Davis Polk

PCAOB Reproposes Standards on Critical Audit Matters, Tied to Audit Committee Communications, and Adds Tenure Disclosure to Auditors' Reports

May 12, 2016 | Client Update | 2-minute read

When it first proposed disclosure of critical audit matters in auditors' reports back in August 2013, the PCAOB faced an outcry. Now the regulator is making a second attempt, emphasizing how its revised proposal reflects responses to public comments and additional outreach.

Under the proposal, auditors' reports must include any critical audit matters arising from the audit, but the definition of such matters have been refined. It covers any matter that was communicated or required to be communicated to audit committees and that (a) relates to accounts or disclosures that are material to financial statements and (b) involved especially challenging, subjective, or complex auditor judgment. Note that the standard is deliberately broad with respect to audit committee communications, and includes matters that were communicated to the audit committee although not specifically required, as well as matters that were required to be communicated whether or not they were actually communicated.

How an auditor decides whether a matter fits this category would be determined by weighing a list of factors. These include the risks of material misstatement, the degree of auditor subjectivity in determining or applying audit procedures to the matter and the nature and extent of the effort required to address the matter (such as whether specialized skills are needed). The auditor should also consider the degree of auditor judgment related to areas that involved significant estimation by management, the nature and timing of significant unusual transactions and the audit evidence obtained regarding the matter.

The auditors' report would identify the critical audit matter, why it was determined to be critical and how it was addressed in the audit, with reference to the relevant financial statements. Although the PCAOB expects most reports to contain at least one critical audit matter, the auditor must make an affirmative statement even if no critical audit matters are found. In response to comments concerned about the possibility that the auditors' report would disclose confidential matters, the release notes that the standard applies regardless of whether or not the information is confidential.

Figure 1 (page 15) of the release contains a helpful chart. Pages 33-34 contain examples of disclosures of critical audit matters.

The auditors' statement will also undergo several other revisions, including a statement about the length of the auditor's tenure and standardized language regarding auditor independence. Comments on the proposal are due by August 15, 2016.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Ning Chiu
+1 212 450 4908
ning.chiu@davispolk.com