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Agenda Item
10

Committee: IAASB

Meeting Location: Warsaw, Poland

Meeting Date: July 9-13, 2007

Proposed ISA 530 (Redrafted), "Audit Sampling"

Objective of Agenda Item

1. To approve as an exposure draft proposed ISA 530 (Redrafted), "Audit Sampling."

Task Force Members

2. The members of the Task Force are:

John Fogarty (Chair)	IAASB Member
Phil Cowperthwaite	IAASB Member

The Task Force wishes to acknowledge the assistance provided by Trevor Stewart, Deloitte & Touche and Jennifer Haskell, IAASB Technical Advisor.

Matters for IAASB Consideration

General

3. The Task Force presented a first read draft to the IAASB at its February 2007 meeting. Since that meeting, the Task Force has met once in person and once via conference call to discuss the comments raised by the IAASB.

4. In response to the direction received from the IAASB, the Task Force has made the following changes in the draft presented:

Material Not Relating to Audit Sampling

5. In February, the IAASB deliberated the Task Force's proposal to clarify and simplify the proposed ISA 530 (Redrafted) by moving material relating to other means of selecting items for testing from ISA 530 to proposed ISA 500 (Redrafted), "Considering the Relevance and Reliability of Audit Evidence." After some debate, the IAASB agreed that by eliminating requirements and guidance that are unrelated to audit sampling, the proposed ISA 530 would be more coherent. In this draft, the Task Force has also removed material that is duplicative of other ISAs.

Objective

6. In February, the Task Force presented the following as the objective of the auditor:

The objective of the auditor is to use appropriate bases for selecting items for testing in order to obtain sufficient appropriate audit evidence.

The IAASB noted that it would be difficult to draft the objective for this particular ISA as an outcome based objective. It also questioned whether obtaining sufficient appropriate audit evidence is the right for the objective for this ISA. It suggested that the Task Force link the objective to the reliability of audit evidence and the evaluation of results.

7. The Task Force believes that, in relation to audit sampling, the objective of the auditor is to obtain sufficient appropriate audit evidence through the sample. It has therefore redrafted the objective as follows:

The objective of the auditor when using audit sampling is to design, perform, and evaluate samples so as to provide appropriate bases for conclusions about the populations tested.

Action Requested

Does the IAASB agree with the proposed objective?

Anomalies

8. The IAASB discussed the guidance relating to anomalous errors in the extant ISA. Questions were raised about whether anomalies really can exist, particularly in audit sampling. It was noted that there is an element of contradiction embedded in the concept because, if the auditor finds an anomaly in the selected sample, then the sample itself is not representative. It was also noted that anomalies are recognized as being possibilities in audit practice today and as a result, to delete references to anomalies through a clarity redraft would be inappropriate. The Task Force was directed to retain the concept of anomalies in the ISA but to emphasize in the redrafting that the occurrence of anomalies is rare.

9. In response to this concern, the Task Force has redrafted the discussion of errors so that it is generic and the redrafted ISA is now silent with respect to specific treatment of anomalies. Paragraph A19 contains the only reference in the ISA to an anomaly and states:

As required by paragraphs 11 and 12, all misstatements and deviations, including those the auditor may believe are anomalous, are included in the relevant projections of the samples to the populations.

Action Requested

Does the IAASB agree that the ISA need not specifically address anomalies?

Other Matters

Definition of Tolerable Misstatement

10. In February, the Task Force expressed concern that the redrafted definition of tolerable misstatement, which was based on the definition of tolerable error in extant ISA 530, was

not correct because it was 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.

11. The IAASB directed the Task Force to take a cautious approach to redrafting the definition of tolerable misstatement.

12. The Task Force has developed the following definition of tolerable misstatement in paragraph 4(h) of proposed redrafted ISA 530.

    "Tolerable misstatement — "An amount that the auditor seeks to obtain reasonable assurance is not exceeded by the actual misstatement in the population".

13. The Task Force view is that tolerable misstatement, as defined above, is the same concept as that discussed in the proposed ISA 320 (Revised and Redrafted) "Materiality in Planning and Performing an Audit," paragraph A13.

14. The proposed ISA 320 (Revised and Redrafted), paragraph A13 states "planning the audit solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated, and leaves no margin for possible undetected misstatements. The amount or amounts the auditor determines for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks is set to reduce to an appropriately low level the probability that the total of uncorrected and undetected misstatements in the financial statements exceeds the materiality level or levels. The determination of this amount or amounts is not a simple mechanical calculation and requires the auditor to exercise professional judgment. It is affected by the auditor's understanding of the entity, updated during the execution of the risk assessment procedures, and by the nature and extent of misstatements accumulated in previous audits (e.g., for an entity with a history of large or numerous misstatements accumulated in previous audits, the amount or amounts so determined would be lower than if such misstatements were not present)."

15. The Task Force has referenced paragraph A13 of the proposed ISA 320 (Revised and Redrafted), and provided guidance on its application to audit sampling in paragraph A1 of proposed ISA 530 (Redrafted). This approach is premised on the idea that the Board is reluctant to change ISAs that have been finalized. The preference of the Task Force is that the term tolerable misstatement be defined in the proposed ISA 320 (Revised and Redrafted) however, the Task Force also recognizes that at the time the proposed ISA 320 was finalized the IAASB was reluctant to label the concept. The Task Force believes that using the same concept but with different terms is not consistent with the objectives of the clarity project.

Action Requested

Does the IAASB agree with that the use of tolerable misstatement in the proposed ISA 530 (Redrafted) is the same concept as an amount lower than materiality as discussed in paragraph A13 of the proposed ISA 320?

Estimated Maximum Misstatement and Estimated Maximum Rate of Deviation

16. The Task Force has introduced the terms *estimated maximum misstatement* and *estimated maximum rate of deviation* in the redrafted ISA. In doing so, it is not the Task Force's intention to require statistical sampling.

17. Paragraphs 4(j) defines the expected maximum misstatement as the upper limit of the range of reasonably possible misstatement. In this context, "reasonably possible" means that the risk is acceptably low that actual misstatement exceeds the upper limit.

18. Paragraph 4(k) defines the expected maximum rate of deviation as the upper limit of the range of reasonably possible rates of deviation. In this context, "reasonably possible" means that the risk is acceptably low that the actual rate of deviation exceeds the upper limit.

19. As discussed at the February meeting, the Task Force view is that the auditor should compare the estimated maximum misstatement with tolerable misstatement or the estimated maximum rate of deviation with the tolerable rate of deviation, rather than with projected misstatement or projected rate of deviation respectively. Accordingly, paragraph 13 requires the auditor to compare the estimated maximum misstatement to tolerable misstatement for tests of details and paragraph 14 requires the auditor to compare the estimated maximum rate of deviation to the tolerable rate of deviation for tests of controls.

20. Guidance on expected maximum misstatement and expected maximum rate of deviation is included in paragraphs A2-A4 of the proposed ISA.

Action Requested

Does the IAASB agree with the requirements in paragraphs 13-14 and the application material in paragraphs A2 – A4 of proposed redrafted ISA 530?

Does the IAASB believe that the requirements in paragraphs 11-14 implicitly require statistical sampling?

Material Presented (Note: Agenda Item 10-B will be used for purposes of the discussion at the meeting.)

Agenda Item 10-A (Pages 2331 - 2352)	Proposed ISA 530 (Redrafted) (Mark-up from Feb 07 IAASB Meeting)
Agenda Item 10-B (Pages 2353 - 2366)	Proposed ISA 530 Redrafted (Clean)
Agenda Item 10-C (Pages 2367 - 2378)	Proposed ISA 530 (Redrafted) (Mark-up from extant ISA 530)
Agenda Item 10-D (Pages 2379 - 2382)	Proposed Disposition of the Present Tense and Other Statements in Proposed ISA 530 (Redrafted)

Agenda Item 10-E Proposed ISA 530 (Redrafted) - Mapping Document
(Pages 2383 - 2400)

Action Requested

21. The IAASB is asked to review and approve ISA 530 (Redrafted) as an exposure draft.

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