



International Federation of Accountants

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Agenda Item

6

Committee: IAASB

Meeting Location: New York

Meeting Date: February 13-16, 2007

Audit Sampling and Other Means of Testing

Objective of Agenda Item

1. To review a first read draft of ISA 530 (Redrafted), “Audit Sampling and Other Means of Testing,” based on the clarity drafting conventions adopted by the IAASB.

Task Force Members

2. The members of the Task Force are:

John Fogarty (Chair) IAASB Member

Phil Cowperthwaite IAASB Member

Jennifer Haskell, IAASB Technical Advisor, has also provided assistance to the Task Force.

Matters for IAASB Consideration

GENERAL

3. This Task Force was formed following the July 2006 IAASB meeting for the purpose of redrafting ISA 530 using the clarity conventions adopted by the IAASB.
4. The Task Force has met four times, once in person and three times via conference call. An earlier version of the redrafted ISA has been reviewed by the Chair of the Clarity Task Force and the staff member responsible for that project.
5. The mandate followed by the Task Force was one of minimal change to extant ISA 530, focusing on the elimination of present tense statements. The Task Force, therefore, is not proposing any wider changes to the document, either in the form of structural changes (as discussed in paragraphs 15 to 17) or in the form of possible matters of substance noted with the redrafted ISA (as discussed in paragraphs 18 to 21), pending discussion of these matters by the Board.

DEFINITIONS

6. For the purposes of extant ISA 530, error is defined as “either control deviations, when performing tests of controls, or misstatements when performing tests of details. Similarly, total error is used to mean either the rate of deviation or total misstatement.”

7. ED ISA 450 (Redrafted), “Evaluation of Misstatements Identified During the Audit” defines error as “an unintentional misstatement in the financial statements.” This definition excludes fraud, as well as control deviations.
8. The Task Force believes that having a word that is defined differently in different standards is confusing. Therefore, in order to avoid any confusion among the ISAs, the Task Force has used either *deviation*, *misstatement* or *deviation or misstatement*, in place of error as applicable, throughout the ISA. Accordingly, the definition of *error* is no longer necessary and has been deleted.
9. In addition, extant ISA 530 defines “anomalous error” and “tolerable error.” Because of the potential confusion with using error, as discussed above, the Task Force has changed tolerable error to *tolerable rate* and *tolerable misstatement*, as appropriate throughout the ISA. These terms are defined in paragraph 4(h) and 4(i) of the redrafted ISA.
10. The term *anomalous error* has replaced by *anomaly* throughout the ISA. *Anomaly* has not been defined in the definitions section, however paragraph 15 of redrafted ISA 530 describes an anomaly as “a deviation or misstatement that 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.” The Task Force is of the view that the way in which the term anomaly is being used is consistent with its English meaning and therefore no definition is necessary.

Action Requested

Does the IAASB agree that the use of error in extant ISA 530 is inconsistent with its use in ED ISA 450 and therefore could cause confusion?

If so, does the IAASB agree that the term error should be replaced with deviation or misstatement, or both, as appropriate?

If so, does the IAASB agree that the terms anomalous error and tolerable error should be changed as outlined in paragraphs 9 and 10 above?

PROJECTING ERRORS

11. Extant ISA 530, paragraph 52, discusses how the auditor treats anomalies when projecting errors to a sample. Paragraph 52 of extant ISA 530 states “When an error has been established as an anomalous error, it may be excluded when projecting sample errors to the population. *The effect of any such error, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous errors.* If a class of transactions or account balance has been divided into strata, the error is projected to each stratum separately. *Projected errors plus anomalous errors for each stratum are then combined when considering the possible effect of errors on the total class of transactions or account balance.*”
12. ED ISA 450, paragraph 5, requires that the auditor accumulate misstatements identified during the audit, other than those that are clearly trivial, distinguishing between factual misstatements, judgmental misstatements and projected misstatements. This requirement

applies to all misstatements, including anomalies. The Task Force is of the view that auditor's consideration of anomalies is implicit within the auditor's consideration of misstatements required by ED ISA 450 and is not required to be discussed separately in ISA 530. Accordingly, the italicized sentences identified above have been deleted in redrafting ISA 530.

Action requested

Does the IAASB agree that the auditor's consideration of anomalous misstatements is implicit in ED ISA 450 and that it is therefore not necessary to discuss anomalous misstatements in redrafted ISA 530?

STRATIFICATION AND VALUE WEIGHTED SELECTION

13. Extant ISA 530, paragraphs 36 through 38 and 39 discuss stratification and value weighted selection, respectively. In redrafting ISA 530, the Task Force struggled with how to position these paragraphs within the ISA while still maintaining the flow of the document. Accordingly, these paragraphs have been moved to Appendix 4.

Action requested

Does the IAASB agree with moving the material relating to stratification and value weighted selection to an appendix?

PRESENT TENSE STATEMENTS ELEVATED TO REQUIREMENTS

14. The Task Force proposes elevating several present tense statements as identified in Agenda Item 6-D, Disposition of Present Tense Statements.

Action requested

Does the IAASB agree with moving the proposed elevations of present tense statements identified in Agenda Item 6-D?

SCOPE OF ISA 530

15. As noted in paragraph 5 of this paper, the Task Force took a minimalist approach to the redrafting of ISA 530. The Task Force is of the view that to successfully clarify this document, it would be necessary to have the focus of ISA 530 be on audit sampling alone. Extant ISA 530 deals mostly with audit sampling, but also includes some limited discussion on other means of selecting items for testing.
16. The Task Force believes that limiting ISA 530 to audit sampling would simplify the current standard. To allow the focus of ISA 530 to be on audit sampling, the Task Force has prepared Agenda Item 6-C, which presents ISA 530 as if it addresses only audit sampling, for discussion by the Board. The Task Force proposal includes moving material relating to other means of selecting items for testing from ISA 530 to ISA 500. Certain material that is repetitive of other ISAs would be deleted as it is included in ISA 530 to provide context to the non-sampling related matters in extant ISA 530. A

summary of the Task Force's proposed changes to Agenda Item 6-A is provided in Agenda Item 6-C.

Action requested

Does the IAASB agree with limiting ISA 530 to audit sampling and including guidance on other means of selecting items for testing in ISA 500?

OTHER MATTERS

17. As the Task Force redrafted ISA 530, it identified some possible issues that, in the Task Force's view, are beyond the scope of the clarity mandate. The Task Force has not taken a position on these issues. The purpose of the Task Force, in raising these issues with the Board, is to determine whether they need to be pursued.

Definition of Tolerable Misstatement

18. The Task Force is concerned that the redrafted definition of tolerable misstatement, which is based on the definition of tolerable error in extant ISA 530 is not correct because it is being defined without reference to reasonable assurance with which it is inextricably bound. Tolerable misstatement is used at the account balance and class of transactions level so that the auditor can conclude with reasonable assurance in relation to materiality at the financial statement level.
19. For the purpose of generating discussion within the Board, the following definition is presented to provide an example of the concepts that the Task Force believes need to be addressed in the definition of tolerable misstatement:

“Tolerable misstatement in an account balance or class of transactions is an amount that the auditor seeks to obtain reasonable assurance is not exceeded by actual misstatement, and which is set so that if such assurance is obtained for all accounts the auditor will have obtained reasonable assurance that the aggregate misstatement does not exceed materiality.”

Projecting Misstatements

20. In redrafting ISA 530, the Task Force considered the language in the second sentence of paragraph 51 of the extant ISA which states “the auditor projects the total error for the population to obtain a broad view of the scale of errors, and to compare this to the tolerable error.” In clarifying this language, the Task Force has established a requirement that the auditor shall compare the total amount of projected misstatement for the population to tolerable misstatement (see paragraph 17 of Agenda Item 6-A). However, the Task Force believes that it is the expected maximum misstatement rather than the projected misstatement that the auditor should compare with the tolerable misstatement.

Anomalies

21. The Task Force is also concerned that extant ISA 530, paragraph 55, confuses the concepts of anomalous errors and isolated events. A sample may be representative of the population as to error frequency (for example) without the specific errors in the sample

being representative of others in the population as to cause. No matter how sure the auditor is that an error is unique and could not possibly have happened twice, that is not a reason for believing that other totally different errors could not have occurred that the auditor just happened not to pick in the random sample. In some sampling applications there may be a good reason to eliminate outliers, but in auditing that often requires assuming things about the population that the auditor is setting out to prove or quantify.

Action requested

Does the IAASB believe that the issues raised in paragraphs 18-21 need to be pursued by the Task Force?

Material Presented (Note: Agenda Items 6-A will be used for purposes of the discussion at the meeting.)

Agenda Item 6-A (Pages 423-440)	Proposed ISA 530 (Redrafted) – Clean – First Read
Agenda Item 6-B (Pages 441-454)	Proposed ISA 530 (Redrafted) – Marked Draft
Agenda Item 6-C (Pages 455-470)	Proposed ISA 530 (Redrafted) – Audit Sampling Only
Agenda Item 6-D (Pages 471-474)	Proposed Disposition of the Present Tense and Other Statements in Proposed ISA 530 (Redrafted)
Agenda Item 6-E (Pages 475-492)	Mapping Document – Proposed ISA 530 (Redrafted)

Action Requested

22. The IAASB is asked to review ISA 530 (Redrafted) in Agenda Item 6-A and provide direction to the Task Force.

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