



Agenda Item 3

Audit Evidence

Objective of Agenda Item

To solicit feedback and input on the proposed revised AU-C section 500, *Audit Evidence* (AU-C section 500).

Task Force

Because of the mutual interest of the AICPA's Auditing Standards Board (ASB) and Assurance Services Executive Committee (ASEC), the Task Force members are comprised of members from both committees and includes representation from the AICPA's Technical Issues Committee (TIC). In addition, the International Auditing and Assurance Standards Board (IAASB) has a keen interest in this project, and consequently, IAASB representatives participate as observers on the Task Force. CPA Canada also is represented in the Task Force. Task Force members are:

- Robert Dohrer, Chief Auditor, AICPA, Chair
- Jay Brodish, PwC
- Jim Burton, GT
- David Finkelstein, SingerLewak (TIC)
- Audrey Gramling, Oklahoma State
- Jen Haskell, Deloitte
- Kristen Kociolek, GAO
- Susan Jones, KPMG
- Eric Turner, CPA Canada
- Alan Young, EY

Background

The overall objective of the project initially is to assess whether revisions of AU-C section 500 are appropriate to address the evolving nature of business and issues that have arisen regarding the standard setting activities by the ASB and the IAASB. These issues include use of Emerging Technologies by both preparers and auditors, Audit Data Analytics (ADA), the application of Professional Skepticism, the expanding use of external information sources as audit evidence, and more broadly the accuracy, completeness, and reliability of audit evidence. Appendix 1 to this Issues Paper contains a more detailed explanation of these issues that have been presented to the

ASB in prior meetings. The revisions in the proposed AU-C section 500 are intended to address these matters.

Prior discussions between the Task Force and the ASB are summarized as follows:

- January 2018—at the joint meeting between ASB and ASEC, the chair of the Task Force provided a high-level overview of the background of the project and a high-level discussion of possible issues identified by the Task Force.
- May 2018—
 - The Task Force provided an overview of the preliminary issues identified by Task Force. These preliminary issues were: 1) definitions, 2) audit procedures, 3) key concepts, and 4) changing the focus of the standard.
 - Task Force explained that it has been exploring possibly developing additional application material that would assist the auditor in assessing whether sufficient appropriate audit evidence has been obtained. The intent of such additional application material or framework would be to change the focus of AU-C 500 from focusing on the performance of audit procedures to obtain audit evidence to a focus in which the auditor’s main objective would be to evaluate whether sufficient, appropriate, and high-quality audit evidence has been obtained. The ASB expressed support for such a framework and agreed that it would be helpful to provide application material. But, it noted that a procedures-based approach and a criteria framework approach are not mutually exclusive, that is, the framework being suggested by the Task Force should complement the procedures-based approach in extant AU-C 500, rather than replace it.

Issues for the ASB’s Consideration

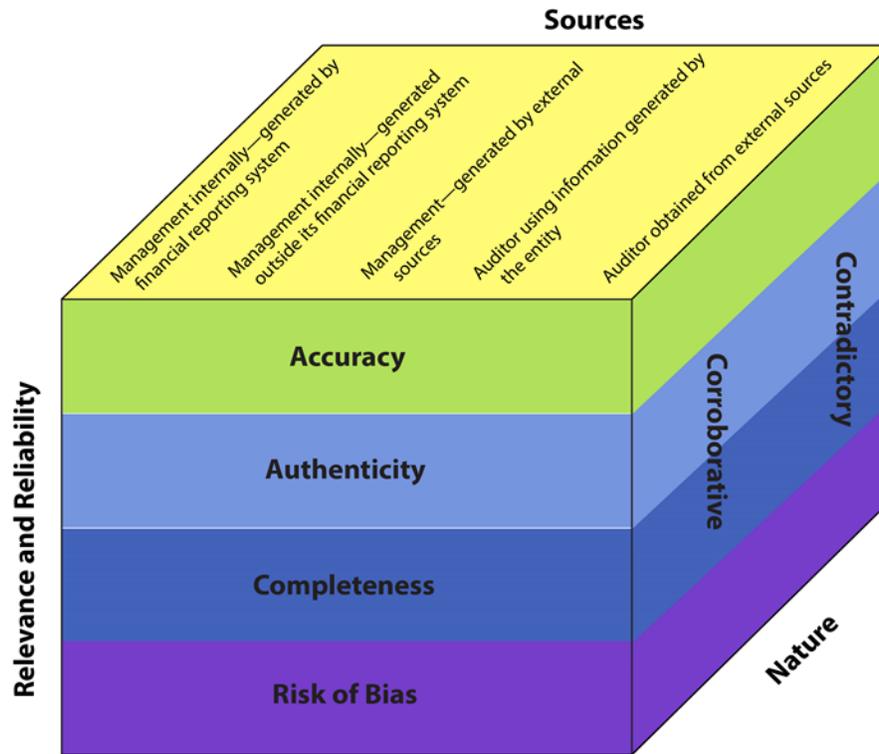
Expanded Guidance to Evaluate Sufficient Appropriate Audit Evidence

As stated above, the focus of the extant guidance is premised on the design and performance of audit procedures to assess the sufficiency and appropriateness of audit evidence. The Task Force believes that this standard should be more about the evaluation of the audit evidence by providing a framework and application material about how to make that evaluation using qualitative attributes underlying audit evidence. The Task Force proposes changing the focus of the evaluation of whether sufficient appropriate audit evidence has been obtained from being based on the audit procedures used to obtain the audit evidence to being based on an assessment of the attributes underlying higher quality audit evidence.

The evaluation of audit evidence has many dimensions and requires the auditor to evaluate the audit evidence obtained from multiple angles. These dimensions include the reliability, sources, and the nature of audit evidence.

In response, the Task Force is suggesting a framework that would assist the auditor in bringing all the attributes together, regardless of the procedures used to obtain audit evidence that might help the auditor evaluate the different attributes and sources in making a conclusion about whether

sufficient appropriate audit evidence has been obtained. The framework is depicted by the following illustration:



It is the perspective of the Task Force that it is the evaluation of relevant information that leads to drawing conclusions about whether sufficient appropriate audit evidence has been obtained. This evaluation is in turn affected by the reliability, sources and nature of the information used as audit evidence.

Relevance

Paragraph 7 of the proposed AU-C 500 states: “The auditor should consider the relevance of the information to be used as audit evidence.” In extant AU-C 500, the consideration of the relevance of the audit evidence is done in tandem with the reliability of the audit evidence. The Task Force suggests separating the two concepts and positioning relevance as the first requirement within the proposed framework as depicted above. This is because, in the Task Force’s views, that the information that the auditor obtains would only be evaluated under the criteria set out in the proposed framework when that information is relevant for the auditor’s purposes. In other words, if the information is irrelevant, the auditor would do no further evaluation of that information.

The articulation of the possible framework has been addressed in the proposed standard by including additional requirements (paragraphs 7-14) that would require the auditor to consider the sources, nature, and relevance and reliability in evaluating whether sufficient appropriate audit evidence has been obtained. The related application material has been reconfigured accordingly and additional application material has been included, as needed.

Questions for Consideration

1. Does the ASB agree with the manner in which the Task Force has treated the interconnected terms, ‘information’ and ‘audit evidence?’
2. What are the ASB’s views on the issue of relevance? Is relevance a precondition for the auditor to apply the evaluation criteria of the framework? Or is it an attribute of audit evidence that should be considered as part of the criteria of the framework?
3. What are the ASB’s views about the new requirements (paragraphs 7-14) and application material (paragraphs A17-A83) in order to implement the additional guidance that would assist the auditor in evaluating whether sufficient appropriate audit evidence has been obtained.? Has the Task Force identified all relevant criteria that would be part of the Framework?

Management’s Specialists

The subject of management’s specialists is addressed in extant AU-C 500, and it is part of the information to be used as audit evidence (paragraph 8 and related application material). As noted above, the Task Force suggests including additional requirements and application material or Framework to assist the auditor in evaluating whether sufficient appropriate audit evidence has been obtained. This Framework includes the sources of audit evidence as one of the attributes that the auditor would be required to consider. In looking how the subject of management’s specialists would be included in the Framework, the Task Force concluded that the extant material does not fit within the additional application material because the topic is not consistent with how other sources of audit evidence would be viewed. Also, the content dealing with management’s specialists in extant AU-C 500 seems excessive to the point that it overwhelms the extant standard.

The Task Force recommends relocating the content dealing with management’s specialists from AU-C 500 to AU-C 620, *Using the Work of an Auditor’s Specialist*. Relocating this content would have the advantage of having both the auditor’s specialists and management’s specialists subjects in one location because both subjects have similar characteristics that an auditor would have to consider in evaluating the work of the specialists. Finally, this integrated approach would be similar to the approach taken by the PCAOB when it released its proposed amendments to the *Auditor’s Use of the Work of Specialists*. It should be noted that because the topics of Auditing Accounting Estimates and the Auditor’s Use of the Work of Specialists are closely interrelated, this would be a good opportunity for the ASB to explore this issue as the ASB plans to revise AU-C 540 following the finalization of ISA 540 (revised) and the release of the PCAOB’s proposed revisions.

Another option to be considered would be to include the extant material regarding Management Specialists in a separate AU-C section of its own following AU-C 620.

Questions for Consideration

4. What are the ASB's views about how the content dealing with management's specialists fit within the proposed Framework? Does the ASB agree with relocating the content to AU-C 620 or even a separate standard?

Definitions

Sufficiency and Appropriateness

Because of the interaction with the quality of audit evidence, auditors today do not necessarily focus entirely on sufficiency of audit evidence in terms of quantity (i.e., "sufficiency"). Due to the evolving nature of audit evidence, auditors can obtain high quality audit evidence more efficiently, and thus auditors might not have to focus as much on how much audit evidence is obtained. Therefore, the Task Force suggests deleting the extant definitions of sufficiency and appropriateness. The Task Force believes that the key factor is appropriateness. Then the auditor has to consider if he or she has obtained enough (sufficient) appropriate evidence to be persuasive. If the evidence is not appropriate, it can never be sufficient or persuasive. Therefore, rather than use the terms "sufficient" and "appropriate" as adjectives of audit evidence, the Task Force suggests retaining the terms as a collective noun in describing audit evidence, that is, sufficient appropriate audit evidence. The concepts underlying "sufficiency" and "appropriateness" are fully discussed in the application material of the proposed revised AU-C 500.

External Information Sources

The proposed AU-C 500 includes the IAASB's conforming amendments to ISA 500 that were finalized in connection with ISA 540 (revised). The conforming amendments to ISA 500 include a new definition of *External Information Sources*, related application material to the definition, and other application material that further explains the concept of External Information Sources. In drafting the proposed AU-C 500, the Task Force included these conforming amendments in the proposed standard (highlighted as grey in the proposed standard).

Upon closer examination of the conforming amendments, the Task Force expressed concern about including them within the proposed AU-C 500. A concern is that based on the Task Force's proposal to include a Framework to evaluate whether audit evidence has been obtained, all information and audit evidence will need to be evaluated using the same attributes of audit evidence regardless of its source. Also, the IAASB's conforming amendments to ISA 500 were written in the context of auditing accounting estimates and not necessarily to address the broader issue of audit evidence. Finally, the Task Force expressed concern about some of the terminology in the new definition, for example, the phrase "suitable for use by a broad range of users." This terminology seems to be overly prescriptive because what about situations in which the auditor obtains audit evidence from external information sources, does such audit evidence has to be 'suitable for use by broad range of users? Additionally, if all of the application material, etc. associated with External Information Sources were included in a revised AU-C 500, the quantity of such material would overwhelm the other material in the standard.

As a result of these concerns, the Task Force believes that this content should not be incorporated within the proposed AU-C 500 and should be further considered when the ASB's AU-C 540

project is undertaken. The Task Force does not believe that such relocation would be ISA-minus because it is matter of geography within the standards.

Other Definitions

The extant AU-C 500 includes a definition of *accounting records*. This definition was developed at a time when paper format was the predominant medium. Since then, electronic information generated using various technologies have increased and become the most common format of documentation. As a result, the Task Force is proposing edits to the definition of *accounting records* in order to modernize it and to recognize, among other things, electronic data, shared information, and emerging technologies, e.g. blockchain.

Overall, the definition of *audit evidence* seems appropriate. However, the definition contains a reference to *other information*. The definition states, in part: Audit evidence includes both information contained in the accounting records underlying the financial statements and *other information*. The Task Force believes that the reference to other information in this definition is not clear because 1) as characterized, it suggests that such other information is not as important as the audit evidence contained in the accounting records underlying the financial statements and 2) other information is a defined term elsewhere in the auditing literature. The Task Force suggests revising the definition to replace the term “other information” and relocating the examples in the definition to the application material.

Audit Data Analytics is not currently defined in AU-C section 500 nor is the term referred to elsewhere in GAAS. Because Audit Data Analytics encompass relatively new tools and techniques, practitioners’ knowledge about Audit Data Analytics vary, and an issue that has been preliminarily discussed is whether it might be helpful to include a definition in AU-C section 500. A 2014 AICPA white paper, “Reimagining Auditing in a Wired World,” includes the following definition of Audit Data Analytics:

"the science and art of discovering and analyzing patterns, identifying anomalies, and extracting other useful information in data underlying or related to the subject matter of an audit through analysis, modeling, and visualization for the purpose of planning or performing the audit." ¹

That definition was subsequently included in the AICPA Audit Guides, *Audit Data Analytics*, and *Analytical Procedures*. The Task Force suggests adding this definition (modified slightly) in the proposed AU-C section 500 as an application material.

Questions for Consideration

5. What are the ASB’s views about the following recommendations made by the Task Force regarding:
 - a. Deletion of the definitions of the terms “sufficiency” and “appropriateness,”

¹ Paragraph 1.10 of *Guide to Audit Data Analytics*

- b. The omission of the definition of External Information Sources and related application material in AU-C 500, and
- c. The revisions to the other definitions.

Audit Procedures

Classification of Audit Procedures

Paragraph 6 of extant AU-C section 500 and the related application material requires the auditor *design and perform audit procedures* that are appropriate in the circumstances for obtaining sufficient appropriate audit evidence. Paragraph A10 in the application material explains that the audit procedures comprise 1) risk assessment procedures and 2) further audit procedures (test of controls and substantive procedures).

The Task Force expressed the view that the assignment of procedures into discrete classifications may no longer seem to be a good working model. Also, the classifications suggest a sequential order which may no longer be valid. Most importantly, however, is concern that the “sufficiency and appropriateness” of audit evidence is considered in the context of the nature of the procedures performed to obtain the evidence. As noted above, the Task Force is recommending a more useful framework in which to consider whether sufficient appropriate audit evidence has been obtained in today’s environment where the distinct classification of audit procedures as described in AU-C section 500.A10 are overly prescriptive because of the use of emerging technologies, tools and techniques by the auditor in obtaining audit evidence.

The Task Force’s views are also based on the evolving use of ADA and other tools and techniques whereby the auditor can examine vast amounts of data, sometimes 100 percent of the population obtained from multiple sources. As a result, with the use of ADA, the Task Force raised the issue of whether the classification of audit procedures is overly prescriptive. For example, in situations where the auditor examines 100 percent of the population, the discrete classifications in extant AU-C section 500 might no longer be needed. When examining 100 percent of the population, is distinguishing between risk assessment procedures and further audit procedures necessary? This also raises the question of what are substantive audit procedures in today’s audit environment?

Automated Tools and Techniques

The auditor performs audit procedures when evaluating information, and in doing so obtains audit evidence. Those audit procedures may be carried out by the use of automated tools and techniques to accomplish the auditor’s objectives. The Task Force is of the view that it is more appropriate to use the broad term *automated tools and techniques* as this likely better describes and encompasses all emerging technologies, including audit data analytics, artificial intelligence, etc. This is consistent with the approach taken by the IAASB in proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement*. To explain this, the Task Force suggests adding the following paragraph to the application materials;

A25. An example of automated tools and techniques are audit data analytics which are described as the analysis of patterns, identification of anomalies, or extraction of other useful information in data underlying or related to the subject matter of an audit through analysis, modeling, or visualization for performing the audit.

As explained above, extant AU-C 500 contains discrete classifications of audit procedures. With the evolving use of ADA, the Task Force has discussed the issue of whether the classification ADA as an audit procedure. The Task Force does not believe that ADA is an audit procedure, but rather it is a technique that an auditor may perform in meeting the objective of an audit procedure and sometimes can be used by an auditor to meet multiple objectives. The Task Force suggests adding application material to make this point clear in the proposed AU-C 500 as follows:

A25. The categories of audit procedures described in paragraph A15 represent the nature of audit procedures that an auditor performs in an audit. A technique such as the performance of audit data analytics, may achieve the objective of more than one type of audit procedure (for example, as both a risk assessment and further audit procedure) and may accomplish the objectives of both types of procedures simultaneously.

Questions for Consideration

6. Does the ASB agree with the use of the broad phrase automated tools and techniques, and the inclusion of audit data analytics as an example? Does the ASB agree that ADA is an audit technique that can be used by the auditor in meeting the objective of an audit procedure and sometimes can meet multiple objectives?

Disposition of Interpretations

Attached to extant AU-C 500 is AU-C 9500 which the following three Interpretations (see Appendix 2 to this Issues Paper for the full text of the Interpretations):

1. The Effect of an Inability to Obtain Audit Evidence Relating to Income Tax Accruals,
2. Auditor of Participating Employer in a Governmental Cost-Sharing Multiple-Employer Pension Plan, and
3. Auditor of Participating Employer in a Governmental Agent Multiple-Employer Pension Plan.

Because these Interpretations address very narrow technical issues that the ASB dealt with over years, the Task Force proposes to retain these Interpretations. Interpretations 2 and 3 would be retained as part of AU-C 500. But, the Task Force believes that Interpretation would be attached to AU-C 705 which deals with modifications to the auditor's report.

Questions for Consideration

7. Does the ASB agree with the Task Force recommendation to retain AU-C 9500?

Items Presented

Agenda Item 3 – Issues Paper

Agenda Item 3A – AU-C 500 Table_Proposed Standard – Clean

Agenda Item 3B – AU-C 500 Table_Proposed Standard – Marked from Extant

Mr. Dohrer will refer to the Issues Paper and Agenda Item 3A in leading the discussion.

Appendix 1

Emerging Techniques and Technologies

Emerging audit techniques, such as ADA, and emerging technologies such as, Artificial Intelligence (AI) and Blockchain, offer both challenges and opportunities that will affect audits of financial and nonfinancial information into the foreseeable future. For the purposes of this paper, the phrase “emerging techniques and technologies” will be used to refer to both emerging audit techniques and emerging technologies. Much activity has been ongoing in the US and internationally regarding how the profession should respond to such emerging techniques and technologies, including consideration of whether changes need to be made to the professional standards. In 2015, the IAASB organized a Data Analytics Working Group (DAWG), chaired by this Task Force’s chair, to inform the IAASB about how and when to respond to developments in technology in the most effective way. Since then, the DAWG has undertaken a comprehensive outreach campaign with various stakeholders that include accounting firms, national standard setters, audit regulators, investors and preparers, among others. In addition, the topic has been presented and discussed with the IAASB at various meetings. These outreach activities and IAASB discussions led to the release in September 2016 of Request for Input, *Exploring the Growing Use of Technology in the Audit, With a Focus on Data Analytics*. The Request for Input sought feedback from stakeholders about various aspects of the use of emerging techniques and technologies. In response to the Request for Input, the DAWG received over 55 comment letters. In January 2018, the DAWG published a Feedback Statement which summarizes the input received from Responders. The key messages were as follows:

- Responders expressed support for the direction of the project.
- The ISAs aren’t “broken” and should remain principles-based but need to reflect the digital era in application guidance. Responders overwhelmingly described a strong desire for practical guidance on the use of data analytics technology. Most responders believe that the principles in the extant ISAs are still appropriate and accommodate the use of data analytics and cautioned against prematurely rushing to change requirements in the standards.
- In connection with standard-setting activity, the IAASB should first consider a project to amend ISA 500, *Audit Evidence*.
- Applying Professional Skepticism when using data analytics is important.

The DAWG continues to advance the project by contributing proposed material to IAASB task forces working on IAASB projects involving risk assessment and quality control, continuing its outreach activities, and providing periodic updates at the IAASB meetings. However, the IAASB has not moved to a formal standard setting phase because the IAASB is devoting its resources to other standard setting priorities.

In the US, the AICPA has undertaken many activities and projects related to the use of ADA and emerging techniques and technologies. In late 2017, in response to work performed by a working

group comprised of members from the ASB and the ASEC, the AICPA released a nonauthoritative guide, *Guide to Audit Data Analytics* (ADA Guide), which discusses the use of ADA in audit engagements.

In March 2018, the AICPA coordinated with CPA Canada to co-publish a [white paper on the implications of Blockchain to the audit and assurance profession](#).

Professional Skepticism

In recent years, the IAASB has had a working group considering the topic of Professional Skepticism. The projects on Quality Control and Group Audits, and Professional Skepticism represented the three areas for which the IAASB sought input from responders in its Invitation to Comment (ITC), *Enhancing Audit Quality in the Public Interest*, issued in January 2016.

As explained in the ITC, the ISAs explicitly recognize the fundamental importance of Professional Skepticism.² Professional Skepticism includes being alert to, for example, audit evidence that contradicts other audit evidence obtained, or information that brings into question the reliability of documents or responses to inquiries to be used as audit evidence. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence.

The key issues identified with respect to Professional Skepticism are as follows:

- Questions have been raised about how auditors can more clearly demonstrate the application of Professional Skepticism, how to better describe the basis for the auditor's professional judgments and how the auditor's mindset has affected the nature, timing and extent of audit procedures performed as well as the critical evaluation of audit evidence.
- Concern about instances in which auditors did not appropriately apply Professional Skepticism in their audits is a recurring theme in audit inspection findings globally and has been a key issue in discussions about audit quality. Regulatory bodies have suggested that enhanced Professional Skepticism by auditors will contribute significantly to improving the quality of audits and that firms should prioritize efforts in this area.
- The existence of many ways to describe the application of Professional Skepticism indicates that the concept of Professional Skepticism, and the expectations of how auditors should appropriately apply it, may need to be more clearly articulated in our standards.

Given this background and the issues related to Professional Skepticism identified above, the Task Force has preliminarily taken an approach to 1) accept the definition of Professional Skepticism as set out in AU-C 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, 2) address these issues by proposing

² ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Standards on Auditing*, defines Professional Skepticism as An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of audit evidence.

to interweave the concepts surrounding Professional Skepticism throughout AU-C section 500 and 3) attempting to explain auditor performance that would demonstrate the application of Professional Skepticism when obtaining and assessing the sufficiency and appropriateness of audit evidence. Simply having a separate section of a standard labeled “Professional Skepticism” or simply sprinkling the words “Professional Skepticism” throughout the standard is not sufficient to achieve the objectives outlined above.

AU-C Section 9500

Audit Evidence: Auditing Interpretations of [Section 500](#)

1. The Effect of an Inability to Obtain Audit Evidence Relating to Income Tax Accruals

- .01 Question**—The IRS’s audit manual instructs its examiners on how to secure from corporate officials "tax accrual workpapers" or the "tax liability contingency analysis," including "a memorandum discussing items reflected in the financial statements as income or expense where the ultimate tax treatment is unclear." The audit manual states that the examiner may question or summons a corporate officer or manager concerning the "knowledge of the items that make up the corporation’s contingent reserve accounts." It also states that "in unusual circumstances, access may be had to the audit or tax workpapers" of an independent accountant or an accounting firm after attempting to obtain the information from the taxpayer. IRS policy also includes specific procedures to be followed in circumstances involving "listed transactions," to help address what the IRS considers to be abusive tax avoidance transactions (Internal Revenue Manual, section 4024.2-.5, 5/14/81, and Internal Revenue Service Announcement 2002-63, 6/17/02).
- .02** Concern over IRS access to tax accrual working papers might cause some entities to not prepare or maintain appropriate documentation of the calculation or contents of the accrual for income taxes included in the financial statements or to deny the independent auditor access to such information.
- .03** What effect does this situation have on the auditor’s opinion on the financial statements?
- .04 Interpretation**—The entity is responsible for its tax accrual, the underlying support for the accrual, and the related disclosures. Limitations on the auditor’s access to information considered necessary to audit the tax accrual will affect the auditor’s ability to issue an unmodified opinion on the financial statements.
- .05** The auditor is required to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.^{fn 1}
- .06** If the entity does not have appropriate documentation of the calculation or contents of the accrual for income taxes and denies the auditor access to entity personnel responsible for making the judgments and estimates relating to the accrual, the auditor is required to conclude whether sufficient appropriate audit evidence has been obtained. If the auditor

^{fn 1} [Paragraph .06](#) of section 500, *Audit Evidence*.

has not obtained sufficient appropriate audit evidence about a relevant assertion, the auditor is required to attempt to obtain further audit evidence.^{fn 2}

- .07** If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor is required to express a qualified opinion or disclaim an opinion on the financial statements.^{fn 3}
- .08** If the entity has appropriate documentation but denies the auditor access to it and to entity personnel who possess the information, the auditor is required to perform procedures to evaluate the consequence of an inability to obtain sufficient appropriate audit evidence due to a management-imposed limitation.^{fn 4}
- .09** The auditor is required to request management to provide a written representation that it has provided the auditor with all relevant information and access, as agreed upon in the terms of the audit engagement.^{fn 5} If management does not provide the written representations required by [section 580](#), *Written Representations*, the auditor is required to disclaim an opinion on the financial statements in accordance section 705, *Modifications to the Opinion in the Independent Auditor's Report*, or withdraw from the engagement.^{fn 6}
- .10** *Question*—An entity may allow the auditor to inspect its tax accrual workpapers but request that copies not be retained for audit documentation, particularly copies of the tax liability contingency analysis. The entity also may suggest that the auditor not prepare and maintain similar documentation of his or her own. What are the auditor's requirements in deciding a response to such a request?
- .11** *Interpretation*—Section 230, *Audit Documentation*, defines *audit documentation* as the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.^{fn 7} The auditor is required to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand
- a. the nature, timing, and extent of the audit procedures performed to comply with generally accepted auditing standards and applicable legal and regulatory requirements;

^{fn 2} Paragraphs .28–.29 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

^{fn 3} Paragraphs .08 and .10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

^{fn 4} Paragraphs .11–.14 of section 705.

^{fn 5} [Paragraph .11a](#) of section 580, *Written Representations*.

^{fn 6} [Paragraph .25](#) of section 580.

^{fn 7} Paragraph .06 of section 230, *Audit Documentation*.

- b. the results of the audit procedures performed and the audit evidence obtained; and
- c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant judgments made in reaching those conclusions.^{fn 8}

[Section 500](#), *Audit Evidence*, states that other information includes information obtained by the auditor from inquiry, observation, inspection, and physical examination. The quantity, type, and content of audit documentation are matters of the auditor's judgment.

- .12** The audit documentation of the results of auditing procedures directed at the tax accounts and related disclosures also includes sufficient appropriate audit evidence about the significant elements of the entity's tax liability contingency analysis. This audit documentation includes copies of the entity's documents, schedules, or analyses (or auditor-prepared summaries thereof) to enable the auditor to support his or her conclusions regarding the appropriateness of the entity's accounting and disclosure of significant tax-related contingency matters. The audit documentation reflects the procedures performed and conclusions reached by the auditor and, for significant matters, include the entity's documentary support for its financial statement amounts and disclosures.
- .13** The audit documentation includes the significant elements of the entity's analysis of tax contingencies or reserves, including roll-forward of material changes to such reserves. In addition, the audit documentation provides the entity's position and support for income tax related disclosures, such as its effective tax rate reconciliation, and support for its intraperiod allocation of income tax expense or benefit to continuing operations and to items other than continuing operations. When applicable, the audit documentation also includes the entity's basis for assessing deferred tax assets and related valuation allowances and its support for applying the "indefinite reversal criteria" discussed in FASB ASC 740-30-25-17, including its specific plans for reinvestment of undistributed foreign earnings.
- .14** *Question*—In some situations, an entity may furnish its external legal counsel or in-house legal or tax counsel with information concerning the tax contingencies covered by the accrual for income taxes included in the financial statements and ask counsel to provide the auditor an opinion on the adequacy of the accrual for those contingencies.
- .15** In such circumstances, rather than inspecting and obtaining documentary evidence of the entity's tax liability contingency analysis and making inquiries of the entity, may the auditor consider the counsel as a management's specialist within the meaning of [section 500](#) and rely solely on counsel's opinion as an appropriate procedure for obtaining audit evidence to support his or her opinion on the financial statements?
- .16** *Interpretation*—No. The opinion of legal counsel in this situation does not provide sufficient appropriate audit evidence to afford a reasonable basis for an opinion on the financial statements. The opinion of legal counsel on specific tax issues that he or she is asked to

^{fn 8} Paragraph .08 of section 230.

address and to which he or she has devoted substantive attention, as contemplated by the legal counsel's response to an auditor's letter of inquiry, can be useful to the auditor in forming his or her own opinion.

- .17** An opinion from an entity's legal or tax counsel, similar to other work products obtained from a management's specialist, is useful in situations in which the auditor does not have adequate technical training and proficiency. In this case, however, the auditor's education, training, and experience, on the other hand, do enable him or her to be knowledgeable concerning income tax matters and competent to assess their presentation in the financial statements.
- .18** Therefore, while the opinion of legal counsel on specific tax issues can be useful to the auditor in forming his or her own opinion, the audit of income tax accounts requires a combination of tax expertise and knowledge about the entity's business that is accumulated during all aspects of an audit. Therefore, as previously stated, it is not appropriate for the auditor to rely solely on such legal opinion.
- .19** *Question*—A entity may have obtained the advice or opinion of an outside tax adviser related to the tax accrual or matters affecting it, including tax contingencies, and further may attempt to limit the auditor's access to such advice or opinion, or limit the auditor's documentation of such advice or opinion. This limitation on the auditor's access may be proposed on the basis that such information is privileged. Can the auditor rely solely on the conclusions of third-party tax advisers? What audit evidence should the auditor obtain and include in the audit documentation?
- .20** *Interpretation*—As discussed in [paragraphs .16–.18](#) of this interpretation, the auditor cannot accept an entity's or a third party's analysis or opinion with respect to tax matters without careful consideration and application of the auditor's tax expertise and knowledge about the entity's business. As a result of applying such knowledge to the facts, the auditor may encounter situations in which the auditor either disagrees with the position taken by the entity, or its advisers, or does not have sufficient appropriate audit evidence to support his or her opinion.
- .21** If the entity's support for the tax accrual or matters affecting it, including tax contingencies, is based upon an opinion issued by an outside adviser with respect to a potentially material matter, the auditor is required to obtain access to the opinion,^{fn 9} notwithstanding potential concerns regarding attorney-client or other forms of privilege. The audit documentation includes either the actual advice or opinions rendered by an outside adviser or other sufficient documentation or abstracts supporting both the transactions or facts addressed as well as the analysis and conclusions reached by the entity and adviser. Alternatives such as redacted or modified opinions may be considered but must, nonetheless, include sufficient content to articulate and document the entity's position so that the auditor can

^{fn 9} [Paragraph .11](#) of this interpretation.

formulate his or her conclusion. Similarly, it may be possible to accept an entity's analysis summarizing an outside adviser's opinion, but the entity's analysis must provide sufficient appropriate audit evidence for the auditor to formulate his or her conclusion. In addition, written representations may be obtained stating that the entity has not received any advice or opinions that are contradictory to the entity's support for the tax accrual.

- .22** If the auditor is unable to accumulate sufficient appropriate audit evidence about whether there is a supported and reasonable basis for the entity's position, the auditor is required to consider the effect of this scope limitation on his or her opinion.^{fn 10}

[Issue Date: March 1981; Amended: April 9, 2003; Revised: December 2005; Revised: March 2006; Revised: March 2008; Revised: June 2009; Revised: October 2011, effective for audits of financial statements for periods ending on or after December 15, 2012.]

New GASB Pension Standards

In June 2012, the Governmental Accounting Standards Board (GASB) issued two new standards that will substantially change the accounting and financial reporting of public employee pension plans and the state and local governments that participate in such plans. GASB Statement No. 67, *Financial Reporting for Pension Plans*, revises existing guidance for the financial reports of most governmental pension plans. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. GASB Statement No. 67 is effective for financial statements for periods beginning after June 15, 2013. GASB Statement No. 68 is effective for financial statements for fiscal years beginning after June 15, 2014.

[Interpretation No. 2](#), "Auditor of Participating Employer in a Governmental Cost-Sharing Multiple-Employer Pension Plan" (paragraphs .23–.29), [Interpretation No. 3](#), "Auditor of Participating Employer in a Governmental Agent Multiple-Employer Pension Plan" (paragraphs .30–.36), and Interpretation Nos. 1–2 of section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, are intended to assist both plan and employer auditors who are auditing entities that have implemented the new accounting standards.

2. Auditor of Participating Employer in a Governmental Cost-Sharing Multiple-Employer Pension Plan

- .23 Question**—GASB Statement No. 68 requires governmental entities (employers) participating in governmental cost-sharing multiple-employer pension plans (cost-sharing plan or plan) to present certain pension amounts in employer financial statements that are calculated by the plan or its actuary. Such amounts are based, in part, on records maintained only by the plan.

^{fn 10} Paragraphs .11–.14 of section 705.

- .24** Do the audited financial statements of the plan prepared in accordance with generally accepted accounting principles (GAAP) and additional unaudited information provided by the plan's management necessary to calculate the employer's net pension liability provide the employer's auditor with sufficient appropriate audit evidence upon which to base the opinion on the affected opinion units of the governmental employer financial reporting entity?
- .25 Interpretation**—No. GASB Statement No. 67 requires only the disclosure of the collective net pension liability for all participating employers in GAAP financial statements of cost-sharing plans, not each employer's proportionate share of the collective net pension liability. Further, GAAP does not require the plan to present deferred outflows of resources or deferred inflows of resources by category, pension expense, or each participating employer's share of collective pension amounts. Unaudited information provided by the plan's management to the employers to support allocations or pension amounts that has not been subjected to further audit procedures beyond those performed in the audit of the basic plan financial statements would not constitute sufficient appropriate audit evidence to support the relevant assertions in the employer's financial statements related to the pension amounts, including required disclosures.
- .26** Absent additional audit evidence from the cost-sharing plan (for example, auditor's opinions on the schedule of employer allocations and certain key elements including net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense in a schedule of pension amounts), the employer auditor would not likely be able to accumulate sufficient appropriate audit evidence to support the pension amounts and disclosures in the employer's financial statements. When pension amounts are material to one or more applicable opinion units of the employer's financial statements and the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements of those opinion units are free from material misstatement, the auditor should modify the audit opinion pursuant to section 705.
- .27 Question**—A plan has engaged its auditor to audit and report on the schedule of employer allocations and certain key elements including net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense in a schedule of pension amounts, as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting*. May an employer auditor use the plan auditor's report as evidence for the audit of the employer's financial statements?
- .28 Interpretation**—Yes. The employer auditor is solely responsible for the audit of the employer's financial statements and, therefore, is responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level. Nevertheless, the employer auditor may use the plan auditor's report on the schedules as evidence that the pension amounts allocated to the employer and included in the employer's financial statements are not materially misstated.

.29 Before using the report of the plan auditor as evidence, the employer auditor should evaluate whether the plan auditor's report and accompanying schedules are adequate and appropriate for the employer auditor's purposes. For example, the employer auditor may review the plan auditor's report and any related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the employer auditor's purposes. Further, the employer auditor has a responsibility to verify and recalculate amounts specific to the applicable employer, including the employer amount used in the allocation percentage (that is, the numerator of the calculation), to recalculate the allocation percentage for the employer, and to recalculate the pension amounts allocated to the employer based on the allocation percentage.

[Issue Date: April 2014.]

3. Auditor of Participating Employer in a Governmental Agent Multiple-Employer Pension Plan

.30 *Question*—GASB Statement No. 68 requires governmental entities (employers) participating in governmental agent multiple-employer pension plans (agent plan or plan) to present certain pension amounts in employer financial statements that are calculated by the plan or its actuary. Such amounts are based, in part, on records maintained only by the plan.

.31 Do the audited financial statements of the plan prepared in accordance with GAAP and additional unaudited information provided by the plan's management necessary to calculate the employer's net pension liability provide the employer's auditor with sufficient appropriate audit evidence upon which to base the opinion on the affected opinion units of the governmental employer financial reporting entity?

.32 *Interpretation*—No. GASB Statement No. 67 does not require the plan to present net pension liability, deferred outflows of resources or deferred inflows of resources by category, pension expense, or each participating employer's specific pension amounts. Unaudited information provided by the plan's management to the employers to support allocations or pension amounts that has not been subjected to further audit procedures beyond those performed in the audit of the basic plan financial statements would not constitute sufficient appropriate audit evidence to support the relevant assertions in the employer's financial statements related to the pension amounts, including required disclosures.

.33 Absent additional evidence obtained, for example, through the suggested best practices as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Agent Multiple-Employer Plans: Issues Related to Information for Employer Reporting*, the employer auditor would not likely be able to accumulate sufficient appropriate audit evidence to support the pension amounts and disclosures in the employer's financial statements. When pension amounts are material to one or more applicable opinion units of the employer's financial statements and the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements of those opinion units are free from material misstatement, the auditor should modify the audit opinion pursuant to section 705.

- .34 Question**—A plan has engaged its auditor to audit and report on the schedule of changes in fiduciary net position by employer, as described in the AICPA’s State and Local Governments Expert Panel white paper referenced in [paragraph .33](#) of this interpretation. May an employer auditor use the plan auditor’s report as evidence about the fiduciary net position and changes in fiduciary net position for the audit of the employer’s financial statements?
- .35 Interpretation**—Yes. The employer auditor is solely responsible for the audit of the employer’s financial statements and, therefore, is responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level. Nevertheless, the employer auditor may use the plan auditor’s report on the schedule as evidence about both the fiduciary net position and changes in fiduciary net position of the employer. However, the employer auditor should consider whether the opinion is on the schedule as a whole or on each employer column. If the opinion is on the schedule as a whole, it is likely that the employer auditor will need additional evidence to support these amounts in the employer’s financial statements (examples of such audit evidence are included in the white paper referenced in [paragraph .33](#) of this interpretation).
- .36** Before using the work of the plan auditor as evidence, the employer auditor should evaluate whether the plan auditor’s report and accompanying schedule are adequate and appropriate for the employer auditor’s purposes. For example, the employer auditor may review the plan auditor’s report and any related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the employer auditor’s purposes.

[Issue Date: June 2014.]