

## SA 530 “Audit sampling”

### Limitations of Traditional Approach

- Economically wasteful.
- Inefficient because of checking all transactions.
- Emphasises routine checking which is time-consuming and costly.
- Routine errors and frauds have diminished due to formal internal controls.
- Extensive checking often does not reveal material issues.

### Risk-Based Approach

- Modern audit approach focuses on principles and controls.
- Reduces non-consequential routine checking.
- Allows auditors to focus on areas of higher risk and importance.

### Meaning of Sampling

- Audit sampling refers to application of audit procedures to less than 100% of items within a population of audit relevance such that every sampling unit has a chance of selection.
- The objective of the auditor is to draw conclusions about the population from which the sample is selected.

### Precautions to be taken while applying test check techniques.

1. Thorough study of **accounting system** should be done before adopting sampling
2. Proper study of internal **control systems**.
3. **Areas** which are **not suitable** for **sampling** should be carefully considered. Eg: compliance with statutory provisions, transactions of unusual nature etc.
4. Proper **planning** for Sampling methods to be used and explaining the staff,
5. Transactions and balances have to be properly **classified** (stratified)
6. Sample **size** should be appropriately determined.
7. Sample should be chosen in **unbiased** way,
8. **Errors** found in the sample should be analysed properly.

### Population

#### Meaning

Population refers to the entire set of data from which

- a sample is selected and
- about which the auditor wishes to draw conclusions.

### Characteristics

#### Appropriateness

- Appropriate means the population from which the samples are drawn shall be **relevant** for the specific **objective**.
- Appropriateness will include consideration of the direction (**Book to source** or **source to book**) of testing or assertion to be checked
- For example, if the auditor’s objective is to test for overstatement of accounts payable (Occurrence/Existence),

the relevant population could be defined as the accounts payable listing.

- Basically if we are checking overstatement, we are actually checking occurrence assertion.
- On the other hand, when testing for understatement of accounts payable (Completeness), the population is not the accounts payable listing but rather subsequent disbursements, unpaid invoices, suppliers’ statements, etc that provide audit evidence of understatement of accounts payable;
  - When testing for understatement, the auditor looks for liabilities that should have been recorded but weren’t. The accounts payable listing won’t show these missing liabilities because it only includes what has already been recorded. Instead, by examining payments made after the year-end, unpaid invoices, and other documents, the auditor can find evidence of liabilities that should have been included in accounts payable but were omitted, hence identifying understatement.

### Completeness.

- **Conclusion** about the entire population can be **drawn only** when the **population is complete**
- Example: Auditor can’t draw conclusions about all vouchers unless satisfied all vouchers are filed

### Reliable

Auditors should obtain **evidence** about the **reliability** of the population. If the population is **not reliable** with respect to accuracy and source, the sample drawn will definitely **not** be **relevant** for the specific audit objective.

### Sampling Unit

- The individual items constitute a population.
- For example checks listed on deposit slips, credit entries on bank statements, sales invoices or debtors’ balances, or a monetary unit.
- The conclusion on the population is based on the audit procedures applied on the sampling unit.

**Population Example:** If an auditor aims to test the existence and accuracy of sales transactions for a company during the financial year 20XX-YY, the population would be all sales transactions recorded by the company in that period. In the context of the above population, a sampling unit could be an individual sales invoice. Each invoice represents a single unit within the overall population of sales transactions that the auditor might select for testing.

### Sampling Process

1. Sample Design
2. Sample Size
3. Sample Selection
4. Audit Procedures
5. Nature and Cause of Deviation
6. Projecting
7. Evaluating Results of Audit

### Sample Design, Size And Selection of Items For Testing

#### Sample Design

💡 - Sample design means planning how to choose sample

While designing an audit sample auditor should consider the

- **purpose** of audit **procedure** and **characteristic** of **population** from which the sample will be drawn
- The auditor first considers
  - the specific objectives to be achieved and
  - the combination of audit procedures which is likely to best achieve those objectives.
- Auditor has to clearly define what will be considered as a misstatement. It will help the auditor in projecting the misstatement in the population.
  - 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.
- Assessment of characteristic of population in Tests of Controls
  - Involves estimating the expected Rate of deviation (i.e., how often the control is expected to fail) based on control design and implementation.
- Assessment of characteristic of population in Tests of Details
  - Involves estimating the expected amount of error in the population.
  - Influences the decision on examination extent; high expected errors may warrant 100% examination or large sample size.

### Sample Size

- The auditor shall determine a sample size sufficient to **reduce** sampling **risk** to an **acceptably low level**.
- The level of sampling risk that the auditor is willing to accept affects the sample size required.
- The **lower** the **risk** the auditor is willing to accept, the **greater** the **sample size** will need to be
- The sample size can be determined by the application of a statistics-based formula or through the exercise of professional judgement. In both the cases various factors can have an impact on size of sample

### Examples of Factors Influencing Sample Size for Tests of Controls –

The following are factors that the auditor may consider when determining the sample size for **tests of controls**.

FACTOR	EFFECT ON SAMPLE SIZE
An increase in the extent to which the auditor’s risk assessment takes into account relevant controls <i>When the auditor plans to rely more on controls, they need to be more confident that the controls are working properly. To gain that confidence, they must test more samples. So, the sample size increases.</i>	<b>Increase</b>
An <b>increase</b> in the <b>tolerable</b> rate of deviation	<b>Decrease</b>
An <b>increase</b> in the <b>expected</b> rate of deviation of the population to be tested	<b>Increase</b>
An <b>increase</b> in the auditor’s desired level of <b>assurance</b>	<b>Increase</b>

### Examples of Factors Influencing Sample Size for Tests of Details

The following are factors that the auditor may consider when determining the sample size for **tests of details**.

FACTOR	EFFECT ON SAMPLE SIZE
An <b>increase</b> in the auditor’s assessment of the <b>risk</b> of material misstatement	<b>Increase</b>
An <b>increase</b> in the use of <b>other</b> substantive <b>procedures</b> directed at the same assertion.	<b>Decrease</b>
An <b>increase</b> in the auditor’s desired level of <b>assurance</b> .	<b>Increase</b>
An <b>increase</b> in <b>Tolerable</b> misstatement.	<b>Decrease</b>
An <b>increase</b> in the amount of misstatement the auditor <b>expects</b> to find in the population	<b>Increase</b>
<b>Stratification</b> of the population when appropriate	<b>Decrease</b>

### Selection of Items for Testing (Selecting the sample)

- The auditor should select items for the sample in way that all sampling units must have equal chance of selection
- Statistical sampling requires random selection so each unit has selection chance
- The sampling units might be **physical** items (such as invoices) or **monetary** units.
- With non-statistical sampling, an auditor uses professional **judgement** to select the items for a sample.
- Biasness must be avoided in simple selection
- The sample **must** be **representative**.
  - This means that it must be closely **similar** to the whole population although **not necessarily** exactly the **same**.
- Sample should be **large enough** for meaningful results.

As the number of transactions of WY Limited for the financial year 2023–24 were very large, the auditor of WY Limited decided to use the technique of Audit Sampling. Before selecting the sample from Repair and Maintenance Expenses, the auditor of WY Limited wished that the entire data of Repair and Maintenance Expenses of WY Limited for financial year 2023–24 should have three characteristics. These three characteristics are:

- Simple, Completeness, Relevant.
- Appropriateness, Simple, Relevant.
- Reliable, Simple, Relevant.
- Appropriateness, Completeness, Reliable