presents the auditor with sufficient appropriate audit evidence in all cases. See paragraph 3 of ISA 520 (Redrafted).
 - Deleting the words "in response to assessed risk of material misstatement" in the scope and objective of ED-ISA 520. See paragraphs 1 and 3 of ISA 520 (Redrafted).
 - Redrafting the scope of ED-ISA 520 to replace the words "in arriving at the auditor's overall conclusion" to "when forming an overall conclusion." The IAASB is of the view that the redrafting will better reflect the process followed by the auditor as intended in the extant ISA 520 and also better align it with the remainder of the ISAs. See paragraph 1 of ISA 520 (Redrafted).

Substantive Analytical Procedures

13. 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.
14. A few respondents commented that the auditor's decision to use substantive analytical procedures is dealt with in ISA 330 (Redrafted) and not in the extant ISA 520. The respondents expressed concern over the addition of the words "in deciding to use" in paragraph 8 of ED-ISA 520 as the requirement in paragraph 8 of ED-ISA 520 would only apply *after* the auditor has made the decision to perform analytical procedures. Therefore, the additional wording inappropriately changes the original intention of the requirement in the extant ISA 520. Some respondents also felt that the subparagraphs in the requirement could be further simplified.

IAASB Decision

15. The IAASB did not intend to change in this regard, or imply that there is such a change to, the general scope and requirements of the extant ISA 520. It considered the respondents' comments and concluded that the words 'in deciding to use' in paragraph 8 of ED-ISA 520 contradicted the scope of the ISA as the auditor does not make decisions with regard to the use of substantive analytical procedures when complying with the requirements of the extant ISA 520. Based on the responses received, the IAASB agreed to delete the words. It further agreed to reorder and redraft subparagraphs 8(a) - 8(e) of ED-ISA 520 to achieve a better flow of the requirements. See paragraph 5 of ISA 520 (Redrafted).

Other Specific Matters

Nature of Analytical Procedures

16. Paragraphs 2-4 of ED-ISA 520 contained material of an informative nature with regard to analytical procedures. Some respondents expressed the view that they should be repositioned as guidance as this would appropriately reflect the nature of these paragraphs. The IAASB agreed that paragraphs 2-4 of ED-ISA 520 did not imposed requirements on the auditor and, therefore, are more appropriately stated as application material.

Considerations Specific to Smaller Entities

17. Paragraph A11 of ED-ISA 520 stated that in the case of smaller entities, information the auditor may require for purposes of performing analytical procedures may be limited due to the lack of timeliness in the processing of transactions and preparation of reliable financial information. Many respondents commented that the lack of information, or that the information may be unreliable, is not restricted solely to smaller entities. The IAASB agreed with the respondents' comments and deleted the paragraph accordingly.