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At a glance

The PCAOB adopted a new auditing standard to enhance the auditor's report, including communicating critical audit matters and disclosure of auditor tenure.

PCAOB adopts new standard enhancing auditor reporting

What happened?

On June 1, 2017, the PCAOB adopted a new auditing standard, AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (the "new standard") and related amendments to other auditing standards.

Why is this important?

The new standard is intended to make the auditor's report more relevant for investors by requiring the auditor to communicate additional information about the audit. The new standard will require communication of critical audit matters (CAM) for many audits conducted under PCAOB standards. Communication of CAM will not be required for audits of brokers and dealers reporting under the Securities Exchange Act of 1934 Rule 17a-5; investment companies other than business development companies; employee stock purchase, saving, and similar plans; and emerging growth companies.
The new standard will also require disclosure of auditor tenure and provide other changes to clarify the auditor's role and responsibilities.

The new standard retains the existing "pass/fail" opinion, but makes significant changes to other aspects of the auditor's report. The requirements in the new standard are largely unchanged from those included in the PCAOB's May 2016 proposal.

Critical audit matters

CAM are any matters arising from the audit of the financial statements communicated, or required to be communicated, to the audit committee and that (1) relate to accounts or disclosures that are material to the financial statements; and (2) involved especially challenging, subjective, or complex auditor judgment.

In determining CAM, the auditor will be required to take into account specific factors such as the auditor's risk assessment, areas in the financial statements that involved the application of significant judgment or estimation by management, significant unusual transactions, and the nature and extent of audit effort and evidence necessary to address the matter.

The auditor's report will be required to (1) identify the CAM; (2) describe the principal considerations that led the auditor to determine the matter is a CAM; (3) describe how it was addressed in the audit; and (4) make reference to the relevant financial statement accounts and disclosures. If the auditor determines there are no CAM, the auditor must state so in the auditor's report.

Other enhancements to the auditor’s report

The auditor’s report will be required to include a statement disclosing the year in which the auditor began serving consecutively as the company’s auditor (“auditor tenure”). A number of other changes to existing requirements are intended to clarify the auditor's role and responsibilities and make the auditor's report easier to read. These requirements include (1) addressing the auditor’s report to the company’s shareholders and the board of directors; (2) standardizing the form of the auditor's report; (3) disclosing that the auditor is required to be independent; and (4) adding the phrase “whether due to error or fraud,” when describing the auditor’s responsibilities under PCAOB standards to obtain reasonable assurance about whether the financial statements are free of material misstatement.

What's next?

Subject to approval by the SEC, provisions related to CAM will take effect for audits for fiscal years ending on or after June 30, 2019 for large accelerated filers; and for audits for fiscal years ending on or after December 15, 2020 for all other companies to which the requirements apply.

The other changes to the auditor’s report will take effect for audits for fiscal years ending on or after December 15, 2017.

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