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Analytical Review Procedures; Statement on auditing standards, 023

American Institute of Certified Public Accountants. Auditing Standards Executive Committee

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Analytical Review Procedures

1. This Statement applies to analytical review procedures in an examination made in accordance with generally accepted auditing standards. It provides guidance for consideration by the auditor when he applies such procedures, but no specific analytical review procedures are required by this Statement.

2. Analytical review procedures are substantive tests of financial information made by a study and comparison of relationships among data. The auditor’s reliance on substantive tests may be derived from tests of details of transactions and balances, from analytical review procedures, or from any combination of both. That decision is a matter of the auditor’s judgment of the expected effectiveness and efficiency of the respective types of procedures (see SAS No. 1, section 320.73).

3. A basic premise underlying the application of analytical review procedures is that relationships among data may reasonably be expected by the auditor to exist and continue in the absence of known conditions to the contrary. The presence of those relation-

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1 This Statement amends the first sentence of section 320.70 of SAS No. 1 to read as follows:

The evidential matter required by the third standard is obtained through two general classes of auditing procedures: (a) tests of details of transactions and balances and (b) analytical review procedures applied to financial information.
ships provides the auditor with evidential matter required by the third standard of field work. The application of analytical review procedures may indicate the need for additional procedures or may indicate that the extent of other auditing procedures may be reduced.

4. When analytical review procedures identify fluctuations that are not expected, or the absence of fluctuations when they are expected, or other items that appear to be unusual, the auditor should investigate them if he believes that they are indicative of matters that have a significant effect on his examination.

**Timing and Objectives of Analytical Review Procedures**

5. The timing of analytical review procedures will vary with the auditor's objectives. Analytical review procedures may be performed at various times during an examination:

a. In the initial planning stages to assist in determining the nature, extent, and timing of other auditing procedures by identifying, among other things, significant matters that require consideration during the examination.

b. During the conduct of the examination in conjunction with other procedures applied by the auditor to individual elements of financial information.

c. At or near the conclusion of the examination as an overall review of the financial information.

**The Nature of Analytical Review Procedures**

6. Analytical review procedures include the following:

a. Comparison of the financial information with information for comparable prior period(s).
b. Comparison of the financial information with anticipated results (for example, budgets and forecasts).

c. Study of the relationships of elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience.

d. Comparison of the financial information with similar information regarding the industry in which the entity operates.

e. Study of relationships of the financial information with relevant nonfinancial information.

Various methods may be used to perform these procedures. They may be made using dollars, physical quantities, ratios, or percentages. The methods selected by the auditor are a matter of his professional judgment.

7. Analytical review procedures may be applied to overall financial information of the entity, to financial information of components such as subsidiaries or divisions, and to individual elements of financial information. The auditor should consider the following factors when planning and performing analytical review procedures.

a. The nature of the entity. For example, an auditor performing an examination of a diversified entity may conclude that the application of analytical review procedures to the consolidated financial statements may not be as effective or efficient as the application of those procedures to the consolidated financial statements of a nondiversified entity.

b. The scope of the engagement. For example, an examination of a specified element, account, or item of a financial statement may include fewer analytical review procedures than would an examination of financial statements.

c. The availability of financial information about the entity's financial position and results of operations. Examples may include budgets and forecasts and detailed financial information about the entity's subsidiaries or divisions and interim periods.

d. The availability of relevant nonfinancial information. Examples may include units produced or sold, number of employees, hours
worked by nonsalaried personnel, and square feet of selling floor space, which may be related to financial information.

e. **The reliability of financial and nonfinancial information.** The auditor should consider the possibility that financial or nonfinancial information might not be reliable based on his knowledge of the entity, including his knowledge of the means by which the information is produced.

In that connection, the auditor should consider knowledge obtained during previous examinations, the results of his study and evaluation of internal accounting control, and the results of his tests of details of transactions and balances. He should consider the types of matters that in preceding periods have required accounting adjustments. For example, the auditor may decide not to conduct certain analytical review procedures until near the completion of his examination if he is aware that trial balance amounts may require substantial adjustments; or he may decide to make only limited comparisons of actual and budgeted income and expense when the entity’s budget is a motivational tool and not an estimate of the most probable financial position, results of operations, and changes in financial position.

f. **The availability and comparability of financial information regarding the industry in which the entity operates.** The auditor should consider whether industry information, such as gross margin information, is reasonably available and current and whether data used to compile the information is comparable to the information being evaluated. For example, broad industry information may not be comparable to that of an entity that produces and sells specialized products.

### Investigating Significant Fluctuations

8. The auditor should investigate fluctuations that are not expected, the absence of fluctuations that are expected, and other items that appear to be unusual that are identified by analytical review procedures when he believes that those fluctuations or unusual items are indicative of matters that have a significant effect on his examination. When investigating such significant fluctuations,
the auditor ordinarily would begin by making suitable inquiries of management. He would then (a) evaluate the reasonableness of replies to his inquiries by reference to his knowledge of the business and other information already obtained during the conduct of the examination and (b) consider the need to corroborate the replies to his inquiries by the application of other auditing procedures. If management is unable to provide an acceptable explanation of significant fluctuations, the auditor should perform additional procedures to investigate those fluctuations further.

9. In deciding the nature and extent of procedures which should be used to investigate significant fluctuations, the auditor’s consideration should include the following factors:

a. The objective of the analytical review procedures. For example, the objective may be to assist the auditor in planning his examination by identifying areas that may need special consideration (such as identifying any significant increases in inventories by inventory locations). The extent to which the auditor decides to corroborate an explanation of a significant fluctuation in those circumstances depends on whether the resulting audit plan he develops would otherwise provide sufficient evidential matter.

b. The nature of the item. For example, an auditor investigating a fluctuation in inventory turnover in a manufacturing company might corroborate a response to his inquiry by obtaining other evidential matter, such as evidence with respect to unusual quantities of inventories represented to be on hand at the date of the financial statements. Conversely, an auditor might limit to inquiries his investigation of a fluctuation in prepaid insurance for the same company.

c. The auditor’s knowledge of the entity’s business. For example, the auditor may be aware of an extended strike by manufacturing employees during the year. He may conclude that this is a satisfactory explanation for a decline in sales volume and not apply other procedures to investigate this otherwise significant fluctuation.

d. The results of other auditing procedures. For example, the auditor may decide not to apply other procedures to investigate an otherwise significant fluctuation in depreciation expense because
he may already be aware of major additions or retirements from his tests of property transactions.

e. **The auditor's study and evaluation of internal accounting control.** For example, the extent to which the auditor decides to corroborate an explanation of an increase in bad debt expense may vary depending on his evaluation of internal accounting control in the credit department.

10. In his investigation of significant fluctuations, the auditor also should be alert to the possible effect of his findings on the scope of his examination of related accounts. For example, a finding that accounts receivable have increased due to slow collections in a "tight money" environment may indicate the need for expanded tests of collectibility.

*The Statement entitled "Analytical Review Procedures" was adopted by the assenting votes of sixteen members of the Committee. Mr. Gotlieb and Mr. Powell dissented.*

Mr. Gotlieb and Mr. Powell dissent to the issuance of the Statement because, although they believe it provides instructive guidance to auditors in basic auditing procedures, they believe it does not offer sufficiently specific guidance for it to be promulgated as a standard which requires justification for departure. Also, they believe the Statement provides no guidance as to how the auditor should document the complex, judgmental thought processes when the auditor in his professional judgment decides not to apply analytical review procedures.
Auditing Standards Executive Committee (1977-1978)

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