Agenda Item 7

Audit Evidence

Objective of Agenda Item

To provide an overview of the issues identified to date by the AICPA Task Force in consideration of standard-setting related to AU-C section 500, *Audit Evidence* (AU-C section 500).

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), which functions similarly to the IFAC's Small and Medium Practices Committee. 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, RSM, Chair
- Jay Brodish, PwC
- Jim Burton, Grant Thornton
- David Finkelstein, SingerLewak (TIC)
- Jen Haskell, Deloitte
- Kristen Kociolek, US GAO
- Susan Jones, KPMG (IAASB)
- Steve Morrison, MBAF
- Eric Turner, CPA Canada (IAASB)
- Alan Young, EY (IAASB DAWG)

Background

The initial overall objective of the project is to assess whether revisions of AU-C section 500 are appropriate to address the evolving nature of audit services and issues that have arisen resulting from other 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. If revisions of AU-C section 500 are deemed appropriate, the Task Force will then propose appropriate actions to address these matters within the AICPA's body of audit literature.

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 U.S. 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 application 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 U.S., 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.

More recently, the AICPA released the "Audit Data Analytics to Traditional Procedures Mapping Document" to illustrate how data analytics, when applied to the financial statement audit, can help to automate traditional procedures that are currently being performed manually.

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, 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.[1] 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.

[1] 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."

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 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.

Question for Consideration

1. What are the IAASB's views about the background of the project and are there any other issues or factors that should be taken into consideration?

Focus of AU-C section 500

In the initial exploration of the issues related to AU-C section 500, the Task Force has discussed the focus of the standard. Extant AU-C section 500's objective reads as follows:

> The objective of the auditor is to design and perform audit procedures that enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

As currently articulated, the standard is focused on assessing whether sufficient appropriate audit evidence has been obtained based significantly on the nature of auditor's procedures performed. The Task Force's preliminary thinking is to challenge whether the auditor's judgement about the sufficiency and appropriateness of audit evidence significantly based on the nature of the procedures performed to obtain the evidence is still a viable construction. Rather than continuing the current model, the Task Force is considering expanding the focus of the standard, including its objective, to be also focused on whether the audit evidence as a whole is sufficient, appropriate, and high-quality given the circumstances of the engagement and establishing a framework for evaluating such audit evidence based on certain attributes. Should the quality of audit evidence be based solely on the nature of the procedures performed to obtain the audit evidence? The Task Force has expressed caution of course that a criterion to evaluate whether the audit evidence is of appropriate high quality should not include budget considerations.

Question for Consideration

2. What are the IAASB's views about possibly revising the objective of the standard from the perspective of assessing audit evidence based significantly on the nature of audit procedures performed to obtain the evidence to include qualitative criteria for evaluating whether sufficient high-quality audit evidence as a whole has been obtained given the circumstances of the audit?

Preliminary Issues

In addition, to the considering the focus/objective of the standard, the Task Force has identified a series of preliminary issues in AU-C section 500. These include issues around:

1. Definitions
2. Overarching Concepts of Audit Evidence
3. Audit Procedures
4. Key Concepts
    a. Sufficiency and Appropriateness
    b. Relevance and Reliability
    c. Sources of Audit Evidence

The following section provides more detail with respect to each of these issues.

Definitions

The Task Force discussions with respect to the definitions have included (i) definitions in extant AU-C section 500, (ii) proposed new definitions arising from the IAASB ED 540 project on auditing management's estimates, (iii) and the PCAOB's proposed definition of management's specialists. In addition, the Task Force is exploring whether a definition of ADA is appropriate.

Definitions in Extant AU-C section 500

With respect to the definitions in extant AU-C section 500, the Task Force noted that the definition of *accounting records* needs to be updated. *Accounting records* is defined as follows:

> The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers; journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records, such as work sheets and spreadsheets, supporting cost allocations, computations, reconciliations, and disclosures.

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, a Task Force consideration with respect to the definition of *accounting records* is to modernize it to recognize, among other things, electronic data, shared information, and emerging technologies, e.g. blockchain.

The Task Force also discussed the definitions of *sufficiency and appropriateness*. While the Task Force believes that changes to these definitions might not be necessary, a major consideration of this project will be to explore issues around the underlying attributes in these definitions. For example, should criteria be developed to aid in the evaluation of the sufficiency and appropriateness of audit evidence and be included as application material in the standard?

Audit Data Analytics

Audit Data Analytics is not currently defined in AU-C section 500 nor is the term referred to elsewhere in U.S. Generally Accepted Auditing Standards (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." [2]

That definition was subsequently included in the AICPA Audit Guides, *Audit Data Analytics,* and *Analytical Procedures.* The Task Force will consider that definition in drafting a possible definition of Audit Data Analytics in AU-C section 500. There is also an issue being considered as to whether a definition of Audit Data Analytics in AU-C section 500 would quickly become outdated due to the rapid pace of development of emerging techniques and technologies.

Current Proposal Being Developed by the IAASB and PCAOB

In April 2017, the IAASB released an Exposure Draft, the proposed International Standards on Auditing 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* (ED 540). Among other things, ED 540 included proposed conforming amendments to ISA 500, *Audit Evidence*, that included a proposed definition of *External Information Sources* (EIS). The proposed definition is as follows:

> *An external individual or organization that provides information that has been obtained and used by the entity in preparing the financial statements or obtained independently by the auditor as audit evidence, when such information is suitable for use by a broad range of users. When a particular set of information has been provided by an individual or organization acting in the capacity of a management's expert, service organization, or auditor's expert the individual or organization is not considered an external information source.*

An issue with the proposed definition of an EIS discussed by the Task Force is that the application material related to this new definition does not differentiate management's use of an EIS from the use of an EIS by the auditor when considering the "relevance and reliability" of audit evidence obtained from an EIS and associated work effort. Additionally, the Task Force is considering whether additional guidance would be helpful in distinguishing work effort required to establish the reliability of evidence obtained when an EIS is used by management for a specific purpose versus when Big Data is obtained and used directly by the auditor.

In June 2017, the Public Company Oversight Board, issued a staff consultation paper, *Proposed Amendments to Auditing Standards for Auditor's Use of the Work Specialists.* The PCAOB's

[2] Paragraph 1.10 of *Guide to Audit Data Analytics*

proposal includes a proposed new definition of management's specialists. The Task Force has not identified any issues with the proposed definition; however, it is tracking the PCAOB proposal.

Questions for Consideration

3. What are the IAASB's views about the Task Force's considerations regarding the definitions?

4. Does the IAASB believe that *Audit Data Analytics* should be defined in the standard? If so, does the IAASB agree with the definition in the ADA audit guide?

Overarching Concepts in Audit Evidence

This section describes certain overarching concepts that in the Task Force's opinion are integral in evaluating the sufficiency and appropriateness of audit evidence. These concepts are 1) whether the audit evidence is corroborative or contradictory and 2) the application of Professional Skepticism.

Audit evidence either corroborates or contradicts management's assertions. Some have argued that historically, auditors have over-relied on corroborative audit evidence where there was not an appropriate basis. As a result, auditors have been criticized in inspection findings for lacking Professional Skepticism. In response, some argued that the issue of lack of Professional Skepticism can be addressed, in part, by being unbiased when seeking and documenting audit evidence and employing a heightened sense of Professional Skepticism when evaluating contradictory audit evidence. However, the notion of seeking more contradictory audit evidence may have unintended consequences especially if the suggestion is to create a requirement to obtain such contradictory audit evidence. That is because a requirement to obtain contradictory audit evidence is an open-ended proposition; that is, seeking contradictory audit evidence theoretically could be endless. Therefore, the Task Force does not believe that a requirement to actively seek contradictory audit evidence is operable, but instead, a more workable construct would be a requirement for the auditor to act appropriately when contradictory audit evidence or information comes to his or her attention. It is also important that the auditor not be overly biased when evaluating evidence as corroborative.

Auditors may exercise Professional Skepticism by challenging the reliability of audit evidence. In explaining the concept of reliability, the application material of AU-C section 500 sets out a series of generalizations about audit evidence. Exercising Professional Skepticism may mean challenging whether these generalizations hold true in a particular audit or circumstance. For example, the auditor may challenge the reliability of audit evidence:

- When evidence is obtained from independent sources outside the entity, but it comes to the auditor's attention that the source is not knowledgeable.

- When, in gaining an understanding of the controls over the conversion and maintenance of electronic documents, the auditor identifies a deficiency in internal control.

The Task Force is considering whether the "bar" for establishing the reliability of audit evidence that is corroborative or confirmatory in nature should be higher than if the audit evidence is

contradictory or disconfirming. For example, should disconfirming evidence be dismissed simply because the auditor is unable to establish its reliability in the same manner as the reliability of other confirming audit evidence might be established?

The Task Force also is considering how to best articulate that the auditor should be unbiased when seeking audit evidence and not just simply seek corroborative audit evidence. The Task Force will also explore whether it would be useful to guide the auditor to heighten Professional Skepticism when evaluating not only "contradictory" evidence but also, any information that is "inconsistent" with management's assertions.

Questions for Consideration

5. What are the IAASB's views about the Task Force's considerations of the concepts of corroborative vs. contradictory audit evidence, including the level of specificity in the requirements and application of Professional Skepticism in the context of audit evidence? What are the IAASB's views about the requirement to deal with contradictory audit evidence?

Audit Procedures

Classification of Audit Procedures

Paragraph 6 of 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 no longer seems 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 primarily in the context of the nature of the procedures performed to obtain the evidence. The Task Force is considering whether more useful frameworks in which to consider the sufficiency and appropriateness of audit evidence would be appropriate in today's environment where the distinct classification of audit procedures as described in paragraph A10 of AU-C section 500 are overly prescriptive because of the use of emerging techniques and technologies by the auditor in obtaining audit evidence. For example, would a framework for evaluating audit evidence based on criteria underlying the qualitative attributes, sufficiency and appropriateness of audit evidence regardless of the procedure used to obtain the evidence be more appropriate?

The Task Force's views are also based on the evolving use of ADA and other techniques and technologies whereby the auditor can examine vast amounts of data, sometimes 100 percent of the population. 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? When an aspect of a population has been 100% examined, is there an element of risk assessment remaining or is the risk associated with that aspect now known? This also raises the question of what are substantive audit procedures in today's audit environment?

The Task Force acknowledges that the definition of risk assessment and substantive procedures has implications beyond AU-C section 500, especially for AU-C sections 315 and 330 and notes that paragraph 18 of AU-C section 330 states that for example, "irrespective of the assessed risks of material misstatement, the auditor should design and perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure. That is another instance where a standard might be overly prescriptive in terms of the specific reference to substantive procedures.

The Task Force's consideration of the issue of the classification of audit procedures is to perhaps retain the classifications in extant AU-C section 500 but add more application material explaining that the auditor has flexibility in using the distinct types of audit procedures and that the objectives of each classification might be achieved simultaneously using ADA.

Other Considerations about Audit Procedures

In the initial Task Force discussions about the concepts surrounding audit procedures, the Task Force developed the following observations:

- Retention—Emerging techniques and technologies may create new issues around retention of audit evidence. For example, with artificial intelligence, the audit evidence might not be capable of being reconstructed. This is particularly important in auditing complex accounting estimates.

- Modernization—Several application material paragraphs need modernization. For example, the application material should be updated to reflect that the use of electronic evidence is more widespread and electronic format can be as reliable as paper format. Also, there is an opportunity in describing the nature of audit procedures to introduce or include as examples new and emerging concepts such as Blockchain, text recognition, machine learning, etc. However, in doing so, the terminology should be such that the terms do not become obsolete very quickly.

- The Task Force believes that the application material should be clear that in drawing reasonable conclusions on whether sufficient appropriate audit evidence has been obtained, the assessment should not be based solely on the nature or classification of audit procedures performed to obtain the evidence, but rather it should be focused on the attributes underlying high quality audit evidence.

Questions for Consideration

6. What are the IAASB's views about the Task Force's considerations regarding the audit procedures?

Key Concepts

An overall objective of the audit requires auditors to obtain reasonable assurance, and that the auditor should obtain *sufficient appropriate* audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.[3] The definition of Audit Evidence refers to *sufficiency of audit evidence* as the measure of the quantity of audit evidence and a*ppropriateness of audit evidence* as the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.[4]

Further, paragraph 6 of AU-C section 500 requires the auditor to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining *sufficient appropriate* audit evidence.

Therefore, the Task Force believes "sufficiency and appropriateness" are integral concepts for the auditor in obtaining audit evidence to support the auditor's opinion. The Task Force believes that the AU-C section 500 can be enhanced by adding more material to assist the auditor in determining when he or she has obtained sufficient appropriate audit evidence. This could be perhaps in the form of a framework (see below).

The Task Force's initial observations are that the definitions of sufficiency and appropriateness may still be workable. However, the Task Force is considering including additional guidance to address common misconceptions and to expand on the concept of Professional Skepticism.

Sufficiency

As stated above, the concept of sufficiency refers to quantity of audit evidence. The Task Force discussed that the notion of measuring audit evidence in terms of quantity may be not as important today. Because of the interaction with the quality of audit evidence, auditors currently do not entirely focus on quantity of audit evidence. 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 will continue to consider the notion of "quantity" and misperceptions in using the term and would pursue other terms to describe the point at which the auditor believes the evidence is persuasive. The Task Force believes that the "persuasiveness" of audit evidence should be cast as a mix of both quantity and quality of audit evidence whereby the quantity of audit evidence required may be less if such evidence is of very high quality.

Appropriateness

[3] Paragraph 19 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.
[4] Paragraph 14 of AU-C section 200.

The Task Force is considering whether this is an area where more discussion of the concept of Professional Skepticism could be helpful. Challenging the appropriateness of audit evidence would require challenging its relevance and reliability.

The reliability of evidence relates to the source and attributes of the evidence, and the auditor should challenge, when appropriate, the reliability of the evidence. To then demonstrate the application of Professional Skepticism the auditor should appropriately document those considerations. There might be situations where the evidence comes from management's use of a third party (such as a valuation expert to assist in valuing an intangible asset), but it has come to the auditor's attention that the third party is not knowledgeable. In that situation, the evidence may not be reliable, even though the evidence has been used by management to support its assertions.

The Task Force noted that the evaluation of the appropriateness of audit evidence in extant AU-C section 500 is predominantly focused on internal sources of audit evidence. In recent years, there has been an evolution in terms of sources for audit evidence. For example, auditors have found it useful and sometimes even more reliable to seek information outside the entity, that is, external audit evidence. Similarly, auditors are seeking their own audit evidence by looking at sources outside the entity (e.g., "Big Data"). Because of these evolving sources of audit evidence, the Task Force is considering acknowledgement in the application material of the various sources of audit evidence. The Task Force will also further consider whether the "appropriateness" of audit evidence should be viewed through the same lens for both evidence used by management to support its assertions and evidence obtained independently by the auditor.

The use of the terms sufficiency and appropriateness in describing audit evidence implicitly suggests that the auditor is required to arrive at conclusions whether the audit evidence obtained is sufficient and appropriate for the auditor's purposes. In fact, AU-C section 330 requires the auditor to conclude whether *sufficient appropriate* audit evidence has been obtained.[5] However, AU-C section 500 provides little guidance in terms of providing the auditor guidance of how to arrive at that conclusion. In the initial discussions, the Task Force has considered including more application material that would assist the auditor in assessing whether the audit evidence obtained is *appropriate*.

Relevance

AU-C section 500 states that in designing and performing audit procedures, the auditor should consider the *relevance and reliability* of the information to be used as audit evidence.[6] The concepts of relevance and reliability underlie the concept of appropriateness. In the application material to paragraph 7 of AU-C section 500, it is explained that although audit evidence is primarily obtained from audit procedures performed during the course of the audit, it also may include information obtained from other sources (for example, previous audits, in certain circumstances, and a firm's quality control procedures for client acceptance and continuance). More recently other sources of audit evidence, for example the entity's use of blockchain technology, have become available to the auditor. The quality of all audit evidence is affected by

[5] Paragraph 28 of AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained.*

[6] Paragraph 7 of AU-C section 500, *Audit Evidence.*

the relevance and reliability of the information upon which it is based. The Task Force noted that this application material suggests that sources of audit evidence are solely internal. The Task Force will consider adding more application material to recognize other sources of evidence such as the entity's external information and the auditor's external evidence.

Paragraph A28 of AU-C section 500 explains that relevance relates to the logical connection with, or bearing upon, the purpose of the audit procedure and, when appropriate, the assertion under consideration. The Task Force noted that the emerging use of technology-enabled techniques such as ADA may pose a challenge to this premise. The use of ADA takes another dimension in that the audit evidence may correlate to multiple assertions, for example when using a regression analysis. However, the output of a regression analysis procedure can yield high quality audit evidence even if some of the variables (for example, a consumer price index) may not have an initially apparent connection to the financial statement assertions; however a key consideration would be the auditor's documentation demonstrating how the audit evidence obtained by applying such audit techniques are relevant for the auditor's purposes. The Task Force is considering adding more application material, including examples, to enhance the use of ADA in this context.

Paragraph A30 explains that designing tests of controls to obtain relevant audit evidence includes identifying conditions (characteristics or attributes) that indicate performance of a control and identifying deviation conditions that indicate departures from adequate performance. The Task Force discussed the issue of whether ADA could be used as test of controls. The issue of whether ADA could be used as a test of controls is not currently in the standards or in interpretive guidance such as the AICPA Audit Data Analytics Guide. The Task Force expressed the view that not making any changes to the application material would be appropriate as the application material does not preclude the auditor's use of ADA as a test of controls.

Paragraph A31 explains the objectives of substantive procedures and explains that substantive procedures are comprised of test of details and substantive analytical procedures. The Task Force noted that, as explained above, such classifications are being blurred with the use of emerging techniques and technologies. So, the Task Force will explore the discrete classifications of audit procedures described in the application material of AU-C section 500.

Reliability

Paragraph A32 of AU-C section 500 sets out a series of generalizations about the reliability of audit evidence. Examples of the generalizations in paragraph A32 are as follows:

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies, facsimiles, or documents that have been filmed, digitized, or

otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

In general, the Task Force noted that the generalizations may still be valid in today's environment. However, they need to be challenged and updated, and in some cases may in fact not be valid in today's environment.

Today, the auditor may examine 100 percent of the population using ADA, and in such circumstances, the audit evidence obtained by the auditor may be more reliable because the auditor examines 100 percent of the population, albeit from internal sources, rather than testing a sample and projecting the results to the population where sampling risk is present. The Task Force is also considering application material that will focus auditors to understand what assertions they really tested 100 percent. For example, in testing accounts receivable, if the auditor obtained the entity's year-end accounts receivable schedule and matched up the subsequent cash collections journal against the year-end accounts receivable schedule, what was really tested other than internal consistency of the entity's accounting records (even in this case, the benefit of testing internal consistency 100% should be noted)? If the auditor obtained a direct download of cash receipts from a third-party bank and compared it first to the cash collection journal, then the cash collections journal to the year-end accounts receivable schedule, perhaps that provides more appropriate audit evidence as to existence and valuation, but still does not address issues such as rebates, etc. In other words, it will be important to understand what the auditor is really testing 100 percent.

Another observation made by the Task Force on these generalizations is that there is a focus on original documentation in paper format. However, the Task Force noted that in many cases, audit evidence in today's digital environment, often is originated in digital form and therefore never exists in paper format. Finally, the task force's consideration is to modernize these generalizations by updating such references to *photocopies* and *facsimiles* that have become antiquated.

Paragraph 9 states that when using information produced by the entity, the auditor should evaluate whether the information is sufficiently reliable for the auditor's purposes…The Task Force expressed concern about this requirement being too narrow and believes that the requirement should be broadened to all sources of audit evidence. However, the Task Force also noted that the auditor's evaluation of the reliability of the audit evidence is influenced by the sources of audit evidence because the risks are different. For example, if the information is produced by the entity, there is always a potential risk of management bias. In contrast, if the information is obtained from external sources, the risk about management bias could be greatly reduced, but the risk would be more in the completeness and accuracy of the information.

The Task Force expressed the view that the standard should not inhibit the use of information by differentiating between factors for internal and external information. The requirement should recognize that the sources of audit evidence can originate from various sources as follows:

- Management - internal or external
- Management's specialists
- Auditor – internal or external

Questions for Consideration

7. What are the IAASB's views about the Task Force's considerations regarding the key concepts of audit evidence?

Expanded Guidance to Evaluate the Sufficiency and Appropriateness of Audit Evidence

As stated above, the focus of the extant guidance is significantly premised on the design and performance of audit procedures to assess the sufficiency and appropriateness of audit evidence. The Task Force is considering whether this standard should also focus on the evaluation of the audit evidence by providing more guidance about how to make that evaluation using qualitative attributes underlying the audit evidence. The Task Force is re-examining the focus of the evaluation of the sufficiency and appropriateness of audit evidence from being significantly based on the audit procedures used to obtain the audit evidence to including a balanced assessment of the attributes leading to 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, in other words the evaluation is multi-dimensional. During the discussions, the Task Force considered several attributes that affect the consideration of what is sufficient and appropriate, including the following terms or concepts:

- Relevance
- Reliability
- Authenticity
- Accuracy
- Persuasiveness
- Consistency
- Precision
- Completeness
- Risk of bias, and
- Others

The source of the audit evidence would also be taken into consideration in considering the attributes above. For example, each of the attributes above might be considered in the context of whether the audit evidence was obtained from/by:

- Management internally from its financial reporting system;
- Management internally from outside its financial reporting system;
- Management from external sources;
- Management's specialists;
- Developed directly by the auditor using information generated by the entity;
- Developed by the auditor using information obtained from external sources; or
- Obtained directly by the auditor from external sources.

In response to these observations, the Task Force is considering the development of a framework that would assist the auditor in considering the various attributes as listed above and the sources of audit evidence and evaluating the overall quality of the audit evidence. Such a framework would assist the auditor in bringing all the attributes together, regardless of their source and might help the auditor evaluate the different attributes and sources in making the conclusion about whether sufficient and appropriate audit evidence has been obtained.

When developing the potential framework, the Task Force could also consider the AICPA's ADA guide, which includes the following examples of characteristics that may affect data relevance and reliability[7]:

- Nature
    - Financial, nonfinancial
    - Accounting process and control-related
    - Product and service categories
    - Demographic
    - Economic
    - Geographic
    - Business sector
    - Regulatory
    - Historic
    - Forward-looking
    - Time-sensitive
    - Metadata (for example, file labels, record formats, access and other authorization codes)
    - Raw situational data (for example, customer activity from customer relationship management system)
    - Descriptive information (for example, quality metrics)
    - Summarized data (for example, research reports)
- Sources:
    - Controlled by the accounting department of the audited entity (in-house records or stored externally (for example, in the cloud)
    - Controlled by persons outside of the accounting department of the audited entity (with various possible storage media, as noted in the previous list item)
    - External to, and not controlled by, the audited entity
- Format:
    - Numerical (for example, quantity, currency), text, symbols, other characters
    - Structured (for example, data in a fixed field within a record or file)
    - Unstructured (for example, text)
- Timing:
    - Point-in-time, period of time
    - Rate of change (time lags, continuity)
- Extent
    - Volume

[7] Exhibit 1-5 of *Guide to Audit Data Analytics*

  - Scope (variety of subject matters and sources)
- Level of Aggregation:
  - Financial statement item, account balance, component of an account balance
  - Annual, monthly, daily, hourly, some smaller timing frequency
  - Consolidated, segmented (for example, by division, location)
  - Database files, tables, and fields

Questions for Consideration

8. Does the IAASB agree that the focus of the standard should be re-examined from significantly assessing the sufficiency and appropriateness of audit evidence based on the nature of audit procedures performed to obtain the evidence and be also focused on the attributes underlying the quality of audit evidence in the context of the source of the audit evidence? In doing so, does the IAASB agree that a framework to evaluate audit evidence that would describe the different attributes of audit evidence would be helpful?

Items Presented

Agenda Item 7– Issues Paper

Mr. Dohrer will refer to the Issues Paper in leading the discussion.