



ISA 520 ANALYTICAL PROCEDURES

Proposed redrafted International Standard on Auditing issued for comment by the International Auditing and Assurance Standards Board of the International Federation of Accountants

Comments from ACCA
March 2008

ACCA (the Association of Chartered Certified Accountants) is the largest and fastest-growing global professional accountancy body with over 122,000 members and 325,000 students in 170 countries.

We aim to offer the first choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management. ACCA works to achieve and promote the highest professional, ethical and governance standards and advance the public interest.

www.accaglobal.com

Executive Summary

ACCA welcomes the opportunity to comment on the proposed International Standard on Auditing ISA 520 (Redrafted) *Analytical Procedures* (proposed ISA 520), issued for comment by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants.

We recognise that, without revision, it is a difficult task to redraft proposed ISA 520 in accordance with the Clarity drafting conventions.

We agree with the change in scope of proposed ISA 520 whereby it no longer deals with analytical risk assessment procedures because such material is transferred to ISA 315 (Redrafted) *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* (ISA 315).

We identify difficulties with continuing to use the definition of analytical procedures from extant ISA 520 and in the interaction between the scope, objectives and requirements of proposed ISA 520.

We are concerned that the requirements introduced for optional substantive analytical procedures may operate to deter the use of such procedures, especially in the audit of small companies.

We set out ways in which the above difficulties can be mitigated and suggest that proposed ISA 520 should focus requirements on those substantive analytical procedures that provide pervasive audit evidence.

Analytical risk assessment procedures

We agree with the change in scope of proposed ISA 520 whereby it no longer deals with analytical risk assessment procedures because such material is transferred to ISA 315.

This change allows the objectives of proposed ISA 520 to be more clearly focussed and users may concentrate more easily on the remaining content.

We recognise that proposed ISA 520 is redrafted and not revised and so do not recommend further structural changes.¹

¹ Implementation of our recommendations under the heading *Changes made to Enhance the Clarity of Proposed ISA 520* could be facilitated, however, by changing the scope of proposed ISA 520 so that its requirements apply only to substantive analytical procedures that provide pervasive evidence.

Changes made to Enhance the Clarity of Proposed ISA 520

SCOPE

The scope of proposed ISA 520 should be changed to give explicit recognition to the fact that the use of analytical procedures as substantive procedures in response to assessed risks is not mandatory.

While such procedures will be employed in many audits, there remain some instances where they will not be necessary and that should be recognised both in the scope and in the objectives and requirements of proposed ISA 520.

Recommendations we make elsewhere in this response could be recognised through further changing the scope of proposed ISA 520 so that its requirements apply only to substantive analytical procedures that provide pervasive evidence.

OBJECTIVES

The objectives are not acceptable.

The objectives should be changed to give explicit recognition to the fact that it is not mandatory to use analytical procedures as substantive procedures in response to assessed risks.

We agree that the objectives should deal separately with analytical procedures at the overall review stage. It is not immediately clear, however, how the objectives relate to the requirements, which are collected under three headings. We deal further with this issue, which also relates to the scope of proposed ISA 520, in the section of our response headed *Requirements*.

Objective 6(a) refers to effectiveness. We see no reason why effectiveness should not also feature in objective 6(b). This highlights the fact that effectiveness has been introduced when it did not feature in this way in extant ISA 520. We suggest that the consistency of objectives in similar ISAs is a matter that requires due consideration when finalising proposed ISAs. In this context we note that the Exposure Draft of proposed ISA 505 (Revised and Redrafted) *External Confirmations*, contained the following: *'the objective of the auditor when using external confirmation procedures in response to an assessed risk of material misstatement is to design and perform such procedures to obtain relevant and reliable audit evidence.'* In our February 2008 response we stated that such a construction was acceptable.

We find the use of the two expressions *'analytical procedures as substantive procedures in response to assessed risks'* and *'analytical procedures that assist in arriving at the overall conclusion in an audit of financial statements'* as contrasting compound nouns to be an unnecessary complication of the prose of the objectives. Questions are raised in the minds of users as to whether a change of meaning is intended when these are repeated, or partly repeated, or repeated with insertions in the remainder of proposed ISA 520.

The Application and Other Explanatory Material refers to the *'overall review stage of the audit'* (eg paragraph A15). We have commented on earlier exposure drafts (for example our May 2007 response to proposed ISA (Redrafted) 570 *Going Concern*) that: *'The preferred timing of a requirement is a matter that should be considered on a consistent basis for all ISAs. If sufficiently important, the timing of a requirement should itself be a requirement; if timing is not critical, the preferred timing should be indicated by guidance material or left unstated.'* We consider the timing of *'analytical procedures that assist in arriving at the overall conclusion in an audit of financial statements'* to be sufficiently important to be made explicit in the requirement. A change to the wording of the requirement and the objective to refer to the overall review stage would remove many of the difficulties of using this very long compound noun.

For the reasons set out in this response under the heading *Definition*, we suggest that the words *'design and perform'* are not appropriate. A simple substitution of the word *'use'* would not achieve clear presentation of the objectives, however, which would benefit from more-extensive redrafting.

DEFINITION

The definition of analytical procedures is unchanged from that relevant to extant ISA 520. It has two parts (the second of which itself has two aspects):

(1) *' . . . the term "analytical procedures" means evaluations of financial information made by a study of plausible relationships among both financial and non-financial data.'*

(2) *'Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.'*

The definition becomes particularly important because proposed ISA 520 has introduced requirements for analytical procedures as substantive procedures in response to assessed risks. The definition can be read in two ways. Part (2) may operate as a second category of procedures that come within the definition, or (examining the intent of the extant definition in relation to paragraph 17 of extant ISA 520) it may indicate that the term extends to the resulting *'investigation'* as well as the initial *'study'*.

If part (2) is a second category of procedures, the requirements do not always make sense in relation to analytical procedures that fall within this part of the definition. For example paragraph 8(b) requires that: *'the auditor shall . . . Develop an expectation of recorded amounts or ratios'* but the definition includes [identified fluctuations and relationships] *that are inconsistent with other relevant information*. No expectation is relevant to this inconsistency, as is obvious because the definition continues with an alternative [identified fluctuations and relationships] *that differ from expected values by a significant amount'*.

This difficulty could be addressed by changing the definition, or the requirements. In our view, as proposed ISA 520 is only redrafted, it is more in keeping with the application of the Clarity drafting conventions to retain the extant definition. In the section of this response headed *Requirements* we suggest, therefore, changes to the requirements that acknowledge the problem with the definition that we identify above.

If part (2) indicates that the term extends to the resulting *'investigation'* as well as the initial *'study'* the requirements do not always make sense because of a change in wording from extant ISA 520. An example is paragraph 9 of proposed ISA 520, which is a restatement of paragraph 13 of extant ISA 520. Paragraph 9 uses the words *'shall design and perform analytical procedures'* whereas the extant wording is *'should apply analytical procedures'*. It is clear that *'apply'* does not restrict analytical procedures to aspects that can be designed and performed; in other words it includes investigation. As drafted, paragraph 9 requires only design and performance but omits the extant requirement that the investigation take place at the stage of the audit necessary to *'assist in arriving at the auditor's overall conclusion in an audit of financial statements'*. Such a requirement could be considered implicit, but we do not believe that users will assume that to be the case because of the proposed wording that separates design and performance.

If part (2) of the definition indicates that the term extends to the resulting *'investigation'* we recommend, therefore, throughout the Requirements section, that the words *'designing and performing'* be changed to *'using'* (and *'design and perform'* to *'use'*).

REQUIREMENTS

We do not generally agree with the requirements of proposed ISA 520.

Our comments below should be read together with the concerns we raise elsewhere in this response under the headings *Scope*, *Objectives* and *Definition*.

Paragraph 8

The condition precedent in paragraph 8 is complex and it is unclear whether the intention is to restrict the application of the requirements to circumstances where a decision has already been taken to use substantive analytical procedures. The words '*in deciding to use*' could operate to make the requirements applicable to the planning stage, because it is not possible in practice to differentiate between '*in deciding to use*' and '*in deciding not to use*'.

As we have similarly recommended in relation to the scope and objectives of proposed ISA 520, this requirement should be redrafted to give explicit recognition to the fact that the use of analytical procedures as substantive procedures in response to assessed risks is not mandatory.

Taken together with the heading above it, we assume that the intention of the condition precedent in paragraph 8 is to restrict the application of the requirements so as to exclude those in the planning and overall review stages of the audit. Several of the bulleted requirements would be equally valid for analytical procedures at the planning and overall review stages of the audit. Indeed, as 8(e) makes an explicit link to the requirement in paragraph 10 (which potentially applies to all analytical procedures) the precise application is not wholly clear. We do not suggest, however, extending the application of the requirements in paragraph 8.

Instead, we suggest that as they will generally operate to reduce the quality of auditing their operation should be restricted.

The reduction will come about because: (1) positioning the material as requirements that are not applicable to analytical procedures at the planning and overall review stages will reduce the likelihood that the material will be referred to as guidance in such circumstances, and (2) the presence of requirements relating to substantive analytical procedures will deter their use. This is particularly likely in the audit of small entities where analytical procedures can be valuable in providing substantive evidence.

While we might argue strongly that the introduction of requirements for substantive analytical procedures is an unwarranted elevation of the guidance in extant ISA 520, we recognise that in certain circumstances requirements are appropriate. We suggest that requirements should only be placed on substantive analytical procedures that provide pervasive evidence that may eliminate the need for further tests of details (as discussed in paragraph A5). For 'unsophisticated predictive models' and other analytical procedures that provide useful corroboration when used in combination with other audit procedures, we suggest that the imposition of requirements is not appropriate as they are very similar in nature to analytical procedures at the planning and overall review stages, for which the IAASB is rightly not proposing specific procedural requirements.

Paragraph 9

Our comments under the heading *Definition* are particularly relevant. The wording of paragraph 9 does not make it clear that investigation (and action) should follow design and performance.

As currently drafted, taken together with the requirement in paragraph 10, paragraph 9 does properly require investigation. As a minimum, explanatory material should be added to confirm that paragraph 10 is intended to apply in these circumstances.

Paragraph 10

The paragraph is unclear as to its application. It has a condition precedent that refers to all analytical procedures and so potentially it also applies to those at the planning stage.

There is a requirement in paragraph 8(d) to *'determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph 10'*. Paragraph 10 does not use precisely the same wording. There is no *de minimus* provision in respect of inconsistencies and the words *'recorded amounts'* are not present. If this cross-reference is retained, the wording of the two paragraphs ought to be conformed.

Requirements and objectives

We are concerned that the three headings in the Requirements section are to be related to two objectives. This is made more complicated because, as set out above, the interaction of the objectives and application of the requirements are not clear.

Because of this and for the reasons set elsewhere in this response under the headings *Scope*, *Objectives* and *Definition*, we do not generally agree with the requirements of proposed ISA 520.

We suggest rewriting the requirements, to accord with the decision on the suggestions we make under the headings *Scope*, *Objectives* and *Definition* and to eliminate any of the issues that we identify in relation to requirements, if they remain relevant.

For the reasons set out in the section of our response headed *Definition*, the words *'designing and performing'* should be changed to *'using'* (and *'design and perform'* to *'use'*) throughout the Requirements section.

OTHER MATTERS

The Explanatory Memorandum forming part of the Exposure Draft invites comments on the following other matters:

- Special considerations in the audit of small entities (see below)
- Special considerations in the audit of public sector entities
- Developing nations
- Translation
- Undue costs

Our response contains comments that are relevant to the above except we have not made a distinction between developing nations and others, as the audit of small entities may be present in both. We have no separate comments on public sector aspects of the proposed standard or translation.

Considerations in the audit of small entities

We are particularly concerned that the requirements set out in paragraph 8 could deter the use of analytical procedures and so damage rather than enhance the quality of the audit of small entities.

As set out below, the specific application material is also discouraging and, if it is not possible to rewrite this material to give a more-balanced view, we suggest eliminating it.

Paragraph A11 of proposed ISA 520 refers to unreliability, or lack, of information without exposition of the factors that actually make analytical procedures very valuable in such audits, such as the understandability of relationships. The procedures referred to in paragraphs A4 and A5 are, for example, of clear benefit in many small audits.

Paragraph A10 of proposed conforming amendment to ISA 315 (Redrafted) is to a lesser extent also discouraging. It would be possible to balance the references to timing difficulties with an exposition of the factors that make analytical procedures, nevertheless, very useful in such circumstances.

TECH-CDR-746.DOC

29 LINCOLN'S INN FIELDS
LONDON WC2A 3EE
UNITED KINGDOM

T +44 (0)20 7059 5000
F +44 (0)20 7059 5050

www.accaglobal.com