
Audit Committee Resource

New PCAOB Requirements Regarding
Auditing Estimates and Use of Specialists

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CONTENTS

Overview	3
New Requirements: The Basics	3
Key Takeaways for Audit Committees	4
Learn More	6

OVERVIEW

The Public Company Accounting Oversight Board's (PCAOB) new requirements related to (1) auditing accounting estimates, including fair value measurements, and (2) using the work of specialists will take effect for audits of fiscal years ending on or after December 15, 2020. This document aims to provide audit committees with key takeaways about these new requirements and includes some possible questions audit committees may consider asking their auditors.

NEW REQUIREMENTS: THE BASICS

Auditing Accounting Estimates, Including Fair Value Measurements

Background

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

The New Requirements

In December 2018, the Board adopted a single standard for auditing accounting estimates.

The new standard is risk-based and scalable. It does not prescribe 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. It also reinforces the importance of auditors applying professional skepticism, including by addressing potential management bias. Additionally, the new standard reminds auditors to take into account relevant audit evidence—regardless of whether it corroborates or contradicts the company's assertions.

Auditor's Use of the Work of Specialists

Background

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 who are either employed or engaged by the financial statement preparer and whose work is relevant to the development of accounting estimates. Auditors may 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 (collectively referred to as "auditor's specialists") to assist them in evaluating significant accounts and disclosures, including accounting estimates

in those accounts and disclosures. The role of specialists—whether auditor’s 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 previous PCAOB standards, the requirements dealing with the auditor’s use of the work of a company’s specialist and an auditor-engaged specialist were the same, notwithstanding their fundamentally different roles.

The New Requirements

In 2018, the Board amended our standards 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 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 an auditor’s specialist. For instance, with respect to using the work of the company’s specialist, the amended standard extends the auditor’s responsibility beyond simply obtaining an understanding of that specialist’s work to evaluating the data, significant assumptions, and methods the specialist used and testing data the company provided to the specialist. The requirements do not require the auditor to re-perform the work of any specialists.

We expect these amendments will lead to more uniform practices among audit firms of all sizes, which we expect in turn will lead to increased audit quality.

KEY TAKEAWAYS FOR AUDIT COMMITTEES

As audit committees discuss these new requirements with their auditors, there are several considerations to keep in mind:

- **The effects of the new requirements will not be uniform across all audits.** Some audit firms may have previously implemented aspects of the new requirements for auditing estimates and using the work of specialists, as best practices already incorporated into their firms’ audit methodologies. In those circumstances, companies may not notice a change in their audits. For other companies, particularly those that do not engage one of the largest U.S. audit firms, the opposite may well be true.
- **The extent of effects of the new requirements will depend on the nature and extent of accounting estimates included in the company’s financial statements, and also on whether the company uses a specialist.** The new requirements continue to allow auditors to use the work of the company’s specialist; they do not require the auditor to use an auditor’s specialist. In implementing the new requirements, however, an auditor may choose to use an auditor’s specialist in areas with higher risk of material misstatement. New or significant unusual transactions, the implementation of new accounting standards, the subjectivity of certain assumptions in estimates, and increases

in the use of company specialists are just a few of the considerations that might also influence the auditor's determination of whether and how to involve specialists in the audit.

- **The new standard and amendments do not change the requirements for the auditor's communications with audit committees, including those communications related to critical accounting estimates.** Auditors are still required to communicate an overview of their audit strategy, including the use of specialists, the significant risks identified in their risk assessment procedures, and other matters as identified in [the standard on audit committee communications](#).
- **Auditors are applying these new requirements in extraordinary times and in situations that continue to evolve due to the COVID-19 pandemic.** The uncertainty and volatility in the current economic environment may have a significant effect on the complexity of accounting estimates and measurement uncertainty. The auditor's understanding of methods, data, and significant assumptions used by the company in developing estimates will be important in identifying potential risks associated with estimates contained in the company's financial statements.

Questions Audit Committees Can Consider

1. How might the audit of my company's estimates be affected by the PCAOB's new requirements?
2. To what extent does my company engage specialists to be involved in the preparation of financial statements?
3. Does my auditor involve specialists? If so, in what areas, and how are the specialists used?
4. Is my auditor using a specialist this year for the first time or in a different way than in past audits?
5. Were there any significant changes in my auditor's approach compared to prior years due to the new requirements?
6. Did my auditor have any particular challenges in applying the new requirements at our company?
7. How does my auditor address potential management bias in accounting estimates?

LEARN MORE

For more information, visit the implementation pages for [estimates](#) and [specialists](#) to explore video presentations, guides to navigating the new standards, and other resources.

We intend to continue our outreach efforts to understand how the implementation of these new requirements is progressing and to determine the need for any additional resources for auditors or other stakeholders.

We Want to Hear from You

So we can continue to improve our external communications and provide information that is timely, relevant, and accessible, we want your views on this document. We invite you to fill out **our survey**, which should take no more than two minutes to complete.

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