MEMO# 30729

June 5, 2017

PCAOB Adopts Changes to Auditor's Reports

[30729]

June 5, 2017 TO: ICI Members
Investment Company Directors
Accounting/Treasurers Committee SUBJECTS: Audit and Attest RE: PCAOB Adopts Changes to Auditor's Reports

The Public Company Accounting Oversight Board recently adopted a new audit standard that makes significant changes to the auditor’s report.[1] The new audit standard requires auditors to report critical audit matters (CAMs), which are audit-specific matters that involved especially challenging, subjective, or complex auditor judgment. We are pleased to report that auditor reports for investment companies, other than business development companies, are exempt from the requirement to describe CAMs, as recommended by IDC and ICI in their joint comment letters on the Board’s 2013 and 2016 proposals.[2] The new audit standard retains the existing pass/fail model and requires the auditor to disclose the audit firm’s tenure in the auditor’s report. Aspects of the new audit standard of interest to investment companies are summarized below.

Critical Audit Matters

The new audit standard requires the auditor to communicate in the auditor’s report any CAMs arising from the current period’s audit of the financial statements, or state that the auditor determined there are no CAMs. Communication of CAMs is intended to better inform investors and others that rely on the auditor’s report. A CAM is defined as a matter that was communicated to the audit committee or required to be communicated to the audit committee and that: 1) relates to accounts or disclosures that are material to the financial statements, and 2) involved especially challenging, subjective, or complex auditor judgment. The communication of each CAM must include: 1) identifying the CAM; 2) describing the principal considerations that led the auditor to determine that the matter is a CAM; 3) describing how the CAM was addressed in the audit; and 4) referring to the relevant financial statement accounts or disclosures. The new audit standard requires auditors to document their determination whether or not matters communicated to the audit committee were CAMs.

As noted above, auditor reports for investment companies, other than business development companies are exempt from the requirement to describe CAMs. The new audit standard indicates that investment company auditors may consider voluntarily including communication of CAMs in their auditor reports.[3] The adopting release notes commenters' belief that fund investors rely on disclosure of investment objectives, risks, fees, and performance, and that disclosure of CAMs would not be relevant.

Auditor Tenure

The new audit standard requires the auditor to disclose in the auditor's report the year in which the audit firm began serving consecutively as the company's auditor. Some believe that auditor tenure may influence auditor independence. The adopting release indicates that disclosure of tenure is in the public interest and that disclosure in the auditor's report will make the information readily accessible to investors and others that rely on the auditor's report.

Because investment companies typically have common accounting, internal control, and oversight functions at the complex level, the new audit standard measures audit firm tenure based on the year the auditor began serving consecutively as the auditor of any investment company in the group of investment companies.[4] The auditor's report would include a statement such as: "We have served as the auditor of one or more [Group Name] investment companies since [year]."

Internal Control over Financial Reporting

In its proposals the Board sought comment on whether to require auditor reports for investment companies to include a statement indicating that the auditor was not engaged to perform an audit of internal control over financial reporting. The Board determined not to require such statement. The auditor may, however, include such statement in the auditor's report voluntarily.

Additional Changes to the Auditor's Report

The new audit standard includes several additional changes intended to clarify the auditor's role and responsibility, including: 1) a statement that the auditor is required to be independent; 2) the auditor's report will be addressed to the company's shareholders and board of directors; and 3) adding the phrase "whether due to error or fraud" when describing the auditor's responsibility to obtain reasonable assurance that the financial statements are free of material misstatement.

Effective Date

Subject to approval by the SEC, the new audit standard will take effect as follows: 1) all provisions other than those related to CAMs will take effect for audits of fiscal years ending on or after December 15, 2017; and 2) provisions relating to CAMs will take effect for audits of fiscal years ending on or after June 30, 2019 for large accelerated filers, and for fiscal years ending on or after December 15, 2020, for all other companies to which the requirements apply.

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endnotes

[1] *See* PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial*

Statements when the Auditor Expresses an Unqualified Opinion, (June 1, 2017), *available at* https://pcaobus.org/Rulemaking/Docket034/2017-001-auditors-report-final-rule.pdf.

[2] *See* ICI Memorandum No. 27762, dated December 11, 2013 and ICI Memorandum No. 30147, dated August 18, 2016.

[3] *See* AS 3101.05.

[4] The new audit standard relies on the term "group of investment companies" as described in Section 12(d)(1)(G)(ii) of the Investment Company Act of 1940. *See* AS 3101.10.