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## PCAOB issues new guidance for auditors and audit committees

July 10, 2019



KPMG reports on new PCAOB guidance for communications with audit committees.<sup>1</sup> The guidance applies when an auditor has identified a violation of the independence rules.

### Background and applicability

PCAOB Rule 3526 serves to protect the interests of investors by requiring auditors to provide audit committees with sufficient information to understand how a relationship between the auditor and the audit client might affect the auditor's independence. The PCAOB staff has issued guidance on the independence-related communications with audit committees required under PCAOB Rule 3526(b) when an auditor has identified a violation of independence rules.

### Why did the PCAOB issue new guidance for Rule 3526(b)?

This new guidance for compliance with Rule 3526(b) provides auditors with additional technical assistance needed to foster timely and robust communications between the auditor and the audit committee regarding independence matters.

Specifically, the PCAOB's staff guidance answers questions that auditors have raised about the required communications when an auditor identifies one or more violations of applicable auditor independence rules. Although audit firms typically maintain a system of quality controls to support their compliance with auditor independence rules, violations of the rules can sometimes occur. The guidance explains that, in such situations, where the auditor had addressed the underlying circumstances of the violation, the auditor considers the effect of the violation on its objectivity and impartiality, including whether a reasonable investor with the knowledge of all relevant facts and circumstances would conclude that the auditor is capable of exercising objective and impartial judgment on all issues encompassed by the engagement. The auditor then communicates its analysis to the audit committee, which makes its own determination of whether to continue the audit engagement.

<sup>1</sup> This guidance was developed by the PCAOB staff as of May 31, 2019. The guidance does not establish rules of the Board and does not reflect any Board determination or judgment about the conduct of any particular firm, auditor, or any other person. It also is not a statement of the Board, nor does it necessarily reflect the views of the Board or any individual Board member. [Overview of Staff Guidance of Audit Committee Communications Related to Independence](#)

## KPMG observation

Subject to limited exceptions, the auditor independence rules provide that an auditor is not independent when the audit firm or covered person in the firm violates one or more of the independence rules. Rule 3526(b) requires the audit firm to affirm that it is an independent registered public accounting firm under PCAOB Rule 3520 (the rule requiring the auditor to comply with all applicable independence rules). The PCAOB staff issued guidance to resolve the inherent conflict that can arise when a violation of the independence rules does occur.

## How does the new guidance impact audit committees and audit firms?

The PCAOB staff guidance indicates that audit committees should separately evaluate the auditor's conclusions and decide whether to continue the audit engagement.

If the auditor and audit committee separately determine that the auditor's ability to remain objective and impartial in its judgments has not been impaired, either in fact or from the perspective of a reasonable investor:

- The auditor's annual independence affirmation (i.e. Rule 3526 communication) is modified to state that the auditor would be independent except for the violation(s) it has identified and discussed with the audit committee; and
- The title of the auditor's report remains 'Report of Independent Registered Public Accounting Firm.'

## Did the PCAOB provide guidance on how to modify the annual independence affirmation?

Yes, the PCAOB staff guidance,<sup>2</sup> which includes summary observations and questions and answers, has an example of a disclosure that could be provided to the audit committee by the auditor when the auditor has determined that, notwithstanding the violation, it has retained its ability to remain objective and impartial in its judgments. (See Answer 1f in the Staff Q&As.)

*"We have concluded that our objectivity and impartiality with respect to all issues encompassed within our engagement has not been impaired, and we believe that a reasonable investor with knowledge of all relevant facts and circumstances would conclude that we are capable of exercising objective and impartial judgment on all issues encompassed within our engagement. Except for the violation(s) expressly identified and discussed with you [and as set forth above/in separate communications dated XX/XX/XXXX], the Firm would be independent in compliance with Rule 3520."*

## KPMG observation

We expect that audit firms will use the example wording when a violation(s) of the independence rules occurs during the current audit engagement period.

The PCAOB guidance provides that the auditor need not continue to qualify the annual independence affirmation in subsequent years as long as no additional facts have come to light that would alter the resolution of the prior violation and no new violations have been identified in the subsequent year.

<sup>2</sup> Staff Guidance - Rule 3526(b) Communications with Audit Committees Concerning Independence

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## Effective date and transition

The PCAOB staff did not specify an effective date for the guidance.

### KPMG observation

We believe that the PCAOB staff intended that the guidance be implemented for all applicable PCAOB Rule 3526(b) communications occurring on or after May 31, 2019.

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