Critical Audit Matters: What You Need to Know About the New Auditor’s Communication Requirement

Monday, April 1, 2019
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This program qualifies for 1.5 CPE credits  
*Field of study: Audit*
Goals of today’s program

Provide an understanding as to:

- The PCAOB’s requirements for the auditor to determine and communicate critical audit matters (CAMs)
- Investors’ potential use of CAMs
- The preparation for implementation of CAMs currently being undertaken by audit firms, audit committees, and others
- Some frequently asked questions about CAMs
Panelists

Wes Bricker | Chief Accountant | U.S. Securities and Exchange Commission

Todd Castagno | Executive Director | Morgan Stanley

David Kane | Americas Vice Chair – Professional Practice | Ernst & Young LLP

Leslie Seidman | Independent Corporate Director

Megan Zietsman | Chief Auditor and Director of Professional Standards | Public Company Accounting Oversight Board

Moderator

Cindy Fornelli | Executive Director | Center for Audit Quality
What are Critical Audit Matters (CAMs)?

Definition of a CAM

A matter arising from the audit of financial statements that:

- was communicated or required to be communicated to the audit committee
- relates to accounts or disclosures that are material to the financial statements
- involved especially challenging, subjective, or complex auditor judgment

Provisions related to CAMs will be effective for audits for fiscal years:

- ending on or after June 30, 2019 for large accelerated filers
- ending on or after December 15, 2020 for all other audits to which CAM reporting applies¹

¹ The CAM requirements in AS 3101 do not apply to the audits of emerging growth companies, brokers and dealers reporting under Exchange Act Rule 17a-5, investment companies other than business development companies, and benefit plans.
What will auditors communicate about CAMs?

The communication of each CAM in the auditor’s report will include:

- Identification of the CAM
- Description of the principal considerations that led the auditor to determine the matter was a CAM
- Description of how the CAM was addressed in the audit
- Reference to the relevant financial statement accounts or disclosures

- A new “Critical Audit Matters” section with introductory language for context
- A statement that there are no CAMs, if the auditor makes that determination
Monitoring implementation of CAMs

• The identification and communication of CAMs is a significant change to the auditor’s report

• Auditors and others have expressed to the SEC the importance of monitoring the implementation of this significant change to the auditor’s report

• The PCAOB stated in their release accompanying the adoption of the proposed rules their intent to monitor implementation

• The SEC stated in their approval order of the proposed rules that they supported the PCAOB in taking steps to monitor implementation

• How have the PCAOB and SEC been monitoring implementation of CAMs?
How will investors use CAMs?

• CAMs are the auditor’s views and not those of management
• CAMs are an opportunity for investors to gain insights directly from the auditor
• Investors should be able to use CAMs to learn what “kept the auditor up at night”
• CAMs could enable investors to ask more pointed questions about those matters to which the CAMs relate
• CAMs are not bad or negative
How are auditors preparing for CAMs?

• Conducting dry runs of the CAM requirements. The purpose of the dry runs is to:
  • Understand how CAMs will develop
  • Understand the affect CAMs may have on the financial reporting process
  • Enable communications with stakeholders

• Engaging with audit committees and others to share lessons learned from the dry runs to avoid surprises when the CAM requirements become effective
How can audit committees prepare for CAMs?

• Since CAMs are a significant development for audit committees, they should consider:
  • Discussing the process for determining CAMs with the auditors
  • Seeking out opportunities to educate one another about the CAMs requirement
  • Thinking about how investors may use CAMs
  • Preparing company management and investor relations for questions from investors on CAMs
What are some lessons learned from the CAM dry runs?

• Determining which matters are CAMs involves applying a principles-based approach and significant auditor judgment
• The determination of CAMs will be unique to each audit
• Early and frequent communication from the auditor to management and the audit committee will be critical
• Drafting CAMs that convey concisely why a matter is a CAM and how the CAM was addressed in the audit in a way that is informative, but not overly technical, will take time
Example of a CAM communication

- The CAQ’s recent publication on CAMs includes an illustrative example of a CAM section of the auditor’s report.

- CAMs are intended to be unique to each audit.

- This is only one example of how a CAM communication may be drafted to meet the requirements of the PCAOB standard.

- This example highlights the components of communicating CAMs.
PCAOB staff guidance on CAMs

**Implementation of Critical Audit Matters: The Basics** – A high-level overview of the requirements that may be of interest to audit firms, preparers, audit committees and investors

**Implementation of Critical Audit Matters: Staff Observations from Review of Audit Methodologies** – A summary of observations from reviews the PCAOB’s Office of the Chief Auditor performed of 10 US audit firms’ CAMs methodologies

**Implementation of Critical Audit Matters: A Deeper Dive on the Determination of CAMs** – Provides the staff’s observations about the guidance and answers frequently asked questions about how to determine CAMs
Frequently asked questions on CAMs

• How will CAMs relate to disclosures made by management?
• Will there be a CAM for every critical accounting estimate?
• Can a significant deficiency in ICFR be a CAM? How about a material weakness or a cybersecurity breach?
• How comparable will CAMs be across companies in the same industry?
• Do you think audit committees have an expectation that CAMs be consistent across companies in the same industry?
• To whom do you think investors will go to with questions on CAMs?
• Do you think audit committees or company management have an expectation on the number of CAMs in an auditor’s report?
• Are CAMs similar to the IAASB’s requirement for auditors to communicate key audit matters in their auditor’s report?
Questions and Answers
Key takeaways

• Keep up the momentum
• Communicate and educate
• Maintain focus on the objective of CAM reporting
• CAMs should not be a surprise
• The requirements are principles based
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Additional resources

CAQ

• Publication - Critical Audit Matters: Lessons Learned, Questions to Consider, and an Illustrative Example

• Video - Critical Audit Matters: Audit Committee Perspectives

• Video - New Auditor’s Reporting Model: What Audit Committees Should Know

PCAOB

• Implementation of Critical Audit Matters: The Basics
• Implementation of Critical Audit Matters: Staff Observations from Review of Audit Methodologies
• Implementation of Critical Audit Matters: A Deeper Dive on the Determination of CAMs