

A woman with dark hair, wearing a dark blue shirt with white polka dots, is smiling while talking on a black mobile phone. She is also typing on a laptop keyboard. The background is a soft, out-of-focus office setting. There are two red vertical bars: one at the top left and one at the bottom left.

PREPARING FOR CRITICAL AUDIT MATTERS:

What Management and
Audit Committees Need
to Know



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What is a CAM?

A critical audit matter (CAM) 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 relates to accounts or disclosures that are material to the financial statements and that involves especially challenging, subjective or complex auditor judgment.

How are CAMs Assessed?

CAMs involve “especially challenging, subjective or complex auditor judgment.” In determining whether those criteria apply, the auditor should take into account, alone or in combination, the following nonexclusive factors:



What's Changing?

Audit reports have long contained wording that did not vary much or at all across audit firms, industries or companies. CAMs are expected to be unique to each audit's circumstances and, as such, should not reflect a boilerplate approach. Significant auditor judgment will be required from company to company and year to year to identify and critically evaluate CAMs and discuss in the auditor's report the principal considerations that led to the matter being identified as a CAM and the audit procedures performed to address those considerations.

What can Management do to Avoid Common Adoption Pitfalls?

Engage in meaningful conversation with your auditors around the CAM process. CAM adoption is not a check-the-box exercise, but rather a process that requires thoughtful assessment of the areas of the audit and how those areas align with the definition of critical audit matters in the audit standards.

Consider asking your auditors the following questions:



Do your most common CAM areas align with what the market is seeing (e.g. Business Combinations, Income Taxes, Revenue and Goodwill and Intangibles Impairment)? If not, what are you seeing for most common CAM areas?



Are the identified CAMs aligned with the matters discussed by management in the critical accounting policies?



Does management's internal assessment / grading of the areas of complexity (i.e., areas of management's significant judgments) to prepare financial statements correlate to the areas of complexity identified in the auditor's CAMs?

With respect to reviewing draft CAMs, management should assess whether the content of the CAM includes "original information" or sensitive information that was not previously disclosed by the entity and discuss these matters with their auditors.

With respect to critical accounting policies, management should consider reviewing critical accounting policies with a fresh look at how those are determined, if the language describes in plain English what about those areas are critical, and whether the disclosures clearly articulate all areas of complexity. While there is not a one-for-one relationship between critical accounting policies and CAMs, there are some similarities between the two definitions that often lead to matters identified as CAMs being critical accounting policies.

What can the Audit Committee do to Avoid Common Adoption Pitfalls?

Engage in meaningful conversation with your auditors around the CAM process. Adoption of critical audit matters has placed even more emphasis on the importance of quality discussions between audit committees and the external auditors. Audit committees should consider asking auditors the following questions to drive discussion around CAMs:



Will increased focus on CAMs affect the scope of the audit plan and the amount of audit work that needs to be performed?



What is the expected timeline of discussions and review of draft CAMs with auditors (e.g., during Q2 – Q3)?



What is the protocol to resolve Audit Committee and Management questions and comments on the draft CAMs?



What effect did CAM identification have on the auditor's risk assessment process? Do identified CAMs correlate to significant risks of material misstatement identified for the audit?



How will we resolve instances when the content of the draft CAM includes "original information" or sensitive information that was not previously disclosed by the entity?

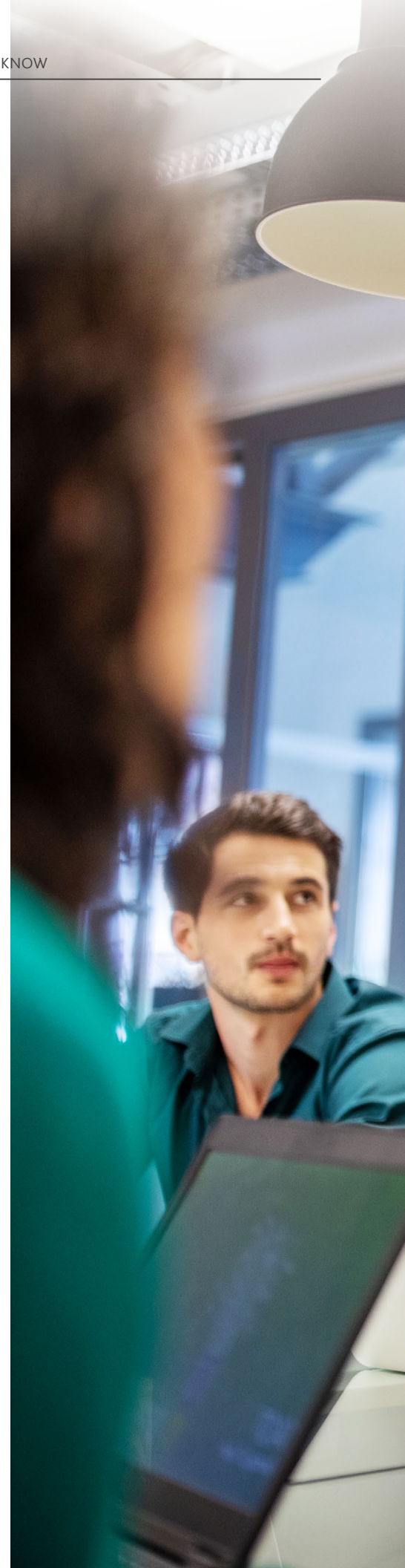


What are the most substantive issues identified or lessons learned as a result of the firm's dry runs related to communicating CAMs in the auditor's report?



Were there any matters considered to be "close calls" when evaluating potential CAMs but determined not to be a CAM? What were the considerations that led to the determination that these matters were not CAMs?

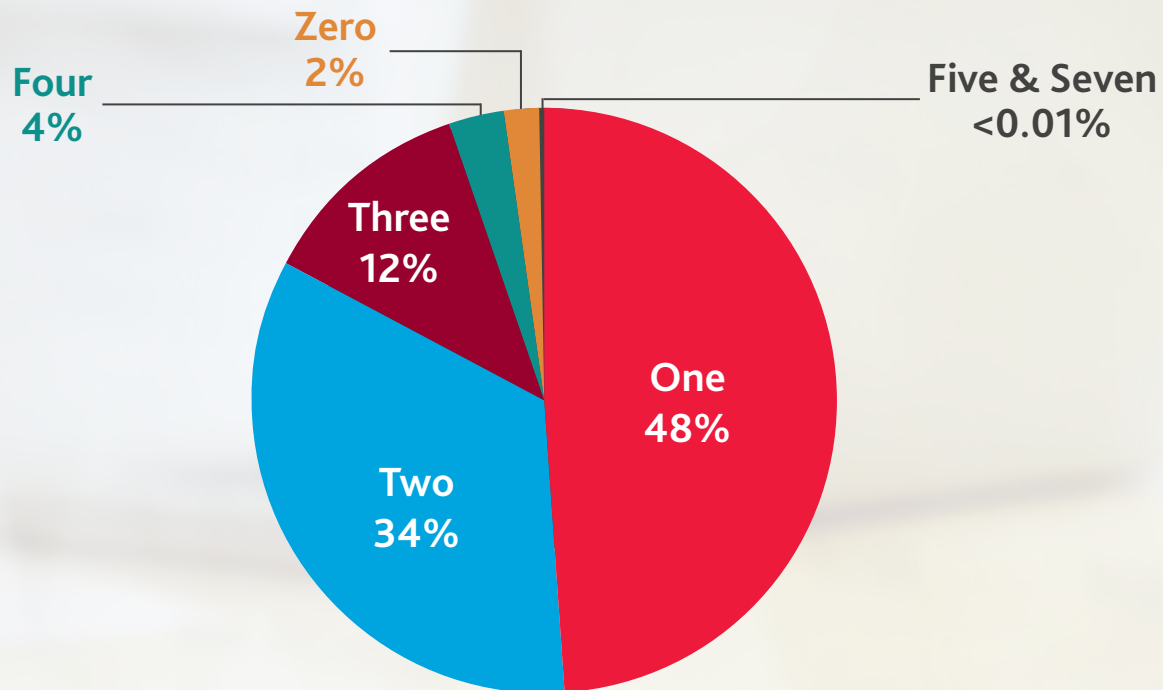
Additional questions can be found by going [here](#).





How Many CAMs Should You Expect?

It has quickly become clear that there is not a set number of CAMs that exists in a given industry or type or size of a company. The below chart shows the number of CAMs identified for all Large Accelerated Filers (LAF) and voluntary filers, with filings through May 31, 2020*.



- ▶ 2,343 LAF reports filed through May 31, 2020
- ▶ 3,965 CAMs identified
- ▶ 40 reports where no CAMs were identified
- ▶ Average of 1.69 CAMs per report (range of 0 to 7 CAMs reported)

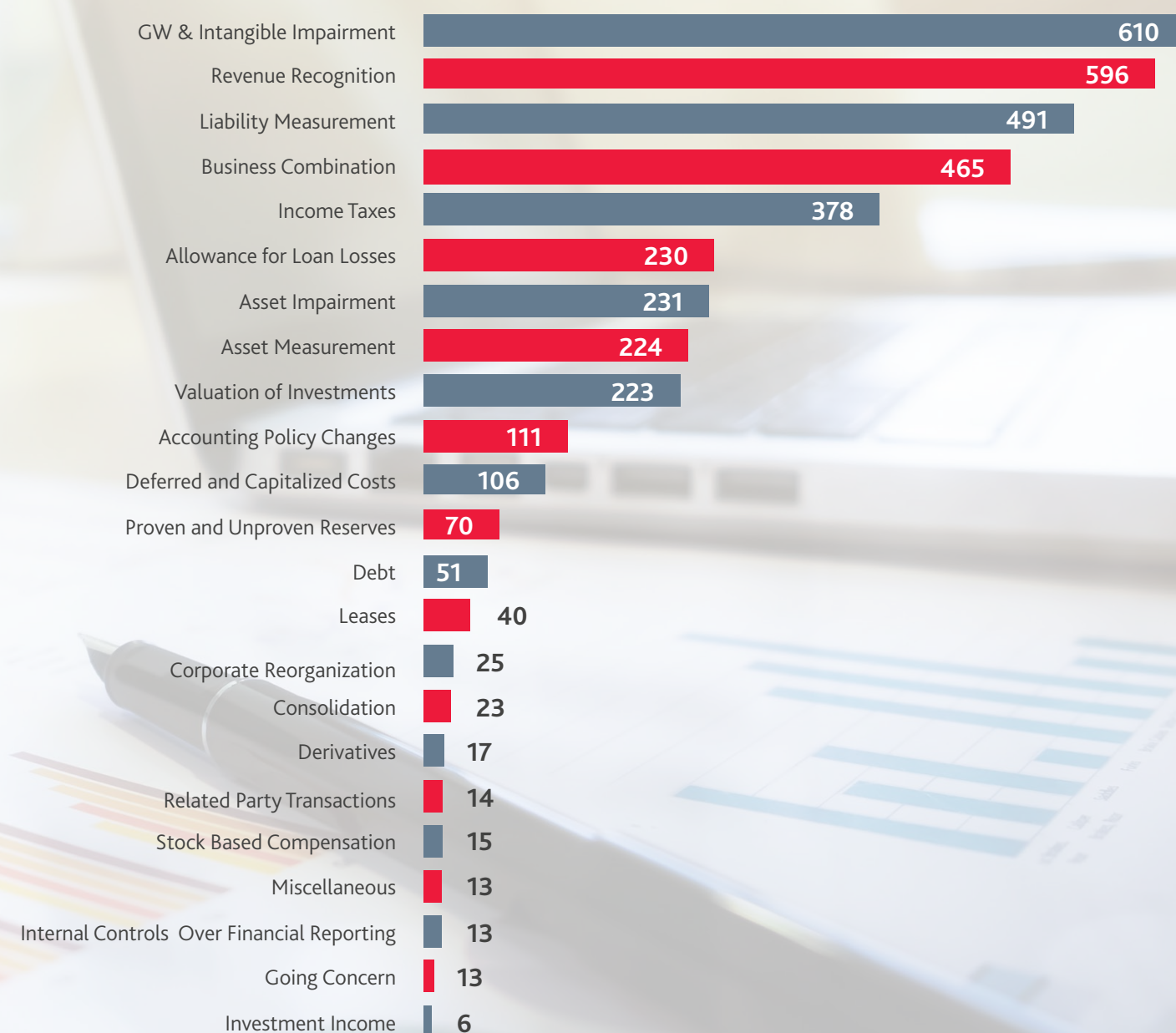
- ▶ Includes:
 - 473 of the S&P 500
 - 31 BDO Reports
 - 413 Foreign Private Issuers

The process of identifying CAMs is time intensive and requires a significant amount of auditor judgment. The facts and circumstances of each engagement will determine how many CAMs are identified in that year for that engagement.

*Data furnished by Audit Analytics.

What are the Most Common Areas of CAMs?

The below chart shows the distribution of identified CAMs across all industries for LAFs with filings through May 31, 2020*.



► Includes 2,343 reports across 11 BDO industry groups communicating 3,965 CAMs

► Average of 1.69 CAMs per report

*Data furnished by Audit Analytics.

What are the Regulators Saying?

In December 2019, the PCAOB issued a CAM Spotlight highlighting its observations from engaging with auditors and audit committees on effective CAM implementation about:

- ▶ Investments in frameworks for CAM implementation
- ▶ Preliminary CAM determination and drafting
- ▶ Ongoing CAM evaluation throughout the audit process
- ▶ Subject matter experts involved in the CAM process
- ▶ Management and audit committee involvement

The PCAOB intends to continue to conduct analysis in 2020 and issue its observations as part of the overall post-implementation review of PCAOB Audit Standard 3101: The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion.

The following is an excerpt from the PCAOB CAM Spotlight:

"Timely and robust engagement with management and the audit committee were important factors in the CAM implementation process. Starting with practice runs and throughout the first year of implementation, regular dialogue among the audit team, management, and the audit committee was helpful in building a common understanding of the purpose of the CAM requirements and in discussing CAM determinations and draft CAM descriptions."

To date, preliminary results from our outreach to audit committees suggest that they generally found the audit team's practice run processes to prepare for implementing the CAM requirements to be helpful and believe that CAM implementation has not changed their interactions with the auditor. While CAMs are the sole responsibility of the auditor, audit committees shared with us that they generally began discussing CAMs with their auditor in 2017 or 2018, well in advance of the effective date of the requirements in 2019."

In addition, the PCAOB issued a [Spotlight on COVID-19](#) in March 2020, which also addressed CAM.

"The COVID-19 crisis may affect the auditor's report, such as when the auditor is determining and communicating critical audit matters (CAMs). The guidance in our publications, Implementation of Critical Audit Matters: A Deeper Dive on Determination of CAMs and Implementation of Critical Audit Matters: A Deeper Dive on the Communication of CAMs, may be relevant when considering the effects of COVID-19 on CAM determinations and communications. While the COVID-19 crisis may not itself be a CAM, it may be a principal consideration in the auditor's determination as to whether one or more CAM(s) exist, and may also affect how CAMs were addressed in the audit."

Additionally, the significance of the impacts of COVID-19 may warrant including additional elements in the auditor's report, such as explanatory language or an explanatory paragraph when there is substantial doubt about the ability of the company to continue as a going concern."

For more information about Critical Audit Matters, read our [Future of Auditor Reporting Insight](#).

FAST FACTS

1. Significant auditor judgment will be required and will vary from company to company and year to year to identify and critically evaluate CAMs.
2. CAM adoption is not a check-the-box exercise, but rather a process that requires thoughtful assessment of the areas of the audit.
3. Adoption of critical audit matters has placed even more emphasis on the importance of quality discussions between audit committees, management and the external auditors





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