

## RECHTMAN CPA PLLC

1646 Federspiel Street  
Fort Lee, NJ 07024  
(917) 566-0020

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AICPA

Sherry Hazel at [Sherry.Hazel@aicpa-cima.com](mailto:Sherry.Hazel@aicpa-cima.com)

Via e-mail

**NOT AN OPINION. THESE  
RECOMMENDATIONS ARE FOR THE  
AICPA CONSIDERATION AND  
DECISION.  
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Re: Exposure Draft – AUDIT EVIDENCE

Dear Ms. Hazel:

I am responding to the exposure letter titled “**Exposure draft proposed statement on auditing standards - Audit Evidence**”.

Yigal Rechtman, CPA, CFE, CITP, CISM is a forensic accountant and auditor with a background in:

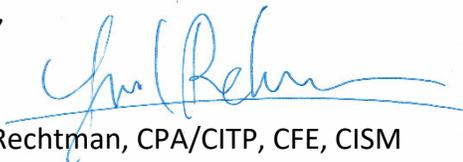
- Fraud investigation of asset misappropriation and financial statement fraud, and damage calculations
- Accounting, auditing and attest, including SSAE 16/SOC-1/SOC-2 reports
- Wide range of litigation support services, including: strategy & consulting, discovery consulting, data mining, document retention and management, data extraction & aggregation, coordination with DOJ, FBI and other agencies.
- Internal controls reviews and testing
- Information systems' integration and reliability, including IT auditing

I am a member of the American Institute of Certified Public Accountants. In the New York State Society of CPAs I am the past chair of the following committees: Consulting division oversight and the Technology Assurance. I am also a member of the Association for Certified Fraud Examiners.

I am a professor at the Lubin School of Business – New York Campus, Pace University, where I teach forensic accounting, auditing and information systems.

I am the author of articles focusing on issues in fraud, damages, accounting, attest, audit, and information systems. I am also a member of the review board at the CPA Journal .

Sincerely,



Yigal M. Rechtman, CPA/CITP, CFE, CISM

COMMENTS ON  
EXPOSURE DRAFT PROPOSED STATEMENT ON  
AUDITING STANDARDS – AUDIT EVIDENCE

Principal Drafter

Yigal M. Rechtman , CPA/CITP, CFE, CISM

COMMENTS ON EXPOSURE DRAFT PROPOSED STATEMENT ON AUDITING STANDARDS

AUDIT EVIDENCE

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

The revised scope section of the proposed SAS explains with sufficient clarity the relationship between the proposed SAS and other AU-C sections (315 and 330). The traversing between three part of the exposure draft – the request for comments, the proposed SAS, and the interpretation of the SAS inhibits the clear following of what is required. It would have been more helpful for the reader to have the questions embedded within the proposed SAS.

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

Overall, for the reasons stated herein the SAS as proposed will not assist the auditor in more effectively evaluating whether sufficient appropriate audit has been obtained. While enhancing skepticism is a good direction, the audit evidence framework as discussed herein gives more opportunities to auditors to get a lower level of confidence in their audit evidence, and yet comply with the standard. The application of skepticism would wok only if the threshold is increased, not decreased as proposed by the draft.

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

The proposed attribute classifies, but does not expand the current types of sources of information considered by the audit as an audit evidence. When it come to analytical procedures, for example the current standard allows and even encourages use of external data point such as industry publications. However, as audit evidence by itself such external data points are of little use when taken by themselves. The provision of three out of a total of five attributes being management-provided evidence has not had a track record of high quality, and has been subject to manipulation. Accordingly, the classification that gives equal weight of the following attributes misleads the auditor in performing their evaluation of audit procedures performed. Such misleading is done by granting equal weight and import to the following attributes:

- Management – generated internally from the financial reporting system; and/or

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- Management – generated outside the financial reporting system, including from sources external to the entity; and/or
- Management – obtained from management’s specialist.

These attributes should be clarified as having a combined weight and value to the auditor that is *lower* than evidence that is obtained by the auditor directly from sources external to the auditor or from sources external to the entity.

We also make these additional two observations:

The aforementioned “financial reporting system” is obscure and somewhat vague: is the proposed SAS referring to any information system that provides relevant financial information, or just strictly defined a system that generates financial reports. Some system (e.g. production machine’s unit count, or a payroll clock) provides information that is utilized in the preparation of financial statement by doing so indirectly and through several steps in the business cycle. The terms should be clearly defined, as per our comment to question number (4), below.

The last attribute is also misleading because it refers to the auditor’s developed evidence from “sources *internal..* to the entity” (em. added). This has in form, the semblance of auditor generated evidence, but in substance these are just as weak as management generated evidence.

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

Yes: the following are other attributes and factors that are missing and should, in our view be added to the proposed SAS that should be considered by the auditor when evaluating the appropriateness of audit evidence:

- **Timeliness of the response:** asset misappropriation and financial statement fraud repeatedly show that lack of candor with the auditors often manifests itself in delay in responding with appropriate audit evidence. The auditor should apply their professional skepticism by evaluating the timeliness of the response, based on the routine or special nature of the evidence, the volume and complexity of the required response, and the relative ease with which of the auditee to provide other evidence.
- **Required explanation:** asset misappropriation and financial statement fraud repeatedly show that convoluted, complex, unusual, or nonsensical responses are indicia of an attempt to conceal the true nature of the underlying activity. The auditor should apply their professional skepticism by evaluating the clarity of the response, based on the routine or special nature of the evidence, the volume and complexity of the required response, and the relative ease with which of the auditee to provide explanations to other

evidence. The auditor should also apply skepticism to the quality of audit evidence that is not self-explanatory or novel.

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

As noted in (3) above, the relative equal weight that is provided on the “Sources” panel is not consistent with existing standards that afford greater reliability to external sources (“Auditor – obtained from sources external to the entity”) versus attributes all the other. As such the diagram is misleading the auditor by not expressing visually the reduced level of reliability from external versus internal sources, and from audit evidence obtained directly by the auditor versus management provided audit evidence. If the presentation intends to simply provide a dimensional view, and not a proportional one, it is crucial that this is described, and perhaps even depicted in the multi-dimensional image that is presented. Otherwise, readers may rely on the purported “equal weight” to the detriment of the audit.

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

We make no comment on the examples.

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

We agree with the approach taken by the ASB in addressing the topic of professional skepticism. To that approach we refer to our responses to questions (4) and (5) above which observe that skepticism should be applied unequally to various classes of sources.

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

We somewhat concur with the approach taken by the ASB in addressing the implementation of professional skepticism. Enhancement can be made as explained in our responses to questions (4) and (5) above which observe that skepticism should be applied unequally to various classes of sources.

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- 9) Are the changes to the definitions in extant AU-C section 500 appropriate? If not, please explain why.
- 10) Are there any other definitions that should be included in the proposed SAS? If so, describe them.

Our combined response to questions 9 and 10 is as follows:

- There is a consistent use in the definitions of that are *not* interchangeable, and yet appear to have been presented as synonymous.
- **Data** is a set of value without context. Data are values that can be discrete (e.g. “yes or no” or variable (e.g. \$0 to \$1000). Data can vary in length, type of communication (e.g. image versus sound versus letters), and can be inputted, stored, processed, and outputted in various ways.
- **Information** is data in context. To understand information, and the related term *information system* (below) the context of the values of data must be understood. For example, data value \$1,000 is irrelevant until we know the context in which it is inputted, stored, processed, or outputted. A credit limit of \$1,000 is not the same context as a weekly salary of \$1,000. The same data value is in both these examples, but the context, and thus the meaningfulness to the user and the auditor, vary significantly.

In addition, we believe that the following definition should be created:

- **Information system** must be defined as discussed in question 3 as either a strict financial information system, a broad framework of providing all relevant information to all relevant users. We do not recommend a hybrid definition of information system. A subset of information system is **financial information system**, where again the definition must be either strict or broad. Here too, we recommend that a compromise definition which will tend to be vague should not be crafted. The drafters may wish to harmonize these definitions between this explore draft and the previously drafted ethics standard titled “Information System Services” by the AICPA from 2018.

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

The examples that are provided do not enhance the standard because they are examples of technology application that are extant in a moment in time and are likely to expire. Moore’s law

observes, predicts and states<sup>1</sup> that the speed and capability of computers can be expected to double every two years, as a result of increases in the number of transistors a microchip can contain.” Although there are variants to this law, the concept remains that technology has been observed to become obsolete in known intervals.

Because the nature of technology, and by extension information system to change and morph in a known speed of every two years, the examples may be relevant as an educational material for current readers of the proposed SAS. However, it is anticipated that with time, these examples will be more irrelevant and possibly contradictory to practices that could be extant in a later point in time. For example, the reference to the current “network of remote servers (which may be referred to as the “cloud”)” may be relevant to users today. However, this technology may morph and change whereby the disambiguation between local storage and local storage will be nil, as distributed ledgers may overcome the need to identify the location of the data that is inputted, stored, processed, and/or outputted.

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

We do not agree that oral confirmation should be supplemented by a written confirmation only for “significant” purposes. Although oral confirmation and the documentation thereof is done for non-confirmatory procedures (for example, inquiry with predecessor auditors, inquiry with management), the proposed standard which states “The ASB decided that an oral confirmation may be as reliable as a written confirmation in particular circumstances provided that the oral request is made to an appropriate individual, a response is knowingly provided by an appropriate individual, and the response is documented by the auditor” is making an error in doing so.

Although the ASB is harmonizing its standards with the PCAOB’s requirements for oral confirmation, there is a difference between the size, type, and complexity of audits that are being performed under PCAOB standards versus under the ASB standards. The reality is that the use of oral confirmation creates an opening for **repudiation**, i.e. the confirmand may claim that they did not make an oral statement. Such risk of repudiation can put more auditors at risk of litigation. The more sophisticated GAAS auditors will likely be able to audit defensively and avoid the non-repudiation elements of an oral confirmation, while the less sophisticated auditors will not be able to do so, and expose themselves inadvertently to greater risk of litigation.

It remains our view that non-repudiation of significant sources of evidence should be steadfastly held and not yielded to because the practices that are applicable to the PCAOB audits.

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<sup>1</sup> “Cramming More Components onto Integrated Circuits”, Gordon E. Moore, Proceedings of the IEEE, Vol. 86, No. 1, January 1998. The exact statement is “The complexity for minimum component costs has increased at a rate of roughly a factor of two per year”.

- 13) Is relocation of the content dealing with management’s specialist from AU-C section 500 to AU-C section 501 or to a separate new standard appropriate? If not, please explain why.
- 14) If you agree that relocation is appropriate, what are your views about whether the management’s specialist content should be addressed in AU-C section 501 or in a separate new standard?

We answer questions 13 and 14 together:

We think that the relocation of content dealing with management’s specialist to a separate new standard is appropriate. As reliance on specialists in audits grows in frequency, there would be room to develop such standards to evolve the standard separately, without amending the proposed SAS.

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

The proposed SAS should result in audit documentation requirements beyond those in AUC section 230 and other AU-C section because the proposes SAS emphasize on the **linkage between audit evidence and the auditor’s opinion**. Such linkage has been at times weak as we learn from various inspection processes such as Peer-review results, PCAOB inspections, and GAO studies (in particular those of ERISA and Not-for-Profit entities).

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