PCAOB
Public Company Accounting Oversight Board

Statement to Consider New Estimates Standard and Amendments Related to Using the Work of Specialists

DATE:
Dec. 20, 2018

SPEAKER:
Duane M. DesParte, Board Member

EVENT:
PCAOB Open Board Meeting

LOCATION:
Washington

I support the adoption of the new and amended standards before the Board today, as I believe they set forth reasonable, targeted enhancements to auditing requirements that will improve audit quality in a cost-effective manner for the benefit of investors.

Over time, financial reporting frameworks have evolved toward greater use of estimation such that today accounting estimates are pervasive and significant, with impacts across many financial statement line items.

Likewise, the use of the work of specialists by both companies and auditors continues to increase in both frequency and significance, in part pursuant to increased accounting estimates but also pursuant to the increasing complexity of business practices and transactions.

PCAOB inspections and enforcement results have indicated the auditing of accounting estimates can be challenging for auditors. Further, through our oversight activities we have identified areas in which our existing standards for using the work of specialists can be enhanced.

Together, the new and amended standards being considered today should result in increased audit quality by clarifying and strengthening requirements in these often complex and subjective areas of the audit.

Estimates

For example, accounting estimates, by their nature, often involve subjective assumptions, measurement uncertainty, and complex processes and methods, and they require significant management judgment. Accordingly, accounting estimates require careful evaluation by the auditor.

The new estimates standard clarifies, strengthens, and brings together the requirements of three existing standards into a single standard, including extending certain of today's requirements for auditing fair value measurements to other significant accounting estimates. Clearer and more uniform requirements should drive more consistent and higher quality auditing.

Of note, the new standard reinforces the importance of the auditor applying professional skepticism in evaluating accounting estimates, including devoting greater attention to considering potential management bias.

In this regard, consistent with today's standards, the new standard emphasizes that the auditor should consider both corroborating and contradictory audit evidence. Importantly, including from a preparer's perspective, neither today's release nor existing standards require the auditor to scour the universe to uncover and consider any and all possible contradictory evidence. Rather, auditors are required to consider relevant contradictory evidence that is obtained during the course of the audit.

Specialists

With respect to using the work of specialists, the amendments to the standards are intended to improve audit quality by strengthening the requirements for evaluating the work of a company's specialist and by applying a risk-based supervisory approach for both auditor-employed and auditor-engaged specialists.

As they relate to company specialists, the amendments extend the auditor's responsibility from simply obtaining an understanding of the specialist's work to actually performing procedures to evaluate the appropriateness of the data, significant assumptions and methods used by the specialist. In other words, the amendments make clear that the auditor cannot accept a specialist's work at face value.

At the same time, I am pleased that the final release is responsive to feedback we received. The final amendments reflect a number of clarifying revisions to eliminate or revise certain originally proposed requirements that may have been perceived by auditors, preparers, and other stakeholders as unnecessarily complex or prescriptive.

For example, the final amendments remove the word "test" from the requirements to evaluate the work of the company's specialist, except in relation to company-produced data. The original proposal could have been interpreted as requiring auditors to reperform the work of a company's specialist, which in my view would be an unnecessary and costly duplication of efforts relative to the incremental improvement in audit quality. Today's release makes clear that auditors are not expected to reperform the work of the company's specialist.

Overall

Significantly, all of the new and amended standards before us today are aligned with the PCAOB's risk assessment standards and are therefore designed to be risk-based and scalable.

Rather than prescribe detailed procedures or a one-size-fits-all approach, the new and amended standards allow the auditor discretion in determining the level of testing and required audit evidence that is commensurate with the risk of material misstatement.

Accordingly, if implemented thoughtfully, the new requirements are not expected to place unwarranted additional burden on either auditors or preparers, and any additional procedures and related costs should be proportionate to corresponding increases in audit quality.

Looking longer term, each of the new standards is also sufficiently principles-based and flexible to accommodate continued advances in the use of data and technology by both preparers and auditors.

Effective Date

Finally, I have carefully considered the proposed implementation effective date, which is for audits of financial statements for fiscal years ending on or after December 15, 2020.

Given the expected improvements in audit quality upon adoption, it is important that the new standards are implemented as expeditiously as reasonably possible. At the same time, I am cognizant firms require sufficient time to update methodologies, develop tools, provide staff training and prepare audit committees and management for the changes.

Upon reflection, I support the proposed 2020 implementation date so that investors benefit from the anticipated improvements in audit quality as soon as practicable. The 2020 effective date also aligns with implementation dates of the new Current Expected Credit Loss accounting standard and the new international auditing standard ISA 540, *Auditing Accounting Estimates and Related Disclosures*.

At the same time, I recognize that adopting the standards will require significant effort. The PCAOB's Office of the Chairman and senior staff have committed that the Office of the Chief Auditor, Division of Registration and Inspections, and Office of Economic Research and Analysis will proactively establish a robust, comprehensive implementation support program to assist firms, both small and large, and other impacted stakeholders across the financial reporting eco-system.

In this regard, a cross functional working group will be established to engage with stakeholders, monitor progress, issue clarifying guidance, conduct webinars and training, and be available for consultations.

Conclusion

In closing, I would like to thank all those who have contributed to the development of these new standards, including current and former PCAOB Board and staff members, the SEC, the Standing and Investor Advisory Groups, and all other parties who participated and provided comments throughout the rule making process. In particular, I would like to recognize our Office of the Chief Auditor, Office of Economic and Risk Analysis, and Office of General Counsel for their tremendous efforts in bringing these standards to completion.