

AUDIT SAMPLING – ISSUES PAPER

Introduction

1. The IAASB approved the exposure draft of ISA 530 (Redrafted) (“ED 530”) at its July 2007 meeting. The comment deadline was October 31, 2007. The IAASB received 44 comment letters. A list of respondents is included in the Appendix to this paper.
2. The following sections summarize general and significant comments received from respondents and the Task Force’s preliminary views and recommendations. The Task Force is seeking guidance from the IAASB in respect of its proposed responses to these comments.
3. As indicated in the cover memo to Agenda Item 8, the Task Force has focused principally on certain significant issues raised by respondents to the exposure draft. Accordingly, the agenda materials presented reflect only the proposed changes in response to those comments.

General Comments

4. At the time of redrafting ISA 530, the IAASB supported some limited revisions to the extant ISA 530 to address concerns in the areas of anomalies and the projection and evaluation of sample results.
5. A number of respondents¹ expressed overall support for ED 530. These commentators indicated that the proposed revisions helped to clarify the auditor’s responsibility and that redrafting had resulted in a clearer standard.
6. Others,² however, expressed various levels of concern that the extent and nature of some of the proposed changes go beyond the scope of the IAASB’s clarity project and the drafting conventions established by the IAASB. Concern was expressed that the draft had not been subject to the full due process that would normally be expected of a revised standard. In addition, concern was expressed that much useful guidance had been lost in the redrafting.
7. In addition, respondents were also concerned that the revisions gave added emphasis to statistical sampling. Concern was expressed that the standard is technical and difficult to understand. EC suggested that there needs to be a clearer distinction made between a statistical approach and a non-statistical approach in the application material. The Task Force believes that the proposed revisions to ED 530 will help to reduce the concern that the proposed ISA favors statistical sampling.
8. One respondent (GAO) recommended “that because statistical principles are too complex to explain in detail in an auditing standard, we encourage IAASB to develop a sampling audit guide that would provide additional guidance on this complex topic. In addition to assisting users, such an audit guide would encourage greater consistency of practice.”

¹ AIA, AICPA, AUAASB, CIPFA, DTT, EYG, FEE, GAO, GTI, NZICA, NIA

² APB, EC, ICAEW, ICAS, KPMG, PWC

9. Except in relation to specific requirements that respondents believed were beyond the clarity mandate, respondents³ generally expressed the view that the criteria for identifying whether a requirement should be specified had been applied appropriately.

Significant Comments

A. SELECTING ITEMS FOR TESTING TO OBTAIN AUDIT EVIDENCE

10. ED 530 proposed that material dealing with the selection of items for testing by means other than audit sampling, i.e. selecting all items and selecting specific items, be moved to proposed ISA 500 (Redrafted)⁴ in order for ISA 530 (Redrafted) to provide a clear focus on audit sampling.
11. A majority of respondents⁵ who commented on the proposal to move the material dealing with selecting items for testing by means other than audit sampling to proposed ISA 500 (Redrafted) supported the decision of the IAASB.
12. EYG and AICPA noted that the material may be more closely related to ISA 330 (Redrafted)⁶ and accordingly may be more appropriately included in that ISA.
13. IDW and KPMG did not support the proposal to move the material dealing with selecting items for testing by means other than audit sampling to proposed ISA 500 (Redrafted). IDW expressed concern that the standard appears to give the impression that audit sampling is a preferred selection technique in most, if not all, audits and that the standard would portray a more balanced approach to the selection of items for testing if it continued to deal with selection of items in general.
14. Based on the responses received, the Task Force believes that it is appropriate that the focus of proposed ISA 530 (Redrafted) be limited to audit sampling.

B. ANOMALIES – PARAGRAPHS 13 AND A16

15. ED 530 sought to clarify the requirements and guidance in extant ISA 530 related to anomalies.
16. Extant ISA 530, paragraph 50, states, “sometimes, the auditor may be able to establish that an error arises from an isolated event that has not recurred other than on specifically identifiable occasions and is therefore not representative of similar errors in the population (an anomalous error). To be considered an anomalous error, the auditor has to have a high degree of certainty that such error is not representative of the population.” In order to address concerns that auditors are inappropriately classifying errors as anomalies, the IAASB agreed that it was appropriate to elevate these present tense statements.
17. In addition, cautionary language was added to the application material to warn the auditor that the smaller the sample relative to the total population, the more difficult it will be for

³ ACAG, AIA, AUAASB, BDO, CICA, CIPFA, DTT, EYG, FARSRS, GTI, HKICPA, ICAIre, ICAP, ICAS, CPA Ire, IDW, IRBA, IRE, NAO, NZICA, PAS, SNAO, PWC, SAICA.

⁴ Proposed ISA 500, “Considering the Relevance and Reliability of Audit Evidence.”

⁵ AIA, AICPA, APB, AUAASB, HKICPA, ICAI, WAO

⁶ ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks.”

the auditor to obtain the level of certainty necessary to determine that the misstatement or deviation is an anomaly.

18. Several respondents⁷ supported the clarification of the guidance in extant ISA 530 dealing with anomalies.
19. Some respondents⁸ questioned the use of the phrases “in extremely rare circumstances” and “high degree of certainty” in the same sentence. CNCC, FEE and IRE suggested that use of both these phrases in the same sentence was excessive. PWC indicated that it is superfluous to have the word “extremely” as the word “rare” connotes that one would not normally expect to find an anomaly. The Task Force notes that the phrase “extremely rare circumstances” is used throughout the ISAs. Further, the Task Force believes that the occurrence of anomalies is extremely rare and that this phrase is appropriate in this instance.
20. The Task Force notes that the term “high degree of certainty” is used in extant ISA 530. While the Task Force has not yet considered whether editorial changes are needed to clarify the meaning of this term, the Task Force believes that there is a significant effort that the auditor needs to undertake to determine that the misstatement is, in fact, an anomaly and that the language used to describe this effort is consistent with extant ISA 530 and appropriate.
21. ACCA suggested that the auditor’s consideration of anomalous misstatement is implicitly dealt with in proposed ISA 450 (Revised and Redrafted)⁹ and therefore it is unnecessary to include some of the present tense statements from extant ISA 530 as requirements in ED 530. At the July 2007 meeting, the IAASB considered a proposal that the discussion of errors be redrafted so that it is generic and that ISA 530 remain silent with respect to the specific treatment of anomalies. At that time, the IAASB concluded that it is appropriate to retain a discussion of the treatment of anomalies in the ISA and to caution the auditor against inappropriately concluding that an anomaly exists in a population
22. Based on the comments received from respondents, the Task Force does not propose to make substantive changes to the requirement in paragraph 13 or the guidance in paragraph A16 of ED 530.

Action requested

Does the IAASB agree with the proposal of the Task Force not to significantly revise paragraphs 13 and A16?

C. PROJECTING AND EVALUATING SAMPLE RESULTS – PARAGRAPHS 14-15 AND A17-21

23. In forming the auditor’s opinion whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, the auditor has to conclude whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement, including, whether in

⁷ AIA, AICPA, APB, AUAASB, BDO, GAO, HKICPA, ICAI-Ire, ICAS, IDW, KPMG, PWC

⁸ CNCC, FEE, IRE, SAICA, PWC

⁹ Proposed ISA 450 (Revised and Redrafted), “Evaluation of Misstatements Identified During the Audit.”

light of the risk assessment and further audit procedures, the use of audit sampling has provided an appropriate basis for conclusions about the population. In issuing ED 530, the IAASB was of the view that the auditor’s conclusions about whether sufficient audit work had been performed based on the sample results is an important aspect of audit sampling that needed greater clarity.

24. In addition to this clarification, new guidance was included in ED 530 (Appendix 5) explaining how estimated maximum misstatement can be used by the auditor to conclude whether the use of audit sampling has provided an appropriate basis for conclusions about the population.
25. ED 530 states,
 - “14. The auditor shall conclude whether, in light of the risk assessment and other procedures performed, the use of audit sampling has provided an appropriate basis for conclusions about the population that has been tested. In making these conclusions:
 - (a) For tests of controls, the auditor shall determine, for the population, the projected rate of deviation and shall evaluate its effect on the objective of the particular audit procedure and on other areas of the audit.
 - (b) For tests of details, the auditor shall determine, for the population, projected misstatement and shall evaluate its effect on the objective of the particular audit procedure and on other areas of the audit. (Ref: Para. A17-A20)
 15. If the auditor determines that the use of audit sampling has not provided an appropriate basis for conclusions about the population, the auditor shall obtain additional audit evidence. (Ref: Para. A21)”
26. Respondents expressed various views regarding the proposed revisions. A number of respondents¹⁰ expressed their support for the revisions, however others¹¹ expressed the view that clarity had been lost and that the proposed requirements do not clearly reflect the requirements of extant ISA 530 paragraphs 51 and 54. In addition, respondents were concerned that helpful guidance contained in paragraphs 53 and 55 of extant ISA 530 had been deleted.
27. KPMG states that, “In the interests of consistency, the ISA has been revised to apply the same approach to controls testing as to substantive testing. This requires the auditor to estimate the rate of deviation in the population rather to confirm the initial hypothesis that the error rate is acceptably low. The proposed change therefore goes beyond clarity. It also does not appear to be consistent with paragraph A41 of ISA 330 (Redrafted)... Paragraph 14 requires that the projected rate of deviation not exceed the tolerable rate of deviation for controls testing. Again, this represents a revision to the ISA since extant ISA 530.51 limits the discussion to tests of detail and not controls.¹² Further, this requirement does not support paragraph A41 of ISA 330 (Redrafted) which discusses comparison of the detected

¹⁰ ACCA, AIA, AICPA, AUAASB, HKICPA, ICA Ire.

¹¹ APB, ICAEW, IDW, IRBA, JICPA, KPMG, PWC

¹² JICPA, APB also made this observation.

rate of deviation with the expected rate. It is also not fully consistent with the approach set out in paragraph 7.”

28. IRBA, JICPA and PWC also noted the deletion of paragraph 53 in the extant ISA 530 that did not require the explicit projection of errors for tests of controls without explanation.
29. The Task Force’s proposal is to revise paragraphs 14 and 15 to more closely align with the language in extant ISA paragraphs 51 and 54, including separating the requirements relating to the projection of misstatements from the evaluation of sample results. In addition, the requirement in extant ISA 530, paragraph 51 that, “the auditor consider the effect of the projected error on the particular audit objective and on other areas of the audit” has been included under the heading “Evaluating sample results.”
30. The language in extant paragraph 53 has been reinstated as paragraph A19 to make it clear that for tests of controls no explicit projection of errors is necessary. A reference to ISA 330 has been added.
31. ED 530 paragraph A19 [new paragraph A21] has been redrafted to align more closely with paragraph 55 of extant ISA 530. Certain editorial changes have been made to clarify the guidance.

Action requested

Does the IAASB agree with the proposed changes to paragraphs 14-15 and A17-A19 of ED 530?

D. ESTIMATED MAXIMUM MISSTATEMENT AND ESTIMATED MAXIMUM RATE OF DEVIATION

32. ED 530 Appendix 5 was added to provide guidance to the auditor when using estimated maximum misstatement for purposes of concluding whether the audit sample has provided an appropriate basis for conclusions. BDO, ICAEW, ICAS and PWC recommended that this appendix be deleted.
33. Given the general views expressed by other respondents that the revisions to extant ISA 530 go beyond the clarity mandate, in addition to the specific views with respect to Appendix 5 expressed by individual respondents, the Task Force proposes that Appendix 5 be deleted. Accordingly, paragraph A20 and the definitions of estimated maximum misstatement and estimated maximum rate of deviation in paragraph 5(j) and 5(k) would also be deleted.

Action requested

Does the IAASB agree with the Task Force’s proposal to delete Appendix 5?

E. DETERMINING SAMPLE SIZE

34. Paragraph 7 of ED 530 states,
 “The auditor shall determine a sample size sufficient to allow the auditor to conclude with an appropriate level of sampling risk that:

- (i) In the case of tests of details, the total misstatement does not exceed tolerable misstatement; or
 - (ii) In the case of tests of controls, the total rate of deviation does not exceed the tolerable rate of deviation. (Ref: Para. A9-A10)”
35. Respondents generally were of the view that the language in extant ISA 530, paragraph 40, was clearer than the redrafted language in ED 530 paragraph 7. APB noted that sampling risk is defined in paragraph 5(c), and accordingly, it is not necessary to introduce the concepts of “tolerable misstatement” and “tolerable rate of deviation” in paragraph 7.
36. KPMG challenged whether it is, in fact, possible to design a procedure that meets the requirement in paragraph 7 without the use of statistical sampling.
37. The Task Force has redrafted paragraph 7 in the proposed ISA based on extant ISA 530, paragraph 40. The requirement in ED 530 paragraph 7, “(i) in the case of tests of details, the total misstatement does not exceed tolerable misstatement; or (ii) in the case of tests of controls, the total rate of deviation does not exceed the tolerable rate of deviation” has been included in new paragraph 16 as part of the auditor’s evaluation of the sample results.

Action requested

Does the IAASB agree with the proposed changes to paragraph 7?

F. OBJECTIVE

38. The objective of ED 530 states, “the objective of the auditor when using audit sampling is to design and select the audit sample, perform audit procedures on the sample items, and evaluate the results from the sample in a manner that will provide an appropriate basis for the auditor to draw conclusions about the population from which the sample is drawn.”
39. The majority of respondents¹³ believe that the objective to be achieved by the auditor is appropriate. Other respondents¹⁴ expressed concern that the objective focuses too much on the process of audit sampling rather than the outcome.
40. The Task Force view is that the preponderance of comments support the objective as drafted, accordingly, at this time the Task Force has not proposed any revisions to the objective.

Action requested

Does the IAASB agree with the Task Force proposal to leave the objective as drafted?

¹³ ACAG, ACCA, AIA, AICPA, APB, AUAASB, BDO, CICA, CalCPA, DTT, EYG, GTI, HKICPA, ICAI, ICAP, ICAS, CPA IRE, IDW, MAZARS, NAO, NZICA, PAS, SNAO, PWC, SAICA.

¹⁴ CIPFA, CNCC, FEE, ICAEW, IRBA, IRE, JICPA, KPMG

G. DEFINITIONS

41. ED 530 Paragraph 5(a) defines audit sampling (sampling) as, “The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection.”
42. A number of respondents¹⁵ suggested that the definition of audit sampling needed to also cover the evaluation component of audit sampling. These respondents recommended adding back the language similar to extant ISA 530 paragraph 3 that states “in order to form or assist in forming a conclusion concerning the population from which the sample is drawn.” The Task Force has revised the definition of audit sampling in paragraph 5(a) of the proposed ISA accordingly.
43. ED 530 Paragraph 5(d) defines non-sampling risk as “The risk that the auditor does not recognize misstatements or deviations included in the sample for what they are.”
44. A number of respondents¹⁶ noted that the term is not used in the ISA and therefore should be deleted. ICAEW indicated that even though the term is not used in this ISA, an understanding of its importance is essential. Others¹⁷ expressed the view that for various reasons the definition as drafted does not appear to be correct. Some of these respondents suggested defining non-sampling risk based on paragraph 8 of extant ISA 530. The Task Force has revised the definition accordingly.

Action requested

Does the IAASB agree with the proposed changes to the definitions?

¹⁵ CICA, CPAB, FEE, ICAEW, ICA Ire, NAO, PWC

¹⁶ APB, BDO, CIPFA, SARG, NZICA

¹⁷ JICPA, KPMG, IDW, NZICA, ICAEW

APPENDIX

List of Respondents to ED-ISA 200

Abbreviation	Category
Professional Organizations	
AICPA	American Institute of Certified Public Accountants
ACCA	Association of Chartered Certified Accountants
AIA	Association of International Accountants
CalCPA	California Society of Certified Public Accountants
CIPFA	Chartered Institute of Public Finance and Accountancy
CNCC	Compagnie Nationale des Commissaires aux Comptes + Conseil Supérieur de l'Ordre des Experts-Comptables
CPA AU	CPA Australia
FAR SRS	FAR SRS
FEE	Federation des Experts Comptables Europeens
HKICPA	Hong Kong Institute of Certified Public Accountants
IBR/IRE	Instituut der Bedrijfsrevisoren / Institut des Reviseurs d'Entreprises
ICAEW	Institute of Chartered Accountants in England and Wales
ICAI - Ire	Institute of Chartered Accountants in Ireland
ICAP	Institute of Chartered Accountants of Pakistan
ICAS	Institute of Chartered Accountants of Scotland
ICJCE	Instituto de Censores Jurados de Cuentas de Espana
CPA Ire	Institute of Certified Public Accountants in Ireland
ICPAS	Institute of Certified Public Accountants of Singapore
IDW	Institut der Wirtschaftsprufer
JICPA	Japanese Institute of Certified Public Accountants
NIVRA	Koninklijk Nederlands Instituut van Registeraccountants (Royal NIVRA)
NIA	National Institute of Accountants
SAICA	South African Institute of Chartered Accountants
National Auditing Standard Setters	
APB	Auditing Practices Board (United Kingdom)
AUAASB	Australian Government, Auditing and Assurance Standards Board
CICA	Canadian Auditing and Assurance Standards Board
IRBA	Independent Regulatory Board for Auditors (South Africa) <i>(also a Regulator)</i>
NZICA	Professional Practices Board, New Zealand Institute of Chartered Accountants
Audit Firms	
BDO	BDO Global Coordination B.V
DTT	Deloitte Touche Tohmatsu
EYG	Ernst & Young Global
GTI	Grant Thornton International
KPMG	KPMG
Mazars	Mazars
PWC	PricewaterhouseCoopers
Public Sector Organizations	

Abbreviation	Category
ACAG	Australasian Council of Auditors-General
GAO	United States Government Accountability Office
NAO	National Audit Office, UK
PAS	Provincial Auditor Saskatchewan
SNOA	Riksrevisionen (Swedish National Audit Office)
WAO	Wales Audit Office
Regulators and Oversight Authorities	
CPAB	Canadian Public Accountability Board
EC	European Commission
Individuals and Others	
JM	Dr. Joseph Maresca CPA, CISA
SARG	Statistical Auditing Research Group

[BLANK PAGE]