



## Agenda Item 3

### *Audit Evidence*

#### **Objective of Agenda Item**

To approve the proposed revised AU-C section 500, *Audit Evidence* (AU-C section 500) as an exposure draft.

#### **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:

- Bob Dohrer, Chief Auditor, AICPA, Chair
- Jay Brodish, PwC
- Jim Burton, GT
- David Finkelstein, SingerLewak (TIC)
- Audrey Gramling, Oklahoma State University
- Kristen Kociolek, GAO
- Susan Jones, KPMG and IAASB Technical Advisor
- Jim Schaberg, Deloitte
- Eric Turner, CPA Canada and IAASB Member
- Alan Young, EY and IAASB DAWG Member

#### **Background**

The overall objective of the project initially was to assess whether revisions of AU-C section 500 are appropriate and necessary to address the evolving nature of business. 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 such audit evidence. Appendix 1 to this Issues Paper contains a more detailed explanation of the 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.
  - The 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 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 framework approach are not mutually exclusive, that is, the procedures-based approach should complement the framework being suggested by the Task Force rather than replace it.
- October 2018—
  - The ASB discussed a first draft of the proposed SAS, Audit Evidence, which would supersede AU-C section 500, Audit Evidence. In presenting the draft of the proposed SAS, the Task Force discussed with the ASB the following matters:
    - a. The project timeline, including coordination with the international standard setting activities,
    - b. expanded guidance to evaluate sufficient appropriate audit evidence, including how the relevance of audit evidence interrelates with the proposed framework,
    - c. whether management’s specialists content should be relocated out of the proposed SAS,
    - d. changes to the definitions,
    - e. how to deal with the content addressing external information sources taken from the IAASB’s conforming amendments from ISA 540,

- f. changes to guidance dealing with audit procedures, and
  - g. disposition of the Interpretations in extant AU-C 500.
- Significant directions provided by the ASB to the Task Force were as follows:
    - Revise objective to sharpen the focus on evaluating sufficient appropriate audit evidence.
    - Retain, with some refinements, the requirements and application material added to provide the auditor with a framework for evaluating whether sufficient appropriate audit evidence has been obtained.
    - Relocate content related to management’s specialists to either AU-C section 620, Using the Work of an Auditor’s Specialist, or a new standard.
    - Incorporate in the proposed SAS conforming amendments to ISA 500, Audit Evidence, arising from the final ISA 540, Auditing Accounting Estimates as those amendments relate to *External Information Sources*.
    - Retain the Interpretations to AU-C section 500 attached to this standard.

**Matters for the ASB’s Consideration**

<i>ASB Comment</i>	<i>Task Force Disposition</i>
<p>Framework to evaluate audit evidence – Mr. Dohrer explained that under the proposed revisions to the standard, only relevant information would be further evaluated under the proposed new framework. Some ASB members expressed concern about this approach. This is because the auditor may not be able to determine relevance until the information had been further evaluated under the proposed new framework.</p>	<p>Upon further reflection, the Task Force agreed that assessing the relevance of information before further evaluation under framework may be difficult. In response, the Task Force has re-positioned relevance as a companion with reliability as attributes of audit evidence that the auditor would have to evaluate in concluding whether sufficient appropriate audit evidence has been obtained. The Task Force notes that under this approach, vast amounts of information will require consideration as to whether sufficient appropriate audit has been obtained.</p>
<p>Framework to evaluate audit evidence – Mr. Dohrer explained that the reliability of audit evidence is based on its accuracy, authenticity, completeness, and risk of bias. A member expressed a view that risk of bias is subsumed in the considerations of accuracy and completeness.</p>	<p>Upon further reflection, the Task Force still believes that risk of bias is a separate element of the reliability of audit evidence. This is because an amount can be accurate and complete and yet be subject to the risk of bias. For example, an accounting estimate could be accurate and complete and still be subject to the risk of bias</p>

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<i>ASB Comment</i>	<i>Task Force Disposition</i>
	<p>because an accounting estimate is not a precise amount recorded in the financial statements. Additionally, the risk of bias may be considered in determining the effort required to establish the accuracy and completeness of audit evidence. Finally, the Task Force believes that risk of bias is necessary in order to better emphasize the use of professional skepticism in evaluating audit evidence.</p>
<p>A member suggested a “roadmap” between the usage of terms or concepts under the extant standard and those contemplated under the proposed framework and cautioned that the consideration of the attributes of audit evidence could be construed as prescriptive requirements.</p>	<p>While the Task Force believes the “roadmap” suggestion was not for actual inclusion in a revised standard, it also does not believe that a “roadmap” between the usage of terms and concepts under the extant and those in the proposed standard is necessary. This is because the terms and concepts under the proposed standard are intended to have the same meaning as the terms and concepts used in the extant standard. The proposed framework to evaluate audit evidence merely re-positions these terms in a manner that would better assist the auditor in evaluating whether sufficient appropriate audit evidence has been obtained.</p> <p>With respect to the comment that the attributes of audit evidence could be construed as prescriptive requirements, the Task Force acknowledges this comment and addressed this concern by requiring the evaluation of whether evidence is sufficient appropriate audit evidence with the application material explaining that the attributes of audit evidence constitute a framework for considerations the auditor uses in making those evaluations.</p>
<p>Paragraph 4 – Members suggested that the objective should be sharpened to focus on obtaining and evaluating audit evidence only.</p>	<p>The Task Force accepted this comment.</p>
<p>Paragraph 6 – The requirements with respect to the consideration of the attributes of audit evidence should be more actionable, that is, use “evaluate” rather than “consider.”</p>	<p>The Task Force made modifications, as appropriate, in response to this comment. The Task Force’s proposal is to propose a requirement that would require the auditor to <i>evaluate</i> sufficient appropriate audit evidence</p>

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<i>ASB Comment</i>	<i>Task Force Disposition</i>
	and would require that the auditor <i>consider</i> each of the factors and attributes of the framework. In making this proposal, the Task Force expressed a concern that making a more actionable requirement, for example, requiring an evaluation for each factor and attribute would create excessive audit documentation requirements as well as being construed as prescriptive requirements (see comment above).
A member commented that AU-C section 500 is a foundational standard and as such questions the relationship among the proposed AU-C section 500 and performance standards, for example, AU-C section 330. Mr. Dohrer responded by saying that the proposed revisions to AU-C 500 could be implemented notwithstanding whether changes were made at this time to either sections 315 or 330.	The Task Force accepts the comment that AU-C 500 is a foundational standard. AU-C 500 builds on the overall concepts in AU-C 200 to describe and explain in more detail the key concepts of audit evidence. Other standards such as AU-C 315 and AU-C 330 address the “performance requirements,” that is, those sections set out the requirements that the auditor is required to perform to obtain sufficient appropriate audit evidence. The Task Force revised paragraph 2 of the proposed standard to make this point clearer.
A member raised a question about the documentation requirements of the standard.	The Task Force believes that no significant incremental audit documentation requirements will result from the proposed revision of AU-C 500. Audit documentation is addressed in AU-C 230 and other standards such as AU-C 315 and 300, because those standards deal with performance requirements in an audit.
Paragraph 15 – This proposed paragraph would have required the auditor to conclude whether sufficient appropriate audit evidence had been obtained at the relevant assertion level. A member expressed the view that this requirement is duplicative to the requirement in paragraph 28 of AU-C section 330. The member suggested not requiring a conclusion in AU-C section 500 and allowing the conclusions in AU-C section 315 and AU-C section 330 to stand on their own.	The Task Force accepted this comment. In doing so, the Task Force also revised the objective of the proposed standard to remove the notion to conclude on the audit evidence obtained.
With respect to the requirements and application material related to the auditor’s use of management’s specialists, Mr. Dohrer explained that the Task Force	The Task Force accepted the proposed relocation. The location of these requirements

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<i>ASB Comment</i>	<i>Task Force Disposition</i>
is suggesting moving that content to either AU-C 620 or to a separate standard. After discussion, the ASB agreed to relocate any incremental requirements and application material related to this content to either AU-C 620 or a separate standard.	and guidance will also be discussed separately by the ASB.

**Questions for the ASB**

1. Does the ASB agree with the Task Force’s disposition of the issues summarized above?
2. With respect to the proposed framework, has the Task Force identified all relevant attributes that would be part of the framework? Does the ASB agree with how the attributes are described?

*Experienced Auditor/Knowledge Person*

Paragraph A13 of the proposed standard states: “Appropriate audit evidence is sufficient when an *experienced auditor* would be persuaded to draw conclusions based on consideration of the audit evidence.” The intent of this application material is to provide a threshold in evaluating the sufficiency of audit evidence that would not be solely a self-assessment by the auditor. In developing this application material, the Task Force considered another term such as a *knowledgeable person* instead of *experienced auditor*. The term “knowledgeable person” is used in the GAO literature in evaluating audit evidence, and the term “experienced auditor” is used in audit documentation standards. The Task Force expressed concern about using the term “knowledgeable person” in this context because only an auditor has the prerequisite skills to draw a conclusion about whether sufficient appropriate audit evidence has been obtained. A “knowledgeable person,” for example an actuary, may have knowledge about certain accounting matters, but he or she may not have the prerequisite skills to draw a conclusion about whether sufficient appropriate audit evidence has been obtained. Also, the Task Force expressed the view that the threshold to evaluate audit evidence should be consistent with the threshold in the audit documentation standard, that being “experienced auditor.” However, using the term “experienced auditor” in evaluating audit evidence may create a difference with the governmental auditing standard.

**Questions for the ASB**

3. What are the ASB’s views about using *experienced auditor* instead of *knowledgeable person* as a threshold in evaluating audit evidence?

**Items Presented**

Agenda Item 3 – Issues Paper

Agenda Item 3A – AU-C section 500 Exposure Draft

Agenda Item 3B – AU-C 500 Table\_Proposed Standard – Marked from Extant

Agenda Item 3C– AU-C 500 Traditional Format

Mr. Dohrer will refer to the Agenda Items 3 and 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.<sup>1</sup> 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

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<sup>1</sup> 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.