

Section 4

AUDIT STRATEGY

4.3 OVERALL AUDIT PHILOSOPHY (CONT'D)

4.3.6 Sample Size (Cont'd)

For illustrative purposes, the sample sizes for "walk-through tests", "compliance tests" and "substantive tests" may be as stated below. However, these sample sizes are merely for guidance only and auditors should exercise their judgement and select the appropriate sample sizes depending on the circumstances. (cont'd)

(d) **Substantive tests if the system is not fully relied on:** (cont'd)

- (ii) **Substantive tests on balance sheet items e.g. debtors.** This depends on the same factors as those in (i) above - audit risk, the population size, the materiality level, the reliability of the system, whether we are expecting errors and whether the balance sheet item has "key items" e.g. doubtful debtors of a particular category, say contractors, in the case of a building materials trading business. If there are "key items" as these which are especially risky, we may have a larger sample but the sample will be concentrated more on these risky items.

In terms of sample size, the criteria will be as follows:

- **If the balance sheet item is below materiality level,** there is no need for substantive testing. However, please review the components of the item e.g. deposits in "other receivables" for reasonableness and to ensure no understatement or overstatement.
- **If the item is above materiality level,** we have to perform substantive tests. The sample size should usually provide for coverage of between 20% by value (for low risk and fairly reliable items), to 30% (for medium risk items) to 50% by value (for high risk and not so reliable items). Sometimes, if the population size is large and very spread out without any large items, it may require a large sample size to reach 20% to 50% coverage. In such cases, the sample size may be reduced to between 5 items (for low risk) and 20 items (for high risk). In extreme examples, increase or reduce the sample size as appropriate. This type of sample selection is only appropriate for tests such as circularisation of receivables.

If we are verifying the adequacy of bad debt allowance, we will not use the same method of selection. Instead, we will focus on "key items" such as overdue debts and large receivable balances i.e. focus on items which are of "high risk". What is the sample size for this type of audit? Usually, we will ignore items of a certain size and only concentrate on the larger ones but in small populations, we may select all the "key items".

In addition, please note that the samples selected above were good only for verification of existence (in the case of circularisation) or valuation (in the case of verification of bad debt allowance). They are however not good for verifying completeness. For this objective, we have to use techniques such as:

- Understanding the sales system and ensure that for all goods delivered, the sales have been taken up and vice-versa.
- Reviewing profit margins to ensure that both sales as well as cost of sales have been properly taken up.