

JANUARY 2024

# CRITICAL AUDIT MATTERS

## A 3-YEAR REVIEW

2020 - 2022

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# INTRODUCTION

As part of the audit, auditors often perform procedures involving challenging, subjective, or complex judgments. However, until recently, the auditor's report did not communicate this information to investors. This resulted in information asymmetry between investors and auditors. Outside the United States, other regulators and standard setters had already adopted expanded auditor reporting.

As a result, the PCAOB issued AS 3101 *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. This standard made significant changes to the auditor's report, including communication of critical audit matters, and was phased in by filer status beginning in 2019.

Critical audit matters are defined as those matters 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.

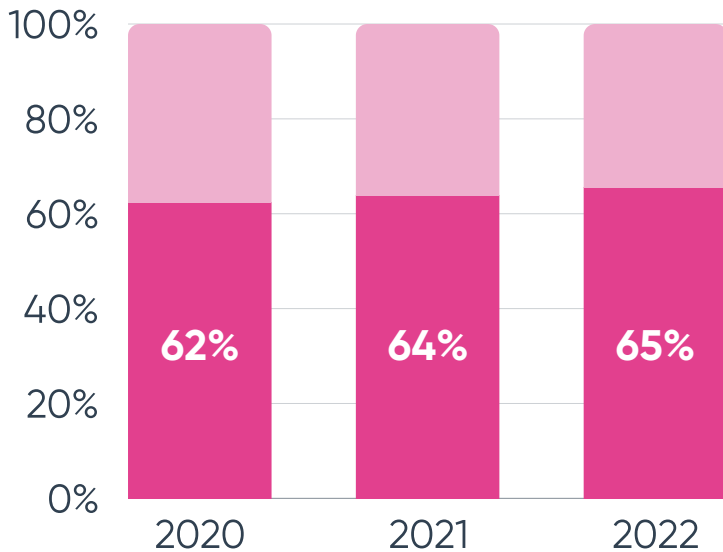
For each critical audit matter communicated in the auditor's report, the auditor must:

1. Identify the critical audit matter;
2. Describe the principal considerations that led the auditor to determine that the matter is a critical audit matter;
3. Describe how the critical audit matter was addressed in the audit; and
4. Refer to the relevant financial statement accounts or disclosures that relate to the critical audit matter.

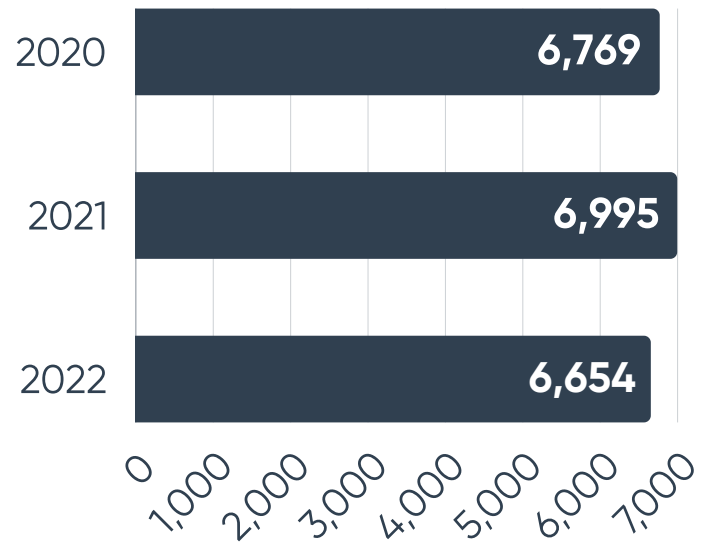
Critical audit matters add to the total mix of information, providing insights relevant to analyzing and pricing risks in capital valuation and allocation, contributing to investor's ability to make decisions. Critical audit matters also focus attention on key financial reporting areas and identify areas that deserve more attention, enhancing the efficiency of investors and others in the consumption of financial information.

# EXECUTIVE SUMMARY

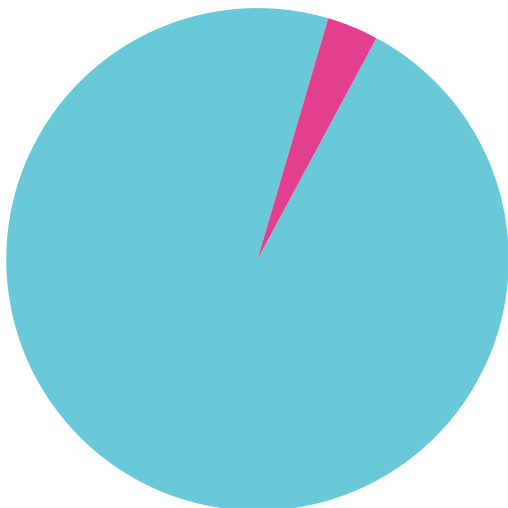
In FY2022, **65%** of opinions contained CAMs. The percent of opinions with CAMs has been **increasing** each year since FY2020.



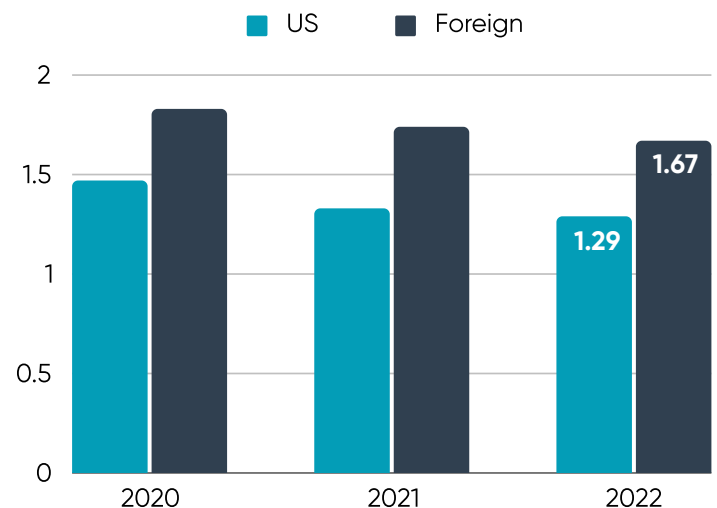
Total CAMs decreased **5%** from FY2021 to a total of **6,654** CAMs in FY2022, the lowest seen over the three year period.



Only **3%** of SPAC opinions included CAMS in FY2022, with **Going Concern** being the most commonly cited CAM topic.

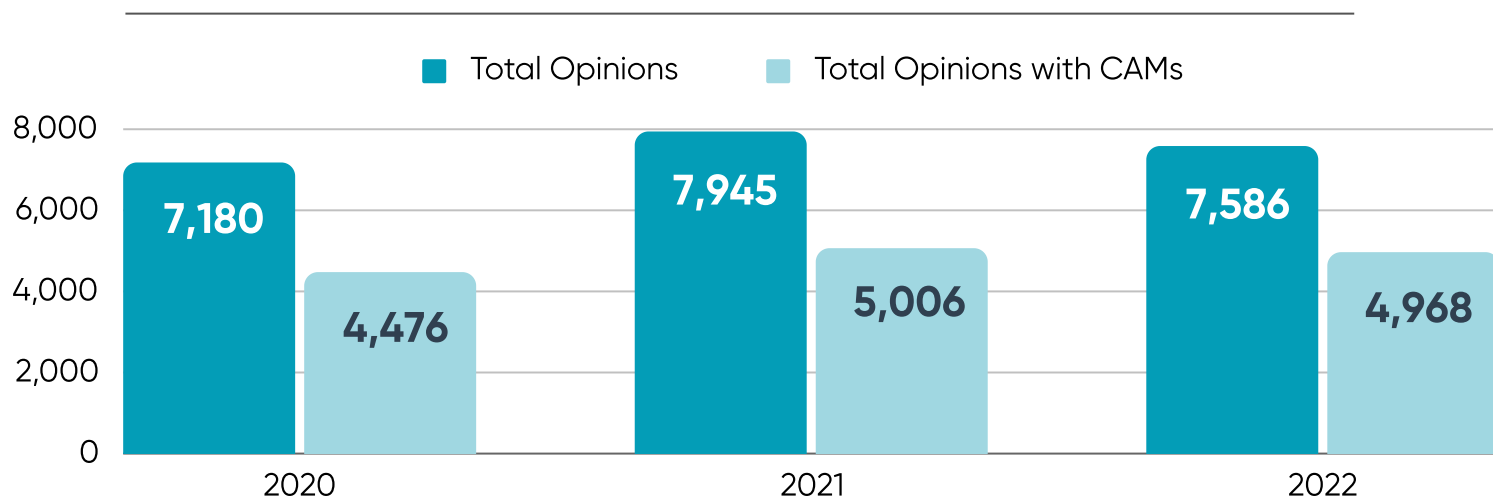


Foreign filers have a higher average number of CAMs per opinion than US filers. In FY2022, foreign filers had an average of **1.67** CAMs per opinion compared to **1.29** for domestic filers.



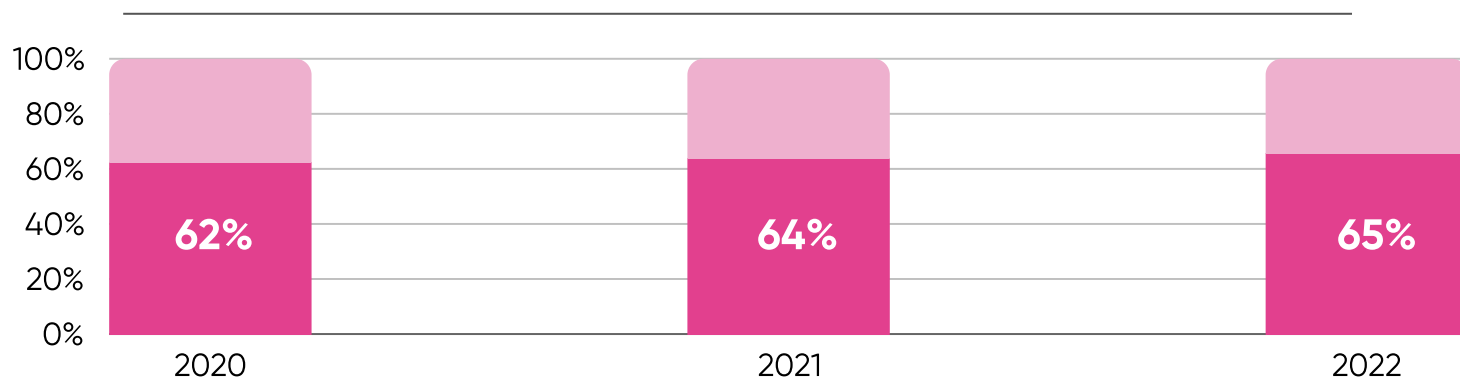
# OVERVIEW

## Total Opinions



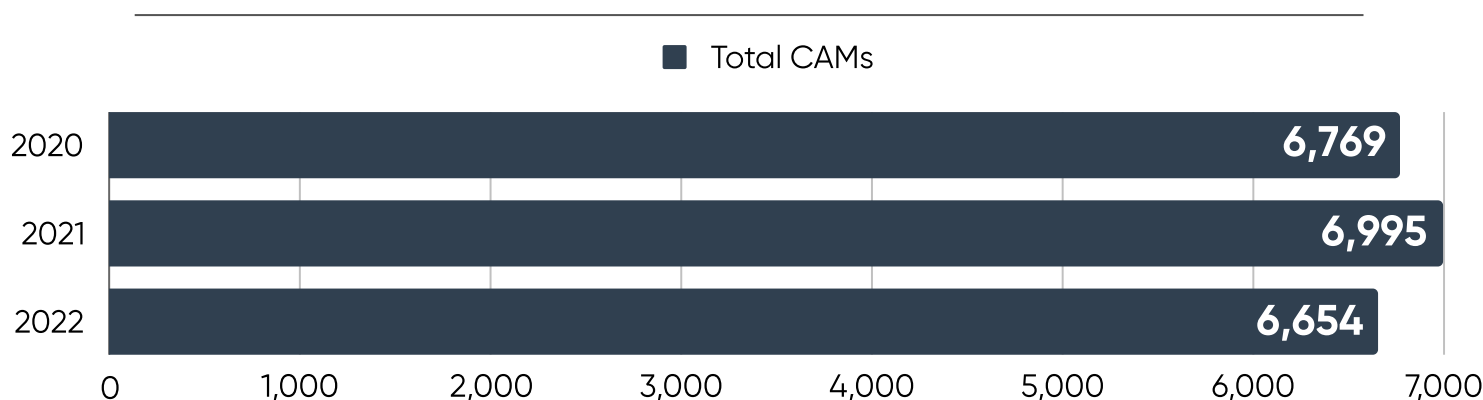
In FY2022, the total number of opinions that included CAMs was 4,968, representing 65% of total opinions for the year. This was a slight increase from the 64% of opinions with CAMs in FY2021 and 62% in FY2020.

## Percent of Opinions with CAMs



Total CAMs peaked in FY2021 at 6,995 CAMs. In FY2022, total CAMs fell by 4.9% to 6,654, the lowest amount seen over the three years. The number of opinions with CAMs fell by only 0.8% from FY2021, indicating that not only were there fewer opinions issued in FY2022, but fewer CAMs issued as a proportion of opinions as well.

## Total Number of CAMs per Fiscal Year



# OVERVIEW

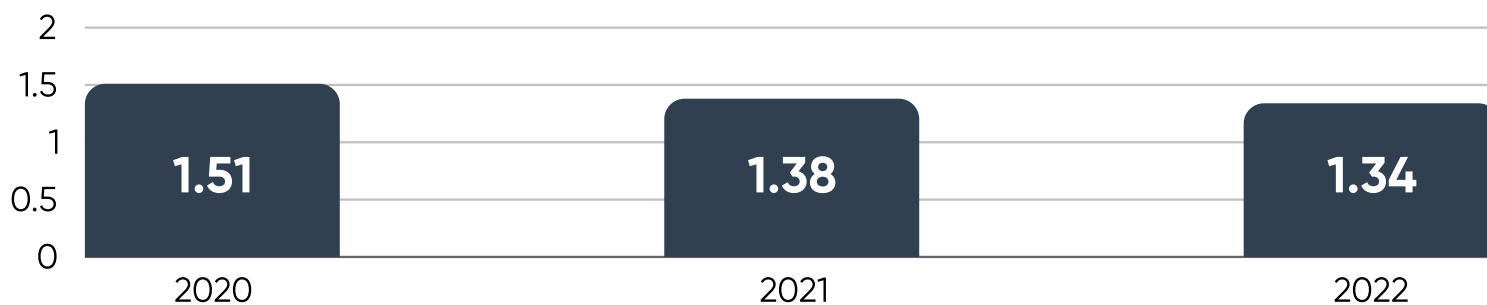
## Frequency of Total CAMs per Opinion

# of CAMs in Opinion	2020	2021	2022
1	61%	70%	73%
2	29%	23%	22%
3	8%	5%	4%
4	2%	1%	1%
5	0.2%	0.1%	0.2%
6	0.09%	0.1%	0.04%
7	0.02%	0.02%	0%

For each fiscal year, the majority of opinions with CAMs had only one CAM per opinion. In FY2022, 73% of opinions with CAMs had only one critical audit matter. As the number of CAMs per opinion increases, the frequency decreases. In FY2022, 22% of opinions with CAMs had a total of two CAMs per opinion. The frequency drops to only 4% when the number of CAMs per opinion increases to three.

Since the majority of opinions have only one CAM, the average number of CAMs per opinion for each fiscal year is very low. In FY2020, the average number of CAMs per opinion was 1.51, the most seen over the three year period. Since then, the average has been steadily decreasing each year, reaching 1.34 CAMs per opinion in FY2022.

## Average Number of CAMs per Opinion



## CAM TOPICS

## Top 10 CAM Topics: 2020-2022

*represented as a percent of total CAMs for the three year period*

Rank	CAM Topic	# of CAMs	% of CAMs
1	Revenue from Customer Contracts	2,683	13%
2	Business Combinations	1,887	9%
3	Goodwill	1,797	9%
4	Allowance for Credit Losses	1,521	7%
5	Other Contingent Liabilities	851	4%
6	Inventory	820	4%
7	Other Investments	742	4%
8	Long-Lived Assets	676	3%
9	Other Debt	625	3%
10	Deferred Income Taxes	588	3%

Revenue from customer contracts is the most common CAM topic seen across all opinions since FY2020. The revenue recognition standard FASB ASC Topic 606, *Revenue From Contracts With Customers*, was one of the most significant changes in US GAAP. It requires a five-step approach to recognizing revenue and includes numerous aspects where significant judgments may apply. A frequent citation from the revenue CAMs was performance obligations, with over 1,000 citations.

The top five CAM topics in FY2022 mirror the top five for the three years except for inventory moving ahead of other contingent liabilities in the ranking.

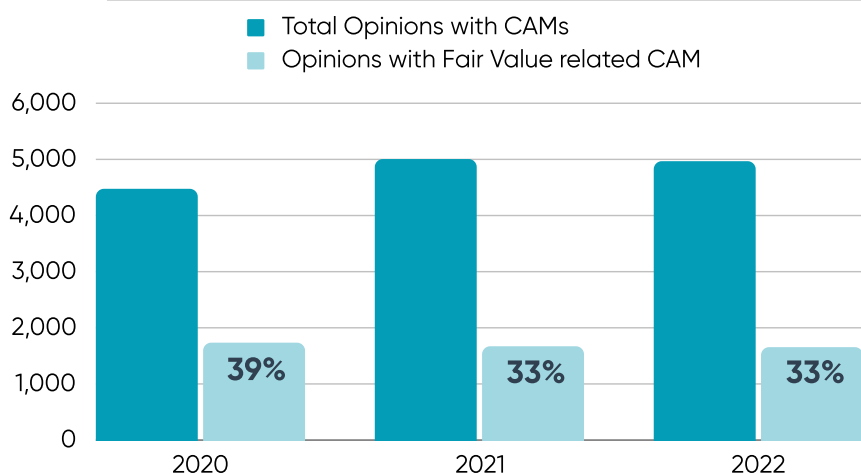
## Top 5 CAM Topics: 2022

*represented as a percent of total CAMs for FY2022*

Rank	CAM Topic	# of CAMs	% of CAMs
1	Revenue from Customer Contracts	929	14%
2	Business Combinations	598	9%
3	Goodwill	573	9%
4	Allowance for Credit Losses	513	8%
5	Inventory	299	4%

# DEEP DIVE

## Valuation of Assets



The impact of a business combination or asset acquisition on an audit is substantial and doesn't end when the initial acquisition accounting is completed. Combining the critical matters citations for asset valuation, fair value, and impairment results in the highest occurring critical matter subject; 33% of all FY2022 opinions with CAMs had a CAM for fair value of assets, exceeding the single subject total of 19% for revenue recognition in FY2022.

The FY2020 CAMs represented the highest occurrence of fair value related CAMs at 2,024 or 30% of total CAMs, reflecting the uncertain forecasts indicating potential impairment during the pandemic. Valuation CAMs declined to 27% in FY2021 and increased slightly to 28% in FY2022.

FY2020 had the lowest number of business combination CAMs, likely due to a 13% decline in merger and acquisition (M&A) transactions in that pandemic year.

M&A activity in FY2021 increased 38% from FY2020, with a corresponding increase in business combination CAMs of 50%.<sup>3</sup>

### Valuation Related CAMs<sup>2</sup>

CAM Topic	2020	2021	2022
Business Combinations	495	745	582
Goodwill	736	487	573
Goodwill and Intangible Assets	136	110	144
Long-Lived Assets	254	197	214
Other Intangible Assets	191	181	167
Property, Plant & Equipment	191	153	143
Research and Development	21	23	21
<b>Total Valuation Related CAMs</b>	<b>2,024</b>	<b>1,896</b>	<b>1,844</b>
<b>Total CAMs</b>	<b>6,769</b>	<b>6,995</b>	<b>6,654</b>

### Understanding Ideagen Audit Analytics Critical Audit Matters (CAMs) Taxonomy

In general, business combinations include the following:

- acquisitions, mergers, takeovers, asset acquisitions
- purchase price allocation, contingent consideration from acquisitions
- initial valuation of intangible assets from acquisition, valuation of goodwill from acquisition
- adjustment in assets and liabilities arising from prior year acquisitions (not including impairment)
- establishment price of acquired in-process research and development (acquired IPR&D)

After the business combination accounting (including post-acquisition adjustments) is complete, the taxonomies selected for the CAM is dependent upon whether both goodwill, intangible assets and/or tangible assets are cited singly or together (e.g. Goodwill, Goodwill and intangible assets, Other intangible assets, Property, plant and equipment (PPE) or Long-Lived assets (if tangible assets are also included in any pairing or for an asset group).

<sup>2</sup> These counts were tabulated by filtering on all of the above taxonomies and performing a Boolean search for fair value, valuation and impairment. This analysis is exclusive of financial instruments and derivatives. NOTE: Asset acquisitions that occur outside of a business combination would be reflected in their respective natural categories.

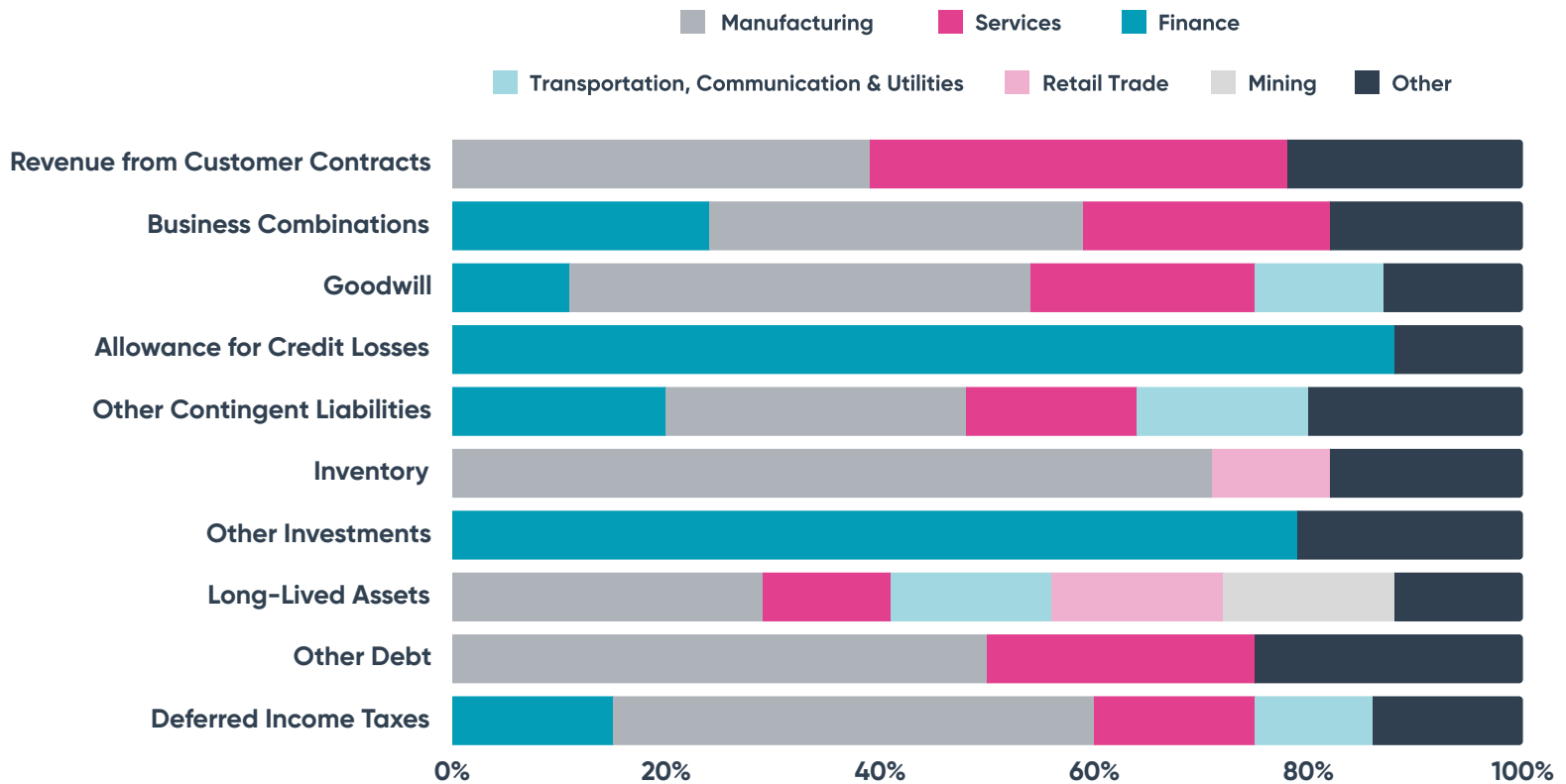
<sup>3</sup> <https://www.statista.com/statistics/914665/number-of-ma-deals-usa/>



# INDUSTRY

## Top 10 CAM Topics Distribution by Industry

represented as a percent of total CAMs for the three year period



Companies in different industries have different audit risks that are commonly addressed in their critical audit matters. The size of an industry, as represented by the number of public companies, also impacts the percentage distribution of CAMs in the above chart.

Revenue from customer contracts CAMs most commonly occur in the manufacturing industry, at 1,049 CAMs, and the service industry, at 1,045, each representing 39% of all CAMs with that topic. While it is the top issue for the construction industry, at 78 CAMs, the size of the industry results in a total of only 3% of all revenue recognition critical matters being associated with the construction industry.

The finance, real estate, and insurance industry make up 88% of total CAMs relating to the allowance for credit losses and 79% of other investments CAMs, reflecting their significant risks in loans receivables and investments.

The manufacturing industry constitutes the largest proportion of CAMs relating to inventory (71%), other debt (50%), and deferred income taxes (45%). These represent their significant risks in inventory, financing of fixed assets, and determining future deductibility of temporary differences, many resulting from accelerated depreciation.

Long-lived assets is the most diverse category among the top ten CAM topics in terms of industry. Manufacturing has 195 CAMs with this topic, constituting 29% of the topic total, reflecting the industry's concentration of plant, property, and equipment assets. However, the services, transportation, retail trade, and mining industries each represent over 12% of the CAMs relating to long-lived assets, reflecting the widespread risks related to asset group valuations.

## INDUSTRY

## #1 CAM Topic by Industry

represented as a percent of total opinions with CAMs for each industry over the three year period

Industry	CAM Topic	# of Opinions	% of Opinions w CAMs
Construction	Revenue from Customer Contracts	78	52%
Services	Revenue from Customer Contracts	1,038	43%
Finance	Allowance for Credit Losses	1,321	40%
Mining	Proven and Unproven Reserves	328	40%
Trans, Comms and Utilities	Regulatory Assets and Liabilities	443	29%
Wholesale Trade	Goodwill	79	25%
Manufacturing	Revenue from Customer Contracts	1,027	20%
Agriculture	Inventory	11	18%
Retail Trade	Long-Lived Assets	109	17%

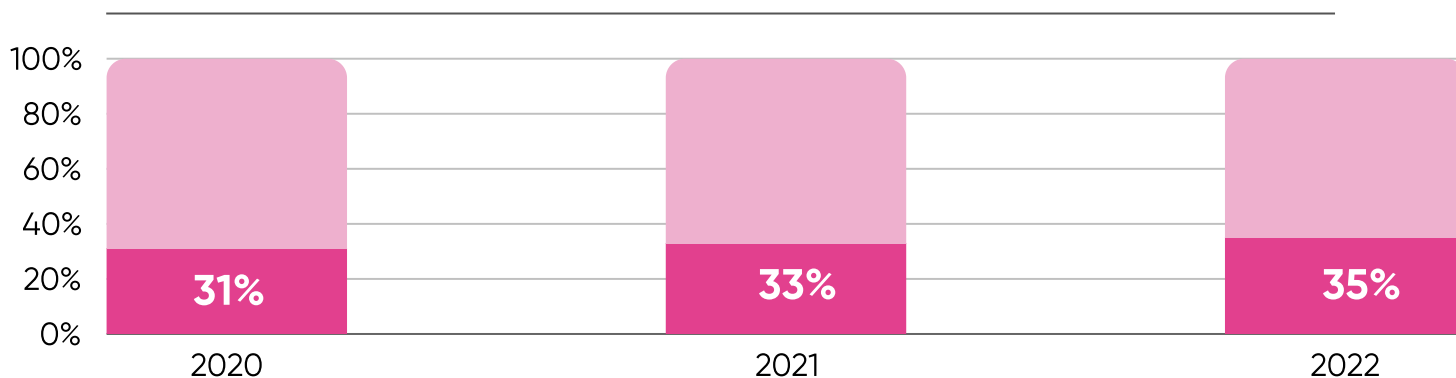
Each industry has its unique factors that auditors commonly focus on while conducting their audits. Revenue from customer contracts is the number one most common CAM topic among all public companies and is also the most common CAM topic found in opinions for companies in the construction, services, and manufacturing industries. CAMs relating to revenue from customer contracts were cited in over half of all construction company opinions with CAMs. In the construction industry, in particular, revenue contracts often include longer duration revenue cycles with performance over time, creating areas of judgment for estimating costs and percentage completion.

For the finance industry, allowance for credit losses was the most common CAM topic, found in 40% of finance opinions with CAMs. As oil, gas, and other extractive industries' largest assets are non-renewable resources, the valuation and depletion of mineral reserves is the most common CAM topic in the mining industry. CAMs relating to proven and unproven reserves were found in 40% of mining industry opinions with CAMs since FY2020.

Companies in the transportation, communication, and utilities industry most commonly have CAMs related to regulatory assets and liabilities. Primarily, these include deferral of certain costs or losses that would otherwise be charged to expense if it is probable that future rates will permit recovery of such costs.

# GOING CONCERN

## Percent of Going Concern Opinions with CAMs



A going concern opinion is issued when there is substantial doubt about an entity's ability to meet its obligations and continue its business for a reasonable period of time. In FY2022, only 35% of all going concern opinions contained at least one critical audit matter. This is about half the total population's rate of opinions with CAMs. The rate of going concern opinions with CAMs increased by two percentage points in both FY2021 and FY2022, increasing in total opinions with CAMs by 158 and 85 opinions, respectively.

Of the 1,649 going concern opinions with CAMs issued over the three fiscal years, only 299, or 18%, also included a going concern CAM. It follows that of the 4,933 total going concern opinions issued in the same period, only 6% also included a going concern CAM.

Presumably, to have a going concern explanatory paragraph without a related CAM, the matter did not meet the criteria of a CAM; which requires discussion with the audit committee, relating to accounts or disclosures that are material to the financial statements and involving challenging, subjective or complex judgments.

Conversely, there were 204 opinions over the three fiscal years of 2020-2022 with a going concern CAM that did not result in a going concern explanatory paragraph in the opinion.

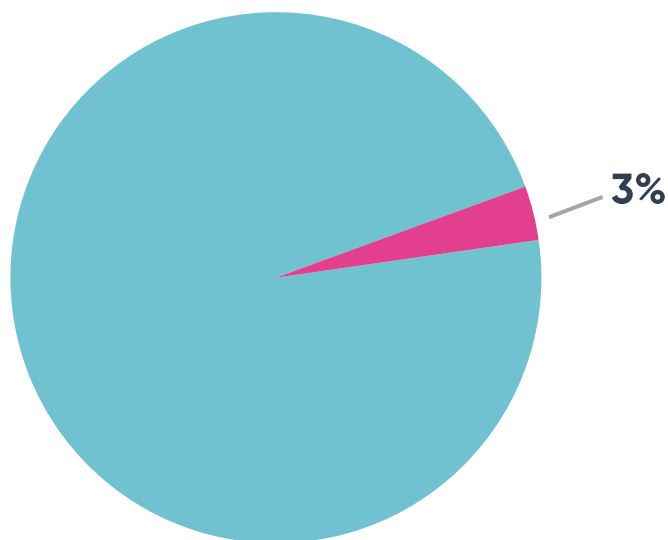
## Top 5 CAM Topics in Going Concern Opinions: 2020-2022

*represented as a percent of total going concern opinions with CAMs for the three year period*

Rank	CAM Topic	# of Going Concern Opinions	% of Going Concern Opinions w CAMs
1	Other Debt	327	20%
2	Going Concern	299	18%
3	Revenue from Customer Contracts	228	14%
4	Business Combinations	137	8%
5	Goodwill	122	7%

# SPECIAL PURPOSE ACQUISITION COMPANIES (SPACs)

## Percent of SPAC Opinions with CAMs



In FY2022, only 18 of the 544 total opinions for special purpose acquisition companies (SPACs) contained CAMs. This is not unexpected as SPACs are companies without commercial operations and are formed to raise money through an IPO for acquiring or merging with another company. As a result, they generally only have a few accounts in their financial statements, primarily cash and cash equivalents, deferred offering costs and debt/equity, as well as operating expenses and investment/interest income.

The most common CAM topic among SPACs in FY2022 related to going concern. Going concern CAMs were found in 39% of all SPAC opinions with CAMs. Generally, SPACs have two years to complete their initial business combination. If the transaction is not completed within the period, most are subject to liquidation.

## Top 3 CAM Topics in SPAC Opinions: 2022

*represented as a percent of total SPAC opinions with CAMs for FY2022*

Rank	CAM Topic	# of SPAC Opinions	% of SPAC Opinions w CAMs
1	Going Concern	7	39%
2	Other Debt	5	28%
3	Related Party Transactions	3	17%

Although only 7 SPAC opinions for FY2022 contained a CAM relating to going concern, 514 SPAC opinions were issued a going concern explanatory paragraph. This means that while 94% of SPACs received a going concern opinion, only 1.4% of those opinions also included a going concern CAM.

# FILER STATUS

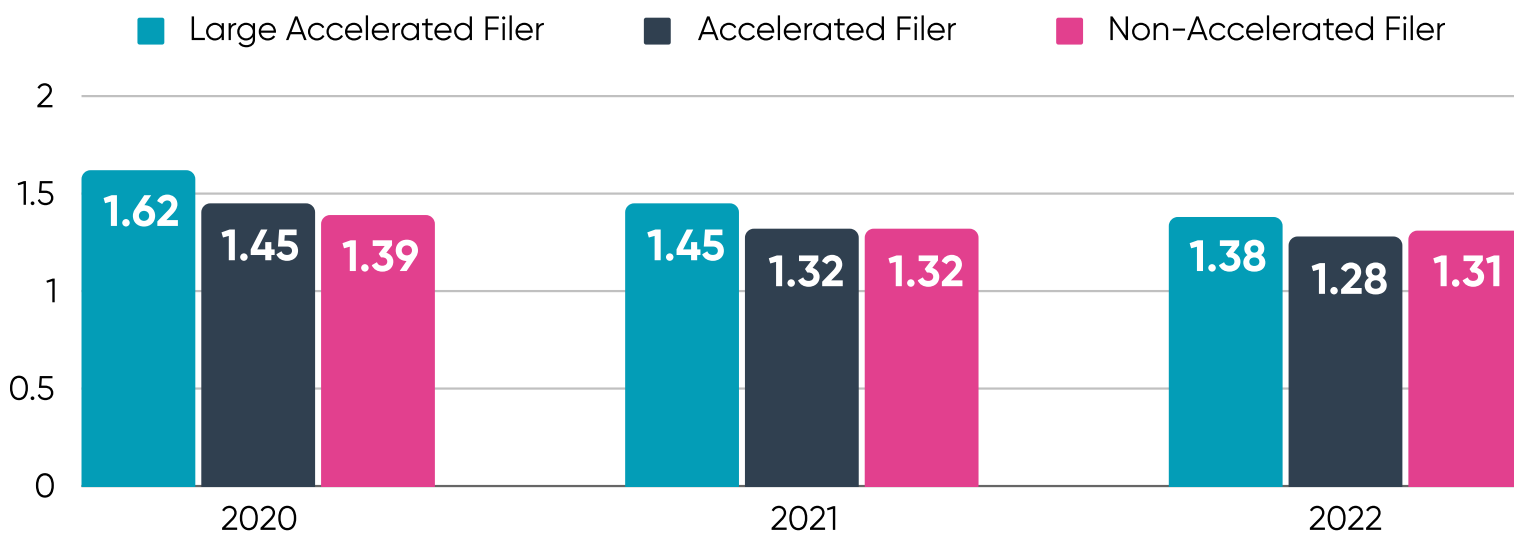
## Percent of Opinions with CAMs

Filer Status	2020	2021	2022	Overall
Large Accelerated Filer	99%	98%	98%	98%
Accelerated Filer	66%	75%	72%	71%
Non-Accelerated Filer	41%	42%	45%	43%

Reflecting the relative complexities of their audits, 98% of large accelerated filer opinions included CAMs, with accelerated and non-accelerated filers following at 71% and 43%, respectively.

The complexity of large accelerated filer audits also leads them to have the largest average number of CAMs per opinion of any filer status. On average, large accelerated filer opinions have 10% more CAMs per opinion than both accelerated and non-accelerated filers.

## Average Number of CAMs per Opinion

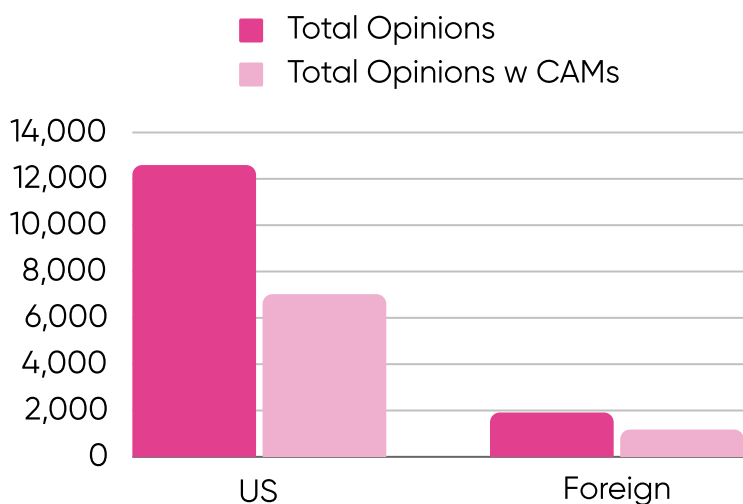


Overall, the number of CAMs per opinion has been decreasing each fiscal year for all filer statuses. Somewhat surprisingly, given their audit complexity, large accelerated filers have seen the largest decrease in the average number of CAMs per opinion over the three years, dropping 15% since FY2020.

The percentage of large accelerated opinions with only one CAM has been increasing year over year, while opinions with more than one CAM have been becoming less frequent. In FY2022, 70% of large accelerated opinions included only one CAM, increasing from 54% in FY2020. The number of opinions with two CAMs has been decreasing from 32% in FY2020 to 24% in FY2022. The same can be seen for large accelerated opinions with three CAMs, dropping from 11% in FY2020 to only 5% in FY2022.

# LOCATION

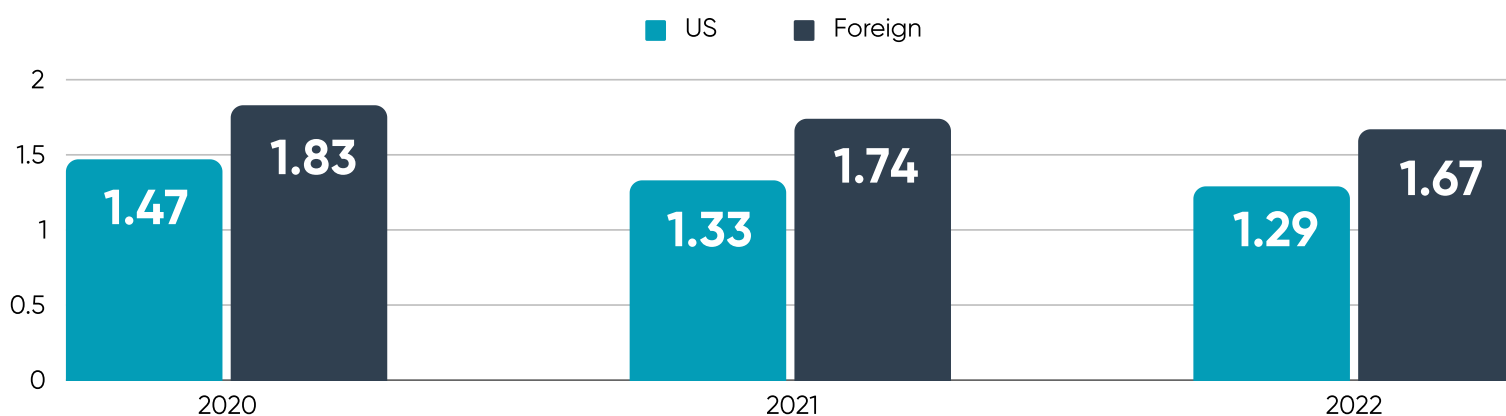
## Percent of Opinions with CAMs



Location	2020	2021	2022	Overall
US	62%	64%	66%	64%
Foreign	62%	62%	61%	62%

Although the population of foreign filers is much smaller than that of US filers, both have relatively similar rates of issuing opinions with CAMs. Since FY2020, 12,595 of the 19,617 total opinions issued by US filers have included CAMs, representing 64% of all opinions. For foreign filers, 62% of the 1,915 total opinions issued since FY2020 have included CAMs.

## Average Number of CAMs per Opinion



The number of CAMs per opinion has been decreasing for both domestic and foreign filers. However, there still remains a significant difference in the number of CAMs per opinion between US and foreign filers. Overall, foreign filers report 28% more CAMs per opinion than US filers. Although these are all CAMs submitted in the standard PCAOB opinion, this discrepancy may be a result of slightly different, broader definitions of key audit matters (KAMs) under International Accounting Standards. The frameworks are substantially similar, and both include those matters communicated or required to be communicated to the audit committee. Under International Standards on Auditing (ISA) 701, KAMs are defined as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.<sup>4</sup>

<sup>4</sup> <https://www.iaasb.org/publications/auditor-reporting-key-audit-matters-3>

# NUMBER OF CAMs

## Most CAMs in One Opinion: FY2022

Company	Location	Fiscal Year	# of CAMs	CAM Topics
Brazilian Electric Power Co.	Brazil	12/31/2022	6	Business Combinations   Pension and Other Post-Employment Benefits   Revenue from Customer Contracts   Long-Lived Assets   Other Revenue   Other Contingent Liabilities
GSK PLC	United Kingdom	12/31/2022	6	Discontinued Operations   Uncertain Tax Positions   Sales Return and Allowances   Other Contingent Liabilities

Numerous CAMs in one opinion are suggestive of a higher risk audit, given multiple areas that needed to be communicated to the audit committee, were material, and required significant judgment by the auditors. In addition, the top number of CAMs all come from companies headquartered outside of the US, and three of the four are reporting under International Financial Reporting Standards.

Brazilian Electric Power Co. had an eventful year in 2022. In June, they concluded a public offering of common shares in Brazil and abroad. This "Privatization" resulted in a dilution of the Brazilian government's ownership from 72% to 47%. Concurrently, as part of the Privatization they conducted a corporate restructuring, which included the transfer of control in two related entities to a company directly owned by the Brazilian Government.

The company amended its bylaws and voting rights to prevent any shareholder or group of shareholders from exercising the rights of more than 10% of the voting shares. They also acquired control of another entity and began consolidating the entity. They are in the process of decreasing the number of special purpose entities (SPEs), of which they currently have 74. They have 23 separate lawsuits challenging their model of Privatization, and the President of Brazil has requested an assessment of the legal grounds for contesting the changes. These details clearly explain the need for multiple CAMs in their opinion.

## Most CAMs in One Opinion: 2020-2022

Company	Location	Fiscal Year	# of CAMs	CAM Topics
Energy Co of Parana	Brazil	2020	7	Revenue from Customer Contracts   Significant Event   Other Liabilities and Provisions   Discontinued Operations   Other Contingent Liabilities   Long-Lived Assets
CXJ Group	China	2021	7	Revenue from Customer Contracts   Selling, General and Administrative Expenses   Other Intangible Assets   Accounts/Loans Receivable   Other Contingent Liabilities

## DATABASE OVERVIEW

The Ideagen Audit Analytics Critical Audit Matters database includes data for over 30,000 critical audit matters, from more than 22,000 audit reports disclosed by over 6,097 SEC public registrants.

The database employs a taxonomy (issue classification) of 57 different accounting categories. Search results from this level of granularity can be filtered by other demographic data such as industry, filer status, location, and audit firm.

The relational nature of the database allows researchers to introduce and compare critical audit matter results into other data sets, such as financial restatements, accelerated filer status, legal exposures, director and officer changes, auditor changes, audit fees, and other data populations. This content extension further allows an analyst to identify anomalies and market patterns that would not be readily apparent without performing this layered approach.

## METHODOLOGY

The critical audit matters data set covers all SEC registrants who have disclosure in their auditor's report relating to critical audit matters in annual filings (10-K, 20-F, and 40-F). Multiple critical audit matters (rows) can relate to the same audit opinion.

The audit opinion of Brokers and Dealers Reporting under Exchange Act Rule 17a-5, investment companies other than Business Development Companies, benefit plans (11-K) and Emerging Growth Companies are excluded from critical audit matter disclosure requirements.

Critical audit matter disclosure became mandatory in the audit opinions of large accelerated filers for fiscal years ended beginning on or after June 30, 2019; and all other public companies with fiscal years ended beginning on or after December 15, 2020. The data includes critical audit matters beginning in FY2020, including those that were issued voluntarily prior to the effective dates.

SPACs are defined as companies with an SIC of 6770 (Blank Checks) and/or companies that identify as a Shell Company.

In the Location analysis, foreign filers are considered those who filed a 20-F or 40-F while US filers relate to 10-Ks.

Companies that do not identify as large accelerated or accelerated filers are classified as non-accelerated filers. This includes non-accelerated filers, smaller reporting companies, and companies that do not disclose a filer status.





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## ABOUT US

Whether for market intelligence, risk management, compliance, or research and public policy, Ideagen Audit Analytics provides the highly structured data you need to make informed decisions.

Our expert team meticulously collects, organizes, and analyzes data – making it easy for our customers find what they need to know. We are trusted to simplify the complex; to illuminate trends; and to reveal actionable insights.

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