

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

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SPEAKER:

William D. Duhnke, Chairman

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After joining the PCAOB earlier this year we wanted to take adequate time to understand the objectives of these proposals and determine whether and how the proposals would support those objectives. Following careful study, I'm pleased that we are able to move these two projects forward today.

Determining whether to begin a new standard-setting project or advance an existing one should rest on two principles:

- First, what problem within our jurisdiction needs to be addressed and is standard setting the appropriate means by which to address it?
- Second, is the proposed standard appropriately tailored? In other words, based on available evidence, do the benefits of the proposal outweigh our understanding of its costs?

These two proposals, in my judgment, meet these threshold requirements.

I. Auditing Accounting Estimates, Including Fair Value Measurements

Between 1988 and 2003, the auditing profession adopted three different standards related to auditing accounting estimates. Although these three standards use a common approach for the substantive testing of estimates, they vary in their level of detail in describing the auditor's responsibilities. The result was inconsistency in the auditing of estimates. The three standards also predate the Board's risk assessment standards and therefore do not fully integrate requirements related to identifying, assessing and responding to risks of material misstatement in accounting estimates.

The objective of this proposal is to adopt a single standard for auditing all accounting estimates that articulates a clearer, more consistent, and risk-based approach. Based on the evidence available at present, the proposed standard thoughtfully addresses known concerns and is well tailored to address this significant and challenging audit area.

The new standard is risk-based and scalable. It neither prescribes detailed procedures for the auditor to perform nor the extent of those procedures in each circumstance. Rather, it requires that the auditor respond to assessed risks and provides direction for testing estimates based on those risks. The new standard builds on our existing risk assessment requirements and focuses the auditors' efforts on those estimates with greater risk of material misstatement.

We are adopting this proposal only after substantial outreach, including two rounds of public comment. Commenters generally supported the objective of improving the quality of audits involving estimates, and suggested areas where the proposed requirements could be modified or clarified. After careful and deliberate consideration of the comments received, we have made responsive changes to address commenters' concerns with certain aspects of the proposal.

II. Auditor's Use of the Work of Specialists

Let me turn now to the *Auditor's Use of the Work of Specialists*. As accounting estimates have become both more prevalent and significant, auditors' use of the work of specialists also continues to increase in frequency and significance. Auditors tend to encounter specialists acting in two capacities. First, they may consider the work of specialists engaged by, or employed by, the financial statement preparer. Auditors will often use the work of such company specialists as audit evidence in evaluating management's estimates. Second, auditors may use the work of their own employed or engaged specialists to assist them in evaluating significant accounts and disclosures, including accounting estimates in those accounts and disclosures. The role of specialists—whether auditor-employed or engaged specialists, or company specialists—is often critical to ensuring high quality financial reporting. When an auditor does not appropriately oversee or evaluate the work of a specialist, there may be a heightened risk that the auditor will be unable to detect a material misstatement.

Under existing PCAOB standards, the auditor has the same responsibilities with respect to both a company's specialist and an auditor-engaged specialist, notwithstanding their fundamentally different roles. Company specialists primarily assist the preparation of the financial statements and are overseen by management, whereas auditor-employed or auditor-engaged specialists are subject to risk-based supervision directly by the audit team.

The objective of this proposal is to better reflect how an auditor uses the work of those different types of specialists and to strengthen the requirements for evaluating the work of a company's specialist. The final amendments align closely with our risk assessment standards, such that an auditor's effort to evaluate the specialist's work is commensurate with the risk of material misstatement. We expect that the changes will direct auditors to devote more attention to the work of a company's specialist and to enhance the coordination between an auditor and the auditor's specialist—whether employed or engaged. These amendments should lead to more uniform practices among audit firms of all sizes. While uniformity is not an end in itself, we expect that greater uniformity in this area will lead to increased audit quality, particularly as it relates to auditing accounting estimates and disclosures when specialists are involved.

As with the estimates projects, we are adopting these amendments only after substantial outreach, including two rounds of public comment. Following our close review of the comments received, the final changes reflect a number of revisions to eliminate or revise certain proposed requirements that may have been perceived by commenters as unnecessarily complex or prescriptive. I'll close by thanking the PCAOB staff for their work in bringing these projects to completion. We appreciate your significant efforts and I'm pleased to support both proposals.