

AN OFFERING FROM THE BDO CENTER FOR CORPORATE GOVERNANCE  
AND FINANCIAL REPORTING

# BDO FLASH REPORT

## CORPORATE GOVERNANCE



### SUBJECT

## PCAOB ISSUES STAFF GUIDANCE FOR CHANGES TO THE AUDITOR'S REPORT

### SUMMARY

The PCAOB has issued Staff Guidance related to Auditing Standard 3101 that will help both firms and audit committees as required changes to auditor reporting are implemented this audit cycle for audits of fiscal years ending on or after December 15, 2017.

### DETAILS

On December 4, 2017 the PCAOB issued [Staff Guidance, Changes To The Auditor's Report Effective For Audits Of Fiscal Years Ending On Or After December 15, 2017 \(Staff Guidance\)](#), to help audit firms in implement changes to the auditor's report under AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. This Staff Guidance was subsequently updated as of December 28, 2017. The Staff Guidance covers key changes to the auditor's report that are effective this year, including changes relating to the disclosure of auditor tenure, a statement on auditor independence, and a required explanatory paragraph on Internal Control Over Financial Reporting (ICFR) in certain circumstances. The Guidance also provides a high-level overview of the requirements relating to Critical Audit Matters (CAMs).

Following is the example report included at Appendix A within the standard that illustrates the key changes to the auditor's report effective for audits of fiscal years ending on or after December 15, 2017.



### CONTACT

**JAN HERRINGER**  
National Assurance Partner  
732-734-3010 / [jherringer@bdo.com](mailto:jherringer@bdo.com)

**AMY ROJIK**  
National Assurance Partner  
617-239-7005 / [arojik@bdo.com](mailto:arojik@bdo.com)

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 December 28, 2017  
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**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].

Basis for Opinion

Basis for Opinion Section

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.

Auditor Independence

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.]

ICFR Explanatory Language, if applicable

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]

CAMs, when effective

[Signature]

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

Auditor Tenure

[City and State or Country]

[Date]

## **Key Changes to the Auditor's Report for Current Audit Cycle:**

### **Form of Auditor's Report**

The new standard requires that the Opinion on the Financial Statements section be the first section, immediately followed by the Basis for Opinion Section. Additionally, section titles have been added to the auditor's report to guide the reader. Appropriate section titles are to be included for explanatory and emphasis paragraphs, such as when a going concern explanatory paragraph is included within the auditor's report.

### **Addressee**

The new standard requires that the auditor's report be addressed to the shareholders and the board of directors, or equivalents for companies not organized as corporations. The Staff Guidance includes the following examples of addressees for companies not organized as corporations:

1. The plan administrator and plan participants for benefit plans;
2. The directors (or equivalent) and equity owners for broker dealers; or
3. The trustees and unit holders or other investors for investment companies organized as trusts.

Auditors can assess, based on the individual circumstances, whether or not to voluntarily include additional addressees in the auditor's report.

### **Auditor Independence**

The new standard requires a statement in the Basis for Opinion section 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.

### **Auditor Tenure**

The new standard requires a statement in the auditor's report containing the year the auditor began serving consecutively as the company's auditor. The disclosure of tenure should reflect the entire relationship between the company and the auditor, taking into account firm or company mergers, acquisitions, or changes in ownership structures. For example, when a company acquires another company, if the acquirer's current auditor continues serving as the combined company's auditor, auditor tenure would continue. However, if the acquired company's auditor is selected to serve as the combined company's auditor, auditor tenure would begin at that time.

Auditor tenure is not affected by the Company's status as a public company. If a company went public and maintained the same auditor, auditor tenure will include the years before and after the company became subject to SEC reporting requirements.

The Staff Guidance states that in determining the year the auditor began serving consecutively as the Company's auditor, the auditor will 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. The Staff Guidance provides the following examples on determining auditor tenure:

1. If the auditor signs the engagement letter in January 2012 to audit a company's financial statements for the year ended December 31, 2012, and the auditor's report is dated February 28, 2013, the auditor would state 2012 as the year the auditor began serving consecutively as the company's auditor.
2. If 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 2011 as the year the auditor began serving consecutively as the company's auditor.
3. If 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 2013 as the year the auditor began serving consecutively as the company's auditor.

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 Electronic Data Gathering, Analysis and Retrieval \("EDGAR"\) 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.

If there is uncertainty as to the year the auditor began serving consecutively as the company's auditor, the auditor should state that the auditor is uncertain and provide the earliest year of which the auditor has knowledge. The Staff Guidance provides the following example of such a statement:

*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.*

For an investment company that is part of a group of investment companies, the new standard requires that 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. The Staff Guidance provides the following example to illustrate this:

*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.*

### Auditor Reporting Regarding ICFR

In certain circumstances, management is required to report on the Company's ICFR, but such report is not required to be audited. In such cases, the auditor is required to include explanatory language to that effect in the Basis for Opinion section. The annotated example included in the Staff Guidance illustrates this presentation by adding the following explanatory language:

*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.*

Additionally, the requirements for auditor reporting on management reports on ICFR have been updated to conform to the new standard. Updated examples are included in [AS 2201, An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements, as amended](#).

### Explanatory and Emphasis Paragraphs

As noted above, explanatory language is to be added when management is required to report on ICFR, but an audit of ICFR is not performed, representing a key change to the list of circumstances in which explanatory language is required. The Staff Guidance also explains that if an audit report includes an emphasis of matter paragraph, an appropriate section title is to be used.

### Information About Certain Audit Participants

If the auditor *voluntarily* decides to provide information about certain audit participants that is required to be reported on PCAOB Form AP, Auditor Reporting of Certain Audit Participants, the auditor should include an appropriate section title.

### Note: [PCAOB AS 1301, Communications with Audit](#)

[Committees](#), now requires engagement teams to provide to and discuss with the audit committee a draft of the auditor's report prior to issuance.

### Key Changes to the Auditor's Report for Future Audit Cycles:

The Staff Guidance addresses the following key change to the auditor's report effective for audits of fiscal years ending on or after June 30, 2019 (for large accelerated filers) and December 15, 2020 (for all other filers):

### Critical Audit Matters

The Staff Guidance provides an overview of requirements to disclose Critical Audit Matters (CAMs) and reminds auditors that CAMs may be included voluntarily before the effective date or for entities for which the requirements do not apply.

**Note:** Communication of CAMs is not required for audits of emerging growth companies; brokers and dealers; investment companies other than business development companies; and employee stock purchase, savings, and similar plans.

### Next Steps:

Refer to BDO's [infographic](#) available within the BDO Center for Corporate Governance and Financial Reporting. BDO intends to continue to provide external thought leadership and training opportunities as they are developed.

Furthermore, audit committees, particularly accelerated filers, are encouraged to begin proactively discussing with their auditors and management matters that could potentially be considered CAMs in advance of when those provisions of the standard become effective.