

**PROPOSED INTERNATIONAL STANDARD ON AUDITING 520  
(REDRAFTED)****ANALYTICAL PROCEDURES**

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

[CLEAN DRAFT]

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	<b>Scope of this ISA</b>
Para 1	1. <del>The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on deals with the auditor's use the application of analytical procedures during in an audit of financial statements.</del>
	<i>Nature of Analytical Procedures</i>
Para 4.1	2. Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:
Para 4 bullet 1	• Comparable information for prior periods.
Para 4 bullet 2	• Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
Para 4 bullet 3	• 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.
Para 5.1	3. Analytical procedures also include consideration of relationships, <u>for example:</u>
Para 5 bullet 1	• 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.
Para 5 bullet 2	• Between financial information and relevant non-financial information, such as payroll costs to number of employees.
Para 6	4. Various methods may be used <del>in to performing the above audit analytical</del> procedures. <u>These which</u> range from simple comparisons to complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, financial statements of components (such as subsidiaries, divisions, <u>branches</u> or segments) and individual elements of financial information. <del>The auditor's choice of audit procedures, methods and level of application is a matter of professional judgment.</del>
	<b>Effective Date</b>
New	5. <u>This ISA is effective for audits of financial statements for periods beginning on or after [December 15, 2009].</u>
	<b>Objective</b>
Para 2.1	6. The <u>objective of the auditor</u> <del>should apply is to design and perform</del> analytical procedures:
Para 2.1 and Para 2.2	(a) <u>That are effective in obtaining relevant and reliable audit evidence when used</u> as risk assessment procedures <del>to</del>

	<del>obtain an understanding of the entity and its environment and or Analytical procedures may also be applied</del> as substantive procedures <u>in response to an assessed risk of material misstatement; and</u>
Para 2.1	(b) <del>That contribute to the auditor's in the</del> overall review <del>at the end of the audit</del> financial statements.
	<b>Definitions</b>
Para 3	7. <u>For the purposes of the ISAs, the following term has the meaning attributed below:</u>
	(a) <del>"Analytical procedures"</del> <u>– means e</u> Evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.
	<b>Requirements</b>
	<b>Analytical Procedures as Risk Assessment Procedures</b>
Para 8.1	8. The auditor <del>should apply</del> <u>shall design and perform</u> analytical procedures as risk assessment procedures <del>to as part of obtaining</del> an understanding of the entity and its environment <u>in accordance with ISA 315 (Redrafted). (Ref: Para. A1 – A4)</u>
	<b>Analytical Procedures as Substantive Procedures</b>
Para 12	9. <u>In deciding to use, and W</u> When designing and performing, analytical procedures, <u>either alone or in combination with test of details, as a</u> substantive procedures <u>to respond to assessed risk of material misstatement at the assertion level in accordance with ISA 330 (Redrafted), the auditor shall will</u> <del>need to consider a number of factors such as the following:</del> <u>(Para. A5 – A6)</u> (a) <u>Determine t</u> The suitability of using substantive analytical procedures given the assertions, <u>taking account of the assessed risks of material misstatement and tests of details, if any, directed towards the same assertion</u> <del>(paragraphs 12a and 12b).</del> <u>(Para. A7 – A11)</u> (b) <u>Evaluate</u> The reliability of data, whether internal or external, from which the expectation of recorded amounts or ratios is developed, <u>taking account of source, comparability, and nature and relevance of information available, and controls over preparation</u> <del>(paragraphs 12c and 12d).</del> <u>(Para. A12 – A13)</u> (c) <u>Evaluate w</u> Whether the expectation is sufficiently precise to identify a material misstatement at the desired level of assurance <del>(paragraph 12e).</del> <u>(Para. A14)</u>

	(d) <u>Determine</u> <del>t</del> The amount of any difference of recorded amounts from expected values that is acceptable <u>without further investigation</u> <del>(paragraph 12f)</del> . (Para. A15-A17)
	<b>Analytical Procedures as Part of the Auditor's Overall Review of the Financial Statements</b>
Para 13.1	10. The auditor <del>should apply analytical procedures at or near the end</del> <u>shall, as part</u> of the auditor's <del>when</del> <u>overall review of the financial statements, design and perform analytical procedures that contribute to</u> forming an overall conclusion as to whether the financial statements as a whole are consistent with the auditor's understanding of the entity. (Ref: Para. A18 – A20)
	<b>Investigating Results of Analytical Procedures</b>
Para 17	11. <del>If</del> <u>When</u> analytical procedures identify significant fluctuations or relationships that are inconsistent with other relevant information or that deviate <u>significantly</u> from predicted amounts, the auditor <del>should</del> <u>shall</u> investigate <del>and obtain adequate explanations and appropriate corroborative audit evidence., through:</del> (a) <u>Inquiry of management and obtaining appropriate audit evidence to corroborate management's responses; and</u> (b) <u>Performing other audit procedures as necessary in the circumstances.</u> (Ref: Para. A21-A22)
	<b>Application and Other Explanatory Material</b>
	<b>Analytical Procedures as Risk Assessment Procedures</b> (Ref: Para. 8)
Para 8.2	A1. <del>Application of a</del> Analytical procedures <u>performed during risk assessment of the entity</u> may indicate aspects of the entity of which the auditor was unaware and will assist in assessing the risks of material misstatement in order to determine the nature, timing and extent of further audit procedures.
Para 9	A2. Analytical procedures applied as risk assessment procedures <del>use</del> <u>may include</u> both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold. <del>Paragraph 10 of ISA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" contains additional guidance on applying analytical procedures as risk assessment procedures.</del>
	Considerations Specific to Smaller Entities
IAPS 1005 Para 71	A3. The <u>availability of information to perform</u> <del>nature and extent of</del> analytical procedures <u>as risk assessment procedures in at the planning stage of</u> the audit of a smaller <u>entity</u> may be

	<p>limited by the timeliness of processing of transactions <u>and preparation of reliable financial information</u> by the <u>small entity</u> <del>and the lack of reliable financial information at that point in time</del>. Further, <del>s</del>Small entities may not have interim or monthly financial information that can be used <u>for purposes of in-analytical procedures at the planning stage</u>. Accordingly, <u>although the auditor may be able to perform limited analytical procedures for purposes of planning the audit or obtain some information through inquiry of the owner-manager, the auditor may need to plan to perform analytical procedures when the first draft of the entity's financial statements is available</u><del>The auditor may, as an alternative, conduct a brief review of the general ledger or such other accounting records as may be readily available.</del></p>
	Considerations Specific to Public Sector Entities
<i>Public Sector Perspective</i> <i>Par 1</i>	<p>A4. The relationships between individual financial statement items traditionally considered in the audit of business entities may not always be <u>relevant appropriate</u> in the audit of governments or other non-business public sector entities; for example, in many <del>such</del> public sector entities there <del>is often</del> <u>may be</u> little direct relationship between revenue and expenditure. In addition, because expenditure on the acquisition of assets <del>is frequently non-</del> <u>may not be</u> 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. <del>In addition, Also</del> in the public sector, industry data or statistics for comparative purposes may not be available. 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. <del>Where appropriate, reference has to be made to available private sector industry data and statistics. In certain instances, it may also be appropriate for the auditor to generate an in-house database of reference information.</del></p>
	<b>Analytical Procedures as Substantive Procedures</b> (Ref: Para. 9)
Para 10.2 and 10.3	<p>A5. <del>The auditor's substantive procedures at the assertion level may be derived from tests of details, from substantive analytical procedures, or from a combination of both.</del> The decision about which audit procedures to use 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.</p>
Para 11	<p>A6. The auditor <del>will ordinarily</del> <u>may</u> inquire of management as to the availability and reliability of information needed to apply substantive analytical procedures and the results of any such procedures performed by the entity. It may be efficient to use analytical data prepared by <del>the entity management, and to consider the results of any such procedures performed by</del></p>

	<u>management</u> , provided the auditor is satisfied that such data is properly prepared.
	Suitability of Using Substantive Analytical Procedures Given the Assertions (Ref: Para 9(a))
Para 12a	A7.Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of substantive 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 <u>relevant to financial reporting</u> . However, <del>reliance on the results use</del> of substantive analytical procedures <u>by the auditor</u> would depend on the auditor's <del>assessment of the risk expectation</del> that the analytical procedures <u>may would not fail to</u> identify relationships as expected when, in fact, a material misstatement exists.
IAPS 1005 Para 73	A8.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.
IAPS 1005 Para 75	A9.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 be a very persuasive source of evidence and may eliminate the need for further verification by means of tests of details provided the components are appropriately verified. In contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may be a less persuasive source of evidence, but may provide useful corroboration if used in combination with other audit procedures.

Para 12b.1 and Para 12b (a)	A10. <del>The In</del> -determination of <del>ing</del> -the suitability of substantive analytical procedures given the assertions <u>is influenced by, the auditor may consider the following: The nature of the assertion and the auditor's assessment of the risk of material misstatement. The auditor considers the understanding of the entity and its internal control, the materiality and likelihood of misstatements of the items involved, and the nature of the assertion in determining whether analytical procedures are suitable.</u> For example if controls over sales order processing is weak the auditor may place more reliance on tests of details rather than substantive analytical procedures for assertions related to receivables or when inventory balances are material the auditor may not rely only on substantive analytical procedures when performing audit procedures on the existence assertion.
Para 12b (b)	A11. <del>Any tests of details directed toward the same assertion.</del> Substantive analytical procedures may also be considered appropriate when tests of details are performed on the same assertion. For example when <u>obtaining audit evidence regarding the valuation assertion for auditing the collectibility of</u> accounts receivable <u>balances</u> , the auditor may apply substantive analytical procedures to an aging of customers' accounts in addition to tests of details on subsequent cash receipts <u>to determine the collectability of the receivables.</u>
	The Reliability of the Data ( <i>Ref: Para 9(b)</i> )
Para 12c 1 & 2	A12. The reliability of data is influenced by its source and by its nature and is dependent on the circumstances under which it is obtained. <u>Accordingly, the following are relevant when In</u> -determining whether data is reliable for purposes of designing substantive analytical procedures, <del>the auditor considers the following:</del>
Para 12c (a)	(a)Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity. <u>(Refer to [Proposed] ISA 500 (Redrafted)<sup>1</sup>)</u>
Para 12c (b)	(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.
Para 12c (c)	(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.
Para 12c (d)	(d)Controls over the preparation of the information. For

<sup>1</sup> [Proposed ISA 500 (Redrafted), "Considering the Relevance and Reliability of Audit Evidence," paragraph A23.



	example, controls over the preparation, review and maintenance of budgets.
Para 12d.	<p>A13. The auditor <u>may</u> consider<del>s</del> testing the <u>operating effectiveness of</u> controls, if any, over the entity's preparation of information used by the auditor in applying substantive analytical procedures. When such controls are effective, the auditor generally has greater confidence in the reliability of the information and, therefore, in the results of substantive analytical procedures. The <u>operating effectiveness of</u> controls over non-financial information <del>can</del> <u>may</u> often be tested in conjunction with other tests of controls. For example, an entity in establishing controls over the processing of sales invoices may include controls over the recording of unit sales. In these circumstances, the auditor could 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 in the current or prior period. <del>In determining the audit procedures to apply to the information upon which the expectation for substantive analytical procedures is based, the auditor considers the guidance in paragraph 11 of ISA 500 "Audit Evidence."</del><sup>2</sup> <u>establishes requirements and provides guidance in determining the audit procedures to apply to the information upon which the expectation for substantive analytical procedures is based.</u></p>
	Determining whether the Expectation is Sufficiently Precise <i>(Ref: Para 9(c))</i>
Para 12e	<p>A14. <del>When the auditor assesses</del><u>In evaluating determining</u> whether the expectation can be developed sufficiently precisely to identify a material misstatement at the desired level of assurance, the auditor may consider <u>matters such as</u> the following:</p>
Para 12e bullet 1	<ul style="list-style-type: none"> <li>The accuracy with which the expected results of substantive analytical procedures can be predicted. For example, the auditor <del>will ordinarily</del> <u>may</u> expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.</li> </ul>
Para 12e bullet 2	<ul style="list-style-type: none"> <li>The degree to which information can be disaggregated. For example, substantive 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.</li> </ul>
Para 12e bullet 3	<ul style="list-style-type: none"> <li>The availability of the information, both financial and non-financial. For example, the auditor <u>may</u> consider<del>s</del> whether financial information, such as budgets or</li> </ul>

2 [Proposed ISA 500 (Redrafted) paragraphs 12(a), A28 and A29.]



	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 <u>may</u> also consider the reliability of the information as discussed in paragraphs <del>12e and 12d</del> <u>A13 and A14</u> above.
	Amount of Difference of Recorded Amounts from Expected Values that is Acceptable <u>(Ref: Para 9(d))</u>
Para 12f.	A15. <del>In designing and performing substantive analytical procedures, the auditor's determination considers of the amount of difference from expectation that can be accepted without further investigation. This consideration is influenced primarily by materiality and the consistency with the desired level of assurance, taking account of . Determination of this amount involves considering the possibility that a combination of misstatements in the specific account balance, class of transactions, or disclosure could aggregate to an unacceptable amount. The auditor is required to obtain more persuasive audit evidence the higher the auditor's assessment of risk<sup>3</sup>. Accordingly, a smaller amount of difference that would be considered acceptable without investigation is needed to achieve the desired level assurance as the assessed risks increases. increases the desired level of assurance as the risk of material misstatement increases by reducing the amount of difference from the expectation that can be accepted without further investigation. Paragraphs 17 and 18 below discuss the auditor's response when the amount of difference between the expected value and the reported value exceeds the amount that can be accepted without further investigation.</del>
Para 12g	A16. <del>When the auditor performed substantive procedures at an interim date and plans to perform substantive analytical procedures with respect to the intervening period, the auditor considers how</del> <u>The matters discussed in paragraphs 9 (a) – 9 (d) 12a-12f are relevant irrespective of whether the auditor performs analytical procedures as substantive procedures on the entity's period end financial statements, or the auditor performed substantive procedures at an interim date and plans to perform substantive analytical procedures with respect to the intervening period as part of the period end. affect the auditor's ability to obtain sufficient appropriate audit evidence for the remaining period. This includes considering whether the period end balances of the particular classes of transactions or account balances are reasonably predictable with respect to amount, relative significance, and composition. See ISA 330<sup>4</sup>, paragraphs 56-61 for establishes requirements and provides guidance on substantive procedures performed at an interim date additional guidance.</u>

<sup>3</sup> ISA 330 (Redrafted), "The Auditor's Response to Assessed Risks," paragraph 7(b).

<sup>4</sup> ISA 330 (Redrafted), paragraphs 23-24.

	Considerations Specific to Smaller Entities
IAPS 1005 Para 73	A17. <del>An unsophisticated predictive model can sometimes be effective as an analytical procedure. For example, where a small 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.</del> The extent of analytical procedures in the audit of a small entity may be limited because of the non-availability of information on which the analytical procedures are based.
	<b>Analytical Procedures as Part of the Auditor's Overall Review of the Financial Statements</b> <i>(Ref: Para. 10)</i>
Para 13.2 to 4	A18. The conclusions drawn from the results of <del>such audit analytical</del> procedures <u>as part of the auditor's overall review of the financial statements during the overall review stage of the audit</u> are intended to corroborate conclusions formed during the audit of individual components or elements of the financial statements and assist in arriving at the <u>auditor's overall conclusion on whether the financial statements as a whole are free from material misstatements</u> <del>as to the reasonableness of the financial statements.</del>  A19. <del>However, they</del> <u>The results of such analytical procedure</u> may <del>also</del> identify a previously unrecognized risk of material misstatement. In such circumstances, the auditor <u>is required to revise the auditor's assessment of the risks of material misstatement and modify the further planned audit procedures accordingly</u> <sup>5</sup> <del>may need to re-evaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the classes of transactions, account balances, or disclosures and related assertions.</del>
IAPS 1005 Para 76 included under general application material as it is not only applicable to smaller entities	A20. The analytical procedures performed <u>as part of the auditor's overall review of the financial statements</u> <del>at this stage of the audit</del> are <u>often very</u> similar to those that would be used <u>as risk assessment procedures</u> <del>at the planning stage of the audit. These may include the following:</del>
<del>IAPS 1005 Para</del>	<del>•Comparing the financial statements for the current year to</del>

<sup>5</sup> ISA 330 (Redrafted), paragraph 30.

<del>76 bullet 1</del>	<del>those of previous years.</del>
<del>IAPS 1005 Para 76 bullet 2</del>	<del>•Comparing the financial statements to any budgets, forecasts, or management expectations.</del>
<del>IAPS 1005 Para 76 bullet 3</del>	<del>•Reviewing trends in any important financial statement ratios.</del>
<del>IAPS 1005 Para 76 bullet 4</del>	<del>•Considering whether the financial statements adequately reflect any changes in the entity of which the auditor is aware.</del>
<del>IAPS 1005 Para 76 bullet 5</del>	<del>•Inquiring into unexplained or unexpected features of the financial statements.</del>
	<b>Investigating Results of Analytical Procedures</b> (Ref: Para. 11)
Para 18 and Para 18 a	A21. <del>The investigation of unusual fluctuations and relationships ordinarily begins with inquiries of management, followed by:</del> Corroborating management's responses <del>for example, by comparing them</del> <u>may include considering how those responses compare</u> with the auditor's understanding of the entity <u>and its environment, or</u> <del>and</del> <u>with</u> other audit evidence obtained during the course of the audit. <del>;</del> <u>and</u>
Para 18 b	A22. <del>Consideration of</del> <u>The</u> need to apply other audit procedures <del>based on the results of such inquiries, if</del> <u>may arise when, for example,</u> management is unable to provide an explanation or if the explanation is not considered adequate.

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