From the Office of PCAOB Board Member Christina Ho

PCAOB Docket 056: Proposed Auditing Standard Designing and Performing Substantive Analytical Procedures and Amendments to Other PCAOB Standards- February 24, 2025, Virtual Meeting with MindBridge Analytics Inc.

<u>Attendees</u>

PCAOB:

- Board Member Christina Ho
- Board Advisor Julie Edwards
- Board Counsel Steven D. Laughton

MindBridge:

- Wenzel Reyes, Senior Methodology Director

<u>Summary of Discussion</u>

Board Member Ho advised that her views are her own and are not necessarily those of the PCAOB Board, other Board Members, or PCAOB staff.

Board Member Ho stated that MindBridge's August 12, 2024, comment letter states that the proposal does not sufficiently encourage or advocate for the use of technology. She asked do you really believe that is necessary since the proposal does not discourage the use of technology? Mr. Reyes replied that the tone of the proposal seems to discourage the use of technology; specifically, the second sentence of proposed AS 2305.07 ("The auditor may not develop the expectation using the company's amount or information that is based on the company's amount."). Mr. Reyes stated that the proposal deletes current AS 2305.04 and .05, which he said seems to further discourage the use of technology such as AI and machine learning, and rhetorically asked where does technology assisted data analytics fit in under this proposed standard? He elaborated that the prohibition on the use of "company amounts" would be problematic from the use of technology perspective; for example, the prohibition on the use of a company's general ledger or subledger amounts would prevent the performance of procedures from a data analytics perspective. He pointed out there is no standard on data analytics and that because the proposed standard restricts the use of company information, there will be uncertainty in the market in that firms will not know how to use technology under the proposed standard.

The discussion then revolved around the term "substantive analytics" being a phrase used before advances in technology where it is/was a manual process with Mr. Reyes pointing out that it may be at odds with the term "advanced data analytics." He noted that substantive analytics is a methodology used by auditors historically to manually test a relatively low risk account with a large volume of transactions that are homogeneous in nature and therefore relatively easier to manually project the potential balance. Mr. Reyes then contrasted substantive analytics to advanced analytics with advanced analytics involving the use of data science techniques,

including machine learning and artificial intelligence, on large datasets to predict certain outcomes. Mr. Reyes noted that the challenge is that the two terms may get conflated within the auditing context. Mr. Reyes then suggested that there be greater clarity with regard to how firms may use technology under the proposed standard; specifically, asking how does technology assisted analysis fit in under AS 2305.07? He noted that if firms cannot use company information, firms will have to "hunt" for other information that may not be subject to controls.

Board Member Ho then asked how would one distinguish the use of company data in the past versus such use in an advanced data analytics stage? Mr. Reyes replied that "in the old days," firms would validate company provided data and associated controls on a sample basis and then, if the validated data meets expectations, do more testing of details. But where anomalies exist, take a larger sample size for validation. The "new way" would be to use technology to validate the entire set of company provided data and then use that validated data to predict, for example, revenue, as opposed to the old way of estimating revenue. Mr. Reyes stated that he does not believe the proposal addresses the "new way." For example, he pointed out that risk assessment, test of details, and analytics can be done simultaneously but the proposal says the information needs to be tested first to see if it's reliable to be used for substantive analytical procedures.

Board Member Ho asked if there's anything else he would like to add. Mr. Reyes stated that technology assisted data analysis enables the auditor to look at every single transaction as opposed to the current sampling methodology, meaning that technology assisted data analysis provides a higher level of sufficient appropriate audit evidence. He noted that only the Big 4 use such technology and that he would like smaller firms to use it. He noted that cost is not a barrier, because the technology is affordable but that its use would require changes in methodology entailing greater internal investment so that firm personnel can comfortably and confidently explain the methodology to PCAOB inspectors. He elaborated that the main barrier is a knowledge gap in that smaller firms lack the knowledge and expertise; specifically, smaller firms lack the personnel and bandwidth to analyze the methodology compared to the Big 4 who have multiple individuals in this area compared to maybe one individual in smaller firms.