

Communications With Auditors and Audit Committees May Change

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The SEC has proposed for comment major revisions in the disclosures auditors are required to make in their reports on financial statements audited pursuant to Public Company Accounting Oversight Board (PCAOB) standards.

PCAOB auditing standards are required to be followed for the financial statements of most public companies. This includes insurance companies, unless the company's only outstanding publicly-held securities are variable annuities or variable life insurance policies.

The new disclosures required in PCAOB-compliant audit reports would include information about any critical audit matters (CAMs) or, if the audit did not uncover any CAMs, a statement to that effect. A CAM is defined as a matter that:

- is communicated to the company's audit committee, either voluntarily or pursuant to PCAOB guidance about such communications;
- relates to accounts or disclosures that are material to the financial statements (although the CAM itself need not be material); and
- involves "especially challenging, subjective, or complex auditor judgment."

The disclosure about any CAM must include:

- the principal considerations causing the auditor to conclude that the matter was a CAM;
- how the auditor addressed the CAM in conducting the audit; and
- reference to the relevant financial statement accounts or disclosures.

Certain types of companies would be excepted from these new CAM disclosure requirements, including: mutual funds and other registered investment companies that are not business development companies; registered broker-dealer firms; and "emerging growth companies" as defined under the Jumpstart Our Business Startups Act.

If approved by the SEC, the new CAM disclosure requirements may have the unintended consequence of impairing full and frank discussions among management, audit committees, and auditors. As the PCAOB has acknowledged, statements about CAMs could provide the basis for legal claims, leading to increased litigation costs and audit fees.

Serious comments have been filed with the SEC on both sides. For example, some public companies, as well as the U.S. Chamber of Commerce, oppose the CAM disclosure requirement, while some money managers and institutional investors support it.

