ASA 520
(April 2006)

Auditing Standard ASA 520
Analytical Procedures

Issued by the **Auditing and Assurance Standards Board**

Australian Government
Auditing and Assurance Standards Board

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PREFACE

Reasons for Issuing Auditing Standard ASA 520 *Analytical Procedures*

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 520 *Analytical Procedures* due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act) established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Main Features

This Auditing Standard establishes mandatory requirements and provides explanatory guidance on the application of analytical procedures during an audit of a financial report.

Operative Date

This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.

Main changes from AUS 512 (October 1995) *Analytical Procedures*

The main differences between this Auditing Standard and the Auditing Standard issued by the Auditing & Assurance Standards Board of the Australian Accounting Research Foundation, AUS 512 (October 1995) *Analytical Procedures*, are that in this Auditing Standard:

1. The word 'shall', in the **bold-type** paragraphs, is the terminology used to describe an auditor's mandatory requirements, whereas an auditor's degree of responsibility is described in AUS 512 by the word 'should'.

2. The explanatory guidance paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas in AUS 512 some obligations are implied within certain explanatory paragraphs. Accordingly, such paragraphs have been redrafted to clarify that the matter forms part of the explanatory guidance.

3. Appendix 1 – Examples of Analytical Procedures in AUS 512 is not included in this Auditing Standard.

AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) makes Auditing Standard ASA 520 *Analytical Procedures* as set out in paragraphs 1 to 29, pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

The mandatory requirements of this Auditing Standard are set out in **bold-type** paragraphs.

Dated 28 April 2006

M H Kelsall
Chairman - AUASB

AUDITING STANDARD ASA 520

Analytical Procedures

Application

1 This Auditing Standard applies to:

(a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with Part 2M.3 of the *Corporations Act 2001*; and

(b) an audit of a financial report for any other purpose.

2 This Auditing Standard also applies, as appropriate, to an audit of other financial information.

Operative Date

3 This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.

Introduction

4 The purpose of this Auditing Standard is to establish mandatory requirements and provide explanatory guidance on the application of analytical procedures during an audit of a financial report.

5 The auditor shall apply analytical procedures as risk assessment procedures to obtain an understanding of the entity and its environment and in the overall review at the end of the audit.

6 Analytical procedures may also be applied as substantive procedures.

7 "Analytical procedures" means 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.

Nature and Purpose of Analytical Procedures

8 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; and
- 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.

9 Analytical procedures also include consideration of relationships:

- 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; and
- between financial information and relevant non-financial information, such as payroll costs to number of employees.

10 Various methods may be used in performing the above audit procedures. These range from simple comparisons to complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial reports, financial information of components (such as subsidiaries, divisions or segments) and individual elements of financial information. The auditor's choice of audit procedures, methods and level of application is a matter of professional judgement.

11 Analytical procedures are used for the following purposes:

(a) as risk assessment procedures to obtain an understanding of the entity and its environment (paragraphs 12-14);

(b) as substantive procedures when their use can be more effective or efficient than tests of details in reducing the risk of material misstatement at the assertion level to an acceptably low level (paragraphs 15-24); and

(c) as an overall review of the financial report at the end of the audit (paragraph 25-26).

Analytical Procedures as Risk Assessment Procedures

12 **The auditor shall apply analytical procedures as risk assessment procedures to obtain an understanding of the entity and its environment.**

13 Application of analytical procedures 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.

14 Analytical procedures applied as risk assessment procedures use both financial and non-financial information, for example, the relationship between sales and square metres of selling space or volume of goods sold. ASA 315 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, contains additional explanatory guidance on applying analytical procedures as risk assessment procedures.

Analytical Procedures as Substantive Procedures

15 The auditor ordinarily designs and performs substantive procedures to be responsive to the related assessment of the risk of material misstatement at the assertion level. 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. The decision about which audit procedures to use to achieve a particular audit objective is ordinarily based on the auditor's judgement about the expected effectiveness and efficiency of the available audit procedures in reducing the assessed risk of material misstatement at the assertion level to an acceptably low level.

16 The auditor will ordinarily enquire 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 the entity, provided the auditor is satisfied that such data is properly prepared.

17 When designing and performing analytical procedures as substantive procedures, the auditor ordinarily will need to consider a number of factors such as the following:

- the suitability of using substantive analytical procedures given the assertions (paragraphs 18 and 19);

- the reliability of the data, whether internal or external, from which expectation of recorded amounts or ratios is developed (paragraphs 20 and 21);
- whether the expectation is sufficiently precise to identify a material misstatement at the desired level of assurance (paragraph 22); and
- the amount of any difference of recorded amounts from expected values that is acceptable (paragraph 23).

Suitability of Using Substantive Analytical Procedures Given the Assertions

18 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. However, reliance on the results of substantive analytical procedures will ordinarily depend on the auditor's assessment of the risk that the analytical procedures may identify relationships as expected when, in fact, a material misstatement exists.

19 In determining the suitability of substantive analytical procedures given the assertions, ordinarily the auditor considers:

(a) *The assessment of the risk of material misstatement.* Ordinarily, the auditor considers the understanding of the entity and its internal control, the materiality and likelihood of misstatement of the items involved, and the nature of the assertion in determining whether substantive analytical procedures are suitable. For example, if controls over sales order processing are weak, the auditor may place more reliance on tests of details rather than substantive analytical procedures for assertions related to receivables. As another example, when inventory balances are material, the auditor ordinarily does not rely only on substantive analytical procedures when performing audit procedures on the existence assertion. ASA 330 *The Auditor's Procedures in Response to Assessed Risks*, indicates that when the approach to significant risks consists only of substantive procedures, the audit procedures appropriate to address such significant risks consist of tests of details only, or a combination of tests of details and substantive analytical procedures.

(b) *Any tests of details directed toward the same assertion.* Substantive analytical procedures may also be considered appropriate when tests of details are performed on the same assertion. For example, when auditing the collectibility of accounts receivable, the auditor may apply substantive analytical procedures to an ageing of customers' accounts in addition to tests of details on subsequent cash receipts.

The Reliability of the Data

20 The reliability of data is influenced by its source and by its nature and is dependent on the circumstances under which it is obtained. In determining whether data is reliable for purposes of designing substantive analytical procedures, ordinarily the auditor considers:

(a) *Source of the information available.* For example, information is ordinarily more reliable when it is obtained from independent sources 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 specialised 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.

(d) *Controls over the preparation of the information.* For example, controls over the preparation, review and maintenance of budgets.

21 Ordinarily, the auditor considers testing the 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 has greater confidence in the reliability of the information and, therefore, in the results of substantive analytical procedures. The controls over non-financial information can 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. In determining the audit procedures to apply to the information upon which the expectation for substantive analytical procedures is based, ordinarily the auditor considers the explanatory guidance in ASA 500 *Audit Evidence*.

Whether the Expectation is Sufficiently Precise

22 In assessing whether the expectation can be developed with sufficient precision to identify a material misstatement at the desired level of assurance, ordinarily the auditor considers factors such as:

- *The accuracy with which the expected results of substantive analytical procedures can be predicted.* For example, the auditor will ordinarily 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, 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.

- *The availability of the information, both financial and non-financial.* For example, the auditor considers 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 also considers the reliability of the information as discussed in paragraphs 20 and 21 above.

Amount of Difference of Recorded Amounts from Expected Values that is Acceptable

23 In designing and performing substantive analytical procedures, ordinarily the auditor considers 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. 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. Ordinarily, the auditor 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 27 and 28 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.

24 When the auditor performs substantive procedures at an interim date and plans to perform substantive analytical procedures with respect to the intervening period, ordinarily the auditor considers how the matters discussed in paragraphs 18-23 affect the ability to obtain sufficient appropriate audit evidence for the remaining period. This ordinarily 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 ASA 330 for additional explanatory guidance.

Analytical Procedures in the Overall Review at the End of the Audit

25 The auditor shall apply analytical procedures at or near the end of the audit when forming a conclusion as to whether the financial report as a whole is consistent with the auditor's understanding of the entity.

26 The conclusions drawn from the results of such audit procedures are intended to corroborate conclusions formed during the audit of individual components or elements of the financial report, and assist in arriving at the conclusion as to the reasonableness of the financial report. However, they may also identify a previously unrecognised risk of material misstatement. In such circumstances, the auditor 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 transaction, account balances, or disclosures and related assertions.

Investigating Unusual Items

27 When analytical procedures identify significant fluctuations or relationships that:

(a) are inconsistent with other relevant information; or

(b) deviate from predicted amounts,

the auditor shall investigate and obtain adequate explanations and appropriate corroborative audit evidence.

28 The investigation of unusual fluctuations and relationships ordinarily begins with enquiries of management, followed by:

(a) corroboration of management responses, for example by comparing them with the auditor's understanding of the entity and other audit evidence obtained during the course of the audit; and

(b) consideration of the need to apply other audit procedures based on the results of such enquiries if management is unable to provide an explanation, or if the explanation is not considered adequate.

Conformity with International Standards on Auditing

29 Except as noted below, this Auditing Standard conforms with International Standard on Auditing ISA 520 *Analytical Procedures,* issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The main difference between this Auditing Standard and ISA 520 is:

- ISA 520 includes a Public Sector Perspective section. This Auditing Standard does not include a separate section on the public sector as it is sector neutral.

Compliance with this Auditing Standard enables compliance with ISA 520.