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# PCAOB Adopts Changes to the Auditor's Report

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On June 1, 2017, the PCAOB adopted a new [auditing standard](#)<sup>1</sup> on the auditor's report (the "standard" or "release"). While retaining the current "pass/fail" opinion of the existing auditor's report, the standard includes several significant modifications, which are discussed below. These changes are intended to increase the informational value, usefulness, and relevance of the auditor's report.

In a [statement](#) announcing the standard, PCAOB Chairman James Doty stated the following:

[The new standard] will make the auditor's report more relevant, useful and informative to investors and other financial statement users in light of the progress of history. The new standard will breathe new life into a formulaic reporting model.

At the same meeting, PCAOB Board member Steve Harris [stated](#) the following:

Today's action is a direct response to calls from investors for the Board to expand the auditor's report to include information about the difficult parts of the audit, and information that the auditor gained from the audit that he or she would like to know as an investor — basically what "kept the auditor awake at night."

The PCAOB will submit the new auditor reporting standard and related amendments to the SEC for its consideration. The SEC's approval process typically includes an additional public comment period. This *Heads Up* provides an overview of the standard.

<sup>1</sup> PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion [AS 3101] and Related Amendments to PCAOB Standards*.

- [Appendix C — Illustration of the Process for Determining and Reporting CAMs \(Adapted From the Release\)](#)
- [Appendix D — Examples of Critical Audit Matters](#)

## Key Changes to the Auditor’s Report

The key changes to the auditor’s report under the standard are:

- Standardized ordering and inclusion of section headers, with the opinion section appearing first.
- Enhanced descriptions of the auditor’s role and responsibilities, including a statement regarding independence requirements.
- Communication of critical audit matters (CAMs).
- Disclosure of auditor tenure — The year in which the auditor began serving consecutively as the company’s auditor.

PCAOB Chief Auditor and Director of Professional Standards Martin Baumann [stated](#) his belief that:

[T]his new auditor reporting standard will make the audit report more informative and relevant, adding to the total mix of information that investors use to make investment decisions.

[Appendix A](#) contains an example of an illustrative auditor’s unqualified report that highlights the changes to the current report. The final standard is not significantly different from the requirements and guidance previously [proposed](#) by the PCAOB in May 2016 (the “2016 reproposal”).

In developing the standard, the PCAOB considered feedback received from comment letters, roundtables, public outreach activities, and discussions with its advisory groups.<sup>2</sup> In addition, the Board considered the efforts undertaken by several international and non-U.S. standard setters and regulators.

[Appendix B](#) compares various aspects of the PCAOB’s standard to similar requirements adopted by the International Auditing and Assurance Standards Board (IAASB), the European Union (EU), and the Financial Reporting Council in the United Kingdom (FRC).

## Communication of CAMs

### Overview of CAMs

A CAM is defined in the standard as “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 involved especially challenging, subjective, or complex auditor judgment.*”

The release also states that CAMs could include matters that were (1) required to be communicated to the audit committee and (2) actually communicated, even if not required.

<sup>2</sup> In June 2011, the PCAOB issued a concept release to solicit comments on a number of potential changes to the auditor’s report and held a public roundtable to obtain additional insights on the alternatives presented in the concept release. After considering the results of its outreach and comments on its concept release, in August 2013, the PCAOB proposed an auditing standard that included new auditor reporting requirements, including a requirement for auditors to communicate CAMs, and additional improvements to the auditor’s report. In May 2016, the Board issued a reproposal of the auditor reporting standard that further modified the proposal in several respects. Refer to Deloitte’s [June 28, 2011](#), and [November 2, 2011](#), *Heads Up* newsletters for summaries of the 2011 concept release and constituent responses, respectively; [September 5, 2013](#), *Heads Up* newsletter for a summary of the 2013 proposal; and [May 27, 2016](#), and [October 14, 2016](#), *Audit & Assurance Update* newsletters for summary of the 2016 reproposal and the feedback received, respectively. In addition, in April 2014 the PCAOB hosted a public meeting to obtain additional insights from a diverse group, including investor advocates, public companies, audit committees, audit firms, academics, and representatives from international standard-setting organizations. See Deloitte’s April 30, 2014, *Heads Up* newsletter for an overview of the discussion.



### Editor's Note

We believe the requirements in the new standard for determining CAMs allow the auditor to identify and communicate those matters that would be of most interest and importance to investors. In particular, we support the steps the auditor takes to identify CAMs, beginning with the population of those matters that were communicated or required to be communicated to the audit committee, and then identifying those matters that relate to accounts or disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgment. PCAOB AS 1301, *Communications With Audit Committees*, and other applicable rules and standards require communication to the audit committee of matters arising from the audit that are relevant to the audit committee's oversight of the financial reporting process.

Further, the standard includes a nonexclusive list of factors for the auditor to take into account, alone or in combination, in determining whether a matter involved especially challenging, subjective, or complex auditor judgment. (See [Appendix C](#) for an illustration of the process for determining CAMs.)



### Editor's Note

We support the inclusion of the nonexclusive list of factors provided in the final standard and their use in determining whether a matter involved especially challenging, subjective, or complex auditor judgment. Some comments received on the 2016 reproposal suggested that the selection of CAMs from the matters that involved “especially challenging, subjective, or complex auditor judgment” will depend on the auditor's experience and skill level and may result in inconsistent application of the requirements of the standard, potentially leading to investor confusion. The PCAOB explained that the CAM definition is grounded in “auditor's expertise and judgment, which is directly responsive to investor requests for information from the auditor's point of view.”

The release further explains that the determination of CAMs “is principles-based and the final standard does not specify any items that would always constitute [CAMs].” For example, the standard does not provide that all matters determined to be “significant risks”<sup>3</sup> under PCAOB standards would be CAMs, because not every significant risk would necessarily involve “especially challenging, subjective, or complex auditor judgment.”

## Auditor Reporting of CAMs

CAMs will be identified and described in a separate section in the auditor's report titled “Critical Audit Matters.” Specific language will precede the description of the CAMs, stating that (1) CAMs do not alter the opinion on the financial statements and (2) the auditor is not providing a separate opinion on the CAMs or the accounts or disclosures to which they relate. The release states that for each CAM communicated in the auditor's report, the auditor will be required to:

- “Identify the [CAM].”
- “Describe the principal considerations that led the auditor to determine that the matter is a [CAM].”
- “Describe how the [CAM] was addressed in the audit.”
- “Refer to the relevant financial statement accounts or disclosures that relate to the [CAM].”

<sup>3</sup> A significant risk is defined as a “risk of material misstatement that requires special audit consideration” (see paragraph .A5 of [PCAOB AS 2110, Identifying and Assessing Risks of Material Misstatement](#)).

The release also states that the determination of a CAM “should be made in the context of [a] particular audit, with the aim of providing audit-specific information rather than a discussion of generic risks.” It is expected that in most audits to which the CAM requirements apply (see applicability information below), the auditor would identify at least one CAM. If no CAMs are identified, the auditor would be required to make a statement to that effect in the auditor’s report.



### Editor’s Note

In their comment letters on the 2016 reproposal, some investors that supported CAM disclosures suggested further modifications to the auditor’s report, such as including the auditor’s assessment of the significant accounting judgments and management estimates and requiring auditors to describe specific insights and findings related to each CAM (i.e., disclose the results of the auditor’s procedures with respect to CAMs). The release explains that communication of the auditor’s findings is not required, but “the auditor may choose to include findings as an indication of the outcome of audit procedures or key observations about a matter” as such information may be valuable to investors.

In addition, some commenters on the 2016 reproposal expressed concern that the auditor may be in the position of communicating original information about the company (e.g., matters related to significant deficiencies in internal control that are required to be communicated to management and the audit committee but not externally). The release explains that through its definition of a CAM, the PCAOB is attempting to strike an appropriate balance between investor demands for enhanced communication about the audit and potential unintended consequences associated with providing it. The PCAOB notes, and we agree, that because each CAM relates to accounts or disclosures that are material to the financial statements, a matter that does not relate to accounts or disclosures that are material to the financial statements cannot be a CAM. In addition, the release states that while the auditor is required to describe the principal considerations that led the auditor to determine that the matter is a CAM, the auditor may do so in general terms (e.g., if a significant deficiency was among the principal considerations in determining that a matter was a CAM, the auditor may describe the relevant control issues that relate to the matter in the broader context of the CAM without using the term “significant deficiency”).<sup>4</sup>

See [Appendix D](#) for illustrative examples of communication of CAMs based on the examples in the 2016 reproposal.

### Period Covered

In the final standard, the Board has retained the requirement to communicate CAMs only for the current audit period. However, the auditor would not be precluded from including CAMs for prior periods.<sup>5</sup>

<sup>4</sup> See section IV.A.1.a.ii (page 21) of the [release](#), which states “the determination that there is a significant deficiency in [ICFR], in and of itself, cannot be a [CAM]; such determination, in and of itself, does not relate to an account or disclosure that is material to the financial statements as no disclosure of the determination is required.”

<sup>5</sup> The standard states, “When the current period’s financial statements are presented on a comparative basis with those of one or more prior periods, the auditor may communicate [CAMs] relating to a prior period. This may be appropriate, for example, when (1) the prior period’s financial statements are made public for the first time, such as in an initial public offering, or (2) issuing an auditor’s report on the prior period’s financial statements because the previously issued auditor’s report could no longer be relied upon.”

## Documentation of CAMs

The standard states that for each matter arising from the audit that both (1) was communicated or required to be communicated to the audit committee and (2) relates to accounts or disclosures that are material to the financial statements, the auditor is required to document whether or not the matter was determined to be a CAM (i.e., involved especially challenging, subjective, or complex auditor judgment) and the basis for such determination. The release specifies that the amount of documentation may vary but should be sufficient to facilitate review by others, including the engagement quality control reviewer.

## Auditor Tenure

The standard requires the auditor to include a statement in the auditor's report containing the year the auditor began serving consecutively as the company's auditor; however, the location for this statement in the auditor's report is not prescribed.



### Editor's Note

In the release, the PCAOB acknowledges that many issuers are already voluntarily disclosing auditor tenure in their proxy statements for annual meetings of shareholders. Deloitte's [review](#) of S&P 100 proxy disclosures in 2016 showed that 67 percent of companies in the S&P 100 currently disclose information about audit firm tenure.<sup>6</sup>

The PCAOB explains in its release that disclosure of audit firm tenure is intended to add to the mix of publicly available information. It is not intended to create an inference either positively or negatively. In recent [remarks](#) at the 36th Annual SEC and Financial Reporting Institute Conference held at the University of Southern California, at which the new requirement was addressed, SEC Chief Accountant Wesley Bricker stated that:

[T]he years of experience may be one of the many factors considered by audit committees in their selection and oversight of the external auditor. In doing so, for example, an audit committee might consider an audit firm's prior service experience in contributing to the firm's understanding of the company's business and audit risks. And, also, an audit committee may want to incorporate prior auditor service into its oversight of the auditor's expertise, incentives and, ultimately, appropriate performance in the conduct of the audit.

## Effective Date

The effective date (pending SEC approval) will be phased in as follows:

- All changes except for communication of CAMs:
  - Audits of fiscal years ending on or after December 15, 2017.
- Communication of CAMs:
  - Audits of large accelerated filers (as defined by the SEC<sup>7</sup>): fiscal years ending on or after June 30, 2019.
  - Audits of all other companies: fiscal years ending on or after December 15, 2020.

However, the release states that auditors may elect to comply with the standard before its effective date at any point after SEC approval.

<sup>6</sup> Note that auditor tenure disclosures in proxy statements vary; in some cases they provide the precise length of auditor tenure, and in other cases they provide a statement such as "XYZ has been the auditor at least since 19XX."

<sup>7</sup> In general, the term "large accelerated filer" refers to an issuer with a public float of \$700 million or more that has been subject to Exchange Act periodic reporting requirements for at least one year and has filed at least one annual report. See [Rule 12b-2 of the Exchange Act](#) (17 CFR 240.12b-2). In addition, the definitions of an accelerated filer and large accelerated filer do not exclude companies that qualify as foreign private issuers, even though the deadlines for Forms 20-F and 40-F annual reports are not affected by accelerated filer or large accelerated filer status.

## Applicability

Communication of CAMs is not required for audits of brokers and dealers reporting under Rule 17a-5 of the Securities Exchange Act of 1934 (the “Exchange Act”); investment companies registered under the Investment Company Act of 1940, other than business development companies; employee stock purchase, savings, and similar plans; and emerging growth companies as defined in Section 3(a)(80) of the Exchange Act. However, the standard permits voluntary inclusion of CAMs in the auditor’s report for such entities. Note that all other provisions of the standard apply to the audits of these entities.

## Considerations for Management and Audit Committees

Although the standard is subject to SEC approval and would be implemented in accordance with phased-in effective dates, management and audit committees will most likely want to start to consider the implications of the new requirements and discuss them with their auditors. Potential questions regarding CAMs may include the following:

- What matters could be CAMs?
- How will management and audit committees engage with the auditor as CAMs are identified and the auditor’s descriptions of the CAMs are developed and finalized?
- How will the timing of auditor communications with management and the audit committee accommodate the discussion of CAMs?
- How do the auditor’s statements regarding CAMs compare to management’s disclosures regarding the same matters?

## Appendix A — Example of an Auditor’s Unqualified Report on an Audit of Financial Statements

The following example of an auditor’s unqualified report on an audit of financial statements illustrates the changes effected by the standard. New text is underlined and changes are explained in the margins.<sup>8</sup>

### Report of Independent Registered Public Accounting Firm

To the shareholders and the board of directors of X Company

#### Opinion on the Financial Statements

We have audited the accompanying balance sheets of X Company (the “Company”) as of December 31, 20X2 and 20X1, the related statements of 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 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].

Section titles added

Opinion moved to first section

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 20X2, based on the criteria established in *Internal Control — Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated [date of report, which should be the same as the date of the report on the financial statements], expressed an unqualified opinion on the Company’s internal control over financial reporting.

Explanatory paragraph moved

#### Basis for Opinion

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

Auditor tenure

We are a public accounting firm registered with the 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. 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.

Clarification of auditor responsibilities

#### Critical Audit Matters [subject to phased-in effective dates; refer to page 5]

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were 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 our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Critical audit matters

[Insert CAMs]

[Signature]

[City and State or Country]

[Date]

<sup>8</sup> The illustrative report assumes that the auditor also audited the company’s internal control over financial reporting and expressed an unqualified opinion as the result of such audit.

## Appendix B — Comparison of Auditor Reporting Standards

The following table summarizes key aspects of auditor reporting requirements under different standards and regulations. The various requirements in different jurisdictions are not expected to result in vastly different reporting by auditors. For example, when the FRC completed its implementation of the EU Audit Regulation and Directive and alignment with the IAASB's standards, it stated that it did not expect the incorporation of its own requirements and those of the EU to result in an increase in the number of key audit matters (KAMs) communicated in the auditor's report over what would be required by the IAASB standard alone.

Also, in its release, the PCAOB acknowledged that while there are differences in the processes of identifying matters to be communicated across jurisdictions, there are "commonalities in the underlying criteria . . . such that expanded auditor reporting could result in the communication of many of the same matters under the various approaches."

Topic	PCAOB	IAASB	EU	FRC
Effective Date	Phased <sup>9</sup>	December 15, 2016 <sup>10</sup>	June 2016 <sup>11</sup>	June 17, 2016 <sup>12</sup>
Definition	<ul style="list-style-type: none"> <li>Relates to accounts or disclosures that are material to the financial statements.</li> <li>Involved especially challenging, subjective, or complex auditor judgment.</li> </ul> <p>CAMs are selected from matters communicated or required to be communicated to the audit committee.</p>	<p>KAMs: Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements in the current period.</p> <p>KAMs are selected from matters communicated with those charged with governance.</p>	<p>Matters required to be disclosed in the auditor's report are those that were assessed as the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud.</p>	<p>KAMs: Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements in the current period.</p> <p>KAMs are selected from matters communicated with those charged with governance.</p>
Determination of whether a matter is a KAM/CAM	Based on a nonexclusive list of factors such as the auditor's assessment of the risks of material misstatement, including significant risks.	Based on a two-step process by (1) identifying the matters communicated with those charged with governance that required significant auditor attention and (2) of those matters, identifying the ones of most significance in the audit as KAMs.	Not specifically addressed.	Based on a two-step process by (1) identifying the matters communicated with those charged with governance that required significant auditor attention and (2) of those matters, identifying the ones of most significance in the audit as KAMs.
Period covered	Current period only, although can include prior periods at the auditor's option.	Current period only.	Does not specify.	Current period only.

<sup>9</sup> New auditor's report format, tenure, and other information: audits of fiscal years ending on or after December 15, 2017; communication of CAMs for audits of large accelerated filers: audits of fiscal years ending on or after June 30, 2019; communication of CAMs for audits of all other companies to which the requirement applies: audits of fiscal years ending on or after December 15, 2020.

<sup>10</sup> Refer to ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, and a number of revised ISAs, including ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, and ISA 570 (Revised), *Going Concern*, issued in January 2015. The IAASB has undertaken an outreach program to support the implementation of the IAASB's standards, including developing an [Auditor Reporting Toolkit](#) to assist with the implementation of the new standards.

<sup>11</sup> See Regulation No. 2014 of the European Parliament and of the Council on Specific Requirements Regarding Statutory Auditor of Public-Interest Entities. EU member states had until June 2016 to adopt the provisions of the legislation into their national law and decide on a number of options that have been afforded to them. Information on member state implementation is available [here](#).

<sup>12</sup> In June 2013, the FRC revised its auditor reporting requirements for entities that apply the UK Corporate Governance Code. For audits commencing on or after October 1, 2012, auditors of those entities were required, among other things, to describe the risks of material misstatement that had the greatest effect on: (1) the overall audit strategy; (2) the allocation of resources in the audit; and (3) directing the efforts of the engagement team. In addition, auditors were required to provide an explanation of how the scope of the audit addressed the risks. In April 2016, the FRC adopted an update to its 2013 auditor reporting requirements. Refer to the FRC's Final Draft, International Standards on Auditing (UK and Ireland) 701, *Communicating Key Audit Matters in the Independent Auditor's Report* (April 2016). This rule is effective for audits of financial statements for periods beginning on or after June 17, 2016.

(Table continued)

Topic	PCAOB	IAASB	EU	FRC
Communication requirements	<p>For each CAM, the auditor must:</p> <ul style="list-style-type: none"> <li>• Identify the CAM.</li> <li>• Describe the principal considerations that led the auditor to determine that the matter is a CAM.</li> <li>• Describe how the CAM was addressed in the audit.</li> <li>• Refer to the relevant financial statement accounts or disclosures that related to the CAM.</li> </ul> <p>If there are no CAMs, requires a statement to that effect.</p>	<p>The description of a KAM in the auditor's report requires a reference to the related disclosures, if any, and should address:</p> <ul style="list-style-type: none"> <li>• Why the matter was considered to be one of most significance in the audit and therefore determined to be a KAM.</li> <li>• How the matter was addressed in the audit.</li> </ul> <p>If there are no KAMs, requires a statement to that effect.</p>	<p>The audit report is required to include:</p> <ul style="list-style-type: none"> <li>• A description of the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud.</li> <li>• A summary of the auditor's response to the risks.</li> <li>• Where relevant, key observations arising with respect to the risks.</li> </ul> <p>Where relevant to the above information provided in the audit report concerning each significant assessed risk of material misstatement, the auditor's report shall include a clear reference to the relevant disclosures in the financial statements.</p>	<p>The description of a KAM in the auditor's report requires a reference to the related disclosures, if any, and should address:</p> <ul style="list-style-type: none"> <li>• Why the matter was considered to be one of most significance in the audit including a description of the most significant assessed risks of material misstatement, including those that have the greatest effect on: <ul style="list-style-type: none"> <li>◦ The overall strategy.</li> <li>◦ The allocation of resources in the audit.</li> <li>◦ Directing the efforts of the engagement team.</li> </ul> </li> <li>• How the matter was addressed in the audit.</li> <li>• Where relevant, key observations arising with respect to those risks.</li> </ul> <p>If there are no KAMs, requires a statement to that effect.</p>

(Table continued)

Topic	PCAOB	IAASB	EU	FRC
Communicating other planning, materiality, and scoping matters	Requires <sup>13</sup> disclosure of other accounting firms participating in the audit in Form AP, which is submitted to the PCAOB by registered public accounting firms. The information will be available on the PCAOB's Web site.	Does not specify.	Does not specify.	<ul style="list-style-type: none"> <li>• An explanation of how the auditor applied the concept of materiality in obtaining and performing an audit and the threshold used.</li> <li>• An overview of the audit scope, including an explanation of how such scope (1) addressed each KAM and (2) was influenced by application of materiality disclosed.</li> </ul>
Audit documentation requirements	If a matter both (1) was communicated or required to be communicated to the audit committee and (2) relates to accounts or disclosures that are material to the financial statements, the auditor is required to document the basis for the determination of whether or not the matter is a CAM.	The auditor is required to document matters that required significant auditor attention (determined from those matters communicated to those charged with governance) and the rationale for the auditor's determination of whether or not each of these matters is a KAM.	Does not specify.	The auditor is required to document matters that required significant auditor attention (determined from those matters communicated to those charged with governance) and the rationale for the auditor's determination of whether or not each of these matters is a KAM.
Form	Requires the "Opinion on the Financial Statements" section to be in the first section of the auditor's report, followed by the "Basis for Opinion" section.	Requires the "Opinion" section to be in the first section of the auditor's report, followed by the "Basis for Opinion" section, unless law or regulation prescribes different placement.	Does not specify.	Requires the "Opinion" section to be in the first section of the auditor's report, followed by the "Basis for Opinion" section, unless law or regulation prescribes different placement.

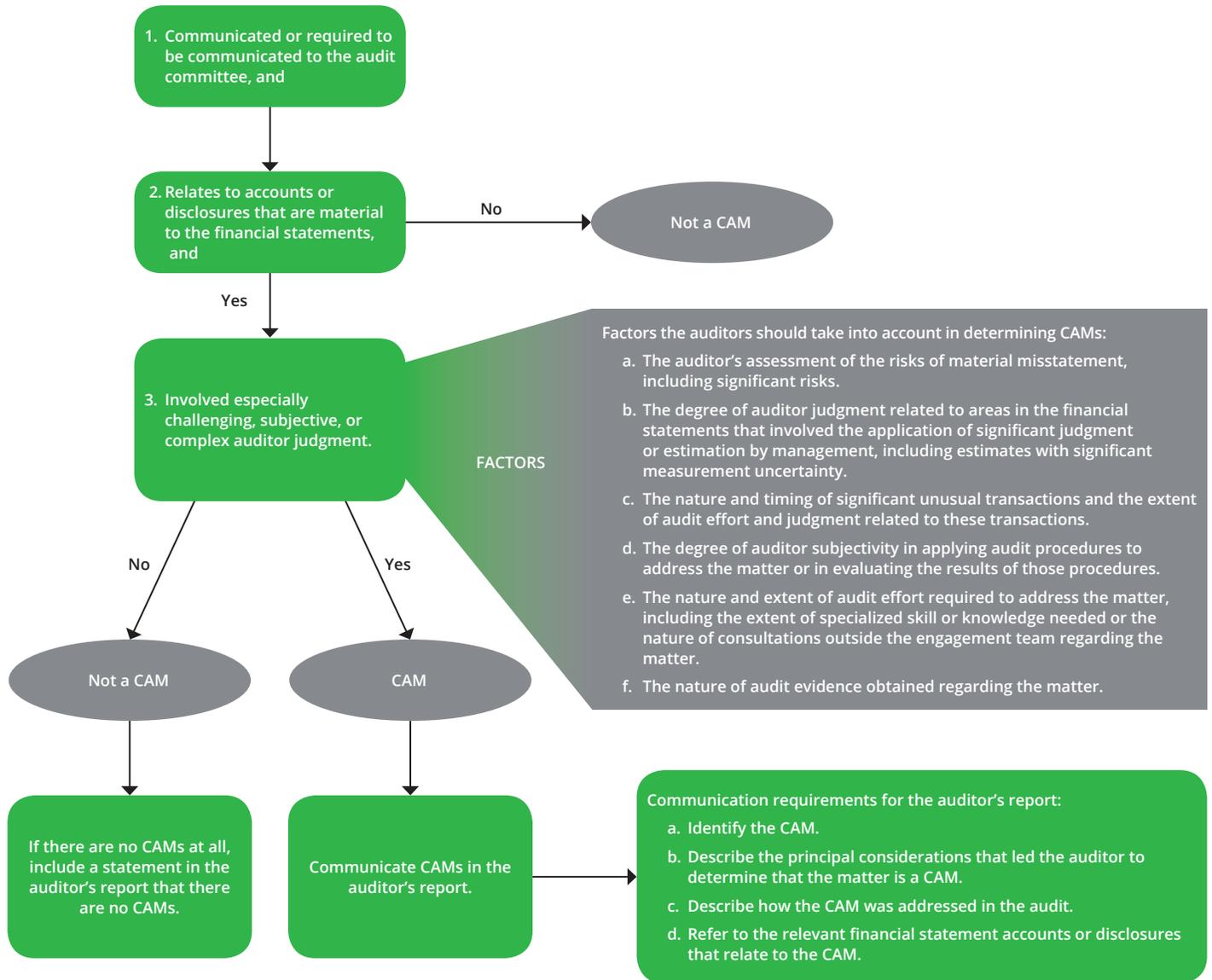
<sup>13</sup> Effective for audit reports issued on or after January 31, 2017, registered public accounting firms are required to disclose the engagement partner name on Form AP, which is publicly available on the PCAOB's Web site. Disclosure of other accounting firms participating in the audit is required for audit reports issued on or after June 30, 2017.

(Table continued)

Topic	PCAOB	IAASB	EU	FRC
Independence disclosure requirements	<p>In the “Basis for Opinion” section, a statement is required that the auditor is:</p> <ul style="list-style-type: none"> <li>• A public accounting firm registered with the PCAOB and</li> <li>• 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.</li> </ul>	<p>In the “Basis for Opinion” section, a statement is required that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor’s other ethical responsibilities in accordance with these requirements.</p>	<p>A statement is required that the auditor remained independent of the audited entity in conducting the audit.</p>	<p>In the “Basis for Opinion” section, a statement is required that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, including the FRC’s Ethical Standards for auditors, and has fulfilled the auditor’s other ethical responsibilities in accordance with these requirements.</p>
Description of auditor’s responsibilities	<p>Requires the phrase “whether due to error or fraud” in the statement describing the auditor’s responsibilities under PCAOB standards to obtain reasonable assurance about whether the financial statements are free of material misstatement.</p>	<p>Requires an expanded description of the responsibilities of management and those charged with governance, as well as the auditor’s responsibilities, including the phrase “whether due to fraud or error,” and the key features of an audit.</p>	<p>Requires an explanation of the extent to which the audit was considered capable of detecting irregularities, including fraud.</p>	<p>Requires an expanded description of the responsibilities of management and those charged with governance, as well as the auditor’s responsibilities, including the phrase “whether due to fraud or error,” and the key features of an audit.</p>
Disclosure of tenure	<p>Requires disclosure of tenure in the auditor’s report.</p>	<p>No requirement.</p>	<p>Requires a disclosure of the date of appointment and the period of total uninterrupted engagement, including previous renewals and reappointments of the statutory auditors or the audit firms.</p>	<p>No requirement (disclosed in the audit committee report).</p>
Disclosure of name of the engagement partner	<p>Requires<sup>14</sup> disclosure of the engagement partner’s name in Form AP, which is submitted to the PCAOB by registered public accounting firms. The information is available on Audit Search, a searchable database on the PCAOB’s Web site.</p>	<p>Requires the name of the engagement partner to be included in the auditor’s report for audits of complete sets of general-purpose financial statements of listed entities unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat.</p>	<p>Requires the audit report to be signed by the statutory auditor or the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm. In exceptional circumstances, such signature(s) need not be disclosed if such disclosure could lead to an imminent and significant personal security threat.</p>	<p>Requires the name of the engagement partner to be included in the auditor’s report on financial statements of listed entities, unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat.</p>

<sup>14</sup> See footnote 13.

## Appendix C — Illustration of the Process for Determining and Reporting CAMs (Adapted From the Release)



### Documentation Requirement

If a matter both (1) was communicated or required to be communicated to the audit committee and (2) relates to accounts or disclosures that are material to the financial statements, the auditor is required to document whether or not the matter was determined to be a CAM (i.e., involved especially challenging, subjective, or complex auditor judgment) and the basis for such determination.

## Appendix D — Examples of Critical Audit Matters

The following two illustrative examples of communication of CAMs are based on the examples included in the 2016 reproposal. In the June 2017 release, the PCAOB explained that “[g]iven the principles-based nature of the requirements for critical audit matters and the objective of providing tailored, audit-specific information, the examples were intended to function as illustrations of how critical audit matters could be communicated, and not as templates for how critical audit matters should be communicated.” However, these illustrative examples are not included in the release accompanying the final standard because the PCAOB believes auditors should provide “tailored, audit-specific information” when communicating CAMs in the auditor’s report. As such, the examples included below are presented purely as illustrative examples of what CAM communications might look like.

### Critical Audit Matters

The critical audit matters communicated below are matters arising from the current-period audit of the financial statements that were 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 our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Critical Audit Matter (CAM)	Principal Considerations in Determining CAM	How the CAM Was Addressed in the Audit
<p><b>Allowance for loan losses — new loan product</b></p> <p>As more fully described in Note 7 to the financial statements, during 2014, the Company [a mid-size regional bank] began actively marketing a nine-year auto loan in addition to the three- and five-year auto loans historically marketed. At December 31, 2015, the nine-year loans represented approximately 18% of the auto loan portfolio. The Company estimates and records an allowance for loans that are impaired but are not yet specifically identified (collective impairment allowance) by developing a loss rate based on historical losses and other factors, including qualitative adjustments to historical loss rates based on relevant market factors. Since management has limited historical loss data for the nine-year loans, it developed a new model to estimate this allowance using historical loss data from its auto loans of shorter terms and loss data from external sources for auto loans of longer terms to model a loss rate for the nine-year loans. In addition, management made qualitative adjustments to the historical loss rates to reflect lower borrower quality and higher risk of collateral impairment compared to its shorter term loans and for economic factors, primarily due to increasing unemployment in the markets served. There was a significant amount of judgment required by management when developing the model, which in turn involved our significant judgment.</p>	<p>The principal considerations for our determination that the allowance for loan losses for nine-year auto loans is a critical audit matter are that it is a new loan product with limited historical loss data and auditing the estimated allowance for losses on these loans involved our complex and subjective judgment.</p>	<p>Our audit procedures related to the collective impairment allowance for the nine-year loans included the following procedures, among others.</p> <p>We tested the effectiveness of controls over the Company’s new model, historical loss data, and the calculation of a loss rate. We also evaluated the qualitative adjustment to the historical loss rates, including assessing the basis for the adjustments and the reasonableness of the significant assumptions. We tested the accuracy and evaluated the relevance of the historical loss data as an input to the new model.</p> <p>We used a specialist to assist us in evaluating the appropriateness of the new model and to review the loss data from external sources used by the Company to determine its relevance to the Company’s nine-year loan portfolio and consistency with external data from other sources. Finally, with the assistance of the specialist, we evaluated the incorporation of the applicable assumptions into the model and tested the model’s computational accuracy.</p>

(Table continued)

Critical Audit Matter (CAM)	Principal Considerations in Determining CAM	How the CAM Was Addressed in the Audit
<p><b>Accounting for acquisitions</b></p> <p>Refer to Notes 2 and 13 to the financial statements.</p> <p>The Company's strategy includes growth by acquisition. Acquisitions represent a significant component of the Company's sales growth through the addition of new customers and new products. During 2015 the Company completed eight acquisitions for net consideration of \$2.1 billion. The most significant of these were (1) the acquisition of all outstanding equity of ABC Inc. for net consideration of \$1.1 billion and (2) the acquisition of all outstanding equity of XYZ Corp. for net consideration of \$0.5 billion.</p>	<p>Auditing the accounting for the Company's 2015 acquisitions involved a high degree of subjectivity in evaluating management's estimates, such as the recognition of the fair value of assets acquired and liabilities assumed.</p>	<p>We planned and performed the following procedures in connection with forming our overall opinion on the financial statements. We tested controls over the accounting for acquisitions, such as controls over the recognition and measurement of assets acquired, liabilities assumed, and consideration paid and payable, including contingent consideration. For each of the acquisitions, we read the purchase agreements, evaluated the significant assumptions and methods used in developing the fair value estimates, and tested the recognition of (1) the assets acquired and liabilities assumed at fair value; (2) the identifiable acquired intangible assets at fair value; and (3) goodwill measured as a residual.</p> <p>More specifically, for the acquisitions of ABC and XYZ, we assessed whether (1) intangible assets, such as acquired technology, customer lists, and noncompetition agreements, were properly identified, and (2) the significant assumptions, including discount rates, estimated useful lives, revenue growth rates, projected profit margins, and the expected rate of return, used in valuing these intangibles were reasonable. Specifically, when assessing the assumptions related to the revenue growth rate and projected profit margins, we evaluated whether the assumptions used were reasonable considering the past performance of ABC and XYZ and the Company's history related to similar acquisitions and considered whether they were consistent with evidence obtained in other areas of the audit, such as assumptions used by the Company in its budget.</p> <p>The purchase consideration for the acquisitions of ABC and XYZ also reflected, in part, the estimated fair value of significant contingent consideration arrangements based on attainment of product development milestones and patent approvals. In testing the valuation of contingent consideration, we assessed the terms of the arrangements and the conditions that must be met for the arrangements to become payable. Finally, we evaluated management's classification of contingent payments to continuing employees as either contingent consideration in the business combination or employee compensation.</p>

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