

Critical Audit Matters

Insights for Audit Committees

Overview

Beginning in 2019, certain public companies' auditors will be required to communicate critical audit matters (CAMs) in the auditor's report. The new requirement for CAMs is a result of the PCAOB's 2017 standard [AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion](#), which made significant changes to the auditor's report. The standard is intended to make the auditor's report more informative and relevant to investors and other financial statement users by shedding light on areas of the audit requiring especially challenging, subjective, or complex auditor judgment. It also makes a [number of improvements to the auditor's report](#), which went into effect in 2017 and that primarily clarify the auditor's role and responsibilities related to the audit.

This document aims to inform audit committees as they engage with their auditors on the new CAM requirements.

The Basics

The PCAOB's standard requires an auditor to determine CAMs using a principles-based framework.

CAM definition

A CAM is any matter arising from the audit of a company's financial statements that meets all of the following criteria:

- A matter that was communicated or is [required to be communicated to the audit committee](#);
- A matter that relates to accounts or disclosures that are material to the financial statements; and
- A matter that involved especially challenging, subjective, or complex auditor judgment.

Effective dates

For audits of large accelerated filers, CAM requirements are effective for fiscal years ending on or after June 30, 2019. For audits of all other companies to which they apply, CAM requirements are effective for fiscal years ending on or after December 15, 2020.

What's included?

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The Office of External Affairs has prepared this resource as a service to audit committees. This resource provides a high-level overview of the new auditor reporting requirements and staff interpretations based on PCAOB Release No. 2017-001 and related staff guidance. This resource does not constitute rules of the Board, nor has it been approved by the Board.

Audits that do not require CAMs

CAMs are not required for audits of:

- ⦿ Brokers and dealers reporting under Rule 17a-5 under the Securities Exchange Act of 1934;
- ⦿ Registered investment companies other than business development companies;
- ⦿ Employee stock purchase, savings, and similar plans; or
- ⦿ Emerging growth companies.

Audit period covered by CAMs

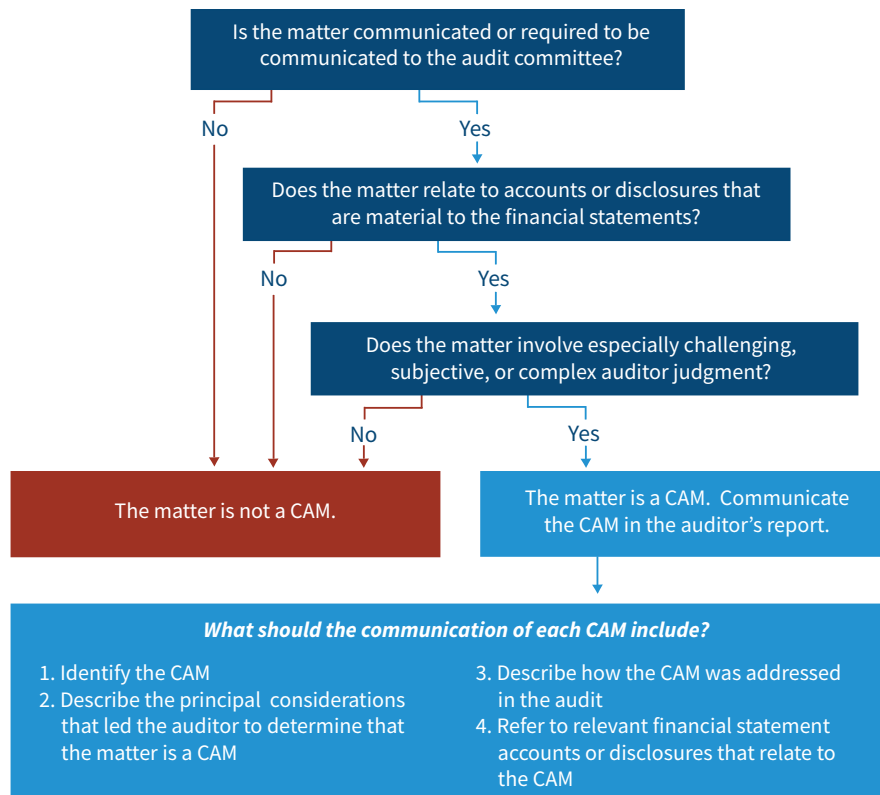
The standard requires that auditors communicate CAMs relating to the audit of the current period’s financial statements or state the auditor determined there are no CAMs in the auditor’s report. When the current period’s financial statements are presented on a comparative basis with those of one or more prior periods, the auditor may communicate CAMs relating to a prior period. This may be appropriate, for example, when:

- ⦿ The prior period’s financial statements are made public for the first time, such as in an initial public offering.
- ⦿ Issuing an auditor’s report on the prior period’s financial statements because the previously issued auditor’s report could no longer be relied upon.

Steps to determine if a matter is a CAM

The chart below illustrates some of the key steps an auditor will go through to determine if a matter is a CAM and what the auditor will communicate in the auditor’s report if a CAM is identified.

When is a matter arising from the audit of financial statements a Critical Audit Matter (CAM)?



For additional information, [view our Basics document](#).

PCAOB Staff Responses to FAQs

Through outreach to investors, audit committees, preparers, and other interested parties, the PCAOB has received a number of questions on CAMs. Responses from the staff that may be of interest to audit committees are included below.

Will the new requirement of the auditor to communicate CAMs change required audit committee communications?

Other than a new requirement for the auditor to provide and discuss with the audit committee a draft of the auditor's report, the PCAOB's [requirements for audit committee communications](#) remain the same. Any matter that will be communicated as a CAM should have already been discussed with the audit committee and, therefore, the information should not be new.

Does the audit committee have a role in determining and approving CAM communications?

No. While the auditor is required to share the draft auditor's report including any CAMs identified with the audit committee, CAMs are the sole responsibility of the auditor. The standard is designed to elicit more information about the audit directly from the auditor. As the auditor determines how best to comply with the communication requirements, the auditor could discuss with management and the audit committee the treatment of any sensitive information.

Does the communication of a CAM indicate a misstatement in the financial statements or deficiency in management's process?

CAMs are intended to provide information to investors and other financial statement users about matters arising from the audit of the company's financial statements that required especially challenging, subjective, or complex auditor judgment, and the auditor's response to those matters. CAMs are not necessarily meant to reflect negatively on the company, nor do they necessarily indicate that the auditor found a misstatement or deficiencies in internal control over financial reporting. A CAM also does not alter the auditor's opinion on the financial statements, and the auditor is not providing a separate opinion on the CAM, or on the accounts or disclosures to which they relate.

How many CAMs should be communicated?

There is no specific number of CAMs that should be communicated in the auditor's report. The number of matters that are reported as CAMs will depend on the nature and complexity of each company's audit. While any matter communicated or required to be communicated to the audit committee could be a CAM, not every matter discussed with the audit committee will necessarily be a CAM.

Are auditors required by the PCAOB to change audit procedures due to new CAM requirements?

Other than the requirements to determine, communicate, and document CAMS, the new requirements do not mandate the performance of additional audit procedures. The auditor will be required to meet certain documentation requirements, including the basis for determining whether a matter was/was not a CAM.

Will CAMs be the same within an industry or could they vary among companies?

The requirements for determining CAMs are principles-based, and auditors' application of the requirements depends on the facts and circumstances of each audit. To that end, the PCAOB standard does not prescribe CAMs for a particular industry, and some company's auditors may report no CAMs. Peer companies' audits could have similar CAMs, or they could be different. Why the matter is a CAM and how it is addressed could also differ from audit to audit.

Are CAMs expected to be the same each year?

There is no expectation that CAMs be the same each year. Each year, auditors determine and communicate CAMs in connection with an audit of the company's financial statements for the current period. Depending on the circumstances, some matters may be considered CAMs each year, while others may not.

The first year that a company is implementing a new accounting standard is an example of a circumstance in which a CAM could be identified in only one year. In year one, auditing the company's implementation of a new accounting standard may require especially challenging, subjective, or complex auditor judgment. This matter, however, may not require the same level of auditor judgment the next year, or it might be a CAM for different reasons than in the first year of implementation.

If a public company experiences a significant event, such as a cybersecurity breach, will that be a CAM?

The requirements for determining CAMs are principles-based, and auditors' application of the requirements depends on the facts and circumstances of each audit. Events such as cybersecurity breaches could affect the financial statements and become the subject of communications between the auditor and the audit committee.

When auditors evaluate such events for purposes of determining CAMs, they will consider the impact the event had on the audit. This will largely depend on the nature and extent of the audit response required to address any affected accounts and/or disclosures.

What is the relationship between CAMs and a company's disclosures regarding critical accounting estimates?

Critical accounting estimates may overlap with CAMs, but they are not the same. [Under SEC interpretation](#), companies should provide a discussion in the Management Discussion and Analysis (MD&A) about critical accounting estimates and assumptions where:

- The nature of the estimates or assumptions is material because of the levels of subjectivity and judgment needed to account for matters that are highly uncertain or susceptible to change; and
- The effect of the estimates and assumptions is material to the financial statements.

While some critical accounting estimates or components of those estimates may be the subject of a CAM, not all necessarily will. Further, the source of CAMs is broader than just critical accounting estimates because the source of CAMs includes all matters communicated or required to be communicated to the audit committee.

What is the interaction between CAMs and company disclosures outside of the financial statements?

When communicating CAMs, auditors are required to refer to the relevant financial statement accounts or disclosures rather than to disclosures outside of the financial statements. Company disclosures outside of the financial statements may, however, be relevant in the context of CAM communication.

When describing CAMs in the auditor's report, the auditor is generally not expected to provide information about the company that has not been made publicly available by the company. Such information, however, may be necessary to describe the principal considerations that led the auditor to determine that a matter is a CAM or how the matter was addressed in the audit. Information a company has made publicly available includes all means of public communication, whether within or outside the financial statements, including SEC filings, press releases, and other public statements.

Are CAMs the same as Key Audit Matters (KAMs)?

While both the PCAOB's requirement and the [International Auditing and Assurance Standards Board \(IAASB\)'s standard](#) use auditor communications with the audit committee as the starting point for sources of communications, the underlying requirements are different:

- KAMs focus on matters that were of most significance during the audit.
- CAMs focus on matters involving especially challenging, subjective, or complex auditor judgment related to accounts or disclosures that are material to the financial statements.

Due to the differences in definition and underlying requirements, it is possible that differences could result in the matters identified or how matters are described in the auditor's report. However, it is also possible that many of the same matters could be communicated under both approaches.

What are the PCAOB's next steps on CAMs?

The PCAOB will monitor and analyze implementation through three primary channels and consider whether any additional guidance might be needed:

1. Stakeholder feedback. Once the initial implementation of CAMs begins in June 2019, the PCAOB will perform an interim analysis on the implementation of the standard to assess stakeholders' experiences and results. The staff will engage with stakeholders, including auditors, investors, financial statement preparers, and audit committee members, through interviews, surveys, and other outreach to learn about stakeholders' experience with CAMs. If you would like to be contacted to provide feedback on CAMs, [please contact our Stakeholder Liaison](#).

2. Compliance and inspections. We will promote compliance through the inspection of audit firms after the changes are implemented. Inspection teams will have the first opportunity to review CAMs in the second half of 2019, starting with auditor's reports of large accelerated filers subject to the CAM requirements for fiscal years ending on or after June 30, 2019. PCAOB staff expects to issue a document outlining preliminary observations from the initial inspections performed in 2019.

3. Post-implementation review. The PCAOB will conduct a post-implementation review to analyze the effectiveness of the new requirements after a reasonable period of time following the completion of implementation in December 2020, and reevaluate costs and benefits of the new standard, including any unintended

consequences, to understand the overall impact on investors, the audit profession, public companies, and other users of the financial statements.

Questions Audit Committees Could Consider Asking their Auditors

The following sample questions are designed to provide audit committees with ideas of the types of questions they may consider—at their discretion—asking their auditors about efforts related to the implementation of new CAM requirements.

- ⦿ What has the audit firm done to prepare for the identification and communication of CAMs in the auditor’s report?
- ⦿ Does the audit firm have a methodology, practice aids, or other training available to its auditors?
- ⦿ Has the audit firm done any dry runs? If so:
 - What did the audit firm learn as a result of the dry runs?
 - Were there any matters considered to be “close calls,” but ultimately not identified as a CAM during the firm’s dry run? What was the thought process behind the final determination?
- ⦿ Were our CAMs similar or different from our industry peers?
 - What is the nature of the differences (or similarities)?
- ⦿ Has the audit team discussed with management how and by whom any investor or stakeholder question regarding CAMs will be addressed?

Stay Connected

The Board is committed to enhancing engagement with audit committees and providing opportunities for ongoing communication. In addition to this resource on critical audit matters, audit committees may be interested in our [Form AP overview](#) and [AuditorSearch](#) tool. If you have other topics that you would like more information on, additional questions regarding our resources or CAMs, or if you are interested in engaging with the PCAOB, please [contact our Stakeholder Liaison, Erin Dwyer](#).

We want to hear from you

In an effort to continue to improve external communications and provide information that is timely, relevant, and accessible, we want to hear your views regarding this document. Please take a few minutes to [fill out our short survey](#).



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