Insights for Audit Committees: The New Auditor's Reporting Standard

The U.S. Securities and Exchange Commission (SEC) unanimously approved the Public Company Accounting Oversight Board's (PCAOB) new auditor's reporting standard. For the first time, auditors will be required to include in their report a discussion of critical audit matters (CAM) communicated to the audit committee. The otherwise proprietary information includes matters that the auditor found involved "especially challenging, subjective or complex auditor judgment." The new standard also includes several other changes to the auditor's report primarily intended to clarify the auditor's role and responsibilities, including disclosure of auditor tenure. Similar but more robust audit reporting standards are required by the International Auditing and Assurance Standards Board.

A reportable CAM is any matter disclosed to the audit committee that satisfies the new standard's explicit criteria (refer to BKD's 2016 insights on the PCAOB's new auditor reporting model). For CAMs related to material accounts and disclosures, the auditor will disclose judgments that went into the auditor's opinion—in turn directing investors and analysts to focus their attention on key financial reporting areas that merit, in the auditor's opinion, the most attention.

Investors and analysts will have insight into the audit through the auditor's lenses—insight currently limited to audit committee members.

In certain situations, there is a concern the auditor may be replacing management as the source for disseminating potentially original information about the company. This brings new audit engagement challenges. From the independent audit committee's perspective, overseeing the audit and auditor—who will be independently reporting CAMs—while also overseeing company-specific information disclosed in management's discussion and analysis (MD&A) and notes to the financial statements, *e.g.*, disclosure of significant accounting policies and practices, estimates and significant unusual transactions, may be a delicate process. With the overarching goal of audit quality and investor protection, maintaining a solid, open relationship with the external auditors likely will be the key to the new standard's successful implementation.

The new reporting allows investors to analyze the MD&A "issuer disclosure" on critical accounting estimates and related matters with the new "auditor disclosure" on audit focus points from an independent perspective.

External auditors, comfortable with the pass/fail approach to the existing auditor's report, face challenges of their own. Namely, to find the right balance between potentially legally influenced or "boilerplate" reporting while achieving the standard's knowledge-sharing intent. Like independent audit committees, the external auditor will need to nurture the confidential audit committee-to-auditor relationship—while preparing independent reporting.

The PCAOB intends to perform a post-implementation review (PIR) to understand how well the revised auditing standard is providing meaningful information to investors and identify any unintended consequences. Due to the phased effective dates, the PIR process is expected to begin with evaluating experiences of large accelerated filers. The SEC is encouraging the PCAOB to be open to changes, depending on the PCAOB's findings, including the effective date for companies other than large accelerated filers.

Along with the PCAOB's adopting release, implementation guidance can be found in the SEC's Order Granting Approval of Proposed Rules. The Center for Audit Quality also has issued an alert on the new requirements.

Required communication of CAMs begins with auditor reports relating to audits of large accelerated filers for fiscal years ending after June 30, 2019. For more information, contact your BKD advisor.

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