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United States Government Accountability Office
Washington, DC 20548

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Subject: American Institute of Certified Public Accountants (AICPA) Auditing Standards Board (ASB) February 2009 Exposure Draft for a proposed Statement on Auditing Standards (SAS), entitled "Audit Sampling" (Redrafted).

This letter provides the U.S. Government Accountability Office's (GAO) comments on the ASB's proposed SAS on audit sampling. Generally, we support the proposed statement and agree that in most cases the standard appropriately discusses important considerations related to auditor use of audit sampling.

The Board has requested comments on the wording of paragraph A17 of the proposed SAS, specifically on the Board's decision to not discuss block sampling as a selection technique in the proposed standard. We agree with the Board's treatment of paragraph A17 in suggesting that only haphazard and random based sample selection methods are appropriate methods for selecting a nonstatistical sample. Block sampling techniques are unlikely to result in a sample that is representative of the population being tested; accordingly, we support the decision to not expand the guidance in paragraph A17 to include block sampling.

Our comments on changes resulting from applying the clarity drafting conventions and from converging with International Standard on Auditing (ISA) No. 530, *Audit Sampling*, along with other suggestions for improving the proposed standard are detailed below.

Responses to Questions on Application of the Clarity Conventions and Converging with International Standards on Auditing

- (1) We believe that the objectives stated in the proposed SAS to be achieved by the auditor are appropriate.
- (2) We agree with the revisions made to the existing standard to converge with the ISA and believe they are appropriate.
- (3) We agree with the differences between the proposed SAS and ISA 530.

(4) Other Comments

Audits of Government Entities

We recommend adding the following paragraph after paragraph A12 to provide guidance on the use of sampling in tests of compliance.

Considerations Specific to Audits of Governmental Entities

When performing a compliance audit in accordance with AU 801, the auditor may use audit sampling in testing the entity's compliance with laws and regulations. This SAS would apply when using sampling in those tests of compliance, but the focus of the auditor's testing would change from providing assurance that the financial statements are free from material misstatement to providing assurance that the entity has complied in all material respects with applicable laws and regulations. To determine sample size in those situations, the auditor would make judgments about the acceptable confidence level and the tolerable and expected rates of noncompliance. (Ref Paragraph 6)

Revise Definition of Stratification

We suggest replacing the stratification definition in the proposed standard with the following definition used in the AICPA Sampling Guide: "The division of the population into groups. It may be used to focus procedures on risk areas or to reduce variability in classical variables sampling populations."

The definition of stratification in paragraph 5 of the proposed standard — *the process of dividing a population into subpopulations, each of which is a group of sampling units that are intended to have similar characteristics (often monetary value)*—is misleading in suggesting that stratifying a population will result in sampling units in each subpopulation that are intended to have similar characteristics. Auditors, also stratify a population for purposes of timing the audit testing. For instance, they may divide a population into two subpopulations, one consisting of transactions that occurred in the first nine months of the year, and the second subpopulation consisting of transactions in the final three months of the year, to conduct interim and final rounds of testing. In this scenario, auditors would have no basis to expect that transactions in each stratum would have similar characteristics. Adopting the audit guide definition of stratification would resolve this concern.

Selection of Items for Testing

We recommend incorporating the discussion of acceptable statistical sampling techniques in paragraph A5 into paragraph A18, which lists the principal methods of selecting samples, so that paragraph A18 discusses both statistical and non-statistical sampling selection methods. This change will provide for a more logical flow of the guidance on sample selection techniques. Accordingly, we suggest deleting paragraph A5 and replacing paragraph A18 as follows:

A18. Auditors may use a variety of sample selection techniques. Probability weighted selection (e.g. monetary unit) is suitable only for statistical sampling, whereas haphazard selection is only suitable for non-statistical sampling. The following techniques may be used to select samples for both non-statistical and statistical sampling approaches:

- a. simple random,
- b. systematic with one or more random starts
- c. stratified sampling

Projecting misstatements

Clearer guidance is needed to help auditors understand the basic procedures involved in projecting misstatements detected when testing a sample of the population. This clarification will help improve the auditor's understanding of these complex measures and promote proper application of the standard. Paragraph A25 should be revised to better explain why (1) misstatements detected in performing tests of detail on a sample of the population are projected to the total population, and (2) the projected material misstatement may not represent an appropriate amount for the entity to record to its financial records. Similarly, paragraph A26 should briefly explain that for tests of control the sample deviation rate is the projected deviation rate for that population. For these reasons, we recommend revising these paragraphs as follows:

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. Tests of detail are performed to detect material misstatements at the relevant assertion level; misstatements detected by tests of detail are normally measured in monetary amounts such as dollars. Therefore, if auditors perform tests of detail on a sample of the population, any misstatements detected in the sample are projected to the population to estimate the total misstatement in the population. This estimated total misstatement, which is also known as the projected misstatement, is then aggregated with the projected misstatements in other account balances and classes of transactions to evaluate whether the financial statements taken as a whole are materially misstated. Since the projected misstatement is an estimate, it may or may not be appropriate for the entity to adjust its financial statements for the projected misstatement,~~

A26. ~~Tests of controls, in contrast, are performed to provide evidence of internal control effectiveness. Any deviations detected by tests of control normally are measured in terms of the deviation rate, i.e., the number of observed deviations divided by the sample size, rather than in dollars. For tests of controls, unless the sample is stratified, no explicit projection of deviations is necessary because~~ the sample deviation rate is ~~also~~ the projected deviation rate for the population ~~as a whole~~. Paragraphs 18 and A50 of the proposed SAS *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* (Redrafted), address ~~when auditors' responsibilities when they detect~~ deviations from controls upon which ~~the auditor they~~ intends to rely. ~~are detected.~~

Evaluating Results of Audit Sampling

To reduce duplication in the standards, we suggest revising paragraph A29 to refer to the requirements in paragraphs 7 and 8 of the proposed SAS *Evaluation of Misstatements Identified During the Audit*. Paragraph A29 essentially repeats paragraphs 7 and 8 but in the form of guidance rather than as requirements. Specifically, the proposed SAS *Evaluation of Misstatements Identified During the Audit* requires auditors to communicate on a timely basis with the appropriate level of management all misstatements accumulated during the audit and to request management to correct those misstatements. If, at the auditor's request, management has examined a class of transactions, account balances, or disclosures and corrected misstatements that were detected, the auditors are required to perform additional audit procedures, as necessary, to determine whether material misstatements remain.

We recommend revising paragraph A29 as follows:

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~~ is required to follow the provisions of paragraphs 7 and 8 of the Proposed SAS, *Evaluation of Misstatements Identified During the Audit*.

- ~~• 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.~~

Guidance on Statistical Sampling

We suggest including in the proposed standard the following guidance on statistical sampling, which explains statistical sampling using language written to be understood by nonstatisticians. This guidance would align the proposed SAS more closely with statistical principles and could be included in the Application and other Explanatory Material section of the proposed SAS and referenced to the definition of statistical sampling in paragraph 5.

Generally speaking, statistical sampling— also called ‘scientific sampling’—denotes the selection of a sample from some population, observing that sample with respect to some property of interest, and then making an inference about the population, throughout using procedures based on *statistical theory*.¹

¹ Dalenius, Tore *Elements of Survey Sampling*” (Stockholm: The Swedish Agency for Research Cooperation with Developing Countries, 1986): I-3.

Clarify Guidance on Tolerable Misstatement

We recommend revising the last sentence of paragraph A6 to clarify the guidance on determining and applying tolerable misstatement to audit sampling procedures. The guidance should state that tolerable misstatement may be *smaller than* performance materiality when the population *from which the sample was drawn is smaller than* the account balance. We recommend the revising paragraph A6 as follows.

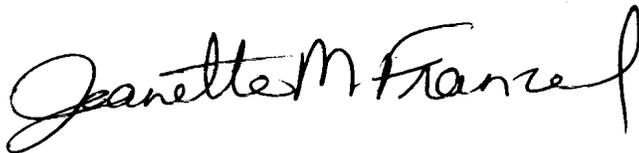
A6. The auditor is required by paragraph 11 of the proposed SAS *Materiality in Planning and Performing an Audit* (Redrafted) to determine performance materiality. Performance materiality is determined in order to address the risk that the aggregate of individually immaterial misstatements may cause 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~~ ~~smaller~~ than performance materiality (for example, when the ~~sample~~ population from which the sample is selected is smaller than ~~lower than~~ the account balance).

Provide Definitions for Technical Terms

We recommend defining technical terms used within the SAS, such as risk of incorrect acceptance/rejection, risk of assessing control risk too low/high, systematic sampling, random selection, and monetary unit sampling, using the definitions from the AICPA's Audit Sampling Guide. These technical terms are used repeatedly in the application section of the standard. Providing definitions will assist users in implementing the standard, help avoid misinterpretations and promote consistency of application. In addition, definitions are an important element of drafting conventions.

We thank you for considering our comments on these important issues.

Sincerely yours,



Jeanette Franzel
Managing Director
Financial Management and Assurance

cc: Mr. Harold Monk, Chair
Auditing Standards Board

The Honorable Mark W. Olson, Chairman
Public Company Accounting Oversight Board