CAQ ALERT
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Select Auditing Considerations for the 2017 Audit Cycle

The Center for Audit Quality (CAQ) is pleased to release our annual *Select Auditing Considerations for the 2017 Audit Cycle Alert* (the 2017 CAQ Alert), as part of the profession's commitment to continuously strengthening audit quality. The 2017 CAQ Alert can be a useful resource for our member firms and is intended to serve as a reminder of certain auditing considerations that may be relevant for the 2017 audit cycle. The 2017 CAQ Alert discusses some of the more judgmental or complex audit areas, including some of those identified by the Public Company Accounting Oversight Board (PCAOB) through its inspection process and in the recent PCAOB Staff Inspection Brief. While the 2017 CAQ Alert highlights certain areas and questions for consideration, it should not be relied upon as definitive or all-inclusive, and should be read and considered in conjunction with the applicable rules, standards, and guidance in their entirety.

In addition to the 2017 CAQ Alert, the CAQ has also issued a companion alert, *Select Considerations for the 2017 Audit Cycle for Brokers and Dealers*. It addresses some of the more judgmental or complex audit areas related to audits of brokers and dealers and provides select information related to these areas.

The 2017 CAQ Alert focuses on the following topics:

- Auditor Independence
- Multinational Audits
- Transitioning to New Accounting Standards
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Auditor Independence

PCAOB inspections staff continue to focus on and assess how a firm's independence quality controls provide reasonable assurance that the firm maintains independence from its audit clients, including how those systems stay abreast of the growth in consulting and other non-audit services.[1] The PCAOB's identification of deficiencies indicated that the systems of quality control of certain firms did not provide sufficient assurance that the firm's personnel understood the independence requirements and that the firm and its personnel complied with the independence requirements.[2] The PCAOB's inspection procedures typically include, among other things, assessment of firms' processes to consider independence issues with accepting new clients, which may happen more frequently due to mandatory rotation outside the US.[3]

Examples of deficiencies observed by the PCAOB related to noncompliance with its rules, or with Securities and Exchange Commission (SEC) rules and regulations on independence, included auditors providing impermissible non-audit services and instances in which auditors did not obtain pre-approval from the audit committee prior to performing non-audit services.[4]

Auditors should continue to assess their personal and professional activities to ensure compliance with applicable independence rules and standards.

Multinational Audits

For multinational audits, the auditor should make inquiries concerning the professional reputation and independence of the other auditor.[5] In addition, when the principal auditor decides not to make reference to the audit of the other auditor, the principal auditor must obtain, review, and retain information consistent with the requirements of AS 1205.12.

Consider the following questions when other auditors are involved in a multinational audit and the principal auditor is not making reference to the other auditor:

- Have the professional reputation and independence of the other auditors been evaluated through inquiries and appropriate measures?[6]
- Has the quality of work performed by the other auditor been appropriately evaluated?[7]
- If applicable, were the potential implications on the multinational audit due to mandatory firm rotation within the European Union or other jurisdictions discussed with the audit committee? For example, is there a new audit firm performing work? If yes, what additional audit procedures by the principal auditor are necessary during the current audit to evaluate the independence and quality of work performed, if any?

Transitioning to New Accounting Standards

SAB 74 (CODIFIED IN SAB TOPIC 11.M) DISCLOSURES

The new revenue recognition, leases, and credit losses accounting standards become effective over the next few years, and these new accounting standards are expected to present significant changes for many companies.[8] Even in situations where

1 PCAOB Staff Inspection Brief, Vol. 2017/3.

2 Ibid.

3 PCAOB Staff Inspection Brief, Vol. 2017/3 and Regulation (EU) No. 537/ 2014 of European Parliament and of the Council (April 16, 2014).

4 PCAOB Staff Inspection Brief, Vol. 2017/3.

5 Auditing Standard (AS) 1205 (AS 1205), *Part of the Audit Performed by Other Independent Auditors*, paragraph .10.

6 Ibid.

7 AS 1205.12.

8 Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers* (Topic 606), ASC 842, *Leases* (Topic 842), and ASC 326, *Financial Instruments – Credit Losses* (Topic 326).

a new accounting standard is not expected to significantly impact a registrant's primary financial statements, the accounting standard's requirements related to footnote disclosures may still result in a significant change.

The SEC Staff Accounting Bulletin (SAB) No. 74 (codified in SAB Topic 11.M), *Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period*, (commonly referred to as "SAB 74"), requires, when a recently issued accounting standard has not yet been adopted, that a registrant discuss the potential effects of the future adoption in its interim and annual SEC filings. Such disclosures are required to be both qualitative and quantitative.[9]

The SEC staff, through guidance and public comments, have suggested that they expect registrants to include the following types of SAB 74 disclosures in their financial statements in the periods before new accounting standards are effective.

- **A comparison of accounting policies**—Companies should provide a comparison of the registrant's current accounting policies to the expected accounting policies under the new accounting standard(s).
- **Status of implementation**—Regulators have advised that the status of the implementation process should be disclosed, including disclosures related to significant implementation matters yet to be addressed or if the implementation process is lagging.[10]
- **Consideration of the effect of new footnote disclosure requirements in addition to the effect on the balance sheet and income statement**—Companies may determine that a new accounting standard is not expected to materially impact the primary financial statements. However, certain new accounting standards require new, comprehensive footnote disclosures that may be significant to the financial statements and require significant judgments. Accordingly, registrants should consider the full scope of a new accounting standard, which covers recognition, measurement, presentation, and disclosure.
- **Disclosure of the quantitative impact of new accounting standard(s) if it can be reasonably estimated**—A registrant who can reasonably estimate the quantitative impact of the new accounting standard should disclose those amounts.
- **Disclosure that the expected financial statement impact of new accounting standard(s) cannot be reasonably estimated**—If the impact of a new accounting standard cannot yet be reasonably estimated, the registrant should disclose that fact. Financial statement users may incorrectly assume there is no material financial statement impact if the registrant does not state otherwise.
- **Qualitative disclosures** - When the expected financial statement impact is not yet known by a registrant, a qualitative description of the effect of the new accounting standard on the registrant's accounting policies should be disclosed. Understanding the registrant's qualitative views could help financial statement users better understand the impact—until it can be quantified—of adoption of a new accounting standard.

Auditors are reminded, as part of performing an audit of the financial statements taken as whole, to evaluate whether adequate SAB 74 disclosures have been included in the financial statements preceding the adoption of new accounting standards.[11] Auditors also have responsibilities under PCAOB standards for performing procedures with respect to SAB 74 disclosures presented in interim financial information.[12] The auditor's procedures in a review of interim financial information are generally limited to analytical procedures, inquiries, and other procedures that address significant accounting and disclosure matters relating to the interim financial information to be reported.[13] After the issuance of a new accounting

9 ASC 250-10-S99-6.

10 SEC staff announcement at 9/22/2016 Financial Accounting Standards Board Emerging Issues Task Force meeting minutes, p. 4.

11 AS 2301, *The Auditor's Responses to the Risks of Material Misstatement* (AS 2301), paragraph .08.

12 PCAOB Staff Audit Practice Alert No. 15, *Matters Related to Auditing Revenue from Contracts with Customers* (Practice Alert No. 15), and AS 4105, *Reviews of Interim Financial Information* (AS 4105), paragraph .02 which defines the term "interim financial information" to mean "financial information or statements covering a period less than a full year or for a 12-month period ending on a date other than the entity's fiscal year end."

13 Practice Alert No. 15, and AS 4105.15.

standard, auditors would ordinarily inquire of management about the application of new accounting principles as part of their review of interim financial information.[14] PCAOB auditing standards require the auditor to communicate to the audit committee if concerns are identified regarding management's anticipated application of a new accounting standard.[15] In the post-effective date period, auditors are required to evaluate consistency of the financial statements with generally accepted accounting principles in the US, including newly adopted accounting principles.[16]

For further details, see CAQ Alert No. 2017-03, *SAB Topic 11.M – A Focus on Disclosures for New Accounting Standards*.

Consider the following question when reviewing interim and auditing annual financial statements:

- Are the company's SAB 74 disclosures included in the financial statements preceding the adoption of new accounting standards adequate? For example, do the SAB 74 disclosures reflect the state of management's progress with implementation?

- Have the disclosures changed from the prior quarter? Have the disclosures been sufficiently audited, as applicable, based on where they are located (i.e., MD&A or footnotes)?

INTERNAL CONTROL OVER FINANCIAL REPORTING

In a June 2017 speech, SEC Chief Accountant Wes Bricker reminded issuers and their auditors that updating and maintaining internal control over financial reporting (ICFR) will be particularly important as companies work through the implementation of the significant new accounting standards. Companies' implementation activities will require careful planning and execution, as well as sound judgment from management.

In a December 2016 speech, Helen A. Munter, director of the PCAOB's Division of Registration and Inspection, commented that the PCAOB inspections staff will want to understand whether auditors have had discussions with their clients related to changes issuers may implement in their processes or controls, whether the auditor has remained independent in the process of client implementation of the accounting standards, and whether the auditor is appropriately reporting any concerns about readiness or technical ability to the audit committee on a timely basis.

As part of the audit of ICFR, auditors are reminded of their responsibility to assess the factors that affect the risks of material misstatement, to design further audit procedures as appropriate,[17] and to consider whether appropriate controls are in place to provide adequate SAB 74 disclosures. Further, auditors may want to consider if there are any material changes in ICFR in connection with the adoption of new accounting standards that may warrant disclosure in interim or annual reporting periods.[18]

Consider the following questions when developing and performing audit procedures in this area:

- If applicable, have any concerns regarding the company's readiness or technical ability related to the implementation of accounting standards issued but not yet effective, including sufficiency of resources been communicated to the audit

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14 AS 4105, *Reviews of Interim Financial Information,* paragraph .55.

15 AS 1301 *Communications with Audit Committees* (AS 1301), paragraph 13(f), states that for new accounting pronouncements the auditor should communicate to the audit committee "situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipated application of accounting pronouncements that have been issued but are not yet effective and might have a significant effect on future financial reporting."

16 AS 2820, *Evaluating Consistency of Financial Statements*, paragraph 7 states, "the auditor should evaluate a change in accounting principle to determine whether (a) the newly adopted accounting principle is a generally accepted accounting principle, (b) the method of accounting for the effect of the change is in conformity with generally accepted accounting principles, (c) the disclosures related to the accounting change are adequate, and (d) the company has justified that the alternative accounting principle is preferable."

17 AS 2110, *Identifying and Assessing Risks of Material Misstatement* (AS 2110), paragraph .18.

18 Item 308 of Regulation S-K (a)(4)(c).

committee (e. g., risks related to internal controls over the transition adjustment and/or “Day 2” accounting)?[19]

- Are appropriate controls in place to provide adequate SAB 74 disclosures (e.g., controls over the completeness and accuracy of SAB 74 disclosures)? For integrated audits, have the controls been evaluated?

- Have there been any material changes in ICFR as a result of adopting new accounting standards that require disclosure during interim periods?

To assist auditors in applying PCAOB standards when auditing companies’ implementation of the new revenue accounting standard, the PCAOB published Practice Alert No. 15 in October 2017. Practice Alert No. 15 discusses (a) auditing management’s transition disclosures in the notes to the financial statements, (b) auditing transition adjustments, (c) considering internal control over financial reporting, (d) identifying and assessing fraud risks, (e) evaluating whether revenue is recognized in conformity with the applicable financial reporting framework, and (f) evaluating whether the financial statements include the required disclosures regarding revenue.[20]

Audit Areas Potentially Affected by Economic Factors

Many current economic environmental factors that were present in the prior year continue to exist in 2017, including continued fluctuations in oil and gas prices, the search for higher-yielding investment returns in a low interest rate environment and the high pace of mergers and acquisitions.[21] In addition, auditors should consider the effects of Brexit on the European financial sector and the related audit risks that may arise.[22]

Consider the following questions when developing and performing audit procedures in this area:

- As part of obtaining an understanding of the entity and its environment under AS 2110, have relevant industry, regulatory, and other external factors including general economic conditions been considered (e.g., Brexit, if applicable)?

- Have current economic environmental factors been considered when testing accounting estimates (e.g., impact on significant assumptions and other inputs to the estimation process)?

- How has auditing merger and acquisition transactions been approached?

  - Has the risk of improper valuations of assets acquired and liabilities assumed been appropriately considered?

  - Have all intangible assets been identified?

  - Has the assignment of goodwill to reporting units been appropriately considered?

  - Have contingent consideration measurements been appropriately considered?

- How have higher-risk instruments, including loans and securities with potentially higher investment returns that may be complex and harder to value, been addressed?[23]

19 During her December 2016 speech at AICPA Conference on SEC and PCAOB Developments by Helen A. Munter, Director, PCAOB Division of Registration and Inspection stated, “We will want to understand whether the auditors have had discussions with their clients related to changes issuers may implement in their processes or controls, whether the auditor has remained independent in the process of client implementation of the standards, and whether the auditor is appropriately reporting any concerns about readiness or technical ability to the audit committee on a timely basis.”

20 Practice Alert No. 15, page 2.

21 PCAOB Staff Inspection Brief, Vol. 2017/3.

22 Ibid.

23 See discussion in PCAOB Staff Inspection Brief, Vol. 2017/3.

Recurring Audit Deficiencies

INTERNAL CONTROL OVER FINANCIAL REPORTING

As it relates to AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* (AS 2201), PCAOB inspections staff continue to consider, among other things, the sufficiency of auditors' procedures performed to identify, test, and evaluate controls that address the auditors' assessed risks of material misstatement, including auditors' testing of controls that contain a review element. Staff Audit Practice Alert No. 11, *Considerations for Audits of Internal Control Over Financial Reporting* (Practice Alert No. 11) provides additional details.

Consider the following questions when developing and performing audit procedures in this area:

- Are management review controls designed with enough precision to achieve the control objective?[24]
- Does the audit strategy consider the assessed risks of material misstatement, and the evidence needed to support the design of the control and its operation, including evidence about the completeness and accuracy of system-generated data or reports[25] used to support the performance of a management review control?
- Are there multiple control activities that are performed as part of the review control that need to be evaluated?
- Does the person performing the control possess the necessary authority and competence to perform the control effectively?[26]

IDENTIFYING, ASSESSING, AND RESPONDING TO RISKS OF MATERIAL MISSTATEMENT

A continued area of focus for the PCAOB is the auditor's processes for identifying and assessing risks of material misstatement at the financial statement assertion level.[27] Proper identification of the risks of material misstatement, including the types of potential misstatements that can occur and the likely sources of those potential misstatements, is necessary when selecting appropriate controls to test, evaluating whether those controls adequately address the risks, and designing and executing substantive procedures.

Consider the following questions when developing and performing audit procedures in this area:

- How has the design and operating effectiveness of controls been tested to support the auditor's planned level of control reliance, including testing the controls over the accuracy and completeness of system-generated data and reports?[28]
- Are substantive procedures, including tests of details, specifically responsive to fraud risks and other significant risks that were identified?[29]
- How was the presentation of the financial statements, including the accuracy and completeness of the disclosures evaluated?[30]
- How was relevant audit evidence that appeared to contradict certain assumptions in the financial statements evaluated?[31]

ACCOUNTING ESTIMATES, INCLUDING FAIR VALUE MEASUREMENTS

Fair value measurements and other accounting estimates are subjective and involve the potential for management bias.

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24 Practice Alert No. 11, page 20.
25 Practice Alert No. 11, page 23, FN 45.
26 Practice Alert No. 11, pages 21-23, and AS 2201, paragraph .44.
27 PCAOB Staff Inspection Brief, Vol. 2017/3.
28 AS 2301, paragraphs .16-.35, and AS 1105, *Audit Evidence* (AS 1105), paragraph .10.
29 AS 2301, paragraphs .11, and .13.
30 AS 2810, *Evaluating Audit Results* (AS 2810), paragraphs .30 -.31.
31 AS 2810.03 and .34.

New accounting standards, including accounting for revenue recognition, leases, and current expected credit losses, require significant judgment.[32] Company policies, processes and ICFR are critical to the development of consistent, objective, and transparent accounting estimates. Auditors are reminded to apply professional skepticism when testing accounting estimates and consider the risk of management bias. PCAOB inspections staff continue to look at auditors' procedures performed to understand how estimates were developed as well as auditors' testing of data and evaluation of assumptions used by management that are significant to the estimate.[33] Audit procedures should not be limited to inquiry[34] and should sufficiently consider contradictory or potentially inconsistent information when testing these areas.[35]

Auditing deficiencies in this area have commonly related to evaluating impairment analyses of goodwill and other long-lived assets, and the valuations of assets and liabilities acquired in business combinations.[36]

Consider the following questions when developing and performing audit procedures in this area:

- How has the potential for management bias been considered, and has professional skepticism been applied when testing accounting estimates, including considering contradictory or potentially inconsistent information?
- Have sufficient audit procedures been performed to understand how estimates were developed, to test data used, and to evaluate assumptions used by management that are significant to the estimate?

Financial Reporting Areas

GOING CONCERN

We encourage auditors to continue to focus on evaluating a company's ability to continue as a going concern in light of the related accounting standard that took effect recently.[37] Accounting Standards Update (ASU) No. 2014-15 requires management to assess a company's ability to continue as a going concern and to provide related footnote disclosures in certain circumstances.

Auditors should assess management's going concern evaluation prepared in accordance with ASU No. 2014-15.[38] The auditor's evaluation of whether substantial doubt exists is qualitative based on relevant events and conditions and other considerations as set forth in AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern* (AS 2415). As noted by the PCAOB, while ASU No. 2014-15 defines a threshold for "substantial doubt" for use by companies in their assessment, PCAOB standards have not changed. As a result, management's determination that substantial doubt does not exist under the provisions of ASU No. 2014-15 is not conclusive as to whether an explanatory paragraph is required in the auditor's report.[39] Auditors should apply professional skepticism and consider the relevant facts, regardless of whether they support or contradict management's assertions.

Consider the following questions when developing and performing audit procedures in this area:

- Has management's going concern evaluation been reviewed, applying professional skepticism? Have relevant facts that support or contradict management's assertions been considered?
- Does management's analysis consider whether current economic factors exist that might impact the issuer's ability to

32 ASC 606, *Revenue from Contracts with Customers*, ASC 842, *Leases*, and ASC 326, *Financial Instruments – Credit Losses*.

33 PCAOB Staff Inspection Brief, Vol. 2017/3 and AS 2501, *Auditing Accounting Estimates*, paragraphs .10 - .11.

34 AS 1105.17.

35 AS 1105.29, and AS 2810.34b.

36 PCAOB Staff Inspection Brief, Vol. 2017/3.

37 FASB ASU No. 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* (ASU No. 2014-15) became effective for all companies for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter.

38 PCAOB Staff Audit Practice Alert No. 13, *Matters Related to the Auditor's Consideration of a Company's Ability to Continue as a Going Concern.*

39 Ibid.

continue as a going concern?[40]

- If applicable, how have conditions and events identified that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time been considered?[41]

EVALUATION OF INCOME TAX ACCOUNTING AND DISCLOSURES

For issuers that have large and growing undistributed earnings in foreign jurisdictions, PCAOB inspections staff may focus on the audit procedures that were performed to evaluate and test management's assertion related to the indefinite reinvestment of those earnings, including the impact of events, such as significant cash transfers from a foreign subsidiary to the US parent.[42] Another area of focus may be the auditor's evaluation of the design and operating effectiveness of controls related to income taxes.[43]

Consider the following questions when developing and performing audit procedures in this area:

- Are there large and growing undistributed earnings in foreign jurisdictions?
- Is there a foreseeable need for cash by the US parent?
- Have there been any significant cash transfers from a foreign subsidiary to the US parent?
- Is management's assertion related to indefinite reinvestment of earnings included in the management representation letter?

Increasing Transparency through Disclosure of Engagement Partner and Certain Other Participants in Audits: PCAOB Rules 3210 and 3211

In May 2016, the SEC approved PCAOB Rule 3210*, Amendments* and Rule 3211, *Auditor Reporting of Certain Audit Participants*. Registered public accounting firms are now required to file with the PCAOB a new form, Form AP, *Auditor Reporting of Certain Audit Participants*.[44] The information reported on Form AP is available publicly in a searchable database on the PCAOB's website. Firms are required to file Form AP for public company audit reports issued on or after:

- January 31, 2017 (Form AP to include engagement partner names)
- June 30, 2017 (Form AP to also include information regarding other accounting firms that participated in the audit)

Form AP is required to be filed by the 35th day after the date the audit report is first included in a document filed with the SEC (e.g., Form 10-K), with a shorter 10-day filing deadline that applies when the audit report is first included in a Securities Act registration statement (e.g., Form S-1).

The 2017 PCAOB inspection program includes procedures to assess the effectiveness of firms' implementation of Rule 3211, including reviewing firms' systems of quality control in this area and assessing compliance with the new rule for particular audit engagements.[45]

While Rule 3211 has no incremental requirements with respect to communications to the audit committee, auditors may consider briefing the audit committee on Rule 3211 and its associated requirements for the auditor. AS 1301 provides existing

40 PCAOB Staff Inspection Brief, Vol. 2017/3.
41 AS 2415.06.
42 PCAOB Staff Inspection Brief, Vol. 2017/3.
43 Ibid.
44 See CAQ Alert No. 2016-03, *Form AP, Auditor Reporting of Certain Audit Participants* (December 2016) for details.
45 PCAOB Staff Inspection Brief, Vol. 2017/3.

requirements with respect to the auditor communications with the company's audit committee.[46]

Consider the following questions when preparing Form AP:

- Have processes to obtain the information required to be disclosed on Form AP been planned and implemented?
- Has the estimate of hours in calculating participation of other accounting firms been sufficiently documented?[47]
- Is the audit committee aware of the information to be disclosed on Form AP?

Other Considerations

ENGAGEMENT QUALITY REVIEW

In past inspections, the PCAOB has observed deficiencies related to areas identified with significant risks of material misstatement and where an engagement quality reviewer reviewed, or should have reviewed, the audit work and related conclusions.[48] Auditors are reminded of the requirements of AS 1220, *Engagement Quality Review* (AS 1220), for the engagement quality reviewer's role, including requirements to evaluate significant judgments made by the engagement team, the engagement team's assessment of and responses to fraud risks, and whether the audit documentation he or she reviewed indicates appropriate audit responses and supports the conclusions reached.[49]

To comply with the provisions of this standard, documentation of an engagement quality review should contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand the procedures performed by the engagement quality reviewer and others who assisted the reviewer.[50]

IMPROPER ALTERATION OF AUDIT DOCUMENTATION

Auditors are reminded of the guidance included in the PCAOB's Staff Audit Practice Alert No. 14, *Improper Alteration of Audit Documentation* issued in April 2016 (Practice Alert No. 14).[51] Practice Alert No. 14 refers to the requirements of AS 1215, *Audit Documentation*, and emphasizes that improperly altering audit documentation in connection with a PCAOB inspection or investigation violates PCAOB rules requiring cooperation with the Board's oversight activities and can result in disciplinary actions with severe consequences.

FIRM SOFTWARE AUDIT TOOLS

Some audit firms are developing new tools and techniques to improve the effectiveness and efficiency of their audit process. PCAOB inspection staff are evaluating the processes that firms have in place to provide the firms with assurance that (1) current tools used to analyze the data meet the audit objectives, (2) engagement teams are effectively using these tools and evaluating the results of screening large data populations, and (3) engagement teams are applying due care, including professional skepticism, when using these tools during the performance of the audit work, including the evaluation of results of that work.[52]

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46 See the CAQ's *Form AP – Auditor Reporting of Certain Audit Participants: A Tool for Audit Committees* (June 2017).

47 PCAOB Staff Guidance on Form AP, *Auditor Reporting of Certain Audit Participants and Related Voluntary Audit Report Disclosure under AS 3101, Reports on Audited Financial Statements* (February 2017), page 13. Also, see guidance related to estimation of hours.

48 PCAOB Staff Inspection Brief, Vol. 2017/3.

49 Ibid.

50 AS 1220.19.

51 Staff Audit Practice Alert No. 14 reflects PCAOB staff concerns about auditors improperly altering audit documentation in connection with a PCAOB inspection or investigation. As of September 29, 2017, the Board has issued 33 disciplinary orders for failure to cooperate with inspections, as well as 28 disciplinary orders for failure to cooperate with a Board investigation or for substantially contributing to a firm's failure to cooperate with a Board investigation. A majority of those orders included improper document alteration. See PCAOB Enforcement Spotlight: Improper Alteration of Audit Documentation.

52 PCAOB Staff Inspection Brief, Vol. 2017/3.

CYBERSECURITY RISKS

PCAOB inspections staff continue to understand and evaluate the procedures performed and documentation prepared by engagement teams to determine whether certain cybersecurity risks pose risks of material misstatement to the company's financial statements. In addition, PCAOB inspections staff also seek to understand whether modifications to the engagement team's risk assessment and planned audit approach occurred or were necessary in response to these risks, including modifications to the procedures to test the design and operating effectiveness of relevant controls or test financial statement accounts and disclosures.[53]

NEW AUDITOR'S REPORT (PENDING SEC APPROVAL)

On June 1, 2017, the PCAOB adopted a new auditing standard, AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (AS 3101) and related amendments to PCAOB auditing standards. As of October 11, 2017, the date of this alert's publication, the auditing standard is pending SEC approval.

This new auditing standard requires significant changes to the auditor's report to be implemented in two phases. In the first phase, changes are intended to provide information about auditor tenure and clarify the auditor's responsibilities. In the second phase, the auditor is required to provide new information about the audit. The auditor's report will continue to be a pass/fail model.

First Phase of Implementation

The first phase of implementation, which affects audit reports issued on financial statements of public companies for fiscal years ending on or after December 15, 2017, primarily includes the following:[54]

- **Disclosure of auditor tenure**—The report must include the year in which the auditor began serving consecutively as the company's auditor.
- **Other changes to the auditor's report to clarify the auditor's role and responsibilities**—These changes include:
    - *Independence*—There must be a statement that the auditor is required to be independent
    - *Addressee*—The auditor's report will be addressed to the company's shareholders and board of directors or equivalents. (Additional addressees are also permitted.)
    - *Enhancements to basic elements*—Certain standardized language in the auditor's report has been changed, including adding the phrase "whether due to error or fraud," when describing the auditor's responsibility under PCAOB standards to obtain reasonable assurance about whether the financial statements are free of material misstatements.
    - *Standardized form of the auditor's report*—The opinion will appear in the first section of the auditor's report, and section titles have been added to guide the reader.

53 Ibid.

54 Related to the first phase of implementation, the requirements of PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* apply to brokers and dealers, Form 11-K filers, investment companies, and emerging growth companies. For all elements of the auditing standard, auditors may elect to comply at any point after SEC approval and before the effective date.

Second Phase of Implementation

The second phase of implementation requires communication of critical audit matters (CAMs).[55] A CAM is defined as any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements; and (2) involved especially challenging, subjective, or complex auditor judgment.[56]

The effective dates for CAMs to be included in the auditor's report are as follows:

- For audits of large accelerated filers: fiscal years ending on or after June 30, 2019; and
- For audits of all other companies to which the requirements apply: fiscal years ending on or after December 15, 2020.

The SEC has until October 26, 2017 to take action on the standard, and auditors are encouraged to monitor the status, and if approved by the SEC, begin finalizing plans for implementation. The CAQ will issue an Alert related to the new standard upon SEC approval.

55 The final auditing standard generally applies to audits conducted under PCAOB standards. However, communication of critical audit matters is not required for audits of brokers and dealers reporting under the Securities Exchange Act of 1934 (Exchange Act) Rule 17a-5; investment companies other than business development companies; employee stock purchase, savings, and similar plans (benefit plans); and emerging growth companies, as defined in Section 3(a)(80) of the Exchange Act. Auditors of these entities may choose to include critical audit matters in the auditor's report voluntarily. The other requirements of the new auditing standard will apply to these audits.

56 Similar changes have taken effect in other jurisdictions. In September 2014, the International Auditing and Assurance Standards Board (IAASB) adopted International Standard on Auditing (ISA) 701, *Communicating Key Audit Matters in the Independent Auditor's* Report. See the IAASB's publications comparing IAASB and PCAOB auditing standards related to the new auditor's report.

References

References to applicable PCAOB rules and other publications cited in the 2017 CAQ Alert are provided below:

- ASC 606 *Revenue from Contracts with Customers*
- ASC 842, *Leases*
- ASC 326 *Financial Instruments – Credit Losses*
- FASB ASU No. 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*
- Accounting Changes and Error Corrections (Topic 250), ASC 250-10-S99-6
- SEC Staff Accounting Bulletin (SAB) No. 74 (codified in SAB Topic 11.M), *Disclosure of the Impact That Recently Issued Accounting Standards Will Have on The Financial Statements of the Registrant When Adopted in a Future Period*
- PCAOB Staff Inspection Brief, Vol. 2017/3: Information About 2017 Inspections (August 2017)
- CAQ Alert No. 2017-03, *SAB Topic 11.M – A Focus on Disclosures for New Accounting Standards* (June 2017)
- *Form AP – Auditor Reporting of Certain Audit Participants: A Tool for Audit Committees* (June 2017)
- *Preparing for the New Revenue Recognition Standard: A Tool for Audit Committees* (December 2016)
- CAQ Alert No. 2016-03, *Form AP, Auditor Reporting of Certain Audit Participants* (December 2016)
- PCAOB Rule 3210, *Amendments* and Rule 3211, *Auditor Reporting of Certain Audit Participants*
- PCAOB Staff Guidance on Form AP, *Auditor Reporting of Certain Audit Participants and Related Voluntary Audit Report Disclosure under AS 3101, Reports on Audited Financial Statements* (February 2017);
- PCAOB Staff Audit Practice Alert No. 11, *Considerations for Audits of Internal Control Over Financial Reporting* (October 2013)
- PCAOB Staff Audit Practice Alert No. 13, *Matters Related to the Auditor's Consideration of a Company's Ability to Continue as a Going Concern* (September 2014)
- PCAOB Staff Audit Practice Alert No. 14, *Improper Alteration of Audit Documentation* (April 2016)
- PCAOB Staff Audit Practice Alert No. 15, *Matters Related to Auditing Revenue from Contracts with Customers* (October 2017)