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Organización Internacional de Comisiones de Valores  
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June 12, 2008

Mr. James M. Sylph  
Executive Director, Professional Standards  
International Auditing and Assurance Standards Board  
International Federation of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017

Email address: Edcomments@ifac.org

***Re: Proposed Redrafted International Standard on Auditing 520, "Analytical Procedures" and Proposed Conforming Amendments to International Standard on Auditing 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment"***

Dear Mr. Sylph:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the opportunity to comment on the Exposure Draft of proposed redrafted international standard on auditing ISA 520, *Analytical Procedures* (the ED), and the proposed conforming amendments to ISA 315 (Redrafted), *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment* (the proposed amendments). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing, and professional standards.

Members of SC 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns, and pursuit of improved global financial reporting. As we review proposed auditing standards, our concerns focus on whether the standards are sufficient in scope and adequately cover all relevant aspects of the area of audit being addressed, whether the standards are clear and understandable, and whether the standards are written in such a way as to be enforceable.

Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1; however, they are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

We welcome the changes that have been made in clarifying and redrafting ISA 520 and in the drafting of the proposed amendments to ISA 315. Matters that we believe should be further addressed are discussed below and the appendix to this letter outlines our responses to the IAASB's request for

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specific comments. Within our recommendations for editorial changes, additions are noted in “bold underline” and deletions in “bold strike through.”

## **ISA 520**

### **Scope of this ISA**

#### **Objective**

We believe paragraph 6(a), specifically, the phrase, “in response to assessed risk” could be interpreted by some readers to mean that when risk is assessed as low, the auditor would not have to perform substantive procedures, whether analytical procedures or other procedures. However, we believe that some substantive procedures (whether analytical procedures or other procedures) should be performed in all audits even where risk is considered low (e.g. identified risks are addressed by controls). This belief is supported by ISA 330, paragraph 20, which states, “Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.”

We agree that the decision whether analytical procedures or some other procedures should be used as substantive procedures will be affected by the assessed risks, as will the nature, timing and extent of the use of such procedures, but are not sure that the important requirement in ISA 330 paragraph 20 is sufficiently apparent in the discussion provided in ISA 520 and request that the Board find some way to strengthen the linkage to the requirement in ISA 330 paragraph 20, so that this important obligation will not be overlooked or misunderstood.

#### **Requirements**

##### **Analytical Procedures as Substantive Procedures in Response to Assessed Risks**

- Paragraph 8(a) requires the auditor to determine the suitability of using substantive analytical procedures. However, we believe the discussion could be further developed to provide more guidance about the factors an auditor should consider when making this determination. The discussion could also include guidance about the limitations of substantive analytical procedures.
- Paragraphs 8(a) through 8(e) set forth requirements that the auditor shall perform in deciding to use, and in using, analytical procedures. We do not believe that these requirements flow logically. Specifically, we believe that the procedures in 8(b) and 8(d) are activities that should be performed directly after the suitability assessments as per paragraphs 8(a) and 8(c), but before the assessment of the acceptable difference per paragraph 8(e). Accordingly, we recommend that the paragraphs be reordered as follows: 8(a), 8(c), 8(b), 8(d) and 8(e).
- Paragraph 8(c) requires the auditor to “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.” In regard to external data, we believe additional guidance is needed that addresses the degree to which an evaluation of the controls over preparation would be expected and how such an evaluation would actually be performed. For example, it would seem that in at least some instances, the general reputation of a widely-used and established external statistical data source providing data to an audited entity would obviate the need for that entity’s

auditor to make an extensive evaluation of how that reporting firm controls the preparation of its data; however, in cases of lesser known external sources, an auditor might need to perform specific procedures on controls over data preparation and/or otherwise corroborate the data. We suggest either deleting the phrase “whether internal or external” to make this requirement less explicit and allow for auditor judgment, or if both terms are retained, providing additional guidance about what is intended regarding an auditor’s evaluation of controls over the preparation of external source data.”

- Consistent with this recommendation, we also recommend that the related application material in paragraph A9 be modified by the addition of an item (e), which would say, “The degree to which an external entity supplying data such as industry or market share statistics, economic trends, etc., is a widely known reporting firm with an established reputation, or is a lesser-known supplier of data.
- In paragraphs 8(d), A3, A12 and A13, the Board replaced the extant phrase “material misstatement” with “a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated.” To ensure consistency with the required evaluation in ISA 450 (Redrafted), *Evaluation of Misstatements Identified during the Audit*, we suggest that this phrase be modified as follows: “a misstatement that, **individually or** when aggregated with other misstatements, may cause the financial statements to be materially misstated.”
- The heading above paragraph 8 and the related application guidance refers to the use of analytical procedures as substantive procedures in response to assessed risks. As noted earlier, we believe the phrase, “in response to assessed risk” could be interpreted by some readers to mean that when risk is assessed as low, the auditor would not have to perform substantive procedures, whether analytical procedures or other procedures. Accordingly, we recommend the words “in Response to Assessed Risks” be removed from the subheadings to avoid any confusion as to the circumstances in which analytical procedures may be used.

## **Application and Other Explanatory Material**

### **Analytical Procedures as Substantive Procedures in Response to Assessed Risks**

- The last sentence of paragraph A2 states, “It may be effective to use analytical data prepared by management, provided the auditor is satisfied that such data is *properly prepared*. (Emphasis added). To be consistent with the requirement in paragraph 8c and retain the focus on auditor judgment of reliability, we recommend that this be changed to “judged reliable.”

### **Suitability of Using Analytical Procedures Given the Assertions**

- Paragraph A6 is problematical and should probably be deleted. This paragraph states in part, “...if inventory balances are material, the auditor *may decide* not to rely only on analytical procedures when performing audit procedures on the existence assertion.” We do not see how an analytical procedure could address “existence” in an audit. The physical existence of inventory is something that would need to be addressed by actual inspection by the auditor or by someone working for the auditor. Further, the use of the phrase “may decide” in this sentence suggests that the auditor may instead decide to rely only on analytical procedures in testing the existence of material inventory balances, which contradicts the requirement in paragraph 4 of ISA 501 (Redrafted) for the auditor to attend the entity’s physical inventory count when inventory is

material to the financial statements. We suggest deleting this paragraph unless some other point is intended, in which case the paragraph should be clarified..

### **Considerations Specific to Smaller Entities**

- Paragraph A11 states, “The extent of use of analytical procedures as substantive procedures in response to assessed risks in the audit of a smaller entity may be limited because of the unreliability, or lack, of information on which the analytical procedures are based.” We believe it is possible that entities of all sizes may produce unreliable information or be unable to provide information from time to time. We do not believe that such matters are limited to smaller entities. Additionally, one may argue that due to the lack of complexity in the businesses of many smaller entities, that analytical procedures may actually be used more frequently as substantive procedures in the audits of smaller entities than in more complex businesses. For example, an auditor may find it more efficient and more effective to test a revenue account in an entity operating one line of business in one jurisdiction. Therefore, we suggest the Board consider deleting this guidance or providing examples to clarify when analytical procedures should not be used as substantive procedures in smaller entities.

### **Evaluation whether the Expectation is Sufficiently Precise**

- Paragraph A12 states, “In evaluating whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated, with other misstatements, may cause the financial statements to be materially misstated, the auditor *may consider* matters such as the following...” Use of the phrase “may consider” in this sentence suggests that the auditor may decide not to consider any of the matters in the bullets that follow (i.e., the accuracy with which the expected result of analytical procedures as substantive analytical procedures can be predicted, the degree to which information can be disaggregated, and the availability of information). It is unclear to us how the auditor could satisfy the requirement in paragraph 8(d) to evaluate whether the expectation is sufficiently precise without considering these matters. We suggest replacing “may consider” with “considers”.

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

- In paragraph A14 we believe the reference to paragraph 9(a)-(d) should be changed to paragraph 8(a)-(d).

## **ISA 315**

### **Requirements**

- We recognize that the IAASB has not proposed any conforming amendments to the requirements of ISA 315 (Redrafted). However, we believe paragraph 6(b) of ISA 315 (Redrafted) should be amended to include a footnote reference to paragraphs 2 through 4 of proposed redrafted ISA 520, which describe the nature of analytical procedures.

### **Application and Other Explanatory Material**

- Paragraph A10 states, in part, “The availability of information to perform analytical procedures as risk assessment procedures in the audit of a smaller entity may be limited by the timeliness of

processing of transactions and preparation of reliable financial information by the entity.” We believe that entities of all sizes may produce unreliable information or be unable to timely process transactions. We do not believe that such matters are limited to smaller entities.

- Paragraph A10 states, in part, “Further, smaller entities may not have interim or monthly financial information that can be used for purposes of analytical procedures. Accordingly, although the auditor may be able to perform limited analytical procedures for purposes of planning the audit or obtain some information through inquiry, the auditor may need to plan to perform analytical procedures to identify and assess the risks of material misstatement when an early draft of the entity’s financial statements is available.”

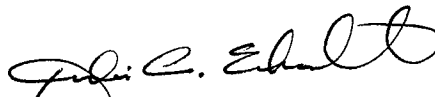
Because we believe that some smaller entities *do*, in fact, have interim or monthly financial information that can be used for purposes of analytical procedures, we recommend these sentences be revised as follows:

**“Further, Some** smaller entities may not have interim or monthly financial information that can be used for purposes of analytical procedures. **Accordingly, In these circumstances**, although the auditor may be able to perform limited analytical procedures for purposes for planning the audit or obtain some information through inquiry, the auditor may need to plan to perform analytical procedures to identify and assess the risks of material misstatement when an early draft of the entity’s financial statements is available.”

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Thank you for the opportunity to comment on this ED. If you have any questions or need additional information regarding this comment letter, you may contact me or Susan Koski-Grafer at 202-551-5300, or any member of the IOSCO Standing Committee No. 1 Auditing Subcommittee.

Sincerely,



Julie A. Erhardt  
Chair

IOSCO Standing Committee No. 1

## **Appendix A: Responses to Request for Specific Comments in the Exposure Draft**

- 1. Are the objectives to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?**

We believe that the objective stated in ISA 520 is generally appropriate, subject to our comment earlier in this letter.

- 2. Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgment by auditors?**

We believe that the criteria identified by the IAASB for determining whether a requirement should be specified have generally been applied appropriately and consistently.