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PCAOB Issues Interim Analysis Report on Initial Impact of CAM Requirements

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On October 29, the Public Company Accounting Oversight Board (PCAOB) released an interim analysis report,[1] along with two accompanying white papers, in which the board provides its analysis and perspectives on the initial impact of its critical audit matter (CAM) requirements and the insights learned from stakeholders.

In June 2017, the PCAOB adopted a new auditor reporting standard, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, which was designed to make the auditor's report more relevant to investors by requiring more information about the audit process. The standard retained the longstanding pass/fail opinion options of the prior version of the auditor's report, but made significant changes to the prior version by requiring the communication of CAMs to inform investors and other financial statement users of matters arising from the audit process that necessitated especially challenging, subjective or complex auditor judgment, as well as how the auditor responded to those specific matters in coming to the overall conclusion on the audit.

The CAMs communication requirements are effective according to the following schedule:

- ***Audits of large accelerated filers:*** Fiscal years ending on or after June 30, 2019.
- ***Audits of all other companies to which the CAMs requirements apply:*** Fiscal years ending on or after December 15, 2020.

While the PCAOB has directed this information to external auditors, it also is both relevant and important information for companies and their audit committees as they prepare to better understand and support the work of external auditors in these areas.

[1] *Interim Analysis Report: Evidence on the Initial Impact of Critical Audit Matter Requirements*, PCAOB, October 29, 2020: https://pcaobus.org/EconomicAndRiskAnalysis/pir/Pages/Post-Implementation-Review-AS-3101-Auditors-Report-Audit-Financial-Statements-When-Auditor-Expresses-Unqualified-Opinion.aspx?utm_source=PCAOB+Email+Subscriptions&utm_campaign=59eb27f2ae-Duhnke-Keynote-Speech-Baruch-College-14th_COPY_01&utm_medium=email&utm_term=0_c97e2ba223-59eb27f2ae-113318797.

Protiviti has been tracking CAMs reported in more than 2,000 Form 10-K filings since August 2019, finding that 99% of companies had a least one CAM, with an average of 1.61 CAMs per company. Over this period, just 15 filers reported no CAMs in their Form 10-K filings. Following is a breakdown of the areas of CAMs reported to date:

CAM Area	Percentage of Total CAMs Reported
Fair Value and Valuation	23%
Goodwill, Intangibles, M&A, Business Combinations	20%
Revenue Recognition	16%
Contingencies/Liabilities, Legal Matters	14%
Taxes	9%
Allowance for Loan Losses	6%
Financial Reporting	4%
Inventory	4%
Compensation/Pensions	3%
Information Technology/Software	1%

These CAM issues are not surprising. They have been, or should be, a significant focus for those charged with governance in their organizations – financial reporting teams, senior leadership and audit committees – as well as for those charged with investor protection, including external auditors, the PCAOB and the Securities and Exchange Commission (SEC). To that end, many of these areas appear frequently in PCAOB inspection reports as well as in previews of potential future inspection focus areas.[2]

In its just-released report, the PCAOB performed an interim analysis of the CAM requirements to gain an initial understanding of audit firms' and engagement teams' responses to the requirements, investors' use of CAM communications, as well as preparer and audit committee experiences related to CAM implementation.

The PCAOB's key findings include the following:

- External audit firms made significant investments to support initial implementation of CAM requirements.
- Investor awareness of CAMs communicated in the auditor's report is still developing, but some investors are reviewing CAMs and finding the information beneficial.

[2] For more information, read "PCAOB Issues Staff Update and Preview of 2019 Inspection Observations," The Protiviti View, October 9, 2020: https://blog.protiviti.com/2020/10/09/pcaob-issues-staff-update-and-preview-of-2019-inspection-observations/.

- Among audits of large accelerated filers, for which the CAM requirements are effective for fiscal years ending on or after June 30, 2019, the staff has not found evidence of significant unintended consequences from auditors' implementation of CAM requirements.

The PCAOB's interim analysis is the board's first step in analyzing the CAM requirements. The board will likely monitor reported CAMs in audits throughout 2021 and issue another report in 2022 to provide further perspectives on any changes in the communication of CAMs and insights on the initial impact of CAMs communicated in the audit reports of smaller issuers (as noted earlier, the requirement to report CAMs becomes effective for audits of all other companies, beyond large accelerated filers, beginning in fiscal years ending on or after December 15, 2020). Because some of the effects of the CAM requirements may take several years to fully manifest or stabilize, the PCAOB expects to publish a more comprehensive post-implementation review in 2024.

The PCAOB also notes it will continue to consider all relevant costs and benefits attributable to the CAM requirements following a reasonable period of implementation.

In addition to its interim analysis report, the PCAOB published two supporting white papers, Stakeholder Outreach on the Initial Implementation of CAM Requirements and Econometric Analysis on the Initial Implementation of CAM Requirements.

Further information on CAM requirements is available on the PCAOB's website.

Our Point of View

Despite the PCAOB's initial view that it has found no significant unintended consequences from implementation of the CAMs requirements for large accelerated filers, there still are several potential consequences that organizations should monitor as these requirements come into effect for all other companies during this coming year-end. First, the PCAOB anticipates additional costs related to increased time needed to prepare and review auditors' reports, including discussions with management and consultation with audit committees, as well as legal costs to review the information provided in the CAMs. In addition, auditors may choose to perform more audit procedures related to areas reported as CAMs (even though the attestation requirements in those areas did not change due to the addition of CAM disclosure), with a resulting cost implication for both auditors and issuers. Questions remain as to how substantial these additional audit procedures and related costs will be over the long term.

Another consequence to consider: The CAM requirement is a significant change in practice that could alter the relationship dynamics between the auditor and the audit client – both management and the audit committee. From the auditor's perspective, it will present an opportunity to offer more insight to investors and regulators (and, indirectly, the plaintiff's bar) as to the underlying audit issues. It is reasonable to expect accounting firms to determine specific areas by industry or capital structure that are most likely to involve especially *challenging, subjective or complex* auditor judgment and are, therefore, likely candidates for CAM treatment. The objective, thus, would be to insulate audit partners from the difficulties of making such determinations on a client case-by-case basis.

It also will be interesting to see if the items reported as CAMs are used by the SEC as a guide in developing questions posed in comment letters to registrants, and how that dynamic, if manifested, impacts the attorney-auditor-client interactions in drafting and issuing securities filings. Likewise, the PCAOB may compile CAM data as a source of input for determining the scope of its inspections process, although, as mentioned, the CAMs reported to date involve financial reporting risk areas well known to the PCAOB.

Another question relates to how auditor communications with management and the audit committee will evolve. PCAOB inspections could create subtle pressure on auditors to "say something" in the audit report whenever a matter is communicated. In our view, it is vital to the auditor-client relationship that auditors be able to distinguish between CAMs and other matters. Inability to do so with clarity could result in a chilling effect on the relationship and communications. Accordingly, PCAOB monitoring is important, as the CAM requirement could impact both the matters communicated by auditors to management and the audit committee, as well as the manner in which those matters are communicated.

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