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Ms. Sherry Hazel
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

GAO's Response to the American Institute of Certified Public Accountants' June 2019 Exposure Draft, *Proposed Statement on Auditing Standards—Audit Evidence*

Dear Ms. Hazel:

This letter provides GAO's comments on the American Institute of Certified Public Accountants' Auditing Standards Board's (ASB) *Proposed Statement on Auditing Standards—Audit Evidence*. GAO promulgates generally accepted government auditing standards, which provide professional standards for auditors of government entities in the United States.

We support the ASB's efforts to update the guidance in the *Audit Evidence* standard to reflect the effect of emerging technologies on the auditing profession. We also believe that the proposed Statement on Auditing Standards (SAS) is adaptable and scalable by private sector and government audit organizations. However, we have concerns about the proposed revision to the definition of sufficiency, as it would create, in our view, unnecessary divergence from other standard setting bodies, including the International Auditing and Assurance Standards Board (IAASB) and the Public Company Accounting Oversight Board (PCAOB). In addition to responding to the specific questions in the explanatory memorandum accompanying the exposure draft, we have noted certain edits that we believe will improve the final SAS.

Thank you for the opportunity to comment. If you have questions about this letter or wish to discuss any of our responses, please feel free to contact me at (202) 512-3133 or dalkinj@gao.gov.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin".

James R. Dalkin
Director
Financial Management and Assurance

Enclosure

Enclosure: Responses to Explanatory Memorandum Questions

- 1. Please provide your views on whether the revised scope section of the proposed SAS clearly explains the relationship between the proposed SAS and other AU-C sections, including AU-C sections 315, 330, and 700. If the scope section does not clearly explain the relationship, please indicate why.**

We believe that the revised scope section generally explains the relationship between the proposed AU-C section 500 and other AU-C sections, including AU-C sections 315, 330, and 700. We believe that the strongest linkages are established between the proposed Statement on Auditing Standards (SAS) AU-C section 500 and AU-C sections 330 and 700 by paragraph A2 of the proposed SAS. We suggest that the Auditing Standards Board (ASB) consider modifying paragraph 3 to make clear that AU-C section 500 may also relate to additional AU-C sections other than those indicated by footnotes 1 through 3 and paragraphs A2 through A3. One option for such a modification is as follows:

“This proposed SAS is to be read in conjunction with other AU-C sections, including those that address the auditor’s responsibilities....”

- 2. If implemented, would the new requirements and application material assist the auditor in more effectively evaluating whether sufficient appropriate audit evidence has been obtained? If not, please explain why.**

We believe that the new requirements and application material would generally assist the auditor in evaluating whether sufficient appropriate audit evidence had been obtained.

- 3. Would the proposed attributes and factors expand the types and sources of information considered by the auditor as audit evidence by lessening the emphasis on how audit evidence is obtained (that is, “audit procedures performed”)? If not, please explain why.**

We believe that the proposed SAS will expand the types and sources of information that the auditor considers as audit evidence, including information generated through automated tools and techniques. We agree that, because the objective of the proposed SAS is to evaluate information to be used as audit evidence, it is appropriate that the focus of the requirements and application guidance be on audit evidence as opposed to specific audit procedures performed to generate the audit evidence.

- 4. Are there relevant attributes and factors of audit evidence missing from the proposed SAS that should be considered by the auditor when evaluating the appropriateness of audit evidence? If so, please describe them.**

We do not believe that there are additional attributes and factors of audit evidence missing from the proposed SAS that the auditor should consider when evaluating the appropriateness of audit evidence.

- 5. Does the diagram in the proposed SAS appropriately depict the attributes and factors that the auditor considers in evaluating whether sufficient appropriate audit evidence has been obtained?**

We believe that the diagram in the proposed SAS may not achieve the ASB’s goal, namely “enhancing the readability and application of the requirements in the proposed SAS.” We note that the diagram closely resembles internal control cubes that both the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and GAO produced.¹ However, the diagram in the proposed SAS does not relate to internal control, and this may cause some confusion in the auditing community.

The COSO and GAO cubes also represent a complete, integrated system of internal control. There are clear relationships between the level of organizational structure, categories of objectives, and components of internal control in these cubes that are not as evident in the proposed SAS diagram. For example, while audit evidence may corroborate or contradict audit assertions, the proposed diagram does not indicate if this is evaluated as a hard dichotomy or a gradation between the two concepts. A similar lack of discrete categories exists in the sources side of the proposed diagram. If this lack of definitive separations is intentional, then we suggest that the ASB clearly explain this intention in the application material. If it is not, we suggest revising the diagram to make the distinctions more clear.

In addition, for the side of the diagram labeled Relevance and Reliability, all of the listed attributes pertain to reliability, as discussed in paragraph A18. There is not a separate block or level in the diagram that captures relevance. As such, relevance is not currently captured in the proposed diagram.

Finally, we note that the diagram is re-presented with a particular side emphasized as stand-alone paragraphs with no accompanying text in three instances (in paras. A12, A34, and A45). We suggest that the ASB consider removing paragraph designations from stand-alone diagrams or merging with paragraphs that contain application guidance text.

We do not object to the use of diagrams or graphics that enhance the readability and application of auditing standards. However, we believe that the ASB may wish to reconsider whether the diagram in the proposed SAS adequately accomplishes this objective.

6. Please provide your views on whether the examples in the proposed SAS are useful to auditors. If the examples are not useful, please explain why.

We believe that the examples of automated tools and technologies in the proposed SAS are generally useful. We would suggest a few changes to enhance the usefulness to auditors. For example, we believe that the description of audit data analytics in the second sentence of paragraph A38 would more appropriately fit at the end of paragraph A66.

In addition, the application guidance adds the phrase “such as audit data analytics” six times when discussing the use of automated tools and techniques (paras. A38, A52, A55, A56, A68 and A69). The frequent use of this modifying phrase can lead a reader to conclude that audit data analytics are the primary acceptable form of automated tools and techniques. We do not believe that the ASB intends to limit automated tools and techniques in this manner, and we suggest that the ASB consider reducing the frequency of this phrase.

¹See Committee of Sponsoring Organizations of the Treadway Commission, *Internal Control – Integrated Framework* (New York: American Institute of Certified Public Accountants, 2013) and GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: September 2014).

7. Do you agree with the approach taken by the ASB in addressing the topic of professional skepticism? If not, please explain why.

We believe that the ASB's approach in addressing the topic of professional skepticism is appropriate.

8. If the guidance in the proposed SAS is implemented, would the application of professional skepticism be enhanced and more clearly understood in evaluating whether sufficient appropriate audit evidence has been obtained? If not, please explain why.

We believe that the application of professional skepticism may be enhanced and more clearly understood in evaluating whether sufficient appropriate audit evidence has been obtained if the guidance in the proposed SAS is implemented. However, we believe that the proposed SAS can address only one of the three issues identified with respect to professional skepticism discussed in the Explanatory Memorandum ("the concept of professional skepticism ... may need to be more clearly articulated in our standards."). Proper application of professional skepticism when evaluating whether sufficient appropriate audit evidence has been obtained depends on whether firms and audit organizations provide appropriate training and guidance to their auditors.

9. Are the changes to the definitions in extant AU-C section 500 appropriate? If not, please explain why.

We do not believe that the changes to the definition of sufficiency in the extant AU-C section 500 are appropriate. The proposed definition would, in our view, unnecessarily diverge from the definition used by other standard setting bodies, including the IAASB and the PCAOB. In addition, we believe that the extant application guidance, such as extant paragraph A4, addresses the ASB's concern that, with the emergence of automated tools and technologies, an emphasis on quantity may not be determinative of sufficiency. (Extant paragraph A4 states, in part, "The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and **also by the quality of such audit evidence (the higher the quality, the less may be required)**." (Emphasis added.)) For these reasons, we do not believe that the changes to the definition are appropriate. If the ASB wishes to connect the idea of persuasiveness to sufficiency, it could add such a discussion to the application guidance.

We believe that other changes to the definitions in extant AU-C section 500 are generally appropriate, including the removal of separate definitions for accounting records and management's specialist. However, we have two suggestions concerning the definition of external information source. The second sentence of that definition is repeated verbatim in appendix A, paragraph 4. We believe that this sentence is more appropriate in the application material and should therefore be removed from the definition in paragraph 8. In that same sentence, there are footnote citations to other AU-C sections for "service organization" and "auditor's specialist" but not for "management's specialist." We suggest that the ASB add a similar footnote reference for "management's specialist" for consistency, especially if it decides to discuss this topic in a separate AU-C section.

10. Are there any other definitions that should be included in the proposed SAS? If so, describe them.

We have not identified other definitions that should be included in the proposed SAS.

11. Please provide your views on whether (a) the guidance added to the application material of the proposed SAS to explain the implications and role of automated tools and techniques in the current audit environment is beneficial and (b) the proposed SAS is enhanced by using illustrations of automated tools and techniques; that is, whether the proposed SAS is more relevant to audits conducted in today's environment.

Overall, we believe that the guidance added to the application material of the proposed SAS to explain the implications and role of automated tools and techniques is beneficial and that the proposed SAS is enhanced by using illustrations of automated tools and techniques. However, we also believe that the ASB should ensure that the guidance in the application material does not create the impression that automated tools and techniques are required in order for an audit to be conducted in accordance with the auditing standards. For example, four of the eight introductory application paragraphs for the section titled Audit Procedures for Obtaining Audit Evidence (Ref: Par. 13) are specifically about or mention automated tools and techniques. The proposed SAS should balance the need to communicate that emerging audit technologies are acceptable with the realization that many users of the standards, especially smaller audit organizations that audit small, simple entities, may not have the resources or may not need to adopt many of these emerging technologies.

In addition, we note that paragraph A51 implies that only by using automated tools and techniques can an auditor achieve the objective of more than one type of audit procedure simultaneously. While automated tools and techniques may simplify this process, auditors have traditionally blended manual audit procedures to simultaneously gather information relevant to multiple assertions. We encourage the ASB to review the guidance in the application material as a whole to ensure that the focus has not shifted too heavily to automated tools and techniques.

Finally, the standard does not address the audit considerations in using evidence generated by automated tools and techniques, such as audit data analytics. As noted by the explanatory memorandum, one of the key messages to the IAASB's Data Analytics Working Group was "Applying Professional Skepticism when using data analytics is important." There is a need to (1) consider controls over the design and application of such techniques to reasonably assure that the tools operated as intended, and (2) apply significant professional judgment in analyzing the information produced by such tools and determining the extent of evidence provided. We believe that these considerations could be added to paragraph A52 of the application guidance.

12. Do you agree that AU-C section 330 combined with the attributes and factors in the proposed SAS would assist the auditor in concluding whether an oral confirmation should be supplemented by a written confirmation of the information?

We believe that AU-C section 330 combined with the attributes and factors in the proposed SAS would assist the auditor in concluding whether a written confirmation of information should supplement an oral confirmation.

Related to this topic, we noted that for the conforming amendments to AU-C section 505.13 and corresponding application guidance in AU-C section 505.A27, "Written" has been struck from the headings. However, both the requirement and the application guidance discuss the scenario

when affirmative written responses are required, and the proposed conforming amendment for AU-C section 505.A27 specifically adds “written” to that paragraph. As such, we believe that “Written” should be retained in these headings.

13. Is relocation of the content dealing with management’s specialist from AU-C section 500 to AU-C section 501 or to a separate new standard appropriate? If not, please explain why.

We do not have a specific preference for the location of the content dealing with management’s specialist. We note that there is justification for leaving the requirements and application material in AU-C section 500. For example, *Appendix A—Considerations Regarding the Use of External Information Sources* contains application material that affects the auditor’s use of information from a management’s specialist. However, there are also reasons to move this content to AU-C section 501 or a separate new standard. Should the ASB determine to relocate these requirements and application material to another AU-C section, whether AU-C section 501 or a separate new standard, we encourage the ASB to add appropriate cross-references to AU-C section 500 in paragraph 8 (definition of “External information source”), appendix A, paragraph 4, and other locations as determined necessary.

14. If you agree that relocation is appropriate, what are your views about whether the management’s specialist content should be addressed in AU-C section 501 or in a separate new standard?

We do not have a specific preference for the location of the content dealing with management’s specialist.

15. Do you believe that the application of this proposed SAS would result in audit documentation requirements beyond those in AU-C section 230 and other AU-C sections? If so, describe how the proposed SAS is perceived to expand the audit documentation requirements existing in AU-C section 230 and other AU-C sections.

We do not believe that the application of this proposed SAS would result in additional audit documentation requirements beyond those in AU-C section 230 and other AU-C sections.

Additional Comments and Suggested Edits

- I. Per paragraph 6 of the proposed SAS, the effective date is for audits of financial statements for periods *beginning* on or after June 15, 2021 (emphasis added). Most but not all SAS effective dates are for audits of financial statements for periods *ending* on or after a certain date (including recent SAS Nos. 134, 136, and 137). To minimize potential confusion regarding effective dates of all SAS, we encourage the ASB to adopt a consistent methodology for selecting SAS effective dates.
- II. The definitions in paragraph 8 are not presented in alphabetical order as they are in all other AU-C sections. We suggest placing them in alphabetical order here for consistency.
- III. For paragraph 10a, we suggest modifying the wording as follows:

- ~~obtaining audit evidence about~~ evaluating the accuracy and completeness of the information

IV. For paragraph 13, we suggest modifying the wording as follows:

13. When designing and performing audit procedures, the auditor should consider whether ~~the results of such audit procedures~~ the auditor can reasonably expected to obtain sufficient and appropriate ~~provide a basis for concluding on the sufficiency and appropriateness of audit evidence~~ to draw reasonable conclusions on which to base the auditor's opinion.

V. For paragraph 14, we suggest rewording the paragraph to clarify what is meant by "matter". Potential wording for this paragraph would be:

14. If either of the following two matters exist, ~~t~~The auditor should determine what modifications or additions to audit procedures are necessary to resolve the matter(s) and should consider the effect of the matter(s), if any, on other aspects of the audit: if

- a. audit evidence obtained from one source is inconsistent with that obtained from another or
- b. the auditor has doubts about the reliability of information to be used as audit evidence. (Ref: par. A73–A74)

VI. We believe that the concept of persuasive could be discussed in the application guidance without modifying the definition of sufficiency, as has been proposed for paragraph A10. However, the ASB should consider modifying the application guidance to change the concept of persuasive to the auditor to persuasive to a knowledgeable person. For reference, in the 2018 revision of *Government Auditing Standards*, paragraph 8.92 reads "In determining the sufficiency of evidence, auditors should determine whether enough appropriate evidence exists to address the audit objectives and support the findings and conclusions to the extent that would persuade a knowledgeable person that the findings are reasonable." Similar to this approach, potential wording for paragraph A10 would be as follows:

A10. Audit evidence is sufficient when a knowledgeable person would be persuaded to reach conclusions consistent with the auditor's based on the audit evidence. The more significant the conclusion being reached, the more persuasive the audit evidence required to support the conclusion may need to be.

If the ASB concurs with these changes, similar edits would need to be made to the proposed conforming amendments for AU-C section 200.A33.

VII. For paragraph A14, consider modifying the second bullet point as follows:

- Information related to employee salaries may provide relevant audit evidence regarding an accounting estimate for a bonus accrual.

VIII. In paragraph A33, the proposed standard discusses biases that may affect the auditor's consideration of information to be used as audit evidence. We believe that the standard should discuss what the auditor should or may do to assess and respond to auditor biases as it does for management's biases in paragraphs A30-A32.

IX. For paragraph A57, consider modifying the paragraph as follows:

A57. Inspection involves a physical examination of an asset or an examination of records or documents, whether internal or external or in paper form, electronic form, or other media. An example of inspection used as a test of controls is inspection of records, using manual or automated techniques, ~~of records~~ for evidence of authorization.