Critical Audit Matters Make Their Debut!

by Lisa Smith and Kerry Fulchino, Deloitte & Touche LLP

Introduction

The first auditors' reports with critical audit matters (CAMs) were filed! In auditors' reports for all large accelerated filers with fiscal years ending June 30, 2019, the CAMs most often identified were related to goodwill and intangible assets, revenue, and income taxes, and on average, 1.8 CAMs were communicated.

In 2017, the PCAOB and SEC approved PCAOB Auditing Standard 3101 (the “standard”),¹ which substantially revised the auditor's reporting model. The most significant change was the requirement for auditors to include CAMs² in the auditor's report. The standard is effective for audits of large accelerated filers for fiscal years ending on or after June 30, 2019, and will become effective for audits of all other companies that are subject to the requirements³ for fiscal years ending on or after December 15, 2020.

The more commonly identified CAMs are related to accounts or disclosures in which there is a high degree of auditor subjectivity associated with applying audit procedures and evaluating the results of those procedures. However, a CAM could also be identified for an account or disclosure that is especially challenging or complex to audit.


² As defined in the standard, a CAM is “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) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment.”

³ The standard specifies that communication of CAMs “is not required for audits of (1) brokers and dealers reporting under [Rule 17a-5 of the Securities Exchange Act of 1934 (the “Exchange Act”).]; (2) investment companies registered under the Investment Company Act of 1940 . . . business development companies; (3) employee stock purchase, savings, and similar plans; and (4) emerging growth companies [as defined in Section 3(a)(80) of the Exchange Act]” (footnotes omitted).
CAM Results for Large Accelerated Filers With Fiscal Years Ending June 30, 2019

August 29, 2019, was the filing deadline for large accelerated filers with fiscal years ending on June 30, 2019. The chart below summarizes CAMs by account/disclosure from auditors’ reports of all large accelerated filers with fiscal years ending June 30, 2019, filed as of August 29, 2019.

CAM Dry Runs

Over the past year, public accounting firms (including Deloitte) made significant progress toward implementing the standard, including developing tools and guidance as well as performing “dry runs” of the CAM requirements for audits of large accelerated filers. In the dry runs, auditors evaluated matters that might be CAMs, considered how CAMs should be drafted, and discussed potential CAMs with management and audit committees to help them understand and prepare for the CAM requirements before the standard’s effective date. The dry runs also provided opportunities for the identification and assessment of implementation challenges, and sharing the draft CAMs allowed auditors, management, and audit committees to align their expectations, thereby avoiding surprises when the standard became effective.

Lessons learned during the dry runs included the following:

- Practicing the identification and communication of CAMs allowed auditors to gain valuable experience, resulting in a smoother implementation process.
- Deciding whether an account or disclosure was a CAM required significant judgment and was specific to the circumstances of each audit. Therefore, what might be a CAM on one audit might not be a CAM on another audit.
- Communicating CAMs that are easily understood by a broad readership can be challenging. For example, it can be difficult to convey concisely why a matter is a CAM or to summarize the audit procedures performed in a manner that is informative but not overly technical.
- Sharing draft CAMs with management, audit committees, and legal counsel provided an opportunity to set expectations about CAMs and to reach a common understanding about applying the standard’s requirements and how the implementation process and timing may work.

In general, the dry runs helped auditors, management, and audit committees be better prepared to implement the requirements when they became effective. Deloitte will continue to perform dry runs in connection with the 2019 audits of all other companies that are subject to the CAM requirements.
Looking Ahead
The PCAOB has indicated that once the initial implementation of CAMs begins, the Board will assess stakeholders’ experiences and results and determine whether to take further action. Issuance of auditors’ reports containing CAMs will continue to increase in the coming months. It is imperative that auditors, management, and audit committees maintain a dialogue on CAMs to prepare for this significant new requirement.
Appendix — Resources

PCAOB Staff Guidance

This year, the PCAOB issued the following staff guidance documents to support implementation of the new CAM requirements:


- *Implementation of Critical Audit Matters: Staff Observations From Review of Audit Methodologies* (March 2019) — “outlines the scope and purpose of the [PCAOB] staff's review [of] CAM methodologies, practice aids, training materials, and examples . . . submitted by 10 U.S. audit firms that collectively audit approximately 85% of large accelerated filers . . . and highlights thematic observations identified during the review.”


- *Implementation of Critical Audit Matters: A Deeper Dive on the Communication of CAMs* (May 2019) — “focuses on questions that may arise when the auditor is communicating CAMs.”

These documents were developed as a result of discussions with auditors regarding their experiences conducting dry runs, the PCAOB staff's review of methodologies, and other outreach efforts.

In addition, to advance its strategic priority related to cultivating effective communication with stakeholders, the PCAOB issued the following resources for audit committees and investors:

- *Audit Committee Resource: Critical Audit Matters* (July 2019) — “aims to inform audit committees as they engage with their auditors on the new CAM requirements.”

- *Investor Resource: Critical Audit Matters* (July 2019) — provides “investors with useful information regarding changes to the auditor’s report, frequently asked questions about CAMs, and information about the implementation of the standard.”

Deloitte Resources

Deloitte has developed a quick-reference guide, *Insights: PCAOB Auditor’s Report — Critical Audit Matters*, which provides information about CAM effective dates, expected benefits of CAMs for companies, considerations for audit committees and management, steps the auditor takes to identify CAMs, and other matters. In addition, Deloitte’s *On the Board’s Agenda: What to Expect From Auditor Reporting of Critical Audit Matters* contains information about identifying and preparing CAMs as well as what boards might expect when reporting them.
Dbriefs for Financial Executives

We invite you to participate in Dbriefs, Deloitte’s webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the “Financial Executives” series on the following topics:

- Business strategy and tax.
- Financial reporting.
- Tax accounting and provisions.
- Controllership perspectives.
- Governance, risk, and compliance.
- Transactions and business events.
- Driving enterprise value.
- Innovation in risk and controls.

Dbriefs also provides a convenient and flexible way to earn CPE credit — right at your desk.

Subscriptions

To subscribe to Dbriefs, or to receive accounting publications issued by Deloitte’s Accounting Services Department, please register at My.Deloitte.com.

DART and US GAAP Plus

Put a wealth of information at your fingertips. The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosure literature. It contains material from the FASB, EITF, AICPA, PCAOB, and SEC, in addition to Deloitte’s own accounting manuals and other interpretive guidance and publications.

Updated every business day, DART has an intuitive design and navigation system that, together with its powerful search and personalization features, enable users to quickly locate information anytime, from any device and any browser. While much of the content on DART is available at no cost, subscribers have access to premium content, such as Deloitte’s FASB Accounting Standards Codification Manual. For more information, or to sign up for a free 30-day trial of premium DART content, visit dart.deloitte.com.

In addition, be sure to visit US GAAP Plus, our free Web site that features accounting news, information, and publications with a U.S. GAAP focus. It contains articles on FASB activities and those of other U.S. and international standard setters and regulators, such as the PCAOB, AICPA, and SEC. Check it out today!

Heads Up is prepared by members of Deloitte’s National Office as developments warrant. This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, “Deloitte” means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2019 Deloitte Development LLC. All rights reserved.