



PCAOB CONSULTATION: PROPOSED AUDITING STANDARD – DESIGNING AND PERFORMING SUBSTANTIVE ANALYTICAL PROCEDURES AND AMENDMENTS TO OTHER PCAOB STANDARDS

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ICAEW welcomes the opportunity to comment on the PCAOB's consultation on a proposal to replace its existing standard related to an auditor's use of substantive analytical procedures with a new standard, together with other amendments to PCAOB standards, published by the PCAOB on 12 June 2024, a copy of which is available from this [link](#).

For questions on this response, please contact the Audit and Assurance Faculty at tdaf@icaew.com quoting REP 63/24.

This response of 12 August 2024 has been prepared by the ICAEW Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the faculty is responsible for audit and assurance submissions on behalf of ICAEW. The faculty has around 25,500 members drawn from practising firms and organisations of all sizes in the private and public sectors.

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GENERAL

1. We welcome the opportunity to comment on the PCAOB's proposal for an improved auditing standard addressing substantive analytical procedures (SAP). SAP are invaluable tools in an auditor's toolkit with the power to enhance both audit quality and efficiency. Auditing standards must strike a balance between driving high standards of audit quality and supporting auditor confidence in using the range the tools available to them, including SAP. The principles-based nature of proposed AS 2305 facilitates this.
2. The PCAOB should, however, consider whether the proposed standard's attempts to prevent failure and inappropriate reliance on technology might unnecessarily deter firms from using SAP for fear of regulatory challenge. The PCAOB's standard-setting activities affect audit firms of all sizes globally, directly or indirectly, and all firms should be performing these procedures properly regardless of size. However, the proposal's attempts to prevent overreliance on company information and reduce the risk of circular auditing or other audit deficiencies, risks further driving the trend towards the use of tests of details (ToD) aided by similar technology-assisted analytical tools among larger firms, and the use of large sample sizes by smaller firms.
3. The PCAOB acknowledges this risk, but we do not believe that the right balance has been struck. Narrowing scope for the use of auditor judgement may reduce the risk of circularity but the price of that risk aversion seems high. SAP, used properly, are powerful tools and can provide persuasive audit evidence more efficiently than ToD. A good auditor can use insightful analytical procedures to identify problems, ask intelligent questions and understand what is really going on. They need to be encouraged, or at least not discouraged, from developing the skills to do this.
4. Paragraph .07 of the proposed standard in particular is excessively narrowly drawn. It addresses the risk of circular auditing by precluding the auditor from developing SAP expectations using company amounts or information based on company amounts. We agree that SAP should not simply mirror company calculations. But the paragraph as drafted can and is being read as an attempt to preclude the use of any company information at all in the development of an expectation, regardless of the fact that the information may be completely unrelated to the area being audited.
5. For example, headcount data is routinely used to help auditors develop expectations for SAP in the audit of payroll costs. If the PCAOB intends to prevent the use of such unrelated information altogether, the proposals as they stand risk rendering SAP redundant. If the PCAOB does not intend this - and we do not believe it does - this needs to be made clearer in the standard itself, preferably by means of a definition. As a minimum, staff guidance with examples beyond the straightforward example provided in the proposals, would help auditors understand what company information they may or may not use.
6. Technology-based tools empower auditors to use large volumes of disaggregated data and thereby develop more precise expectations. As important as it is to address the risks of circular auditing and overreliance on technology more generally, the PCAOB should be mindful of the need to avoid discouraging, however inadvertently, the adoption of technology-based tools by firms that do not yet have access to them.
7. Subject to the issues outlined above and expressed in more detail in our response to the PCAOB's specific questions below, we support the proposals. We agree that proposed AS 2305 makes the requirements for the auditor's use of SAP more robust and explicit than the extant standard, and aligns better with other, more modern PCAOB standards without losing sight of its principles-based foundations. Presenting the requirements in the order the auditors apply them is also helpful.
8. Those questions on which we have no comment we omit from our response below. We have answered some groups of questions in aggregate.

SPECIFIC QUESTIONS

BACKGROUND

- 1. Does the description of current audit practice accurately depict the state of practice? If not, what clarifications should be made? Are there other aspects of current audit practice that we should consider?**
 - 2. Are there other areas of concern relating to auditors' use of substantive analytical procedures that are not described above? If so, what are the areas of concern and what changes should be made to address them?**
 - 3. Does the proposal adequately describe the extent and frequency of auditors' use of substantive analytical procedures in audits? Please provide supporting information, such as the types of accounts generally tested using substantive analytical procedures and other relevant data.**
 - 4. Does the proposal adequately describe how advancements in technology changed the extent and frequency of auditors' use of substantive analytical procedures? Please provide details, including any information on the use of technology-based tools and the increase in the availability of data to perform substantive analytical procedures.**
9. The PCAOB's depiction of current audit practice aligns with our understanding of auditor use of SAP. Advancements in the use of technology and technology-based tools – at both an audited entity and at audit firm level – as well as increasing regulator expectations, have led to many firms refining their methodologies to keep pace. For larger audit firms, at least, proposed AS 2305 codifies best practice.

DISCUSSION OF THE PROPOSAL – INTRODUCTION AND OBJECTIVE

- 5. Are the introduction and objective sections of the proposed standard clear and appropriate? If not, how should they be clarified?**
10. The introductory sections of any standard are important. The PCAOB has struck a good balance between cautioning that SAP are only appropriate 'when designed and performed (...) at a level of precision sufficient to respond to an assessed risk of material misstatement' and allowing that such procedures 'can provide relevant and reliable audit evidence' (Paragraph .01). Used properly, SAP are powerful tools and can provide persuasive audit evidence more efficiently than ToD. It would be counterproductive as well as disappointing if standard-setting inadvertently but effectively discouraged the proper use of SAP.
11. We agree that the new objective section should acknowledge the fact that SAP can provide 'relevant and reliable' audit evidence (Paragraph .03) and note that it aligns with ISA 520 and AU-C 520.
12. Subject to our main comments above regarding the meaning of the paragraph .07 prohibition on the use of the company's amount, and the need for a definition or at least some good quality examples, and our response to questions 13 – 15 below, we do not object to the new broader term 'company's amount' rather than 'recorded amounts or ratios' in the description of what SAP entail to capture the full range of potential comparative methods available to auditors.

DISCUSSION OF THE PROPOSAL – DESIGNING AND PERFORMING A SUBSTANTIVE ANALYTICAL PROCEDURE TO RESPOND TO A RISK OF MATERIAL MISSTATEMENT

- 6. Are the factors that affect the persuasiveness of audit evidence provided by substantive analytical procedures, specifically the precision of the procedure and the reliability of the information used in it, clear and appropriate? If not, how should they be clarified? Are there other factors that affect the persuasiveness of audit evidence provided by substantive analytical procedures? If so, what are they?**
- 7. Are the factors that affect precision clear and appropriate? If not, how should they be clarified? Are there other factors upon which a substantive analytical procedure's level of precision depends? If so, what are they?**

8. Are the requirements for evaluating the relevance and reliability of information used in a substantive analytical procedure in accordance with AS 1105 clear and appropriate? If not, how should they be clarified?

9. Are there specific considerations related to evaluating the relevance and reliability of information used in a substantive analytical procedure, beyond those in AS 1105, that should be included in the proposed standard? If so, what are those considerations and how should they be incorporated in the proposed standard?

13. Paragraph .01 notes that SAP are only appropriate when designed and performed at a level of precision sufficient to respond to an assessed risk of material misstatement. This is effectively repeated in Paragraph .04. We acknowledge that observed deficiencies have driven the standard's emphasis on precision to provide persuasive audit evidence. However, the first two sentences of Paragraph .04 could either be removed or simply integrated as a cross reference or footnote to Paragraph .01 without detracting from the objective of the proposal.
14. Proposed AS 2305 differs from the extant standard, ISA 520 and AU-C 520 in that 'sufficient precision' extends beyond the expectation to the SAP as a whole. We agree that precision does not exist in a vacuum and affects every stage of the procedure. The factors that affect precision detailed in Paragraph .04 cover each of these stages and are clear.

DISCUSSION OF THE PROPOSAL – IDENTIFYING A SUFFICIENTLY PLAUSIBLE AND PREDICTABLE RELATIONSHIP

10. Is the proposed requirement that the auditor identify the relationship or relationships to use in the substantive analytical procedure and determine whether each such relationship is sufficiently plausible and predictable clear and appropriate? If not, how should it be clarified?

11. Is the proposed requirement that the auditor should take into account all relevant information of which the auditor is aware when determining whether a relationship is sufficiently plausible and predictable clear and appropriate? If not, how should it be clarified?

12. Are the examples of events, conditions, and company activities that are included in proposed paragraph .06 described clearly and appropriately? Are there additional events, conditions, or company activities that may affect the plausibility and predictability of a relationship that should be included in the proposed standard as examples? If so, what are they? If the examples of events and conditions are not clear, how should they be clarified?

15. The proposed standard does not prescribe the nature, timing or extent of the procedures to be performed by the auditor to determine that a relationship is sufficiently plausible and predictable, only that it must extend 'beyond inquiry' (Paragraph .05). We note the PCAOB's global reach in our main points above and the need for staff guidance with examples. This is particularly important to the many firms that do not have best practice methodologies and training programmes in place.
16. We agree with the requirement for the auditor to take into account all relevant information of which they are aware, including 'external factors'. Events such as the Covid-19 pandemic can materially affect the plausibility and predictability of trends. We also agree that 'random fluctuations' (Extant AS 2305, Paragraph .02) should no longer be included as conditions causing variation in relationships.
17. We acknowledge the need for auditors to avoid designing procedures based on spurious relationships, and that there is a need to address 'the risk of inappropriate use of technology-assisted analysis'. Nevertheless, the emphasis must be on inappropriate use, rather than the technology *per se*. The dangers of relying on implausible information or omitting key factors are always present, regardless of any technology-based tools that may be used. The technology is rarely the problem. Standards should be technology-agnostic and neither discourage nor encourage appropriate use and the PCAOB should avoid inadvertently discouraging legitimate use in an attempt to manage the associated risks.

DISCUSSION OF THE PROPOSAL – DEVELOPING AN EXPECTATION

13. Is the proposed requirement for the auditor to develop an expectation clear and appropriate? If not, what changes should be made?

14. Is the proposed changed specifying that the auditor may not develop the expectation using the company's amount or information that is based on the company's amount clear and appropriate? If not, what changes should be made?

15. Are there any other factors that the auditor should consider when developing their expectation? If yes, what are they?

18. We agree that there is a need to discourage circular auditing in the form of reperforming company calculations. Paragraph .07 prohibits the development of auditor expectations using company amounts or information based on company amounts. Some firm methodologies already explicitly reflect this provision but do not prohibit the use of unrelated company information for these purposes. We note in our main points above that headcount data is routinely used to help auditors develop expectations for SAP in the audit of payroll costs, for example, and that we do not believe that the PCAOB intends to prohibit this, or that it should seek to prevent the use of such unrelated information for these purposes. The use of non-financial data more widely, including operational and compliance data used in running the business on a day-to-day basis is a powerful check on financial information. It is much harder for fraudsters to alter this data – without which the business would not function at all – as well as data within the financial system. The proposals as they stand risk rendering SAP redundant if the scope of this provision is interpreted as extending to any company information at all. If the PCAOB does not intend this, it needs to be made clearer in the standard itself, preferably by means of a definition. As a minimum, staff guidance with examples beyond the example provided in the proposals would help auditors understand what company information they may or may not use.

DISCUSSION OF THE PROPOSAL - DETERMINING A THRESHOLD FOR EVALUATING DIFFERENCES

16. Is the proposed requirement that the auditor determine a threshold to evaluate the difference between the auditor's expectation and the company's amount clear and appropriate? If not, what changes should be made?

19. We agree that the Paragraph .08 reference to a 'threshold' set 'at or below tolerable misstatement' for evaluating differences between the auditor's expectation and the company's amount is in line with best practice. Various suggestions have been made regarding the need for further clarity on the level at which a threshold below tolerable misstatement might apply, or on tolerable misstatement itself. Clarification can sometimes give rise to a level of prescription which is inconsistent with a risk-based approach and on balance, we do not believe that any further clarification should be provided in this case.

DISCUSSION OF THE PROPOSAL – DIFFERENCES BETWEEN THE AUDITOR'S EXPECTATION AND THE COMPANY'S AMOUNT

17. Are the proposed requirements for evaluating the difference between the auditor's expectation and the company's amount clear and appropriate? If not, what changes should be made?

18. Are there other requirements that should be included within the proposed standard regarding evaluating differences or when the auditor encounters the scenarios described in the standard?

19. Are there other scenarios the auditor may encounter when evaluating differences that should be addressed by the proposed standard?

20. Are there other requirements related to designing and performing substantive analytical procedures that should be included in the proposed standard? If so, what are they? For example, existing AS 2305 includes provisions related to documentation of a substantive analytical procedure. Are there specific considerations related to the documentation of a

substantive analytical procedure that are not included in AS 1215 but should be included in the proposed standard?

20. The requirement in Paragraph .09 for the auditor's procedures to 'extend beyond inquiry' to determine whether there is a misstatement is already effectively codified in equivalent standards which require the auditor to make inquiries of management 'and' perform other audit procedures as necessary (ISA 520 Para. 7; AU-C 520 Para. .07). We support the PCAOB's approach.
21. The PCAOB highlights potential misinterpretations of the proposed requirement for the auditor to determine, in certain situations, whether to modify the design of SAP. We agree that auditors do not have carte blanche to 'redesign and reperform a (SAP) in any situation without appropriately evaluating the difference', or to 'modify the design of a (SAP) so that no differences are identified above the established threshold.' While a general discussion of the modification of SAP for non-legitimate purposes is needed, it falls more within the purview of enforcement rather than standard-setting. Auditors may have entirely legitimate reasons for rethinking the design of SAP and we support the standard's explicit acknowledgment of this.

ECONOMIC ANALYSIS

24. We request comment generally on the baseline for evaluating the economic impacts of the proposal. Is there any additional information regarding auditors' use of substantive analytical procedures or are there additional academic studies we should consider?

25. We request comment generally on the prevalence of substantive analytical procedures in audits conducted under PCAOB standards. Please provide as much details as possible, including data on the use of substantive analytical procedures and the types of accounts on which such procedures are generally performed.

22. Despite their popularity waxing and waning over the years, SAP, when used appropriately, can be more effective and efficient than ToD. Technology represents opportunities, as well as risks in this context. The judicious use of SAP should not be discouraged.

ECONOMIC IMPACTS – BENEFITS

27. Are there any additional potential benefits that should be considered? If so, what are they? Are the benefits quantifiable?

28. Are there additional academic studies or data related to the potential benefits of the proposal that we should consider? If so, please provide citations or other reference information for such studies and data.

23. We agree with the PCAOB's appraisal of the potential benefits of the proposal. We note the Board's efforts to make the requirements more user-friendly by presenting the requirements in the order the auditor would apply them and integrating proposed AS 2305 with other Board-issued standards, etc. The standard's enhanced useability has the potential to reduce the regulatory uncertainty that has gone hand in hand with the use of SAP over the last years.

ECONOMIC IMPACTS – COSTS

29. Are there any additional potential costs that should be considered? If so, what are they? Are the costs quantifiable?

30. Are there additional academic studies or data related to the potential costs of the proposal that we should consider? If so, please provide citations or other reference information for such studies and data.

24. We agree with the PCAOB's assessment of the potential costs of the proposal. Proposed AS 2305 codifies what is already best practice for many, albeit larger, firms. The costs of modifying current audit approaches for these firms is unlikely to be substantial.

We refer the PCAOB to points 26 – 28 below for our thoughts on the potential indirect costs of the proposals for smaller firms.

ECONOMIC IMPACTS – POTENTIAL UNINTENDED CONSEQUENCES

31. The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release adequate? Are there additional potential unintended consequences that the Board should consider. If so, what responses should be considered?

32. Are there any other economic impacts we did not describe above that are relevant to the Board’s consideration?

33. Are there additional academic studies or data related to the potential unintended consequences of the proposal that we should consider? If so, please provide citations or other reference information for such studies and data.

25. The interaction between the proposed conforming amendment in paragraph .40A of AS 2301, *The Auditor’s Responses to the Risks of Material Misstatements* and paragraph .10A of the 2023 amendments to AS 1105 *Audit Evidence* related to technology-assisted analysis, has given rise to concerns that ToD will in future be required on external information, even when the auditor’s expectation is *not* based on that information. We do not believe that this outcome, which would represent unnecessary duplication, is intended. The PCAOB should clarify that this is not required. That aside, we agree with the PCAOB’s analysis of the two potential unintended economic consequences.
26. Firms – particularly smaller firms – could perceive proposed AS 2305 as raising the bar beyond their reach and conclude that the benefits of SAP do not justify the costs of change and regulatory challenge. They may accordingly avoid SAP resulting in audit inefficiencies, particularly if they lack the methodologies, training programmes and software infrastructure to achieve the proposed standard’s best practice expectations.
27. We have concerns about the PCAOB’s explanation that auditors may favour ToD because SAP may be too ‘costly’ and/or may not have provided sufficient appropriate audit evidence and its conclusion that ‘this development would therefore probably benefit, rather than detract from, audit quality when the auditor is unable to perform substantive analytical procedures appropriately.’ This is being read as an admission that the proposed requirements are, at least in part, designed to discourage the use of SAP or encourage more widespread use of ToD among some firms, even in circumstances where a well-designed and well-executed SAP might both be more efficient and provide more persuasive audit evidence. This is regrettable.
28. The PCAOB should not overstate the associated risks or seek to discourage the use of SAP. SAP are not just a valuable audit tool. They are preferable to ToD in some cases.

ALTERNATIVES CONSIDERED

34. Are any of the alternative approaches discussed, or any other approaches, preferable to the approaches that are being proposed to address auditors’ use of substantive analytical procedures to obtain audit evidence? If so, what are they and what reasons support one or more alternative approaches over the proposed approaches?

35. Proposed AS 2305 does not change the existing requirement of AS 2301, that to address significant risks, including fraud risks, the auditor should perform tests of details specifically responsive to the assessed risk. Should changes be made to this existing requirement? If yes, what changes should be made and are there examples where a substantive analytical procedure would be just as or more effective than a test of details in addressing significant risks? When providing examples, please provide as much detail as possible, including a brief description of the account, relevant assertion, design of the substantive analytical procedure, and discuss how the procedure addresses the specific likely source of potential misstatement.

36. Should proposed AS 2305 explicitly address aspects of the use of technology when designing and performing substantive analytical procedures, including situations where the use of technology might improve the quality of audit evidence obtained from such procedures? If so, how?

29. We agree with the PCAOB that standard-setting is the preferred approach. Extant AS 2305 was intended as a stopgap standard in 2003 and the requirements no longer reflect current best practice.
30. We support the decision not to eliminate the existing requirement to perform ToD that are specifically responsive to assessed significant risks.
31. We understand the decision not to specify auditor responsibilities when using technology-based tools. Standards must be future proofed to the extent possible.
32. What is certain *now*, however, is that technology has already radically changed the auditing landscape. As Sir Donald Brydon notes in his 2019 [Report](#) of the Quality and Effectiveness of Audit, ‘the profession has come a long way from “holler and tick” where one person would call out from a ledger, ticks would be marked and a search made for unmatched transactions.’
33. In ICAEW’s 2016 [publication](#) Data Analytics for External Auditors, we encouraged auditing standard-setters and regulators to consider more fully the implications for audit presented by technology-based tools such as data analytics. Firms at that time believed that regulation and standards had been slow to adapt, and that their attempts to improve efficiency with automation were often viewed with suspicion by regulators.
34. Audit firms and regulators alike are now more confident in their approach to audit technologies but there remains a strong sense that standard-setters and audit regulators remain reluctant to address the fundamental challenges to the assumptions underlying auditing standards presented by changes to technology over the last two decades, despite consideration by many standard-setters, including the PCAOB and IAASB, of the impact of changes in technology to their activities in recent years. For example, IAASB is currently articulating a [Technology Position](#), including whether to introduce requirements for auditors to determine when technology-enabled procedures are necessary to achieve engagement objectives. A broader dialogue about these fundamental shifts is needed and the Audit and Assurance Faculty of ICAEW is considering how that might be facilitated.