

new york state society of

NYSSCPA

certified public accountants

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December 30, 2004

Mr. Thomas Lamm
Director of Research, Staff Liaison - Standards Board
Information Systems Audit and Control Association
3701 Algonquin Road
Suite 1010
Rolling Meadows, Illinois 60008

By e-mail: research@isaca.org

Re: Proposed Information System Auditing Standard on Irregularities and Illegal Acts

Dear Mr. Lamm:

The New York State Society of Certified Public Accountants, the oldest state accounting association, representing approximately 30,000 CPAs, welcomes the opportunity to comment on the Proposed Information System Auditing Standard referenced above.

The NYSSCPA Technology Assurance Committee deliberated the Proposed Auditing Standard, assisted by members of the Litigation Services Committee, and prepared the attached comments. If you would like additional discussion with the committee, please contact Joel Lanz, vice-chair of the Technology Assurance Committee, at (516) 933-3882, or Robert Colson of the NYSSCPA staff, at (212) 719-8350.

Sincerely,

John J. Kearney
President

Attachment

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**COMMENTS ON ISACA PROPOSED INFORMATION SYSTEMS AUDITING
STANDARD ON**

Irregularities and Illegal Acts

December 30, 2004

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Marc Engel

Joel Lanz

Joseph B. O'Donnell, Ph.D.

Yigal Rechtman

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NYSSCPA Staff

Robert H. Colson

New York State Society of Certified Public Accountants
Comments to ISACA
Proposed Information System Auditing Standard on Irregularities and
Illegal Acts
December 31, 2004

General Comments

As previously communicated in our response to various ISACA exposure drafts on March 31, 2004, we again express our concern regarding ISACA's use of terms such as "audit," "review," "assurance," etc., which are well-defined and accepted in the accounting profession's authoritative literature. The words "audit" and "review" also have legal implications. Does the proposal cover only internal audit engagements, where management determines the scope, or is the intent of the proposal to IS auditors to perform the same level of work for fraud detection purposes as in an audit or review of financial statements under generally accepted auditing standards? The proposal does not adequately address the differences in the meaning of similar terms and in the performance expectations between IS engagements by internal auditors and by external auditors.

The language of the proposed standard closely follows U.S. general accepted auditing standards for financial statement auditing standards (U.S. GAAS). The problem with this approach is that an IS audit is not a financial statement audit. Standards for IS audits should focus responsibility to detect fraud on IS related activities rather than on broad responsibility as in financial statement audits; however, the proposed standard places general, organization-wide responsibility on the IS auditor rather than focused responsibility on IS. Reference to existing requirements, especially PCAOB Standard 2 and SAS 99 should be considered (these are not even identified as references in the proposal's item #22). Where a GAAS standard exists, it would be desirable for ISACA's proposals to be consistent with them. Otherwise, confusion could arise in the minds of both auditors and the public. This confusion could be avoided by specifying different standards for IS audits performed separately and for IS audits performed as part of a financial statement audit under GAAS.

In addition, because ISACA represents an international membership, definitions and standards promulgated by IFAC may be a more acceptable alternative to U.S. GAAS in helping to minimize misunderstandings as to the level of assurance provided.

CISAs are specialists in their field of IS audits, and fraud examiners are experts in the field of illegal actions. In the case of illegal actions, the proposed standard should require CISA's to involve other audit professionals, such as fraud examiners, with relevant and demonstrable experience and qualifications.

Specific Comments
ISACA Proposed Information System Auditing Standard on Irregularities And
Illegal Acts

Question 1

To what level do you think this is a relevant topic that should be addressed?

This topic should be addressed by ISACA. As other professional organizations have recently enhanced various standards in this area, it is critical that IS auditors understand the expectations held by various stakeholders regarding the responsibility to detect and deter fraud. IS auditors should also be aware of other professional standards, such as SAS 99 in the U.S., that can and should materially affect the work of the IS auditor. This proposed standard should be coordinated with other relevant standards already adopted in existing professional literature.

Question 2

Do you think this topic as presented is generally accepted to a sufficient level to be adopted by the profession?

Overall, the standard should be more specifically tailored to IS Auditors. The proposal addresses several different types of auditors, including CPAs, internal financial auditors, and IS auditors. Specific guidance to IS auditors would be more beneficial to ISACA members. Although well intentioned, it is unreasonable to expect that IS auditors, given their scope of practice in both public accounting and private enterprise, could actually achieve the requirements of proposed standard 6 (e.g., management has knowledge of fraud).

The standard recommends (commentary 18) that the “IS auditor should obtain reasonable assurance that there are no material misstatements due to irregularities and illegal acts.” Despite this recommendation, the proposal is limited in recommending ways to help the IS auditor make this assessment and to detect irregularities and illegal acts. The proposal should consider including:

- factors that increase the risk of irregularities and illegal acts, and
- testing methods specific to IS auditors to detect irregularities and illegal acts, (e.g., leveraging Benford’s Law to perform digital analysis).
- leveraging various appendices included in SAS 99 to “brainstorm” fraud opportunities.

Another concern relates to the limits of what an individual IS auditor can do. For example, the standard reads as if the IS auditor is completely independent without reporting to a superior (e.g., audit partner in public accounting, general auditor in industry, or statutory auditor in government). The IS auditor should first consult with

such superiors to validate concerns and brainstorm about actions. Concerning proposed standard 10, is it reasonable for the IS auditor to obtain written representations from management when the internal audit department as a whole does not?

The concept of materiality should be further defined in the context of this proposed standard. Is the IS auditor qualified (even if a CISA) to make materiality determinations, or should they consult with other internal and external auditors that may be more familiar with applying materiality judgments to the financial implications of exposure to fraud and errors?

Given the IS auditor's organizational status, the IS auditor should be complying with internal audit department policies and guidelines, rather than with standards that the internal audit function as a whole does not need to follow. The IS auditor should follow company and internal audit policies that have been reviewed by legal counsel to avoid any misunderstandings. In public accounting firms, the IS auditor should follow GAAS when engaged in an audit or review of financial statements, including compliance with various firm wide quality control and professional conduct compliance programs that the firm has.

As discussed in the general comments section, to be generally accepted, ISACA standards must be consistent with existing professional auditing standards, especially when describing fundamental audit terminology.

Question 3

Please provide feedback on section 10.

Although this type of requirement is part of GAAS, from a practical perspective, it is not usually performed by internal audit departments. As a result, should the individual IS auditor be held accountable for these representations? Perhaps an alternative would be a standard that requires the internal audit department to obtain such a representation in order to perform the audit in accordance with GAAS. External IS auditors, on the other hand, should not have issues with this statement because it is already required by GAAS.

Question 4

Please provide feedback on section 11.

As previously mentioned, the material should be defined organizationally and the first communication should be with their direct supervisor if possible. When appropriate, consultations with the legal counsel should occur.

Other Comments

- Title** states: “Irregularities.” Consider using “Fraud” instead throughout the document and in the title to be more consistent with recently issued auditing standards in the profession.
- Item 04** states: “recognizing the possibility that material misstatements due to irregularities”. The proposal is not clear about the type, effect, or class of misstatements. If these are *financial* misstatements, standards already exist that address such assertions. Other types of assertions, such as operational, operational effectiveness, operational efficiency, etc., may also be made, and they may be false or inaccurate as a result of irregular or illegal acts.
- Item 05** states “the auditor should obtain an understanding of the organization and its environment...” The proposal should state that the auditor *must* obtain such an understanding, so that this becomes a mandatory requirement under the standard. Without this requirement, IS auditors without the proper understanding of the organization’s environment may not properly achieve audit objectives.
- Items 06 and 10** To be consistent with GAAS, evidence should be both sufficient and competent. Another consideration is whether IS auditors would be willing to accept this level of responsibility. Will management (CEO, CFO, Board of Directors) accept being interviewed by the IS auditor?
- Item 07** discusses the need to “perform procedures to test the appropriateness of internal controls...” The proposed standard should also address the evaluation of the results of these tests. Without a proper evaluation of the results of the test procedures, as should be required by the standards, the IS auditor’s opinion can not be substantiated in his or her report.
- Item 14** The phrase "...that give rise to..." does not make sense in the context in which it occurs. We would suggest replacing it with the word “affect.”
- Item 15** This item should be expanded to include: “the auditor should document all communication, planning, results, evaluation and conclusions...”
- Item 17** The proposed standard implies this responsibility on the IS auditor. The attempt to reduce it in the commentary section will be ineffective if an IS auditor is sued for negligence based on this standard. This point should be part of the standard and not in the commentary. The standard needs to be reworded with this in mind.
- Item 19** States that the risk of not detecting illegal acts is higher than that of not detecting irregularities and errors. Like illegal acts, however, irregularities can

be deliberate, and both irregularities and errors can be accompanied by attempts at concealment. Moreover, depending on how “irregularities” and “errors” are defined, either can lead to an illegal act or possibly be illegal themselves.

Item 20&21 These items contain directions that are contrary to the current definition of professional skepticism, which instructs the auditor to neither assume honesty nor dishonesty. In addition, each audit should stand on its own and not rely on previous efforts (although these efforts may be used for audit planning).