Exposure Draft comments: PROPOSED STATEMENT ON AUDITING STANDARDS: AUDIT EVIDENCE

Thank you for the opportunity to respond to the ED of this cornerstone auditing standard. My specific comments are directed to the noted questions in order of concern.

Questions 2, 4 and 5. Model and diagram.

A model can be a useful tool for conceptualizing the dimensions and aspects of gathering audit evidence. A concern with the ED and the illustrated model of evidence is its failure to explicitly recognize an important distinction about the nature of evidence gathered. Specifically, whether audit evidence directly relates to or supports the numbers and disclosures in the financial statements under examination (e.g., source documents supporting the numbers and disclosures) or only indirectly relates to the financials (e.g., tests of controls, external information, peer information, etc.). This distinction seems critical in assessing the value of evidence gathered, and might be more clearly distinguished in the model by creating a 2 dimension top side to the cube (directly related and indirectly related) with the various other information sources as subsets, as appropriate.

For example, a thought about direct evidence was expressed in paragraph .A15 in AU-C section 500, but that thought seems to be absent in the ED.

.A15 Some documents represent direct audit evidence of the existence of an asset (for example, a document constituting a financial instrument such as a stock or bond)...

Paragraph .A35 simply lists (management) internal information amongst the 5 possible sources. From that reference it is not clear whether it refers to information providing direct or indirect evidence supporting the balances and disclosures. The sources and the nature of audit evidence can be different.

Much of the document currently seems focused on information and sources that are indirectly related to the financial statement amounts and disclosures. This imbalance of emphasis in such a fundamental standard may be misleading to practitioners. The profession has presumably already learned lessons from audit approaches that over-emphasized indirect audit evidence rather than gathering direct supporting evidence. In addition to the mega-audit failures of the early 2000 period, an illustrative example in a smaller entity was Collins Industries which in 1992 manipulated key financial ratios and
financial markers in advance of a refinancing in order to obtain favorable refinancing. One reason the auditors failed to identify the manipulation because of over-reliance on indirect sources of audit evidence. The manipulated appearance of consistency of key financial ratios and markers gave a false impression of corroboration. The SEC brought an action against Collins which resulted in a settlement.

Questions 9 and 10. Definitions

The pervasive use of the terms relevance and reliability throughout the ED indicate that these are terms of importance to the proposed Standard and should be defined here. These definitions can be added without adding bulk to the proposed SAS.

A nuance in the definition of sufficiency in paragraph 8 is the de-emphasis on the concept of quantity and emphasis on the persuasiveness of evidence. Persuasiveness seems to refer to both quantity and relevance and reliability (appropriateness), as discussed in paragraph .A11. The judgmental fuzziness of the term “persuasiveness” and its proposed circular discussion in the application material indicates that practice might be better served to have sufficiency restored to its prior context (extent) and continue to make the clear statement like in .A11 in the requirements of the Standard that extent is not the sole determinant of persuasiveness. In fact, that statement might warrant placement in the requirements section in an expansion of proposed paragraph 9.

From a definitional standpoint, the term persuasiveness might be best positioned as an over-arching combination of sufficiency (extent) and appropriateness. This would be in-line with the discussion currently in proposed paragraph .A11, and would not disturb the essence of existing definitions and conventions.

This carries through to the proposed significant revision of AU-C 200, another cornerstone Standard. As a documentation issue, the documentation of the quantity and appropriateness of the evidence can be envisioned and are established in practice. How could one document persuasiveness except thorough the concepts of quantity, relevance and reliability?

Question 15. Documentation requirements

The evidence model introduces the terms authenticity and bias (.A18). In an already crowded field of assertions, do these terms really create new assertions? It would seem these concepts can already be subsumed by the existing assertions, and the specific dimensions of those assertions as it relates to audit evidence can be discussed in the application material. This would simplify the discussion as well as dispel an uncertainty as to what needs to be documented and how.

As noted elsewhere, I think the documentation of persuasiveness as currently defined in the ED will be difficult to operationalize apart from noting extent and appropriateness.

Questions 9 and 11. Examples

Examples are always helpful to practitioners. However, it is not clear that the ED provides any useful auditing guidance as it relates to various mentioned technologies such as AI and block-chain. I am unaware of any nuances of application of the audit evidence principles that are clarified here. In the absence of specific guidance, it is unclear what purpose these references serve.

Analytical Procedures and Use of Audit Data Analytics (paragraphs 66-70)
There is useful guidance in these paragraphs but they seem misplaced since they relate directly to AU-C section 520. It seems more appropriate to add this section to the Application material there. I would not think most practitioners would think to look for such guidance in AU-C section 500. Placement here also tends to slant the emphasis in the ED towards indirect audit procedures as evidence and adds unnecessary bulk to a cornerstone standard. In as much as these technologies may involve also indirect information and involve analytical techniques, their discussion might also find a more logical home at this time in AU-C section 520 pending further information regarding how these technologies are used by entities and auditors and how audit assurance should be gained when they these technologies are fundamental to the financial statements. These new technologies should be an area of continuing monitoring and study. A “white-paper” may be a more appropriate venue to expose and explore new technologies than in an auditing Standard.

In any case, the use of automated tools (CAATS – computer assisted audit techniques) to perform various procedures is not new and has been practiced for decades using proprietary Firm software or commercial software (e.g., ACL and IDEA). Artificial Intelligence and expert systems were introduced into some audit practices in the mid 1980s.

As drafted to reflect mention of these technologies and analytics, the ED seems unnecessarily long.

**Question 13 and 14. Relocation of management specialist guidance**

The relocation suggestion is very appropriate.

AU-C section 501 is already a crowded document with a mixture of guidance. Also, auditors have exhibited confusion over the current guidance regarding specialists.

A separate standard with addresses both management and auditor specialists would help distinguish the guidance and clarify the issues.

**Question 7 and 8 Professional Skepticism**

As an over-arching concept, the topic likely only needs specific illustration in Standards where the topic of skepticism might not be obvious. However, care should be taken to avoid the impression, pending a review of the entire literature, that unless mentioned specifically, the concept does not apply. A similar issue currently exists today regarding audit documentation where some Standards include specific documentation suggestions. Others, that rely on the basic AU-C section 230 documentation principles of “procedure-evidence-conclusion”, seem to cause practitioners to not consider that requirement fully, resulting in varying quality in documentation.

For example, it is not uncommon to find a checkmark next to a risk assessment conclusion (e.g., “low”) without any mention of the procedure performed or any evidence on which the conclusion is based.

There is no basis on which to give government statistics as a whole a “seal of approval.” When some statistical disclosures have political consequences, and are subject to human processing, the same skepticism needs to be applied to preliminary statistical published data as any other data. Examples exist of governmental statistics being misstated by omission, commission or error.

Suggestion:

Appendix A paragraph 8
“The nature and authority of the external information source (For example, a central bank or government statistics office with a legislative mandate to provide industry information to the public can likely be considered a reliable external information source for certain types of information.)”

Other

Paragraph .A2 in the current AU-C section 500 regarding the insufficiency of inquiry by itself has been relegated in the ED to paragraph .A56. This remains a point of practice misunderstanding and non-compliance, and seems to warrant a more prominent position in the ED. The ED also omits current guidance that “...nor is inquiry alone sufficient to test the operating effectiveness of controls.” In light of noted practice issues, it is suggested that this current guidance be retained.

Respectfully submitted,

Lynford Graham, CPA, Ph.d., CFE