Agenda Item 10-C

MARK-UP FROM EXTANT ISA 530

PROPOSED INTERNATIONAL STANDARD ON AUDITING 530 (REDRAFTED)

AUDIT SAMPLING ~~AND OTHER MEANS OF TESTING~~

Paragraph of extant ISA 530	Redrafted ISA 530 (as per Agenda Item 10-B).
	Introduction
	Scope of this ISA
1	1. ~~The purpose of t~~ This International Standard on Auditing (ISA) ~~is to establish standards and provide guidance~~ deals with ~~on~~ the use of audit sampling and other means of selecting items for testing when designing audit procedures to ~~gather~~ obtain audit evidence. This ISA is applicable when the auditor performs tests of controls and tests of details.
New	2. This ISA complements ISA 500, Audit Evidence, which deals with what constitutes audit evidence in an audit of financial statements, the auditor's responsibility to obtain information that is capable of providing sufficient appropriate audit evidence, and the evaluation of whether sufficient appropriate audit evidence has been obtained.
	Effective Date
57	3. This ISA is effective for audits of financial statements for periods beginning on or after [date[1]].
	Objective
2	4. 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. ~~When designing audit procedures, the auditor should determine appropriate means for selecting items for testing so as to gather sufficient appropriate audit evidence to meet the objectives of the audit procedures.~~
	5. For purposes of the ISAs, the following terms have the meanings attributed below:
3	(a) Audit sampling (sampling) — ~~involves~~ The application of audit procedures to less than 100% of items within a population ~~class of transactions or account balance~~ such that all sampling units have a chance of selection. ~~This will enable the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the~~

[1] This date will not be earlier than December 15, 2008.

	~~population from which the sample is drawn. Audit sampling can use either a statistical or a non-statistical approach.~~
6	(b) Population — ~~means~~ The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions. For example, all of the items in a class of transactions or account balance constitute a population. A population may be divided into strata, or sub-populations, with each stratum being examined separately. ~~The term population is used to include the term stratum.~~
7	(c) Sampling risk — ~~arises from~~ The ~~possibility~~ risk that the auditor's conclusion, based on a sample may be different from the conclusion reached if the entire population were subjected to the same audit procedure. There are two types of sampling risk: (i) The risk the auditor will conclude, 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 error does not exist when in fact it does. Because it ~~This type of risk~~ affects audit effectiveness and is more likely to lead to an inappropriate audit opinion, the auditor is primarily concerned with this type of sampling risk. The term "confidence level" is used to denote its complement – one minus the risk; ~~and~~ (ii) The risk the auditor will conclude, 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 error exists when in fact it does not. This type of risk affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect. ~~The mathematical complements of these risks are termed confidence levels.~~
8 Redrafted.	(d) Non-sampling risk — The risk that the auditor does not recognize misstatements or deviations included in the sample for what they are. ~~arises from factors that cause the auditor to reach an erroneous conclusion for any reason not related to the size of the sample. For example, ordinarily the auditor finds it necessary to rely on audit evidence that is persuasive rather than conclusive, the auditor might use inappropriate audit procedures, or the auditor might misinterpret audit evidence and fail to recognize an error.~~
9	(e) Sampling unit — ~~means~~ The individual items constituting a population~~, for example checks listed on deposit slips, credit entries on bank statements, sales invoices or debtors' balances, or a monetary unit~~.
10	(f) Statistical sampling — ~~means~~ An ~~any~~ approach to sampling that has the following characteristics:

	(i) Random selection of a sample ~~the sample items~~; and (ii) Use of probability theory to evaluate sample results, including measurement of sampling risk. A sampling approach that does not have characteristics (i) and (ii) is considered non-statistical sampling.
11	(g) Stratification — ~~is~~ The process of dividing a population into subpopulations, each of which is a group of sampling units which have similar characteristics (often monetary value).
12 Tolerable error replaced with tolerable misstatement and tolerable rate of deviation.	~~Tolerable error means the maximum error in a population that the auditor is willing to accept.~~ (h) Tolerable misstatement — An amount that the auditor seeks to obtain reasonable assurance is not exceeded by the actual misstatement in the population. (Ref: para A1)
12	(i) Tolerable rate of deviation — A rate that the auditor seeks to obtain reasonable assurance is not exceeded by the actual rate of deviation in the population.
New	(j) Estimated maximum misstatement – The upper limit of the range of reasonably possible misstatement. In this context, "reasonably possible" means that the risk is acceptably low that the actual rate of deviation exceeds the upper limit. (Ref: Para A2-A4)
New	(k) Estimated maximum rate of deviation – 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. (Ref: Para A2-A4)
New from ISA 450	(l) Projected misstatements – The auditor's best estimate of misstatements in populations involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn.
	Requirements
	Sample Design, Size and Selection of Items for Testing
31	6. When designing an audit sample ~~audit procedures,~~ the auditor ~~should~~ shall consider the objectives of the audit procedure and the characteristics of the population from which the sample will be drawn. (Ref A5-A11)

40	7. The auditor shall determine a sample size sufficient to allow the auditor to conclude with an acceptably low level of sampling risk that: ~~In determining the sample size, the auditor should consider whether sampling risk is reduced to an acceptably low level~~. (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 A12-A13)
42	8 The auditor ~~should~~ shall select items for the sample ~~with the expectation that~~ in such a way that all sampling units in the population have a chance of selection. (Ref A14-A15)
	Performing the Audit Procedure
44, 45 46	9. The auditor ~~should~~ shall perform audit procedures appropriate to the particular audit objective on each item selected. If a selected item is not appropriate for the application of the audit procedure, ~~the audit procedure is ordinarily performed~~ the auditor shall perform the procedure on a replacement item. ~~Sometimes however,~~ If the auditor is unable to apply the designed audit procedures to a selected item~~,~~ ~~because, for instance, documentation relation to that item has been lost. If suitable alternative audit procedures cannot be performed on that item, the auditor ordinarily considers that item to be in error~~ the auditor shall consider that item to be a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details. The auditor shall also consider whether the reason for the inability to examine the items have implications for the assessed risk of material misstatement due to fraud, for the assessed level of control risk that the auditor expects to be supported, or for the degree of reliance on management representations. (Ref A16-A17)
	Nature and Cause of Deviations and Misstatements
47	10. The auditor ~~should~~ shall consider the sample results, the nature and cause of any ~~errors~~ deviations or misstatements identified, and their possible effect on the objective of the particular audit procedure and on other areas of the audit. (Ref A31-A18)
	Projecting and Evaluating Sample Results
	11. For tests of details, the auditor shall determine, for the population, both projected misstatement and estimated maximum misstatement, and shall evaluate their effect on the objective of the particular audit procedure and on other areas of the audit. (Ref: Para. A19).
	12. For tests of controls, the auditor shall determine, for the population, both the projected rate of deviation and the estimated maximum rate of deviation, and

	shall evaluate their effect on the objective of the particular audit procedure and on other areas of the audit. (Ref: Para. A19)
	13. For tests of details, the auditor shall compare estimated maximum misstatement to tolerable misstatement. If estimated maximum misstatement exceeds tolerable misstatement the auditor cannot conclude with reasonable assurance that actual misstatement does not exceed tolerable misstatement. In that case, the auditor shall perform further audit procedures that will either achieve such reasonable assurance or prove that actual misstatement does, in fact, exceed tolerable misstatement.
	14. For tests of controls, the auditor shall compare the estimated maximum rate of deviation to the tolerable rate of deviation. If the estimated maximum rate of deviation exceeds the tolerable rate of deviation the auditor cannot conclude with reasonable assurance that the actual rate of deviation does not exceed the tolerable rate of deviation. In that case, the auditor shall either perform further audit procedures that will achieve such reasonable assurance or shall reconsider the appropriateness of reliance on the controls that were tested. (Ref: Para. A20)
54	15. The auditor shall ~~should~~ evaluate the sample results to determine whether the assessment of the relevant characteristic of the population is confirmed or needs to be revised. (Ref A31-A32)
	Application and Other Explanatory Material
	Definitions

	Tolerable Misstatement (Ref: Para. 5(i))
New	A1. The concept of tolerable misstatement is described in paragraph A13 of ISA 320, "Materiality in Planning and Performing an Audit." This ISA describes the application of tolerable misstatement to audit sampling. Tolerable misstatement is used to design samples that, taken together with all the other evidence considered by the auditor, should be sufficient to allow the auditor to conclude with reasonable assurance that total misstatement in the financial statements is not material. Tolerable misstatement is set lower than materiality for two reasons. The first is prudence: it provides a margin of safety against an unexpectedly high incidence of misstatements, so that if tests do not turn out as expected, the auditor may still be able to conclude with reasonable assurance that total misstatement is not material. The second is to reduce aggregation risk so that when sample results for a specific population are aggregated into the results for the audit as a whole, the auditor may obtain reasonable assurance that the aggregate misstatement in the financial statements is not material. The determination of tolerable misstatement 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).
	Estimated Maximum Misstatement and Estimated Maximum Rate of Deviation (Ref: Para. 5(j)-(k))
New	A2 Projected misstatement is the auditor's best estimate of the amount of misstatement in the population. Estimated maximum misstatement, on the other hand, is the upper limit of the range of reasonably possible misstatement; and is always larger than projected misstatement. Even if no misstatements are detected in a sample, so that projected misstatement is zero, there is a probability that at least some misstatement exists despite the lack of sampling evidence. The risk ordinarily declines for increasingly large amounts of potential misstatement, and at some point on the continuum of potential misstatement reaches an acceptably low level. That point is the estimated maximum misstatement. If misstatements are detected in the sample, the projected misstatement is greater than zero and the estimated maximum misstatement is greater than it would have been had no misstatements been detected.
New	A3. When the sample is evaluated, estimated maximum misstatement is compared with tolerable misstatement to determine whether the auditor has achieved reasonable assurance that actual misstatement is tolerable. When statistical sampling is used the evaluation can be performed with statistical rigor to determine the estimated maximum misstatement relative to acceptable

	risk and the results of the sample. When non-statistical sampling is used the same rigor is not possible though the concepts of estimated maximum misstatement and acceptable risk are just as relevant, as is the comparison of estimated maximum misstatement with tolerable misstatement. In fact, many auditors apply the mechanics of a statistical evaluation as an aid to professional judgment even though the evaluation lacks statistical rigor. These same general concepts also apply to the evaluation of other types of substantive tests, even though they may need to be judgmentally applied.
New	A4. Considerations analogous to those discussed in paragraphs A2 and A3 in relation to estimated maximum misstatement also apply to the estimated maximum rate of deviation in the context of tests of controls.
	Risk Assessment Procedures
13a	A2. ~~In accordance with~~ ISA 315, "~~Understanding the Entity and Its Environment~~ Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment," requires the auditor to perform risk assessment procedures ~~to obtain an understanding of~~ through understanding the entity and its environment, including its internal control. Ordinarily, risk assessment procedures do not involve the use of audit sampling. However, the auditor ~~often plans and performs~~ may plan and perform tests of controls concurrently with obtaining an understanding of the design of controls and determining whether they have been implemented. In such cases, the ~~following~~ discussion of tests of controls in paragraphs A3-A4 of this ISA is relevant.
	Tests of Controls
14	A3. In accordance with ISA 330, "The Auditor's ~~Procedures in Response~~ Responses to Assessed Risks" tests of controls are performed when the auditor's assessment of risks at the assertion level includes an expectation of the operating effectiveness of controls.
16	A4. Audit sampling for tests of controls ~~is generally~~ may be appropriate when application of the control leaves audit evidence of performance (for example, initials of the credit manager on a sales invoice indicating credit approval, or evidence of authorization of data input to a microcomputer based data processing system).
	Sample Design (Ref: Para. 6)
27 Inserted text from paragraph 3	A5. ~~The auditor may decide to apply audit sampling to a class of transactions or account balance.~~ Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either non-statistical or statistical sampling approaches. ~~Audit sampling is discussed in detail in paragraphs 31-56.~~
32	A6. ~~The auditor first considers~~ When designing an audit sample, the auditor's

	consideration includes the specific objectives to be achieved and the combination of audit procedures which is likely to best achieve those objectives. Consideration of the nature of the audit evidence sought and possible ~~error~~ deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes ~~an error~~ a deviation or misstatement and what population to use for sampling.
33	A7. The auditor's consideration of the objectives of the audit procedure, as required by paragraph 9, includes a~~A~~ clear understanding of what constitutes a deviation or misstatement so ~~an error is important to ensure~~ that all, and only, those conditions that are relevant to the objectives of the audit procedure are included in the projection of deviations or misstatements. For example, in a test of details relating to the existence of accounts receivable, such as confirmation, payments made by the customer before the confirmation date but received shortly after that date by the client, are not considered a misstatement. Also, a misposting between customer accounts does not affect the total accounts receivable balance. Therefore, it is not appropriate to consider this ~~an error~~ a misstatement in evaluating the sample results of this particular audit procedure, even though it may have an important effect on other areas of the audit, such as the assessment of the likelihood of fraud or the adequacy of the allowance for doubtful accounts.
	A8. ~~When performing~~ For tests of controls, ~~the auditor generally makes an assessment of the rate of error the auditor expects to find in the population to be tested. This~~ the assessment of the rate of deviation is based on the auditor's understanding of the design of the relevant controls and whether they have been implemented, or on the examination of a small number of items from the population. Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. ~~These assessments are~~ This assessment is useful for designing an audit sample and for determining sample size. For example, if the expected rate of ~~error~~ deviation is unacceptably high, tests of controls will normally not be performed. ~~However, when performing tests of details~~ If the expected ~~amount of error~~ misstatement is high, 100% examination or use of a large sample size may be appropriate, when performing tests of details.
	Statistical versus Non-Statistical Sampling Approaches
28/29	A9. The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment, however sample size is not a valid criterion to distinguish between statistical and non-statistical approaches ~~regarding the most efficient manner to obtain sufficient appropriate audit evidence in the particular circumstances~~. For example, in the case of tests of controls the auditor's analysis of the nature and cause of ~~errors~~ deviations will often be more important than the statistical analysis of the mere presence or absence (that is, the count) of ~~errors~~ deviations. In such a situation, non-statistical sampling may be most appropriate.
30	A10. ~~Often~~ While the approach adopted ~~does~~ may not meet the definition of statistical sampling, elements of a statistical approach may be used, for example

	the use of random selection using computer generated random numbers. However, statistical measurements of sampling risk are valid only when the approach adopted has the characteristics of statistical sampling ~~only when the approach adopted has the characteristics of statistical sampling are statistical measurements of sampling risk valid~~.
	Information on Which Audit Procedures Are Based
36-39 (moved to appendix 4)	A11. In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value weighted selection is appropriate. Appendix 1 provides further discussion on stratification and value weighted selection.
	Sample Size (Ref: Para. 7)
40	A12. Sample size is affected by the level of sampling risk that the auditor is willing to accept. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.
41 29	A13. The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment ~~objectively applied to the circumstances~~. Appendices 2 and 3 indicate the influences that various factors typically have on the determination of sample size, and hence the level of sampling risk. When circumstances are similar, the effect on sample size of factors such as those identified in Appendices 2 and 3 will be similar regardless of whether a statistical or non-statistical approach is chosen.
	Selection of Items for Testing (Ref: Para. 8)
42 Inserted text from extant paragraph 9	A14. Statistical sampling requires that sample items are selected at random so that each sampling unit has a known ~~chance~~ probability of being selected. The sampling units might be physical items (for example, check listed on deposit slips, credit entries on bank statements, sales invoices or debtor's balances ~~such as invoices~~) or monetary units. With non-statistical sampling, an auditor uses professional judgment to select the items for a sample. Because the purpose of sampling is to draw conclusions about the entire population, it is important that the auditor selects ~~the auditor endeavors to select~~ a representative sample by choosing sample items which have characteristics typical of the population, and ~~the sample needs to be selected~~ so that bias is avoided.
43	A15. The principal methods of selecting samples are the use of random selection, systematic selection and haphazard selection. ~~number tables or CAATs, systematic selection and haphazard selection.~~ Each of these methods is discussed in Appendix 4.
	Performing Audit Procedures (Ref: Para 9)
45	A16. An example of when it may be necessary to perform the procedure on a replacement item is when ~~For example~~ a voided check may be selected when testing for evidence of payment authorization. If the auditor is satisfied that the

	check had been properly voided such that it does not constitute ~~an error~~ a deviation, an appropriately chosen replacement is examined.
46	A17. An example of when ~~Sometimes, however,~~ the auditor is unable to apply the designed audit procedures to a selected item is when ~~because, for instance,~~ documentation relating to that item has been lost. ~~An example of a suitable alternative audit procedure might be the examination of subsequent receipts when no reply has been received in response to a positive confirmation request.~~
	Nature and Cause of Deviations and Misstatements (Ref: Para 10)
49	A18. In analyzing the ~~errors~~ deviations and misstatements identified ~~discovered~~, the auditor may observe that many have a common feature, for example, type of transaction, location, product line or period of time. In such circumstances, the auditor may decide to identify all items in the population that possess the common feature, and extend audit procedures in that stratum. In addition, such deviations or misstatements may be intentional, and may indicate the possibility of fraud.
	Projecting and Evaluating Sample Results
52	A19. 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. In rare circumstances, the auditor may conclude that a sample is not representative of the underlying populations. In such cases, the results of such samples cannot be used to draw conclusions about the population. ~~When a misstatement has been established as an anomaly, it may be excluded when projecting sample errors to the population.~~
56	A20. In performing further audit procedures to achieve reasonable assurance that actual misstatement does not exceed tolerable misstatement or that the actual rate of deviation does not exceed the tolerable rate of deviation, ~~If the evaluation of sample results indicates that the assessment of the relevant characteristic of the population needs to be revised,~~ the auditor may: • Request management to first investigate misstatements or deviations that have already been identified ~~errors~~ and the potential for further misstatements or deviations ~~errors~~, and to make any necessary adjustments; and/or • Tailor ~~Modify~~ the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures; ~~and/or~~ • ~~Consider the effect on the audit report.~~
54	A31. In the case of tests of controls, an unexpectedly high sample ~~error~~ deviation rate may lead to an increase in the assessed risk of material misstatement, unless further audit evidence substantiating the initial assessment is obtained. In the case of tests of details, an unexpectedly high ~~error~~ misstatement amount in a sample

	may cause the auditor to believe that a class of transactions or account balance is materially misstated, in the absence of further audit evidence that no material misstatement exists.
55	A32 For example, if the ~~total amount of~~ projected ~~error~~ deviations or projected misstatement plus ~~anomalous error~~ anomaly is less than but close to ~~that which the auditor deems tolerable~~ the tolerable rate or tolerable misstatement, the auditor would ~~considers~~ the persuasiveness of the sample results in the light of other audit procedures, and may consider it appropriate to obtain additional audit evidence. The total of projected ~~error~~ deviations or projected misstatement plus ~~anomalous error~~ anomalies is the auditor's best estimate of ~~errors~~ deviations or misstatements in the population. However, sampling results are affected by sampling risk. Thus when the best estimate of ~~error~~ deviations or misstatement is close to the tolerable ~~error~~ rate or tolerable misstatement, ~~the auditor recognizes the~~ there is a risk that a different sample would result in a different best estimate that could exceed the tolerable ~~error~~ rate or tolerable misstatement. Considering the results of other audit procedures helps the auditor to assess this risk, while the risk is reduced if additional audit evidence is obtained.
	Appendix 4 Stratification
36	Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without a proportional increase in sampling risk. Sub-populations need to be carefully defined such that any sampling unit can only belong to one stratum.
37	When performing tests of details, a class of transaction or account balance is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, ~~which~~ as these items may contain the greatest potential ~~monetary error~~ misstatement in terms of overstatement. Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, for example, when testing the valuation of accounts receivable, balances may be stratified by age.
38	The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the auditor will need to consider the risk of material misstatement in relation to whatever other strata make up the entire population. For example, 20% of the items in a population may make up 90% of the value of an account balance. The auditor may decide to examine a sample of these items. The auditor may evaluate the results of this sample and reach a conclusion on the 90% of value separately from the remaining 10% (on which a further sample or other means of gathering audit evidence will be used, or which may be considered immaterial).

	Value Weighted Selection
39	When performing tests of details it will often be efficient, particularly when testing for overstatements, to identify the sampling unit as the individual monetary units (for example, dollars) that make up a class of transactions or account balance. Having selected specific monetary units from within the population, for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units. ~~This approach to defining the sampling unit ensures~~ One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes. This approach is ordinarily used in conjunction with the systematic method of sample selection (described in Appendix 3) and is most efficient when selecting items using CAATs.