

Webinar: New Auditor's Report – Overview of Changes Effective in 2017

Disclaimer

The views expressed by each of the presenters are their own personal views and not necessarily those of the PCAOB, members of the Board, or the PCAOB staff.

Polling Question

- The audit report has undergone significant change where?
 - A. U.S. only
 - B. U.S. and U.K.
 - C. Globally

Polling Question

The audit report has undergone significant change where?

A. U.S. only

B. U.S. and U.K.

C. Globally

Learning Objectives

- ❑ Understand key changes to the auditor's report that are effective for audits of fiscal years ending on or after December 15, 2017, including:
 - Determination and reporting of auditor tenure
 - New ICFR explanatory language
- ❑ Become aware of CAM requirements, applicability, and effective dates
- ❑ Be familiar with the resources and tools available to assist with the implementation of changes effective December 15, 2017

Today's Topics

- ❑ Overview of the New Auditor's Report
- ❑ Key Changes Effective December 15, 2017
 - Addressee
 - Auditor Tenure
 - ✓ Determination
 - ✓ Reporting
 - ICFR Explanatory Language
- ❑ Introduction to Critical Audit Matters
- ❑ Resources

Overview of the New Auditor's Report

- ❑ AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*
- ❑ Retains pass/fail opinion but makes significant changes to the auditor's report:
 - Critical audit matters
 - Additional improvements

New Auditor's Report – Overview of Key Changes Effective December 15, 2017



- ❑ Basic Elements and Form of Auditor's Report
 - Required order of the "Opinion on the Financial Statements" and "Basis for Opinion" sections
 - Section titles
 - Required addressee
 - Indication that the notes are part of the financial statements
 - Statement on auditor independence
 - New phrase "whether due to error or fraud"
 - New language about the nature of the audit that aligns with the risk assessment standards
 - Auditor tenure
- ❑ Management Reports on ICFR with no Auditor Reporting

These key changes apply to audits conducted under PCAOB standards

New Auditor's Report – Example Auditor's Report (changes underlined)

Section Title

Report of Independent Registered Public Accounting Firm

To the shareholders and the board of directors of X Company ←

Addressee

Opinion on the Financial Statements

Opinion Section

We have audited the accompanying balance sheets of X Company (the "Company") as of December 31, 20X2 and 20X1, the related statements of [*titles of the financial statements, e.g., income, comprehensive income, stockholders' equity, and cash flows*], for each of the three years in the period ended December 31, 20X2, and the related notes [*and schedules*] (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of [*at*] December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with [*the applicable financial reporting framework*].

Basic Elements and Form of Auditor's Report - Addressee

The auditor's report must be addressed to the shareholders and the board of directors, or equivalents for companies not organized as corporations.

- ❑ For companies not organized as corporations:
 - Plan administrator and plan participants for benefit plans;
 - Directors (or equivalent) and equity owners for brokers or dealers; and
 - Trustees and unit holders or other investors for investment companies organized as trusts.

- ❑ The auditor's report may include additional addressees. The auditor can assess, based on the individual circumstances, whether or not to include additional addressees in the auditor's report.



New Auditor's Report – Example Auditor's Report (changes underlined)

Section Title

Auditor Independence

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

Basis for Opinion Section

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters [if applicable]

[Signature]

We have served as the Company's auditor since [year].

Auditor Tenure

[City and State or Country]

[Date]

Basic Elements and Form of Auditor's Report - Auditor Independence

The auditor's report must include a statement that the auditor is a public accounting firm registered with the PCAOB (United States) and is required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB.

- This statement is required to be in the Basis for Opinion section.

Basic Elements and Form of Auditor's Report – Other Enhancements

- ❑ Added new phrase *whether due to error or fraud*, when describing the auditor's responsibility under PCAOB standards to obtain reasonable assurance about whether the financial statements are free of material misstatement
- ❑ Updated description of the nature of the audit to align with the language in the PCAOB's risk assessment standards

New Auditor's Report – Auditor Tenure

The auditor's report must include a statement containing the year the auditor began serving consecutively as the company's auditor.

□ Determining Auditor Tenure

- Reflect the entire relationship between the company and the auditor
 - ✓ The auditor's relationship with the company is not affected by the company's status as a public company
- Calculate taking into account firm or company mergers, acquisitions, or changes in ownership structure



New Auditor's Report – Auditor Tenure

□ Determining Auditor Tenure

- Look to the year when the firm signs an initial engagement letter to audit a company's financial statements or when the firm begins performing audit procedures, whichever is earlier.
- If auditors cannot readily determine when an initial engagement letter was signed, they can determine tenure based on their own records, the company's records, or publicly available information, such as company filings available on the SEC's EDGAR system.
- In the absence of other evidence about when the auditor signed an initial engagement letter or began performing audit procedures, tenure can be determined based on the year in which the auditor first issued an audit report on the company's financial statements or, if earlier, the auditor's estimate of when work would have commenced to enable the issuance of such report.

New Auditor's Report – Auditor Tenure

- ❑ Determining Auditor Tenure – Investment Company
 - For an investment company that is part of a group of investment companies, the auditor's statement regarding tenure will contain the year the auditor began serving consecutively as the auditor of any investment company in the group of investment companies.

If Firm A has been auditing investment companies in XYZ group of investment companies since 1980, the current auditor's report for XYZ fixed income fund, whose inception date was in 2010, will state that Firm A has served as the auditor of one or more XYZ investment companies since 1980.

New Auditor's Report – Auditor Tenure

- Determining Auditor Tenure – Other Entities
 - If the auditor of the company's financial statements also audits the financial statements of related entities, auditor tenure is determined separately for each engagement.

Company W is the sponsor of an employee benefit plan that is subject to annual reporting on Form 11-K. Auditor ABC has been the auditor of Company W since 2002 and the auditor of Company W's employee benefit plan since 2011.

The auditor's report on Company W's financial statements would show that auditor tenure began in 2002. The auditor's report on the financial statements of Company W's employee benefit plan would show that auditor tenure began in 2011.

Auditor Tenure – Example A

- ❑ The auditor signs the engagement letter in December 2011 to audit a company's financial statements for the years ended December 31, 2010, 2011, and 2012.
- ❑ The auditor would state in the auditor's report _____ as the year the auditor began serving consecutively as the company's auditor.
 - A. 2010
 - B. 2011
 - C. 2012

Auditor Tenure – Example A

- ❑ The auditor signs the engagement letter in December 2011 to audit a company's financial statements for the years ended December 31, 2010, 2011, and 2012.
- ❑ The auditor would state in the auditor's report _____ as the year the auditor began serving consecutively as the company's auditor.

A. 2010

B. 2011

C. 2012

Auditor Tenure – Example B

- ❑ The auditor signs the engagement letter in January 2013 to audit a company's financial statements for the years ended December 31, 2010, 2011, and 2012.
- ❑ The auditor would state in the auditor's report _____ as the year the auditor began serving consecutively as the company's auditor.
 - A. 2010
 - B. 2011
 - C. 2012
 - D. 2013

Auditor Tenure – Example B

- ❑ The auditor signs the engagement letter in January 2013 to audit a company's financial statements for the years ended December 31, 2010, 2011, and 2012.
- ❑ The auditor would state in the auditor's report _____ as the year the auditor began serving consecutively as the company's auditor.

A. 2010

B. 2011

C. 2012

D. 2013

Auditor Tenure – Example C

- ❑ Auditor ABC cannot locate the initial engagement letter nor do they know when the firm began performing audit procedures for Company X either by looking at the firm or company records.
- ❑ However, auditor ABC knows that they issued the first auditor's report on a company's financial statements for the year ended December 31, 1990 in March 1991.
- ❑ The auditor would state in the auditor's report _____ as the year the auditor began serving consecutively as the company's auditor.
 - A. 1990
 - B. 1991
 - C. 1992

Auditor Tenure – Example C

- ❑ Auditor ABC cannot locate the initial engagement letter nor do they know when the firm began performing audit procedures for Company X either by looking at the firm or company records.
- ❑ However, auditor ABC knows that they issued the first auditor's report on a company's financial statements for the year ended December 31, 1990 in March 1991.
- ❑ The auditor would state in the auditor's report _____ as the year the auditor began serving consecutively as the company's auditor.

A. 1990

B. 1991

C. 1992

However, if the auditor estimates that in order to issue the auditor's report in 1991, the work would have commenced in 1990, the auditor could state 1990 as the year the auditor began serving consecutively as the company's auditor.

Auditor Tenure – Example D

- ❑ The auditor has been the auditor of Company X since 1990. Company X undergoes an IPO in 2018 and includes the auditor's report on the company's financial statements for the years ending December 31, 2015, 2016, and 2017.
- ❑ The auditor would state in the auditor's report _____ as the year the auditor began serving consecutively as the company's auditor.
 - A. 1990
 - B. 2015
 - C. 2017
 - D. 2018

Auditor Tenure – Example D

- ❑ The auditor has been the auditor of Company X since 1990. Company X undergoes an IPO in 2018 and includes the auditor's report on the company's financial statements for the years ending December 31, 2015, 2016, and 2017.
- ❑ The auditor would state in the auditor's report _____ as the year the auditor began serving consecutively as the company's auditor.

A. 1990

B. 2015

C. 2017

D. 2018

Auditor Tenure – Example E

- ❑ Auditor ABC has been the auditor of Company X since 1997. Auditor DEF has been the auditor of Company Y since 2002. Company X acquires Company Y in 2017; Company X is the accounting acquirer.
- ❑ Auditor ABC continues to serve as the combined company's auditor. The auditor's report on the combined company's financial statements for the year ending December 31, 2017 is dated February 28, 2018.
- ❑ The auditor would state in the auditor's report _____ as the year the auditor began serving consecutively as the company's auditor.
 - A. 1997
 - B. 2002
 - C. 2017
 - D. 2018

Auditor Tenure – Example E

- ❑ Auditor ABC has been the auditor of Company X since 1997. Auditor DEF has been the auditor of Company Y since 2002. Company X acquires Company Y in 2017; Company X is the accounting acquirer.
- ❑ Auditor ABC continues to serve as the combined company's auditor. The auditor's report on the combined company's financial statements for the year ending December 31, 2017 is dated February 28, 2018.
- ❑ The auditor would state in the auditor's report _____ as the year the auditor began serving consecutively as the company's auditor.

A. 1997

B. 2002

C. 2017

D. 2018

New Auditor's Report – Auditor Tenure

□ Reporting of Tenure

- Auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.
- No required location is specified within the auditor's report.
- If there is uncertainty as to the year the auditor began serving as the company's auditor, state that the auditor is uncertain as to the year and provide the earliest year of which the auditor has knowledge.

[Signature]

We are uncertain as to the year we [or our predecessor firms] began serving consecutively as the auditor of the Company's financial statements; however, we are aware that we [or our predecessor firms] have been Company X's auditor [or Company X's auditor subsequent to the Company's merger] consecutively since at least 19XX.

[City and State or Country]

[Date]

New Auditor's Report – Auditor Tenure

□ Reporting of Tenure

- Auditors have discretion to provide additional information in the auditor's report about tenure, if the information would provide context or otherwise assist the reader's understanding of the relationship between the auditor and the company.

For example, when tenure is calculated taking into account the tenure of predecessor accounting firms and/or engagement by predecessors of the company under audit, the auditor may wish to provide information about these historical relationships.



Management Reports on ICFR with no Auditor Reporting

- ❑ In some circumstances, management is required to report on the company's ICFR but such report is not required to be audited, and the auditor is not engaged to perform an audit of management's assessment of the effectiveness of ICFR.
- ❑ In such cases, the auditor is required to include the following explanatory language in the Basis for Opinion section:

The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Management Reports on ICFR with no Auditor Reporting

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

ICFR
Explanatory
Language,
if applicable



Explanatory Paragraphs

- ❑ The standard includes a list of circumstances with references to other PCAOB standards in which the auditor is required to include explanatory paragraph (or explanatory language) in the auditor's report. Those include, among others:
 - Going concern (AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*);
 - Other auditors (AS 1205, *Part of the Audit Performed by Other Independent Auditors*);
 - Change between periods in accounting principles or in the method of their application (AS 2820, *Evaluating Consistency of Financial Statements*); and
 - A material misstatement in previously issued financial statements has been corrected (AS 2820).
- ❑ Some PCAOB standards specify the location of required explanatory paragraphs within the auditor's report and may also have a requirement for an appropriate section title.
- ❑ If the auditor is required to include an explanatory paragraph but the location is not specified, the paragraph may be placed where the auditor considers appropriate.

Emphasis Paragraphs

- ❑ Although not required, the standard includes the ability for the auditor to emphasize a matter regarding the financial statements (“emphasis paragraph”).
- ❑ Emphasis paragraph may be placed where the auditor considers appropriate.
- ❑ If the auditor includes an emphasis paragraph in the auditor's report, the auditor is required to use an appropriate section title.

Other Reporting Situations

- Supplemental Information (AS 2701)
- Reviews of Interim Financial Information (AS 4105)
- Special Reports(AS 3305)

New Auditor's Report – Effective Dates



- Effective for audits of financial statements for fiscal years ending on or after December 15, 2017.
 - Basic Elements and Form of Auditor's Report, including Auditor Tenure
 - Management Reports on ICFR with no Auditor Reporting
 - All other auditor's report changes, except for CAMs

Polling Question

- ❑ What does CAM stand for?
 - A. Critical Accounting Matter
 - B. Critical Audit Matter
 - C. Current Audit Matter
 - D. Certified Audit Magician

Polling Question

- ❑ What does CAM stand for?
 - A. Critical Accounting Matter
 - B. Critical Audit Matter**
 - C. Current Audit Matter
 - D. Certified Audit Magician

Critical Audit Matters

Definition: A critical audit matter 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.

Critical Audit Matters - Factors

In determining whether a matter involved especially challenging, subjective, or complex auditor judgment, the auditor should take into account, alone or in combination, the following factors, as well as other factors specific to the audit:

- The auditor's assessment of the risks of material misstatement, including significant risks;
- The degree of auditor judgment related to areas in the financial statements that involved the application of significant judgment or estimation by management, including estimates with significant measurement uncertainty;
- The nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions;
- The degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of those procedures;
- The nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team regarding the matter; and
- The nature of audit evidence obtained regarding the matter.

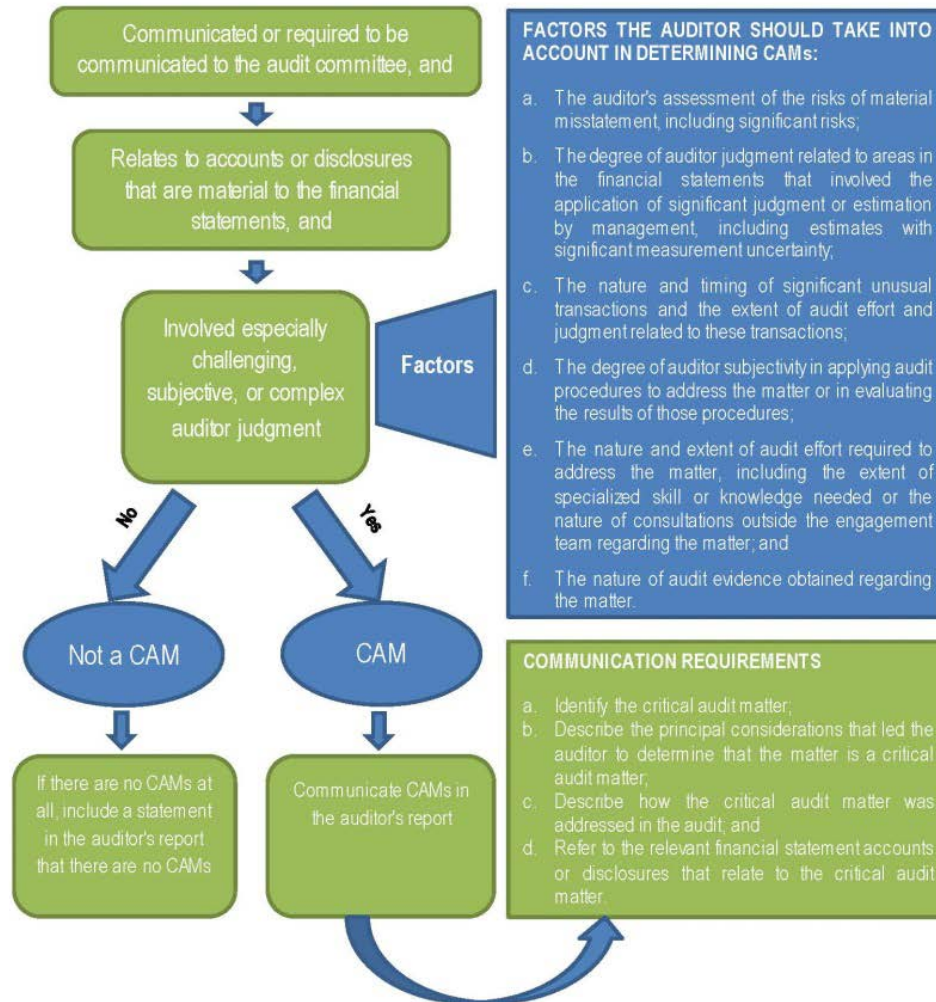
Critical Audit Matters

Communication requirements: The communication of each critical audit matter in the auditor's report includes:

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

Critical Audit Matters

Determining and Communicating Critical Audit Matters ("CAMs")



Critical Audit Matters

Phased in effective date for audits of:

- Large accelerated filers – for fiscal years ending on or after June 30, 2019; and
- All other companies to which the requirements apply – for fiscal years ending on or after December 15, 2020.

CAM requirements do not apply to audits of:

- Brokers and dealers;
- Investment companies, other than business development companies;
- Employee benefit plans; and
- Emerging growth companies

Auditors of these entities may choose to include CAMs voluntarily.

Resources



- ❑ AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*
- ❑ PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments To PCAOB Standards* (June 1, 2017)
- ❑ SEC, *Order Granting Approval of Proposed Rules on the Auditor's Report*, Exchange Act Release No. 34-81916 (Oct. 23, 2017).
- ❑ Staff guidance, *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or after December 15, 2017* (updated Dec. 28, 2017)
- ❑ Questions pertaining to ARM may be directed to the staff in the PCAOB's Office of the Chief Auditor via the standards' help line at (202) 591-4395 or may be submitted through a web form at <https://pcaobus.org/About/Pages/ContactUsWebForm.aspx?Contact=Standard-related%20Inquiries>

Wrap-Up & Key Takeaways

- ❑ Changes effective December 15, 2017
 - Basic Elements and Form of the Auditor's Report
 - New Explanatory Language
- ❑ Critical Audit Matters, effective later



Staff guidance addresses implementation changes effective December 15, 2017

