

May 29, 2009

Ms. Sherry Hazel
AICPA
1211 Avenue of the Americas
New York, N.Y. 10036-8775

By e-mail: shazel@aicpa.org

Re: Proposed Statement on Auditing Standards, *Audit Sampling* (Redrafted)

Dear Ms. Hazel:

The New York State Society of Certified Public Accountants, representing 30,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above captioned exposure draft.

The NYSSCPA's Auditing Standards Committee deliberated the exposure draft and prepared the attached comments. If you would like additional discussion with us, please contact Robert N. Waxman, Chair of the Auditing Standards Committee at (212) 755-3400, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,



Sharon Sabba Fierstein
President

Attachment

**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

COMMENTS ON

**PROPOSED STATEMENT ON AUDITING STANDARDS, *AUDIT SAMPLING*
(REDRAFTED)**

May 29, 2009

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**New York State Society of Certified Public Accountants
Auditing Standards Committee**

**Comments on
Proposed Statement on Auditing Standards, *Audit Sampling* (Redrafted)**

The New York State Society of Certified Public Accountants welcomes the opportunity to comment on the AICPA Auditing Standards Board's (ASB) Proposed Statement on Auditing Standards, *Audit Sampling*, (Redrafted).

General Comments

We support the ASB's efforts to improve the audit testing procedures undertaken during an audit and to converge the proposed standards with International Standards on Auditing (ISAs). However, we believe that the ASB missed an opportunity to strengthen SAS 39, *Audit Sampling*. A stated objective of the proposal is to improve the clarity of ASB standards. Yet, as discussed below, we find that the exposure draft (ED) perpetuates two of the most serious deficiencies of SAS 39. First, it places "nonstatistical" sampling on an equal evidentiary footing with statistical sampling despite the fact that the reasons for doing so have evaporated long ago; second, it permits the auditor to disregard readily obtainable and statistically valid results from a probability sample by the expedience of labeling such a sample "nonstatistical."

The ED does not provide a clear approach to the evaluation of samples by stressing the relationship of the sample point estimate to risk. The appropriate measurement instrument for any sample that satisfies the "representativeness" requirement should be a confidence interval that is universally accepted. Statement on Audit Procedures Number 54, and *Statistical Auditing*, by Donald M. Roberts (AICPA, 1978) provide such guidance. The incorporation of much of the verbiage of ISA 530 in the interest of "convergence" will result in a document that will contain the technical errors that exist in SAS 39 and the deletion of significant, relevant items.

This ED does not contain any indication of any results of an audit sample that can provide a basis for proposing an adjusting journal entry to correct for misstatements. The orientation of this ED appears to provide a basis for rationalizing or disregarding adverse sample results.

The conceptual errors in and omissions from the proposed standard, if adopted as written, could result in practitioners who are inexperienced in statistical theory being exposed to serious risk of liability when faced by knowledgeable and credible experts in adversarial proceedings.

Further, we believe that it would have been helpful if the AICPA Audit and Accounting Guide, *Audit Sampling*, had been published subsequent to the publication of the final standard so that it would have been derived from the ultimate guidance provided by this ED.

We suggest that this ED be revised as indicated in our comments.

Requested responses

1. Are the auditor's objectives appropriate?

The auditor's objective, as expressed in paragraph 4 of the ED, is appropriate.

2. Are the revisions made to converge the existing standard with ISA No. 530 (Redrafted) appropriate?

The revisions are not appropriate because we believe that ISA No. 530 (Redrafted) is flawed. International convergence should not be an end in itself, especially if there are problems with the standard toward which convergence is directed.

3. Are the differences between the proposed SAS and ISA No. 530 (Redrafted) identified in the exhibit, and other language changes, appropriate?

Where there are differences between the ED and ISA No. 530, they are frequently inappropriate, as discussed below.

Specific Comments

All ED text is in *italics*, followed by our comments.

Definitions

Haphazard selection. The approximation of random selection without the use of a structured selection technique, such as a random number generator. It is the selection of sampling units without any intentional bias; that is, without any special reason for including or omitting items from the sample. Haphazard selection does not consist of selecting sampling units in a careless manner and is implemented in a manner such that the auditor expects the resulting sample to be representative of the population.

Despite its common usage, "haphazard" is an unfortunate choice of words, notwithstanding the "careless manner" sentence. A better choice of terms is "informal." If substituted for "haphazard," the use of "informal" would obviate the need for the last sentence.

Population. The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

This is factually incorrect and, consequently, misleading. The data from which the sample is selected and the data about which the auditor wishes to draw conclusions may not be congruent. The latter data is the population; but the former data comprise the “frame.” Ideally, there should be no difference between the two data sets.

However, this is frequently not the case in practice. In most audit applications, the frame is a list or file from which the selected items are identified. If there are items in the population that are not in the frame, the list is incomplete (a failure of a key transactions or account balance assertion) and the test yields invalid results. If, there are items in the frame that do not belong to the population of interest, those items need to be identified and treated accordingly. For example, in a substantive test of details, such items, if not extracted before sampling, would be assigned a monetary misstatement value of zero; the average misstatement would be projected to the frame, yielding an unbiased estimate (the projection) of the total misstatement.

In order to improve practice, the ED should distinguish between the population and the frame by defining both terms. By doing so, the ED would more effectively guide auditors to perform procedures to address appropriately differences that may exist.

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

a. 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. [Emphasis added.]

The ED implies that a test of controls might not be a test of details and *vice versa*. This is incorrect and is contrary to long-standing usage in practice. The term “test of details,” when intended to exclude a test of controls, has always been expressed with the adjective “substantive” preceding it. A test of details (of transactions or balances), whether intended to test for misstatement or for compliance with controls (or both) is a term that may be used for any test that involves inspection of the individually selected sampling units. In the case of a test of controls, this might involve, for example, inspecting documents to determine that appropriate approvals were given or reviews were performed. Moreover, AU 350.44 specifically and correctly recognizes the dual nature of tests of details.

The dropping of the adjective “substantive” is inappropriate in light of a recent ASB decision to add that adjective when referring to analytical procedures.

b. 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. [Emphasis added.]

The statement that “[t]his type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect” (which is a carryover from AU 350) is appropriate for a test of controls. For a substantive test of details, however, the risk of incorrect rejection is also equal to estimation risk. Estimation risk measures the chance that a confidence interval will fail to contain the actual amount of misstatement within its calculated range. The purpose of an audit sample is to provide a basis for an audit decision. An unfavorable (or undesirable) result in a substantive test of details does not necessarily lead to additional work. In fact, the results may be sufficiently precise to provide for the proposal of a materially correct adjusting journal entry. A confidence interval and its associated risk provide an objective basis for proposing an adjusting journal entry should the sample results indicate that risk of intolerable misstatement is unacceptable. The risk addressed in b. is the risk that the audited account (post adjustment) is not materially (tolerably) correct.

The statement that “[t]his type of erroneous conclusion affects audit efficiency as it would usually lead to additional work” is inappropriate because (1) the auditor does not know if the sample findings are incorrect, and (2) the findings may be sufficiently precise for the auditor to propose an adjusting journal entry.

We suggest that the last sentence be replaced with the following:

While this risk is a consideration and might result in additional work, this risk is identical to the risk that an account balance, subsequent to any adjusting entry, is misstated by an amount that exceeds the tolerable amount.

See our comment relative to paragraph A2 below.

Sampling unit. The individual items constituting a population. (Ref: par. A4)

The sampling unit is the item that is actually examined by an auditor. It may be, for example, an account, a transaction, or a line item within a transaction. It is not a “monetary” unit (notwithstanding popular usage; see further comment regarding paragraph A4, below). As stated above, whether or not the sampling units constitute the population of interest depends on the relationship of the frame to that population.

Statistical sampling. An approach to sampling that has the following characteristics:

- a. *Random selection of the sample items (Ref: par. A5)*
- b. *The use of an appropriate statistical technique to evaluate sample results including measurement of sampling risk*

A sampling approach that does not have characteristics (a) and (b) is considered nonstatistical sampling.

Random sampling is statistical sampling. Statistical evaluation of a randomly selected sample is a best practice and is always appropriate. Accordingly, characteristic b. above should be eliminated. See our comment regarding paragraph A7. We suggest the following definition be substituted:

Statistical sampling. Statistical sampling is probability sampling, in which each item in the frame has a known chance of selection. A probability sample is evaluated by appropriate statistical techniques.

We recognize that auditors may seek to avoid random selection entirely if statistical evaluation of random samples is to be required. Some auditors may decide to apply “haphazard” sampling in order to avoid the need to perform an appropriate statistical evaluation. For this reason, the ASB should express a preference for random sampling (that is, statistical sampling). There are few situations in which some form of random selection is impracticable. Client data which is not readily amenable to computer-aided selection can usually be subjected to informal selection techniques that approximate equal probability random selection. An informal sample is one that is selected without conscious bias and without random numbers or computerized random selection. See our comment to paragraph A7 for an example of an informal selection procedure.

The ED’s definition perpetuates an erroneous concept: that a random sample need not be evaluated by “the use of an appropriate statistical technique.” This is an invitation to an auditor to act inappropriately by ignoring readily available statistical evaluation methods. “Professional” judgment in this instance is an inferior substitute for measurement.

Tolerable misstatement. A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

This is a substantial and inappropriate definitional departure from what is presented in AU 350.18. The wording is ungainly and is not a definitional improvement. Moreover, this definition does not include those situations in which monetary misstatement exceeds the tolerable amount. Although somewhat difficult to apply, the original definition of AU 350.18 is superior. See our comment on paragraph A6.

Tolerable rate of deviation. A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

See immediately preceding comment.

Sample Design, Size, and Selection of Items for Testing

8. The auditor should select items for the sample in such a way that the auditor can reasonably expect the sample to be free of intentional bias and thus will be representative of the relevant population and likely to provide the auditor a reasonable basis for conclusions about the population. (Ref: par. A16-A18)

This text is a carryover from AU 350 and continues to confuse the meaning of bias within the context of sampling procedures. Bias is an estimation issue; not a selection issue. Selection with probability proportional to size is clearly biased toward selection of the larger items, yet, it is the application of an appropriate estimator that eliminates bias. There are common estimators (such as the ratio estimators) that are biased. The bias can be estimated and be applied to provide a correction for the estimator. The following wording is preferable because it correctly encompasses both selection and evaluation of a sample:

The selection and evaluation of a sample should be performed in such a way that the resulting estimates are unbiased.

Performing Audit Procedures

10. If the audit procedure is not applicable to the selected item, the auditor should perform the procedure on a replacement item. (Ref: par. A19)

This guidance is incorrect and should be removed because it will lead to invalid results. As stated above, there are situations in which the population is only a subset of the frame. Items deemed to be “not applicable” are, nevertheless, members of the frame from which the sample was selected. If such items are removed from the sample and are replaced only with “applicable” items, the expected occurrence rate of “applicable” items will be greater than their occurrence rate in the frame. Estimates (projections) obtained from such samples will be biased. It is especially important in a substantive test of details that such items, if selected, are assigned misstatement values of zero and must remain in the sample. Only if the exact number of “not

applicable” items in the population is known may a “not applicable” item be replaced. Otherwise, and this is generally the case, the total number of “not applicable” items is unknown. See our comments on paragraphs A19 and A20.

*11. If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor should treat that item as a deviation from the prescribed control, in the case of tests of controls, **or a misstatement, in the case of tests of details.** (Ref: par. A20-A21) [Emphasis added.]*

Treating those items for which the auditor is unable to apply test procedures as deviations from prescribed controls is reasonable and conservative because the result is less reliance on the controls for purposes of determining the scope of substantive tests.

However, the same is not true for a substantive test of details. In such a case, the inability to apply audit procedures is a scope limitation that must be evaluated and considered for its effect on the audit opinion as per AU 508.20-32. Whether or not the potential impact of such a limitation is intolerable can be estimated and assessed by projecting the recorded amounts of such items. However, to consider such items to be misstated is not only inconsistent with other literature that speaks to such limitations (AU 508.20-32), but it raises the risk that an auditor will propose an adjusting journal entry that will create rather than correct a material misstatement (see our comment to A.20). Moreover, considering untested items as misstatements requires the auditor to specify the amounts by which such items are presumed to be misstated and, for tests of valuation and accuracy assertions, the algebraic signs of those presumed misstatements. The emphasized text is inappropriate and should be deleted.

The following two sections, entitled “Projecting Misstatements” and “Evaluating the Results of Audit Sampling,” present separately what is actually a unified topic: Sample projection is integral to evaluation.

Projecting Misstatements

13. For tests of details, the auditor should project misstatements found in the sample to the population. (Ref: par. A25–A26)

This paragraph should be eliminated and combined with paragraph 14. The current wordings of AU 350.26 (for substantive tests of details) and AU 350.41 (for tests of controls) are superior to the above sentence. Further, the referenced paragraphs A25-A26 fail to provide necessary amplification. The point estimate obtained from a sample (referred to in the ED as the projection) provides little information regarding the risk that material (or intolerable) misstatement exists. In probability sampling, a

calculated confidence interval provides such information. See our comment on paragraph 14 below.

Evaluating Results of Audit Sampling

14. The auditor should evaluate

a. the results of the sample and (Ref: par. A27–A29)

b. whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. (Ref: par. A28–A29)

The evaluation of the results of a sample includes the calculation of a point estimate (a projection in the case of a substantive test of details, and deviation rate in the case of a test of controls) and confidence interval (to use statistical sampling terminology). The latter provides a measure of the risk that the actual, but unknown, misstatement or deviation rate is beyond the calculated confidence limits. The foregoing can be expressed in a number of ways, including using the existing verbiage of AU 350.26 and .41.

The language of ED paragraph 14 (including the referenced A27-A29) fails to provide appropriate guidance and might unintentionally cause the commission of malpractice by suggesting that an auditor simply decide that audit sampling has not provided a reasonable basis for conclusions without stating, in accordance with AU 339, what enables the auditor to make such a decision. In fact, the only objective basis for such a decision to be made, given a properly executed sample, is an imprecise confidence interval. We believe that even an imprecise confidence interval indicates that planning assumptions need to be revised and additional testing is needed.

The words of AU 350.26, “appropriate consideration should be given to sampling risk” (and similar guidance in AU 350.41 for a test of controls), are proposed to be deleted, leaving the auditor with neither a standard nor even unambiguous guidance as to an appropriate evaluation methodology. We believe that this deletion is inappropriate.

As stated in the introductory comments, the confidence interval is a universally accepted methodology for the evaluation of a probability sample (and even a sample whose selection may reasonably be assumed to be the functional equivalent of a random sample). Such a methodology, whether presented as a method of estimation or as a test of hypothesis, should be an explicitly required approach.

Sampling Risk (Ref: par. 5)

A2. The risk of incorrect rejection and the risk of assessing control risk too high relate to the efficiency of the audit. For example, if the auditor’s evaluation of an audit sample leads the auditor to the initial erroneous conclusion that a balance is materially misstated when it is not, the application of additional audit procedures and consideration of other audit evidence might lead the auditor to the correct conclusion. Similarly, if the auditor’s evaluation of a sample leads him or her to unnecessarily assess control risk too high for an assertion, the auditor might increase the scope of substantive procedures to compensate for the perceived ineffectiveness of the controls. Although the audit may be less efficient in these circumstances, the audit is, nevertheless, effective. [Emphasis added.]

The highlighted text, which modified the original AU 350 term, “risk of underreliance,” in a previous change to AU 350 does not provide clarity to the concepts discussed. The original term is the meaningful expression of risk.

It is especially inappropriate that the ED ignores the risk of overreliance, which is expressed in the current text of AU 350 as the risk of assessing control risk too low, and is clearly the more important risk for a test of controls.

In an earlier revision of SAS 39, the ASB introduced “risk of assessing risk too low (too high)” as replacements for “risk of overreliance (underreliance).” The substitution has no practical meaning in statistics. In fact, the performance of an audit sample to test controls provides a direct and incontrovertible measure of risk. If, for example, an auditor selects a random sample of 100 items, which discloses no control deviations, the auditor can conclude that there is only a 5% risk that the deviation rate in the population exceeds 3%. If 3% is the tolerable deviation rate, 5% is the appropriate control risk. The risk of assessing control risk too low is (in the context of the current and proposed jargon), mathematically, zero. We recommend that the ED be revised to restore the control risk definitions in the original SAS 39 text.

The statement that *the risk of incorrect rejection ...relate[s] to the efficiency of the audit* (AU 350.13) is misleading and incomplete regarding substantive tests of details. The risk of incorrect rejection is, in fact, estimation risk. It is the risk that the actual misstatement amount is not within the two-sided confidence interval that is calculated from the sample results. If sufficiently precise, such an interval provides a reliable basis for proposing a materially correct adjusting journal entry without the need to perform additional procedures. See our comment on the sampling risk in paragraph 5 above.

Sampling Unit (Ref: par. 5)

*A4. The sampling units might be physical items (for example, checks listed on deposit slips, credit entries on bank statements, sales invoices, or debtors’ balances) or **monetary units**. [Emphasis added.]*

We believe that it is incorrect to equate monetary units with sampling units, however popular that usage may be. In practice, the smallest auditable data source (line item, invoice, account) is the sampling unit. Some writers on the subject of sampling have addressed this fact by creating the notion of the monetary unit serving as a “hook” that enables the auditor to identify the actual item (*i.e.*, sampling unit) to be vouched, traced, or otherwise inspected. That “hooked” item (sometimes also referred to in auditing literature as “physical unit”) is the sampling unit. For engagement documentation purposes, it is far better to identify the sampling unit properly. We recommend deleting the last prepositional phrase, “or monetary units.”

A5. Random selection techniques include the following:

- a. Simple random*
- b. Systematic random*
- c. Monetary unit*
- d. Probability weighted*

Item d. should be eliminated because monetary unit sampling is a probability weighted random selection technique. The text should read:

c. Probability weighted, including monetary unit.

Tolerable Misstatement (Ref: par. 5)

A6. The auditor is required by paragraph 11 of the proposed SAS Materiality in Planning and Performing an Audit (Redrafted) to determine performance materiality. Performance materiality is determined in order to address the risk that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements. Tolerable misstatement is the application of performance materiality to a particular sampling procedure. Tolerable misstatement may be the same amount or an amount lower than performance materiality (for example, when the sample population is lower than the account balance).

It is unclear what this paragraph accomplishes and why the introduction of a new term, “performance materiality,” is an improvement over AU 350’s definition of “tolerable misstatement” (which is a difficult concept to implement properly and not improved by the proposed alternative). We recommend that the ED be revised to retain the original definition of tolerable misstatement.

Sample Design, Size, and Selection of Items for Testing

Sample Design (Ref: par. 6)

*A7. 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 nonstatistical or statistical sampling approaches.** [Emphasis added.]*

The definitions of statistical and nonstatistical sampling approaches require substantial revision.

As previously stated, any probability sample is a statistical sample. A probability sample is one in which item selection is left strictly to the laws of chance. The principal property of such a sample is measurability. The results can be measured by applying appropriate statistical procedures. If results can be measured, they should be measured; those results should not be assessed solely by professional judgment. A secondary property of a properly documented probability sample is that it can be replicated by a reviewer.

Well-organized and computerized client files provide natural frames for probability (statistical) sampling. In cases in which a client's files do not readily lend themselves to the formal methods associated with probability sampling, informal methods may be applied, taking care not to introduce any unintended bias. Such populations may be thoroughly mixed (as in the case of a shuffled deck of cards) or their frames may provide no indication to the auditor as to whether the items identified in the frames are misstated or have associated control deviations. For example, a frame might consist of index cards in a file drawer, from which the auditor selects cards throughout the drawer without inspecting them. Informally selected samples may be evaluated as though they had been randomly selected provided that the working papers describe the frame and the selection method. An informal sample emulates a simple random or systematic random sample (that is, an equal probability sample) because it is selected without conscious bias and because the organization of the frame does not cause unintended bias.

There are situations in which the auditor employs judgment to decide which items to select because the auditor believes the selected items to be of greater audit interest than items that are passed over for selection. Those situations involve nonstatistical sampling and can be evaluated only by the exercise of sound, rational auditor judgment.

A8. When designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to achieve that purpose.

We believe that this sentence does not add any substantive guidance to considerations that are applicable to other audit test procedures and should be removed.

Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling

This sentence is unclear and does not provide meaningful guidance. We suggest that the entire paragraph be replaced by the following:

When planning an audit sample, the auditor decides the classes of transactions or accounts that are of audit significance. The auditor's understanding of the client's information systems and the records that the client maintains enables the auditor to decide on a suitable frame for selection of a sample. The auditor also decides which assertions are to be tested (which lead to the auditor's decisions as to the defining of deviations or misstatement conditions).

In fulfilling the requirement of paragraph 8 of the proposed SAS, Audit Evidence, (Redrafted), when performing audit sampling, the auditor is required to perform audit procedures to obtain evidence that the population from which the audit sample is drawn is complete.

This appears to be the only section of the ED that addresses the frame/population issue. We suggest expanding the guidance and presenting it in a separate paragraph.

*A10. The auditor's consideration of the purpose of the audit procedure, as required by paragraph 6, includes a clear understanding of what constitutes a deviation or misstatement so that all, and only, those conditions that are relevant to the purpose of the audit procedure are included in the evaluation of deviations or projection of 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, **an incorrect posting between customer accounts does not affect the total accounts receivable balance. Therefore, it may not be appropriate to consider this 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 risk of fraud or the adequacy of the allowance for doubtful accounts.** [Emphasis added.]*

It is incorrect to suggest that the highlighted example may not describe a relevant deviation or misstatement. In fact, it describes a failure of internal control regarding the transactions-based assertion that transactions are properly classified. The fact that this example is used in the context of a substantive test of details refutes any notion that a test of details may not also serve as a test of controls, particularly when apparent control failures are identified. The highlighted text should be deleted.

*A11. In considering the characteristics of a population for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of the relevant controls **or on the examination of a small number of items from the population.** [Emphasis added.]*

The highlighted text presents an impracticable approach to planning. A small sample is unlikely to detect relatively infrequent control deviations and, thus, will provide no useful planning information. Moreover, such an approach unnecessarily extends the elapsed time needed to complete the test of controls in that it involves the selection of two samples. Finally, such a procedure is in fact a sequential sampling procedure, which entails greater complexity in evaluation [see Roberts, op cit, pp. 59-61]. The highlighted text should be deleted.

*This assessment is made in order to design an audit sample and to determine sample size. For example, if the expected rate of deviation is unacceptably high, the auditor will normally decide not to perform tests of controls. **Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. If the expected misstatement is high, 100 percent examination or use of a large sample size may be appropriate when performing tests of details.** [Emphasis added.]*

The emphasized text is potentially misleading. A 100 percent examination is rarely practicable and, even then, only for small populations. It is inappropriate to suggest that undefined "large" sample sizes should be viewed by auditors as the evidential equivalent of a risk-free 100 percent examination. While the expected misstatement is a sufficient parameter for monetary unit sampling and tests for overstatement (assuming that tolerable misstatement and risk of incorrect acceptance are specified), it would be insufficient for stratified random sampling, (e.g., inventory price tests, if misstatements in both directions are deemed likely). In general, it is population volatility, as measured by the standard deviation of misstatements (including zero amounts), which is the appropriate term to use. Volatility is a function of both the proportion of non-zero misstated items and variability of those non-zero misstatements. If the standard deviation is small or can be controlled by adequate stratification, large sample sizes may not be necessary.

The emphasized text should be deleted and replaced by the planning considerations, such as those described in AU 350 pars. 16-17 & 21-22.

A12. 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.

This sentence is insufficiently informative to provide an auditor with a useful basis for making an audit sampling decision. For example, cluster sampling (both single and multi-stage) is not mentioned. See the previous comment. This paragraph should be elaborated upon or deleted.

A14. The sample size can be determined by the application of a statistically based formula or through the exercise of professional judgment. Various factors typically influence determination of sample size, as follows:

For substantive tests of details:

- *The auditor's desired level of assurance (complement of risk of incorrect acceptance) that tolerable misstatement is not exceeded by actual misstatement in the population;*

A more straightforward statement is:

The auditor's desired level of assurance (the complement of the risk of incorrect acceptance) that actual misstatement is no greater than tolerable misstatement

- *Tolerable misstatement*
- *Expected misstatement for the population*
- *Stratification of the population when performed*
- *For some sampling methods, the number of sampling units in each stratum.*

While the text for describing planning considerations for tests of controls is reasonable, these bullets are inelegantly worded. We suggest the following as a replacement for the four bulleted items above:

Sample size is sensitive to auditor-specified factors and population characteristics.

- Auditor-specified factors
 - tolerable misstatement
 - risk of incorrect acceptance
- Population characteristics
 - proportion of misstatements in the population
 - volatility of the misstatements (i.e., their standard deviation)
 - population size, for small and stratified populations

*A15. The decision whether to use a statistical or nonstatistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to decide between statistical and nonstatistical approaches. **An auditor who applies statistical sampling uses tables or formulas to compute sample size based on the judgments in paragraph A14.** [Emphasis added.]*

The statistical/nonstatistical issue is addressed in the comment relative to A7. However, the highlighted text contains an error that requires correction.

Sample sizes can always be arbitrarily or judgmentally determined (even for statistical sampling). There are situations in which an auditor does not have

information deemed adequate for computation of a sample size or in which time or budget restrictions limit the extent of testing. The sufficiency of such a sample size (or the lack thereof) will be evident upon evaluation of the sample. The highlighted text should be deleted.

An auditor who applies nonstatistical sampling uses professional judgment to relate the same factors used in statistical sampling in determining the appropriate sample size. Ordinarily, this would result in a sample size comparable to the sample size resulting from an efficient and effectively designed statistical sample, considering the same sampling parameters. This guidance does not suggest that the auditor using nonstatistical sampling also compute a corresponding sample size using an appropriate statistical technique. [Emphasis added.]

We believe that it is inappropriate for the ED to fail to suggest “that the auditor using nonstatistical sampling also compute a corresponding sample size using an appropriate statistical technique,” if such a technique is available. However, as previously stated, sample sizes can always be arbitrarily specified. The highlighted text should be deleted.

Selection of Items for Testing (Ref: par. 8)

A16. To be considered representative, an audit sample is selected in a manner such that the auditor can reasonably expect that the sample is free of intentional bias or preference.

See comment in regard to paragraph 8 above.

*A17. With statistical sampling, sample items are selected in a way that each sampling unit has a known probability of being selected. **With nonstatistical sampling, haphazard or random-based selection is used to select sample items.*** [Emphasis added.]

Random sampling is measurable by appropriate statistical methods and is, therefore, statistical sampling. The highlighted text should be deleted or replaced with:

With nonstatistical sampling, the auditor uses judgment to decide which items are to be selected from the frame.

A18. The principal methods of selecting samples are the use of random selection, systematic selection, and haphazard selection.

See the comment relative to the Definitions section, above, regarding the use of the term “haphazard.”

A18 is redundant and is covered by A17. It should be deleted.

A19. An example of when it is necessary to perform the procedure on a replacement item is when a voided check is selected while testing for evidence of payment authorization. If the auditor is satisfied that the check has been properly voided such that it does not constitute a deviation, an appropriately chosen replacement is examined. Another example is a telephone expense item selected as part of a sample for which a deviation has been defined as a transaction not supported by receiving report; telephone expense may not be expected to be supported by a receiving report. If the auditor has obtained assurance that the transaction is not applicable and does not represent a deviation from the prescribed control, the auditor would replace the item with another transaction for testing the relevant control. [Emphasis added.]

This paragraph should be deleted because both examples present invalid approaches to sampling. It can easily be proved that, for both examples, replacing items in the manner suggested will result in biased estimates. Such samples will have higher rates of deviations or misstatements than exist in the sampled populations because the “applicable” items will be over-represented in the sample. Projections resulting there from will be based on projections to populations that include all other non-applicable items whereas the samples will not include those items. See the comment regarding paragraph 10 above.

The second example does not define a deviation properly. A receiving report is just one piece of evidence that applies only to a subcategory of some, but not all, expenditures. Its presence is relevant only when it is expected to be present, and its absence is not an exception, nor does it make the sample item not applicable with regard to the underlying characteristic being tested, that is, the validity of the expenditure (not the presence of a receiving report).

A20. In some circumstances the auditor may not be able to apply the planned audit procedures to selected sample items; because, for example, the entity might not be able to locate supporting documentation. The auditor’s treatment of unexamined items will depend on their effect on the auditor’s evaluation of the sample. If the auditor’s evaluation of the sample results would not be altered by considering those unexamined items to be misstated, it may not be necessary to examine the items. However, if considering those unexamined items to be misstated would lead to a conclusion that the balance or class contains material misstatement, the auditor may consider alternative audit procedures that would provide sufficient appropriate audit evidence to form a conclusion. AU section 316, Consideration of Fraud in a Financial Statement Audit (AICPA, Professional Standards, vol. 1), also requires the auditor to consider whether the reasons for the auditor’s inability to examine the items have implications in relation to assessing risks of material misstatement due to fraud, the assessed level of control risk that the auditor expects to be supported, or the degree of reliance on management representations.

An auditor's inability to examine items constitutes a scope limitation unless adequate alternative evidence is obtained to meet the audit objective. The best one can do in a substantive test, in the absence of adequate alternative procedures, is to project the recorded amounts of the untested items in order to estimate the extent of the limitation (that is, the estimated aggregate size of the effectively untested items) and consider the effect on the audit report. We suggest the following be inserted between the third and fourth sentences:

The auditor can assess the potential extent of unexamined items by projecting their recorded amounts to the frame including an appropriate allowance for sampling risk.

A24. A representative sample is expected to be representative of the population only with respect to the incidence of misstatements or deviations and not necessarily with respect to their nature. The auditor may not assume that the observed incidence of misstatements or deviations in the sample is not representative of the population because a misstatement or deviation included in the sample is caused by unusual circumstances (sometimes referred to as an anomalous or isolated misstatement or deviation). [Emphasis added.]

The first sentence should be deleted because it is incorrect. Any observable characteristic, whether quantitative or qualitative, can be estimated or projected. In the case of a probability sample, the precision of the estimate is measurable at any specified level of confidence.

The second sentence, is correct, but does not follow from the first.

“Representative,” as used within the context of audit sampling, has referred to the overall property of a sampling procedure in relation to the population and not to any specific sample outcome. Failure to recognize this fundamental fact can lead to such improper rationalizing and inherently risky decisions as discarding a sample or a sampling result because it is not, in the auditor’s judgment, “representative.”

*A25. The auditor is required by paragraph 13 to project misstatements for the **population to obtain a broad view of the scale of misstatement, but this projection may not be sufficient to determine an amount to be recorded.*** [Emphasis added.]

The expression “a broad view” has no operational meaning in the context of audit sampling. The projection is an estimate of the total amount of misstatement-- one sample outcome obtained from a myriad of possible outcomes. The statistical term for the projection is “point estimate.”

A25 is one of several instances in the ED that exhibits bias against using sample results as a basis for audit decision-making. This paragraph does not provide any indication of what constitutes an insufficiency. Thus, the text is merely an opportunity for the auditor to disregard the objective results of a substantive test of details. If, in

fact, the auditor has satisfied the representativeness requirement with respect to selection and evaluation, the only basis for considering the projection (that is, the sample point estimate) to be insufficient is that the precision of the estimate, as calculated at an auditor-specified confidence level (assurance), is too large to provide a reasonable basis for a conclusion. The resultant quantifiable risk of drawing an incorrect conclusion is too large for auditor comfort. The ED fails to discuss any explicit requirement to perform the confidence interval estimation or hypothesis testing that is common to other professions.

We suggest the following wording:

The auditor is required by paragraph 13 to project misstatements for the population including an appropriate allowance for sampling risk. When considered together, the projection and its associated allowance for sampling risk might be sufficient to determine an amount to be recorded.

*A28. In the case of tests of details, the projected misstatement is the auditor's best estimate of misstatement in the population. As the projected misstatement approaches or exceeds tolerable misstatement, the more likely it is that actual misstatement in the population may exceed tolerable misstatement. Also, if the projected misstatement is greater than the auditor's expectations of misstatement used to determine the sample size, the auditor **may conclude** that an unacceptable sampling risk exists that the actual misstatement in the population exceeds the tolerable misstatement. [Emphasis added.]*

If the projected misstatement exceeds the tolerable amount, the auditor should conclude that the risk is too high to be acceptable, because such risk would exceed 50 percent. The statement seems to be rationalizing an auditor's decision to ignore sampling results. The appropriate basis for an audit decision is, in probability sampling, the confidence interval, which is calculated using appropriate statistical techniques. In a judgmentally selected sample, the auditor must assess the risk of potential exposure to intolerable misstatement, and decide accordingly. We suggest replacement of the last sentence in the paragraph with the following, which is partially adapted from AU 350.26:

The projected misstatement should be compared with the tolerable misstatement, and appropriate consideration should be given to sampling risk for both statistical and nonstatistical sampling. For probability samples and for samples that may reasonably be presumed to emulate random samples, the auditor applies appropriate statistical methods. For other samples, the auditor exercises professional judgment.

*Considering the results of other audit procedures helps the auditor to assess the risk that actual misstatement in the population exceeds tolerable misstatement; **and, the risk may be reduced if additional audit evidence is obtained.** [Emphasis added.]*

The highlighted text should be deleted. Intolerable misstatements do exist in accounting populations. Yet, the guidance in the ED is oriented toward finding possible explanations that might refute the sample findings, and not toward guiding an auditor when there is a high level of assurance that intolerable misstatement exists. Neither inquiry nor analytical procedures can be shown to be superior to a properly planned and executed substantive test of details. The only measurable approaches to reducing risk are to select and examine additional sample items, or to propose an adjusting journal entry. Moreover, extending a sample is more likely to confirm, not refute, the initial sample results.

A29. If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may

- *request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments, or*
- *tailor 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.*

Proposed SAS Evaluation of Misstatements Identified During the Audit addresses misstatements identified by the auditor during the audit.

This last paragraph sums up the ED's contradictory guidance: Use samples because they provide audit evidence, but do not make decisions based on those results if those results do not support a favorable conclusion (i.e., that any potential misstatement is tolerable). Either find other evidence that can be used to explain a sample result as aberrant or ask management to investigate further.

A well-planned sampling procedure will provide a reasonable basis for both accepting a population whose misstatement does not exceed the tolerable amount, and for proposing appropriate action when a sample result leads to a decision that misstatement may exceed the tolerable amount. One such action is the proposal of an adjusting journal entry that will reduce any potentially remaining misstatement to an amount that is unlikely to exceed the tolerable misstatement. A sample that fails to do so is either poorly planned or is revealing a situation that is worse than even good planning has led the auditor to believe

As stated previously there is no consideration in this ED for use of the universally employed mechanism that enables a sampler to draw reliable conclusions from a sample – the confidence interval (or its companion, the test of hypothesis).