

Basis for Conclusions: ISA 530 (Redrafted), Audit Sampling

*Prepared by the Staff of the International Auditing and
Assurance Standards Board*



**International Federation
of Accountants**

BASIS FOR CONCLUSIONS:

ISA 530 (REDRAFTED), AUDIT SAMPLING

This Basis for Conclusions has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB). It relates to, but does not form part of, ISA 530 (Redrafted), “Audit Sampling,” which was approved by the IAASB in June 2008.¹

Background

1. In September 2006, the IAASB agreed the conventions to be used in drafting future International Standards on Auditing (ISAs). These conventions are commonly referred to as the IAASB’s Clarity conventions.²
2. The IAASB has undertaken to redraft all of its ISAs in accordance with the Clarity conventions. This approach responds to the desire for all ISAs to be consistently drafted, and subject to a single statement of their authority and effect. The IAASB has agreed, in response to the general call for the Clarity project to be completed within a reasonable time, that while a significant number of the ISAs are under substantive revision as well as redrafting to reflect the new conventions, others will be subject to a limited redrafting to reflect only the conventions and matters of clarity generally. ISA 530 is in the latter category.
3. The IAASB issued an exposure draft of proposed ISA 530 (Redrafted) (ED-ISA 530) in July 2007, with a comment date of October 31, 2007. The IAASB received forty-four comment letters from a variety of respondents, including IFAC member bodies, national standard setters, firms, regulators, government organizations, and others. Input was also received from IFAC’s Small and Medium Practices Committee. The IAASB made changes to ED-ISA 530 in response to these comments. In addition, the IAASB discussed significant issues in the development of ED-ISA 530, and the finalization of ISA 530 (Redrafted), with its Consultative Advisory Group (CAG). The CAG raised no significant concerns about the proposed treatment of these issues with the IAASB.
4. This Basis for Conclusions explains the more significant issues raised by respondents on ED-ISA 530, and how the IAASB has addressed them. Respondents generally expressed support for the clarifications made to the extant ISA as a result of the redraft.

Objective

5. ED-ISA 530 proposed the following objective:

¹ See minutes of the June 16-20, 2008 IAASB meeting at <http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4272>.

² The IAASB’s Clarity conventions, and the authority and obligation attaching to them, are established in ISA 200 (Revised and Redrafted), “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing,” which was approved by the IAASB in June 2008 for submission to the Public Interest Oversight Board for its confirmation of due process.

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.

6. The majority of respondents were of the view that the objective to be achieved by the auditor is appropriate. Several respondents, however, were concerned that this proposed objective focused more on the process of audit sampling than on the outcome that should be accomplished. A few respondents suggested that it would be helpful if the objective were to be drafted to more closely relate to the overall objective of the auditor, that is, to obtain sufficient appropriate audit evidence.
7. The IAASB did not agree that the objective of the auditor in respect of audit sampling is to obtain “sufficient appropriate audit evidence” within the broader meaning of this phrase. Rather, the objective is that, within the narrow context of audit sampling, the sample provide the auditor with a reasonable basis on which to draw conclusions about the population from which the sample was selected. The IAASB determined that this principle should be retained in the objective. Nevertheless, the IAASB accepted that the proposed objective appeared unduly procedural in nature. Accordingly, the IAASB agreed to amend the objective as follows to be more outcome-oriented:

The objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected. (See paragraph 4 in the redrafted ISA).

Definition of Non-Sampling Risk

8. ED-ISA 530 proposed to define non-sampling risk as “the risk that the auditor does not recognize misstatements or deviations included in the sample for what they are.”
9. Some respondents noted that the term is not used in the ISA and therefore need not be defined. Others, however, supported retaining a definition of the term but were of the view that the proposed definition seemed incorrect. Some of the latter respondents suggested that the redrafted definition of non-sampling risk is too restrictive. These respondents noted that the redrafted definition excludes aspects of the extant ISA definition that address the risk of drawing an incorrect conclusion, and that the redrafted definition is not consistent with how the term is used in ISA 500 (Redrafted).³ They suggested retaining the substance of the definition of non-sampling risk under the extant ISA, that is, that non-sampling risk arises from factors that cause the auditor to reach an erroneous conclusion for any reason not related to the size of the sample.
10. The IAASB determined that the term should continue to be defined in the ISA even though it is not used, as an understanding of it is important in the context of the ISA. In relation to the definition itself, the IAASB accepted, after further deliberation, that the extant definition would be more appropriate, subject to a refinement as there may be more to

³ ISA 500 (Redrafted), “Audit Evidence.”

sampling risk than the size of the sample. Accordingly, the IAASB determined that non-sampling risk should be defined in the redrafted ISA as “the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.”⁴

Selecting Items for Testing

11. ED-ISA 530 proposed that material dealing with the selection of items for testing by means other than audit sampling, that is, selecting all items and selecting specific items, be moved to ISA 500 (Redrafted) in order for ISA 530 (Redrafted) to provide a clear focus on audit sampling.
12. The majority of respondents who commented on this proposal expressed support for it. A few suggested that the material being moved was more closely related to ISA 330 (Redrafted)⁵ and therefore belonged more appropriately in that ISA.
13. A few other respondents did not support the proposal as they were concerned that ED-ISA 530 gave the impression that audit sampling is the preferred selection technique in most, if not all, audits. They suggested that the ISA 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. The IAASB did not agree with the suggestion that the material dealing with the selection of items for testing by means other than audit sampling would be more appropriately placed in ISA 330 (Redrafted) because that ISA deals more with the principles of designing and implementing appropriate responses to assessed risks of material misstatement, than with the way in which actual audit procedures should be performed to enable the auditor to obtain sufficient appropriate audit evidence. The IAASB also did not agree with the suggestion that a better outcome would be achieved by retaining the material concerned in the redrafted ISA because the ISA is specifically intended to focus on the auditor’s obligations when the auditor *has decided to use audit sampling* as the means for selecting items for testing in performing specific procedures. The IAASB does not believe that moving the material concerned to ISA 500 (Redrafted) would introduce an undue bias in favor of audit sampling given that ISA 500 (Redrafted) explains that there are different means available to the auditor for selecting items for testing, of which audit sampling is but one. Rather, the nature of audit sampling and the potentially complex considerations it

⁴ The redrafted ISA defines sampling risk as:

The risk that the auditor’s conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

- (i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
- (ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

⁵ ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks.”

involves warrant a separate ISA focused on the topic to provide clear requirements and guidance to the auditor when the auditor has chosen audit sampling as the means to select items for testing.

15. Accordingly, the IAASB reaffirmed its decision to move the material on selecting all items and selecting specific items to ISA 500 (Redrafted), leaving ISA 530 (Redrafted) to deal with audit sampling only. Nevertheless, to make the scope of the redrafted ISA clear, the IAASB agreed to include a statement in the scope paragraph to the effect that ISA 500 (Redrafted) provides guidance on the means available to the auditor for selecting items for testing, of which audit sampling is one means.

Anomalies

16. Many respondents expressed support for the clarification of the guidance in extant ISA 530 dealing with anomalies, including the proposal to establish the requirements, from the extant present tenses, that:
 - (a) The auditor obtain a high degree of certainty that a misstatement or deviation deemed, in extremely rare circumstances, to be an anomaly is not representative of the population; and
 - (b) The auditor obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.
17. One respondent, however, disagreed with these proposed elevations on the grounds that the auditor's consideration of anomalous misstatement is already implicitly dealt with in ISA 450 (Revised and Redrafted).⁶ The IAASB did not share this view because it believes that it is in the public interest for ISA 530 (Redrafted) to explicitly set out the obligations that the auditor has to fulfill before concluding that a misstatement or deviation deemed to be an anomaly is not representative of the population. Without these explicit requirements, the IAASB believes that there would be a risk that the auditor would inappropriately dismiss misstatements or deviations as anomalies.
18. Some respondents argued that the use of the phrases "in extremely rare circumstances" and "high degree of certainty" in the requirement above was excessive. The IAASB did not share this view as the occurrence of an anomaly should be extremely rare given that, by definition, an anomaly is the result of a non-recurring event or set of circumstances. From a terminology standpoint, the IAASB also noted that the phrase "extremely rare circumstances" is already used in other ISAs. With regard to the phrase "high degree of certainty" (which is terminology used in the extant ISA), the IAASB believes that this appropriately conveys the significant level of work effort required to justify a conclusion that a misstatement or deviation is an anomaly. In other words, the phrase suitably conveys the need for the auditor to obtain sufficient appropriate audit evidence to demonstrate that the misstatement or deviation is indeed an anomaly. The IAASB therefore determined that the wording used in ED-ISA 530 should remain unchanged.

⁶ ISA 450 (Revised and Redrafted), "Evaluation of Misstatements Identified during the Audit."

19. ED-ISA 530 proposed cautionary guidance to the effect that “the smaller the sample size in which the misstatement or deviation occurs, the more difficult it will be for the auditor to obtain the level of certainty necessary to determine that the misstatement or deviation identified is an anomaly.” The IAASB determined, after due re-deliberation, that this guidance should be deleted as it could be misinterpreted to mean that the larger the size of the sample, the easier it will be for the auditor to explain away the anomaly.

Projecting and Evaluating Sample Results

20. When it finalized ED-ISA 530, the IAASB took the view that an important aspect of audit sampling that needed greater clarity was the auditor’s conclusion about whether the use of audit sampling has provided an appropriate basis for conclusions about the population. For this purpose, ED-ISA 530 proposed a requirement that:

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.
21. In addition, ED-ISA 530 proposed new guidance in Appendix 5 to explain how estimated maximum misstatement and estimated maximum rate of deviation may be used by the auditor to conclude whether the use of audit sampling has provided an appropriate basis for conclusions about the population.
22. Although some respondents expressed support for these proposed clarifications, several others felt that clarity had been lost and that the proposed requirement went beyond the substance of the extant requirements pertaining to the projection of errors and the evaluation of the sample results, that is, that:
- (a) For tests of details, the auditor should project monetary errors found in the sample to the population; and
 - (b) The auditor should evaluate the sample results to determine whether the assessment of the relevant characteristic of the population is confirmed or needs to be revised.

In particular, it was noted that under the proposed requirement, the auditor would need to estimate the rate of deviation in the population instead of confirming the initial hypothesis that the error rate is acceptably low, which would represent a change going beyond clarity. It was also pointed out that the proposed requirement to determine the projected rate of deviation for controls testing was a further change beyond the scope of clarity as the extant requirement is limited to the projection of misstatements for tests of details.

23. In addition, some respondents argued that specific guidance supporting the extant requirements above and that had been deleted from ED-ISA 530 should be reinstated as it is helpful to the proper understanding of the requirements.
24. In the light of these concerns, the IAASB accepted that some of the meaning and substance of the extant requirements and guidance relating to projecting and evaluating sample results may have been lost during the redrafting exercise. Accordingly, the IAASB agreed to amend the requirements and guidance proposed in ED-ISA 530 as follows to be more consistent with the extant ISA:
- (a) In relation to projecting misstatements, a separate requirement that, for tests of details, the auditor project misstatements found in the sample to the population has been established (paragraph 14 of the redrafted ISA);
 - (b) In relation to evaluating the results of audit sampling, a requirement that the auditor evaluate (i) the results of the sample; and (ii) whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested has been established (paragraph 15 of the redrafted ISA);
 - (c) Guidance from the extant ISA to the effect that, for tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population has been reinstated (paragraph A20 in the redrafted ISA); and
 - (d) Guidance relating to evaluating the results of audit sampling has been aligned to the effect that the closer the projected misstatement plus anomalous misstatement is to tolerable misstatement, the more likely that actual misstatement in the population may exceed tolerable misstatement (paragraph A22 in the redrafted ISA).
25. Finally, as suggested by a few respondents on the grounds of project scope extension, the IAASB agreed to delete Appendix 5 in ED-ISA 530. As a consequence, the definitions of the terms “estimated maximum misstatement” and “estimated maximum deviation” were also deleted.

Determining Sample Size

26. ED-ISA 530 proposed the following requirement in relation to sample size determination:
- The auditor shall determine a sample size sufficient to allow the auditor to conclude with an appropriate level of sampling risk that:
- (a) In the case of tests of details, the total misstatement does not exceed tolerable misstatement; or
 - (b) In the case of tests of controls, the total rate of deviation does not exceed the tolerable rate of deviation.
27. Respondents generally expressed the view that the wording of the requirement in the extant ISA is clearer. In particular, it was noted that as sampling risk is already defined, it is unnecessary to introduce the concepts of “tolerable misstatement” and “tolerable rate of deviation” in the requirement. It was also questioned whether it would be possible to

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design a procedure that meets the requirement as drafted without the use of statistical sampling.

28. The IAASB accepted these comments and, accordingly, redrafted the requirement to be consistent with the extant requirement, that is, that the auditor determines a sample size sufficient to reduce sampling risk to an acceptably low level (paragraph 7 of the redrafted ISA). The IAASB agreed that the evaluation of whether or not (a) in the case of tests of details, the total misstatement exceeds tolerable misstatement; or (b) in the case of tests of controls, the total rate of deviation exceeds the tolerable rate of deviation, would already be covered by the auditor's evaluation of the results of the sample.