Objectivity or Subjectivity in Audit Sampling?

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Abstract: In financial audit practices, sampling is used to collect audit evidence that are all-important in order to convince the financial auditor on the level of adequacy of financial statements with the financial reporting framework applicable to the audited entity, with the verity of the performance of the audited activity. The audit survey technique is used to audit both the elements of internal control, and the account activities and the account balances. The responsibilities of the financial auditor give point to the decisional process in auditing, especially in respect of establishing the adequate types, moment and quantities of audit evidence. This is the reason why many auditors fear for the implementation of audit survey. Their behaviour is justified by the risks implied by the sampling which can hall-mark the efficiency and efficacy of the audit survey, especially when the financial auditor does not have enough knowledge of the audited entity. Furthermore, there appears temporarily the doubt about the objectivity of subjectivity in the audit survey, about undermining the professional reasoning when implementing the audit survey. Considering all these arguments, the implementation of an ample methodology of research on the audit survey becomes really necessary in order to demonstrate that the sampling technique (an important decisional instrument of the financial auditor) must be objective, argued, devoid of doubts or assumptions; this methodology regards documentation, calculation, observation, analysis and synthesis.

Key-Words: financial audit, sampling, survey, audit risk, audit evidence, financial statements.

1 Introduction
The accomplishment of a financial audit mission under efficiency and efficacy conditions is related to rationality and anticipation in the process of collecting audit evidence. And this is due to the fact that the adequate proportioning of the financial auditor’s workload is directly influenced by his/her decision about “the nature, the scheduling and the planned ampleness of risk evaluation procedures and of auxiliary audit procedures on a level with statements, as answer to the evaluated risks” [1]. The financial auditor’s decision must take into consideration “reasonable costs, which is why, when collecting audit evidence, the exhaustive techniques of verifying events, transactions, information from financial statements was replaced with the survey technique”[2].

Within this context there must be also mentioned financial auditor’s behaviour when collecting audit evidence, especially when choosing and implementing certain sampling technique (survey), in order to establish the minimal dimension of the examined sample. And this is due to the fact that there cannot be found a generally valid recipe and the existent circumstances while internal and external factors of influence may hall-mark financial auditor’s rationality within the decisional process of sampling.

2 The professional reasoning – between objectivity and subjectivity

2.1 Dilemmas pointed out in the literature
The international frame of reference related to audit sampling is given by the International Standards on Auditing (ISA) 530 “Audit Sampling”; the last one presents minimal reference elements such as: sampling risk, non-sampling risk, sampling unit, statistical sampling, stratification, tolerable error, etc. [3] But the presentations of requirements and explanations of ISA 530 “Audit Sampling” are a far cry from the numerous questions related to the
manner in which a survey of the elements of the auditable field should be made so that accomplishing an audit mission in terms of efficiency and efficacy would not suppose other interpretations and dilemmas.

The literature presents numerous statements pro and against the manner in which audit sampling should be performed so that the concrete selection and application of a sampling technique would subscribe the aims targeted by the auditor and so that the result of audit evidence of the selected elements would offer a real basis for placing the financial auditor on record about the quality of information presented within the financial statements. To this effect, their analysis leads to the existence of dilemmas which compares objectivity and subjectivity regarding the audit survey that represent the object of this research. There can be distinguished the following opinions presented in the national and international literature concerning sampling modes and implicitly its objectivity or subjectivity; I am going to present arguments for each opinion, some considerations that I believe to be necessary.

- The presence of difficulties when selecting sampling elements if any stratified population; this presence raises suspicions when applying the Central Limit Theory (CLT), a statistical theory which implies that the average of all results of sampling of one stratified population is approximately equal to the average of population [4];

I consider that in this case sample representativeness is important being given by the characteristics of sample elements which must be found within the ones of the population it belongs to. The deficiency of representativeness of elements selected in the sample can be due not only to the given circumstances for the analysed population, but only to some causes related to the auditor such as observation error. [5]

- In case of samples including between 100 and 200 elements (dimensions frequently encountered in practice) which have a low error rate, the financial auditor must analyse thoroughly if it would be adequate to up-scale the results obtained from the examination of sampling elements on a level with the auditable field [6];

From this point of view, I consider that it is important to sample the results of the examination of the selected sampling elements having a low error rate (before being generalized on a level with the auditable field) with the results of other audit evidence. This substantiation process must be based on the financial auditor’s professional scepticism.

- Appealing to non-statistical sampling methods supposes that the financial auditor would apply the professional reasoning to a greater extent than in the case of the methods of statistical sampling. But, on the other hand, it must be taken into consideration the fact that in practice there has been proven the reticence of some financial auditors when applying statistical sampling methods due to higher costs in regard of: financial auditors’ training, selection and evaluation of sampling elements [7];

The mark of subjectivity is eloquent when the probability theory is not used, when we rely more on the hazard even if we appeal to the two essential auditing principles: professional reasoning, professional scepticism.

- The testing methods used by the auditor lead to results which are expressed in monetary terms even if the sampling elements can be with reference to monetary elements from account activities, account balances or to non-monetary elements such as the one related to the internal control [8];

The transformation of non-monetary elements which can be subject to a sample under check in monetary elements of reference; this transformation will always contain a dose of subjectivity within the used commensuration algorithm. But the transfer from the non-monetary reference to the monetary one is necessary because, nowadays, the fundamental aim of auditing financial statements is to identify monetary errors significant on the whole of the assertions declared by corporate respondents in audited financial statements.

ISA 530 “Audit Sampling” contains minimal elements, presented as requirements and explanations: they are elements that offer a frame too general for evaluating risks implied by the audit survey.

2.2 Factors that may impair the professional reasoning

Taking into account the general aim of each audit mission – diminishing audit risk under the terms of the affirmation of an efficient and efficacious audit process –, by implementing the survey on audit, the financial auditor must prove the accomplishment of a process which can underlie the process of identifying false information so that, subsequently, could be evaluated their impact on the financial position and the performances presented in the audited financial statements.
The audit survey means that the financial auditor establishes a sample for less that 100% of the elements of an auditable field. To this effect, the financial auditor must decide which will be the auditable fields and the sample size, decision made by appealing to professional reasoning and to the professional scepticism.

The decision regarding auditable fields takes into consideration the assertions declared within the financial statements by the corporate respondents. The financial auditors may considerate as auditable field the assertions externalized within the account activities and balances differently approached from the point of view of audit aims they target. Within this context, the applied practices showed situations in which there might be established many versions of the auditable field for the assertions from an account. For instance, for the account used when registering providers, the financial auditor can establish three versions of this auditable field: a first version referring to the existent assertions within the account activity, a second version referring to the declared assertions within the balance account, a third version referring to the aim of the audit “existence” of the assertions from the annual account activity.

From this point of view, taking an adequate decision calls in question the exactness of some choices for one or more variants of the auditable field. This exactness depends largely on factors such as:

- Auditor’s level of understanding and knowledge on the five informative components referring to the audited client. They take into consideration: the Regulatory framework and other external factors, the Nature of the entity, Aims, strategies and risks afferent to the business, the Evaluation and revision of client’s financial performance, the Control environment and control monitoring. [9]
- Level of knowledge and competences of the financial auditor.
- Financial auditor’s attitude towards applying the professional scepticism, on one hand, and flexibility when treating risks, on the other hand.
- The previous experience of the key-members of the mission team within the client-entity.
- Changes of the circumstances that take place within the audit mission, etc.

When establishing the sample size, both in the national and international practices, and in the theories regarding audit sampling, there is emphasised the relationship between the sample size and the estimated level of inherent risks and risks related with the internal control, alongside the prefigured level of the significance threshold and the degree of reliability related with the relevance of the results of the preliminary analytical procedures. In fact, according to the Quality Audit Guide [10], between the sample size and the size related with the inherent risk factor, the control risk factor, the significance threshold and the relevance of the analytical revision is an inversely proportional relationship. Namely, the minimal sample size (MSS) would be the higher the smaller the sizes related with the four variables are at a certain value given to the auditable field (AF). These variables are: the inherent risk factor (IRF), the control risk factor (CRF), the significance threshold (ST) and the relevance of the preliminary analytical revision (RAR).

MSS=AF: (IRF x CRF x ST x RAR)

The use of this model for calculating the minimal sample size and the predefined procedures for establishing the size of the four variables in order to take a decision related with the sample associated to each auditable field involves subjectivism elements, due to:
- the predefined calculation model;
- In practice there could be found other elements too, apart from the four variables, which can contribute to the assurance of the justness of the sample size of an auditable field;
- the predefined marks in order to be expressed the appreciations the financial auditor makes for the control factor and the relevance of the analytical revision according to the model and the predefined procedures.

Thus, the procedures used by the financial auditor in the association of a monetary term which would measure either risks, or certitudes he/she refers to; where applicable, the two variables of the model are focused on the financial auditor’s professional judgements, on his/her perception in given circumstances, which could be different from the predefined ones (respectively marks from 1 to 5 for the control risk factor, marks from 1 to 3 for the relevance of the analytical revision).

- the model used for estimation of the general inherent risk and of the specific inherent risk of each pattern of audited financial information.

First of all, measuring the susceptibility related to the existence of some significant misrepresentations within the account activity or balance may be different if the financial auditor takes also into consideration other analysis elements unlike aspects referring to management, control environment, operational environment, audit aspects – in case of the general inherent risk – respectively aspects different from the ones established for measuring the specific inherent risk (the predisposition to

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errors of the system, the vulnerability related to the level of education and empowerment of the accountant, the existence of complex and uncommon operations, of estimations, of risks associated to losses, the misappropriation of funds, frauds).

Secondly, the establishment of the inherent risk factor uses a predefined risk matrix, the same for all auditable fields, irrespective of the number of fields that compose the auditable field; in this context, the probability for the misrepresentations to exist increases the higher the number of elements that form the auditable field is. At this rate, risk measurement should be more severe, more pessimistic in order to increase the certitude when it comes about the identification of significant misrepresentations within financial information patterns.

- the arbitrary that characterizes the test of internal control elements; the financial auditor is the one who chooses the type of the control test, the time for applying the control test and the their necessary quantity in order to argue and found the financial auditor’s apprehension on the internal control of the audited entity, in order to be convinced of the appropriate performance of the existent internal control, in order to present the reasons for which the internal control is trusted (necessary for arguing a smaller amount of background tests, etc.);
- the evaluation given to the limit of significance on which misrepresentations, omissions can be or cannot be significant.

The financial auditor’s perception related to significance may differ under the influence of some internal or external factors that guide the intercessions for establishing the level of significance based on some suspicions of misrepresentation within the audited financial statements.

- the arbitrary that is used for selecting the preliminary analytical procedures applied when identifying the significant events that took place during the analysed period, of uncommon variations of balance accounts with significant values.

The results of the preliminary analytical revision used for determining the degree of confidence appreciated on the three levels with marks from 1 to 3 may lead to assessments unlike reality; this may happen if the financial information that form the elements of the analytical procedure are not neutral, trustful, respectively are influenced by the corporate respondents’ behaviour and not only.

Alongside the aspects previously presented, when establishing the minimal sample size, there are different influences which raise questions related to the objectivity or subjectivity in applying the professional reasoning. These influences are also due to factors on which depends the justness of some choices for one or more versions of the auditable field, factors reproduced within this study.

The frequent analyses on the subjectivism degree that results from the implementation of procedures for establishing sample size point out the importance of the requirement for the internal control of the audited entity to provide reliable financial information.

This is the reason why evaluating risks associated to internal control with marks from 1 to 5, must be argued through the results obtained pursuant to the tests applied to the elements of the internal control. It should be noticed that the marks given to the risk control factor (excepting the mark 1 which does not affect the sample size) influence just in terms of decreasing the sample size. Therefore, it is eloquent that, when establishing the influence of internal control risks on the sample size, it was taken into consideration only the hypothesis related to the existence of an adequate internal control which gives reliable intelligence and whose level of adequacy estimated by the financial auditor (justified with the results of audit evidence) is stipulated to influence just in terms of diminishing the sample size.

But, the reality of the practice demonstrates frequently situations in which the assessment of control risk should lead to the increase of sample size. And this in the context in which the results of control tests applied by the financial auditor show the existence of an inappropriate internal control, that generates significantly misrepresented information, of a risked internal control environment, of an aggressive working style of the corporate respondents, etc.

3 The relationship between risk and the minimal sample size

In order to demonstrate the impact of the subjectivist tendencies of auditor’s assessments regarding risk elements on sample size, after an ample theoretical documentation, we focused on observing in practice the way of applying the predefined model, the type of relationship it establishes between evaluated risks and sample size, the established procedures for evaluating risk elements. These intercessions were previous to a comparative analysis for studying the influences of the variables of the model on the sample size, being
given place to an integration of the results of this study.

The examination of the causal relationship between the variables of the model and the minimal sample size was carried out on the auditable field given by the account balance which keeps track of the providers at a construction company. The Providers account balance in 31st of December 2011, according to the corporate respondents, presents a value of population of 3,500,000 lei and a number of 477 elements of the declared population as a position to be paid at the end of the audited period.

Implementing the predefined calculation model, by specific procedures based on applying the professional reasoning, in order to calculate the minimal sample size it was considered a significance threshold of 10,000 lei.

We tried to observe if the impact of a little different assessments of the financial auditor on risk and certitude elements (inherent risks, control risks, the relevance of the analytical revision) considered within the predefined model – where arguments pro and against become in hilarious in many cases – has a significant effect on the minimal sample size. Therefore, we did a comparative research according to the aspects presented within Table1 – where the inherent risk factor is evaluated at 3 – and in Table 2 – where the inherent risk factor is evaluated at 1,75. The evaluations for the inherent risk factor were made on the basis of the risk matrix [11] and of the risk level assessed for the general inherent risk (GIR), as well as of the risk level assessed for the specific inherent risk (SIR), for all audit aims targeted by the financial auditor for the auditable field of the providers (existence, completeness, correct period, correct evaluation, correct imputation, correct elaboration, achievable value, rights and responsibilities, presentation and disclosure). The risk matrix gives the opportunity to be chosen 1 currency risk factor from the 11 versions with distinct monetary values of risk factors; this choice depends on the non-monetary assessments of the financial auditor for the two inherent risks (GIR and SIR).

Taking into account both the 5 versions of the marks that can be given, according to the financial auditor’s professional judgement for the given circumstances, to the internal control factor (ICF), and the 3 variants of the marks that can be given to the relevance of the analytical revision (RAR), and by implementing the predefined model there results significant differences of the minimal sample sizes, as Table1 shows:

Visualy, according to the aspects synthetized in Table1, the variation of the sample size from the 117 selected elements to 8 elements is represented below, in Figure1:

Other significant differences of the MSS can be seen in Table2, where IRF is assessed to 1,75.

According to the aspects synthesized in Table2, Figure2 represents the variation of the sample size from 200 selected elements to 13 elements.
Above the already presented aspects, different assessments of the financial auditor on one audit aim (such as existence) up against other audit aims would lead to taking into consideration for the same auditable field (of different debtors) of two versions of the minimal sample size of different sizes. Their elements would be object of the implementation of audit procedures in order to identify misrepresented information.

4 Conclusion

When assessing risk elements which influence the choice of auditable fields and the minimal sample size of an auditable field – elements found both in the evaluation manner of the 4 versions of the used model, and in the predefined model for calculating sample size – there must be eliminated unclear, interpretable aspects of subjectivism which impair the objective reasoning of the financial auditor.

And this is due to the fact that it is the only way in which the intercessions prosecuted by the financial auditor, when applying the professional reasoning in terms of professional scepticism and flexibility, can assure the choice of risk and certitudes factors; these factors lead to an adequate size of the samples subject to the audit procedures. Moreover, the results of the evaluation of the sample elements would assure a level of certitude related to the lack of misrepresented information from the audited financial statements at least of 95%. Furthermore, the financial auditor should explicitly argue and document with adequate proofs the objectivity in the entire process of selecting audit activities, elements of the sample which give proofs regarding the lack of false information in the audited financial statements.

References: