OICV-IOSCO

Organización Internacional de Comisiones de Valores
International Organisation of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valore

February 29, 2008

Mr. James M. Sylph
Executive Director, Professional Standards
International Auditing and Assurance Standards Board
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017

Email address: Edcomments@ifac.org

Re: Proposed Redrafted International Standard on Auditing 530 *Audit Sampling*

Dear Mr. Sylph:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the opportunity to comment on the Exposure Draft of proposed redrafted international standard on auditing ISA 530, *Audit Sampling* (the ED). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing, and professional standards.

Members of SC 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns, and pursuit of improved global financial reporting. As we review proposed auditing standards, our concerns focus on whether the standards are sufficient in scope and adequately cover all relevant aspects of the area of audit being addressed, whether the standards are clear and understandable, and whether the standards are written in such a way as to be enforceable.

Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1; however, they are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

In general, we welcome the changes that have been made in clarifying and redrafting ISA 530. Our main concern relates to the requirements when designed audit procedures cannot be applied to items in the sample and when audit procedures on sample items indicate the presence of deviations or misstatements.

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: (34.91) 417.55.49 • Fax: (34.91) 555.93.68
mail@oicv.iosco.org • www.iosco.org

Paragraph 10 – inability to perform audit procedures
We suggest that additional guidance be given for situations when the planned audit procedure cannot be applied to the selected item. In these circumstances, the auditor should evaluate the reason why such procedures are inapplicable. For example, it may be that the original sample size was chosen in the expectation that the sample might include items for which those audit procedures would be inappropriate. In such circumstances, there may be no need to choose a replacement item, although it will likely be appropriate for the auditor to carry out alternate procedures on such items. In addition, the auditor will have an implicit expectation of the number of items in the sample for which the planned audit procedures are inappropriate. A finding that the actual number of such items is significantly different from what was anticipated likely indicates that the characteristics of the population are not consistent with the auditor's prior beliefs or that the sample is not representative of the population. Consequently, the validity of the entire sample needs to be reconsidered.

Paragraph 13 – possible anomalies
In Paragraph 13, we agree with the change to extant ISA 530 to elevate the present tense statements in extant ISA 530 related to anomalies to requirements and we agree that only in extremely rare circumstances would an auditor be justified in treating a misstatement or deviation as an anomaly. In this regard, we believe that the examples included in paragraph 50 of extant ISA 530 should be retained because they facilitate the auditor's understanding of valid anomalies. However, the present wording of paragraph 13 suggests the auditor should look for evidence to support a conclusion that a misstatement or deviation is not representative of the population, and hence, anomalous, as opposed to a more neutral search for audit evidence regarding whether the deviation is, or is not, anomalous. We suggest that the requirement should be amended to require that the auditor looks for sufficient evidence to enable them to determine with a high degree of certainty *whether or not* the misstatement or deviation really is anomalous. Finally, similar to the statement in paragraph 11, the auditor should be required to ascertain whether the anomaly has fraudulent misstatement implications.

Paragraph 14 – Projecting sample results
We believe that paragraph 14 could benefit from clarification. First, paragraph 14(a) includes the term "projected rate of deviation", which is not defined in paragraph 5. As the term "projected misstatement" is defined in paragraph 5, we believe that this term should be similarly defined. More substantially, the use of the term "projected rate of deviation" needs clarifying – i.e. whether the ISA is referring to a projected rate before or after carrying out the tests of controls. Auditors will normally only test controls if they initially have reasonable expectations that such controls are working sufficiently well, i.e. the projected rate of deviation is very low. After testing, the auditor will likely need to reassess the effectiveness of controls.

We believe the standard should give more guidance as to what the auditor should do when the rate of deviation in the sample is significantly different from what was anticipated. For example, it may be that the auditor's evaluation is such that they choose not to rely on the controls. Alternately, it may be that after further inquiry, the auditor can determine that the rate of deviation in the sample is not representative of the rate in the population. For example, a breakdown in internal controls may have occurred for an identifiable and limited time period when certain personnel were absent, but otherwise, the controls were working effectively. In such circumstances, it may be appropriate to generally rely upon the controls but perform additional substantive tests to ensure that no material errors arose when the controls were found to be not working.

We also have several comments on additional improvements and changes that are needed to further improve the Standard's enforceability and clarity. We include these comments in the Appendix to this letter.

Reponses to Request for Specific Comments in the Exposure Draft

1. **Are the objectives to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?**

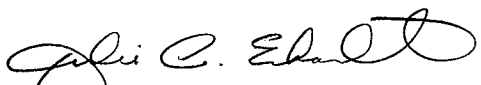
   We believe that the objective would be clearer if it were focused on the outcome; as written, the objective also addresses procedural matters. A possible rewording would be: "The objective of the auditor when using audit sampling is to design and select an audit sample in such way that, after appropriate audit procedures have been performed on the sample and the results evaluated, will enable the auditor to draw conclusions about the population from which the sample is drawn."

2. **Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgment by auditors?**

   We generally believe that the criteria identified by the IAASB for determining whether a requirement should be specified have been applied appropriately and consistently.

Thank you for the opportunity to comment on this ED. If you have any questions or need additional information regarding this comment letter, you may contact me or Susan Koski-Grafer on 202-551-5300, or any member of the IOSCO Standing Committee No. 1 Auditing Subcommittee.

Sincerely,



Julie A. Erhardt
Chair
IOSCO Standing Committee No. 1

Appendix A - Additional Comments

Scope – Paragraph 2

We question whether paragraph 2 should be included as part of the "Scope of this ISA"; we believe that it would be more appropriate to include this sentence as part of the "Application and Other Explanatory Material".

Definitions – Paragraph 5

We have several recommendations with respect to the definitions given in the draft Standard.

5 (a) Audit Sampling
Audit sampling is defined 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*" (emphasis added). The italicized phrase seems to be redundant given the requirement in paragraph 8.

Additionally, we believe that the definition of audit sampling should include an acknowledgement of why sampling is being used, that is, to evaluate some characteristic of the population. This is important because there are instances in which audit procedures could be applied to less than 100% of the items in a population but where this standard would not apply. For example, an auditor may examine only a few transactions from an account balance or class of transactions to (a) gain an understanding of the nature of an entity's operations or (b) clarify his understanding of the entity's internal control[1]. We therefore recommend that audit sampling be defined as:

> "The application of audit procedures to less than 100% of items within a population of audit relevance for the purpose of evaluating some characteristic of the population."

5(d) Non-sampling risk
Non-sampling risk is defined but the term is not used anywhere in the proposed standard, consequently, we are unsure as to why this term is included. If retained however, we believe the proposed definition should be modified because it is more limited than that given in extant ISA 530, which indicates 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. Thus, extant ISA 530 notes that the use of inappropriate audit procedures is an example of non-sampling risk (extant paragraphs 8 and 20). Under the draft definition, this risk of applying inappropriate audit procedures would not be included as a non-sampling risk. We therefore recommend defining non-sampling risk as:

All aspects of audit risk other than that due to sampling. Non-sampling risk includes the risks that the auditor:

i) selects audit procedures that are not appropriate to achieve the specific objective; and
ii) does not recognize misstatements or deviations included in the sample for what they are.

5(f) Statistical sampling
The phrase "random selection of the sample items" is potentially confusing to the user since it is very close to the term "random sampling". While the draft standard does not clearly define what is meant by

[1] This distinction is made in AU Section 350, *Audit Sampling*. See footnote 1.

the phrase "random selection of the sample items", its implied meaning is different from the very specific meaning of the term "random sampling" when used in a statistical context. We recommend changing the first part of the definition of statistical sampling to:

(i) Selection of the sample in accordance with predetermined statistical procedures (for example, as a random, systematic, stratified or clustered sample)

See also suggested rewording of A11.

5(g) Stratification

We suggest that that the definition given exclude monetary value as an example of stratification, or that other examples are also included, e.g. geographic location. In the present draft, the rationale for stratification is suggested, though not made explicit, in Appendix 1. However, we recommend including, perhaps as part of the definition, an explanation as to why and when the auditor might wish to use a stratified sample; namely, there must be a reason to believe that the variance of the characteristic of the sample about which the auditor is seeking evidence is lower *within the strata* than is the variance *within the general population.* (If the variance is not believed to be lower, there is no point forming sub-groups of the population for separate analysis, and it is more correct to call such groups clusters rather than strata.)

5(h) and 5(i) Tolerable misstatement and Tolerable rate of deviation

The definitions of "tolerable misstatement" and "tolerable rate of deviation" would be clarified by using language closer to that used in extant ISA 530. For example:

(h) Tolerable misstatement – The maximum monetary error in a population that the auditor is willing to accept.

(i) Tolerable rate of deviation – The maximum number of deviations in a population that the auditor is willing to accept.

The following application guidance could then be added to clarify these concepts:

> Tolerable misstatement is a planning concept and is related to the auditor's determination of materiality for planning the financial statement audit in such a way that tolerable misstatement, combined for all of the tests in the entire audit, does not exceed materiality for the financial statements. Tolerable misstatement is normally set for a specific audit procedure at less than financial statement materiality so that when the results of the audit procedures are aggregated, the required overall assurance is obtained.[2]

5(k) Estimated maximum rate of deviation

This term is not used in the proposed ISA and we therefore recommend that the definition be removed.

Requirements

Paragraph 6 – sample design

We believe it would be helpful if the standard were to give guidance as to when an auditor would use sampling.

Paragraph 6 – sample size

The draft standard tells an auditor that the auditor shall select a sample based on the tolerable level of misstatement or tolerable rate of deviation but we believe it would also be helpful if the standard were to give guidance as to how those tolerable levels should be determined.

---

[2] This language is consistent with paragraph 3 of SAS 111, *Amendment to Statement on Auditing Standards No. 39, "Audit Sampling".*

Paragraph 7 – sample size
Neither paragraph 7 nor the application guidance discusses how sample sizes should be determined when the auditor performs dual-purpose tests. We believe that application guidance that addresses the sample sizes to be used in these tests would be helpful to clarify how the auditor should deal with these circumstances. We therefore recommend that paragraph 7 be revised to:

> The auditor shall determine a sample size sufficient...
> (i) ...
> (ii) ...
> In some circumstances the auditor may design a sample that will be used for dual purposes: testing the operating effectiveness of an identified control and testing whether the recorded monetary amount of transactions is correct. The size of a sample designed for dual purposes shall be the larger of the samples that would otherwise have been designed for the two separate purposes.

Paragraph 8 – selection of sample items
The phrase "in such a way" to describe how the auditor is to select items is not sufficiently instructive. Furthermore, the proposed standard allows that in certain circumstances non-statistical sampling might be appropriate. (For example, cursory inspection may enable the auditor to conclude that certain classes of sampling units do not warrant further investigation.) Therefore, we recommend that paragraph 8 be revised to:

> When using statistical sampling, the auditor shall use a sampling method in which all items in the population have a known probability of selection.

[also see comments concerning A11 below]:

Application and Other Explanatory Material (paragraphs A1 – A21)

A11 (see also discussion above re paragraph 5(f).) We recommend the following wording:
Statistical sampling requires that sample items are selected in a way that each sampling unit has a known probability of being selected.

A12 Cluster sampling is also a valid method of statistical sampling that might be given as an example here, and explained in Appendix 4.

A14 The example should encompass not only when the documentation "has been lost" (which implies it existed but has been misplaced or inadvertently is gone) but also the possibility that the documentation does/did not exist or is deficient. We recommend rewording as:
An example of when the auditor is unable to apply the designed audit procedures to a selected item is when documentation is nonexistent or deficient.

A19 We recommend that A19 be clarified to use defined terms; additionally, much of the text in paragraph A19 seems to be superfluous. We therefore recommend that paragraph A19 be revised as follows:
When the projected rate of deviation exceeds the tolerable rate of deviation or the projected misstatement plus anomalous misstatement exceeds the tolerable misstatement, the sample does not provide an appropriate basis for conclusions about the population that has been tested. If the

total of projected misstatement plus anomalous misstatement is less than but close to the tolerable misstatement, the auditor may consider the persuasiveness of the sample results in light of other audit procedures, and may consider it appropriate to obtain additional audit evidence. Considering the results of other audit procedures and obtaining additional audit evidence helps the auditor to address sampling risk.

A21 We recommend that the wording be extended to include the statement that the auditor's professional skepticism should be heightened when considering resolutions of misstatements or deviations based on management's investigation; for example, if management produces documentation that was previously thought to be lost – see note re A14, above. Also, the ISA should provide guidance of how sample results are affected for "resolved" items.

Re Extant ISA 530

Old paragraph 16 – states: "Audit sampling for tests of controls is generally appropriate when application of the control leaves audit evidence of performance (for examples, 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)."

Old paragraph 35a – states: "When performing audit sampling, the auditor performs audit procedures to ensure that the information upon which the sampling is performed is sufficiently complete and accurate."

The two paragraphs above seem to have been deleted – they are neither in ISA 530 (redrafted) nor ISA 500 (redrafted). The rationale given for their exclusion from ISA 530 is that ISA 530 is "about appropriateness applying sampling to tests of controls rather than about designing and evaluating an audit sample" and "appropriateness and completeness of population is addressed in proposed ISA 500."

However, ISA 500 generally addresses "selection of specific items" and not audits sampling; therefore, we suggest that it would be appropriate and useful to retain paragraphs 16 and 35a in proposed ISA 530.