

Implementation of Critical Audit Matters: Staff Observations from Review of Audit Methodologies

Insights for Auditors

Overview

The PCAOB has a new standard—[AS 3101](#)—that requires communication of critical audit matters (CAMs) in the auditor’s report. CAM requirements are effective for audits of large accelerated filers for fiscal years ending on or after June 30, 2019, and for all other companies to which the requirements apply for fiscal years ending on or after December 15, 2020.

In anticipation of the first phase of CAM implementation, the PCAOB’s Office of the Chief Auditor reviewed CAM methodologies, practice aids, training materials, and examples (“methodologies”) submitted by 10 U.S. audit firms that collectively audit approximately 85% of large accelerated filers. These materials were submitted to PCAOB staff between May 2018 and January 2019, and were in differing stages of completion.

This document outlines the scope and purpose of the staff’s review and highlights thematic observations identified during the review. It also provides auditors with relevant information on the requirements of AS 3101 and related discussion presented in the Board’s rulemaking releases.

The staff’s review of methodologies and thematic observations aim to offer helpful insights for all audit firms as they prepare to implement the new requirements for CAMs.

Purpose of the Review

The purpose of the PCAOB staff review of methodologies was to gain insight into how audit firms are preparing to implement the new CAM requirements and to consider how their materials are aligned with the standard and the discussion in the Board’s rulemaking releases.

The staff review does not mean the PCAOB has approved any audit firm’s methodology. As always, it is the responsibility of the audit firms to develop methodologies that comply with PCAOB standards. The purpose of the review by the Office of the Chief Auditor is separate from the PCAOB inspections process. As such, the review does not provide assurance that deficiencies related to CAM requirements will not be identified in a PCAOB inspection.

What’s included?

- ✓ Overview
- ✓ Purpose of the Review
- ✓ Thematic Staff Observations

The PCAOB Office of the Chief Auditor staff is providing thematic staff observations and relevant guidance for auditors to consider when implementing the new auditor reporting requirements, including critical audit matters. The staff observations and relevant guidance in this document do not establish rules of the Board, do not constitute determinations of the Board, and have not been approved by the Board.

Thematic Staff Observations

The following describes observations based on the review of two or more audit firms' methodologies. It also describes the standard's requirements and related discussion from Board releases.

Source of CAMs - audit committee communications

Some audit firm methodologies excluded certain audit committee communications from the source of CAMs. It is important to note that the standard does not exclude any audit committee communication from the population of potential CAMs.

Audit-specific factors

In the context of determining which matters involved "especially challenging, subjective, or complex auditor judgment," certain methodologies did not prompt auditors to include consideration of audit-specific factors, but instead only referenced the [six factors listed in the standard](#). The standard requires the auditor to take into account the six factors listed **and** other factors specific to the audit.

Describing principal considerations

Some example CAMs that were reviewed included only a statement that the matter involved especially challenging, subjective, or complex auditor judgment. Simply stating that a CAM was especially challenging, especially subjective, or especially complex—or some combination of those—does not fulfill the requirement of the standard without specific language explaining why.

The auditor is required to describe the principal considerations that led to the determination that a matter is a CAM. The auditor's description should be specific to the circumstances and provide a clear, concise, and understandable discussion of **why** the matter involved especially challenging, subjective, or complex auditor judgment.

Describing how a matter was addressed in the audit

The auditor is required to describe how the CAM was addressed in the audit. The standard includes principles-based guidance on how this requirement can be met. The description may include any, or a combination, of the following: (1) the auditor's response or approach that was most relevant to the matter; (2) a brief overview of the procedures performed; (3) an indication of the outcome of the audit procedures; or (4) key observations with respect to the matter.

Some audit firm materials directed auditors to describe general internal control testing in every CAM communication. Auditors, however, are expected to tailor CAM communications to the audit to avoid standardized language and to reflect the specific circumstances of the matter. For example, if the auditor decides to include control testing in the description of how the CAM was addressed in the audit, the auditor would describe the testing of the relevant controls.

Reference to the relevant financial statement accounts or disclosures

Some methodologies indicated that the auditor can communicate either the relevant account or the relevant disclosure, but not both, to avoid duplication. A CAM may relate to one or more account(s) or disclosure(s) or both. The standard does not limit the ability of the auditor to refer to accounts **and** disclosures when communicating CAMs.

Publicly available information

When communicating CAMs in the auditor’s report, the auditor is not expected to provide information about the company that has not been made publicly available by the company unless such information is 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.

Some methodologies identified “publicly available” information only as information disclosed in financial statements or a document containing the financial statements. Information can be made publicly available by the company in a variety of ways, however, including the annual report, press releases, or other public statements.

Discussing CAMs with the audit committee

Some audit firm methodologies indicated that the auditor would provide draft CAMs for the audit committee’s review and feedback. While the auditor is required to provide to and discuss with the audit committee a draft of the auditor’s report and a dialogue regarding CAMs is expected, auditors should remember that CAMs are the responsibility of the auditor—not the audit committee.

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