AUDITING

ASB issues auditor reporting standard

The Auditing Standards Board (ASB) has monitored the auditor reporting projects of the International Auditing and Assurance Standards Board (IAASB) and the Public Company Accounting Oversight Board, as well as the IAASB’s project addressing the auditor’s focus on financial statement disclosures. After considering the implications of these projects on audits of nonissuers, the ASB recently issued Statement on Auditing Standards (SAS) 134, Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements, which supersedes AU-C sections 700, 705 and 706. Following is a brief summary of some changes resulting from the issuance of SAS 134, among many others:

- The SAS provides some changes to the format of and verbiage used in the auditor’s report issued for audits of nonissuers, including, among others:
  - The auditor’s opinion is presented in the first section of the auditor’s report.
  - The descriptions of the responsibilities of management and the auditor are expanded.

- Auditors of nonissuers may be engaged to communicate key audit matters, defined as those matters that, in the auditor’s professional judgment, were of most significance in the audit. Key audit matters are selected from matters communicated with those charged with governance.

- If, after considering identified conditions or events and management’s plans, the auditor concludes that substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time remains, the auditor should include a separate section in the auditor’s report under the heading “Substantial Doubt About the Entity’s Ability to Continue as a Going Concern” instead of an emphasis-of-matter paragraph.

- The auditor is required to communicate with those charged with governance about the significant risks identified by the auditor as part of the required communication of an overview of the planned scope and timing of the audit.

- Certain amendments are intended to focus the auditor’s attention on disclosures earlier in the process of auditing financial statements.

SAS 134 is effective for audits of financial statements for periods ending on or after December 15, 2020.
Omnibus Statement on Auditing Standards issued

In developing and updating auditing standards, the Auditing Standards Board (ASB) considers, among other matters, the standards of other standard setters, such as the Public Company Accounting Oversight Board (PCAOB). Accordingly, the ASB has reviewed recent PCAOB auditing standards to consider whether the standards include material that, if included in the requirements or application material of U.S. generally accepted auditing standards, would enhance audit quality for audits of nonissuer financial statements in an effective and efficient manner. As a result, the ASB recently issued Statement on Auditing Standards (SAS) 135, Omnibus Statement on Auditing Standards – 2019, which includes the following amendments, among several others:

- Additional requirements for the auditor to communicate with those charged with governance:
  - Significant unusual transactions
  - Matters that are difficult or contentious for which the auditor consulted outside the engagement team and that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process
  - That uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit

- Enhanced requirements to identify previously unidentified or undisclosed related parties or significant related party transactions; and enhanced procedures to test the accuracy and completeness of the related parties and relationships and transactions with related parties identified by the entity

- Required communication to the component auditor about the nature of the entity’s relationships and transactions with those related parties in the list of related parties prepared by group management and any other related parties of which the group engagement team is aware

- Requirements for basic procedures for obtaining information for evaluating significant unusual transactions

SAS 135 is effective for audits of financial statements for periods ending on or after December 15, 2020.

ACCOUNTING

FASB provides targeted transition relief for CECL

In June 2016 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which introduced the current expected credit loss (CECL) method for measuring credit losses on financial assets measured at amortized cost, replacing the previous incurred loss methodology. ASU 2016-13 also modified the accounting for available-for-sale debt securities, which must be individually assessed, and expected credit losses recognized, when fair value is less than the amortized cost basis.

When analyzing the adoption of ASU 2016-13, some entities have decided to instead elect the fair value option in Subtopic 825-10, “Financial Instruments – Overall,” for newly originated or purchased financial assets. Those entities historically have measured similar financial assets at amortized cost. The entities noted that, because of the limitations for when the fair value option can be elected, they would be
required to maintain dual measurement methodologies (i.e., fair value for new assets and amortized cost for existing portfolios) that would result in noncomparable financial statement information for users.

To address these concerns, the FASB recently issued ASU 2019-05, *Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief*, which gives entities the ability to irrevocably elect the fair value option in Subtopic 825-10 for certain existing financial assets upon transition to ASU 2016-13. Financial assets that are eligible for this fair value election are those that qualify under Subtopic 825-10 and are within the scope of Subtopic 326-20, “Financial Instruments – Credit Losses – Measured at Amortized Cost.” An exception to this is held-to-maturity debt securities, which do not qualify for this transition election.

For entities that have not yet adopted the credit losses standard, the new ASU will be effective when they implement the credit losses standard. For entities that already have adopted the credit losses standard, the new ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted in any interim period after the issuance of the new ASU as long as an institution has adopted the credit losses standard.

**FASB proposes to simplify the accounting for income taxes**

The Financial Accounting Standards Board (FASB) recently issued a proposed Accounting Standards Update (ASU), *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*. If finalized, the proposed ASU would remove the following exceptions to the general principles in Topic 740:

- Exception to the incremental approach for intraperiod tax allocation when there is a loss from continuing operations and income or a gain from other items (such as discontinued operations or other comprehensive income)
- Exception to the requirement to recognize a deferred tax liability for equity-method investments when a foreign subsidiary becomes an equity-method investment
- Exception to the ability not to recognize a deferred tax liability for a foreign subsidiary when a foreign equity-method investment becomes a subsidiary
- Exception in the interim-period income tax accounting when a year-to-date loss exceeds the anticipated loss for the year

The proposed ASU also would simplify the accounting for income taxes by:

- Requiring that an entity recognize a franchise tax (or similar tax) that is partially based on income in accordance with Topic 740 and account for any incremental amount incurred as a non-income-based tax
- Requiring that an entity evaluate when a step up in the tax basis of goodwill should be considered part of the business combination in which the book goodwill originally was recognized and when it should be considered a separate transaction
- Specifying that an entity is not required to allocate in its separate financial statements the consolidated amount of current and deferred tax expense to a legal entity that is not subject to tax, but that an entity may elect to do so for a legal entity that is disregarded by the taxing authority
- Requiring that an entity reflect the effect of an enacted change in tax laws or rates in the annual effective tax rate computation in the interim period that includes the enactment date
- Making minor Codification improvements for income taxes related to employee stock ownership plans and investments in qualified affordable housing projects accounted for using the equity method

The proposed ASU is available for comment until June 28, 2019.
FASB responds to SEC disclosure update and simplification

In 2018 the SEC issued Release No. 33-10532, Disclosure Update and Simplification, which amended certain disclosure requirements that had become redundant, outdated or superseded. In this Release the SEC also referred certain of its disclosure requirements that overlap with, but require incremental information to, generally accepted accounting principles to the Financial Accounting Standards Board (FASB) for potential incorporation into its Accounting Standards Codification. After considering these referred disclosures, the FASB recently issued a proposed Accounting Standards Update (ASU), Disclosure Improvements: Codification Amendments in Response to the SEC’s Disclosure Update and Simplification Initiative.

If finalized, the proposed ASU would affect a variety of topics in the Codification. The proposed ASU is available for comment until June 28, 2019.

SEC

Proposed changes: Accelerated and large accelerated filer definitions

The SEC recently proposed a rule, Amendments to the Accelerated Filer and Large Accelerated Filer Definitions. If finalized, the proposed amendments would exclude from the accelerated and large accelerated filer definitions an issuer that is eligible to be a smaller reporting company under the smaller reporting company revenue test (i.e., annual revenues of less than $100 million in the most recent fiscal year for which audited financial statements are available and public float of less than $700 million). As a result of the proposed amendments, smaller reporting companies with less than $100 million in revenues:

- Would not be required to obtain an attestation of their internal control over financial reporting from an independent auditor. However, they would continue to be required to make assessments of the effectiveness of internal control over financial reporting.
- Would not be subject to accelerated or large accelerated filing deadlines for annual and quarterly reports.

An issuer that is eligible to be a smaller reporting company that has a public float between $75 million and $250 million would be an accelerated filer if its annual revenues are $100 million or more, and thus would remain subject to all requirements applicable to accelerated filers.

In addition, if finalized, the proposed amendments would revise the transition provisions for exiting accelerated filer and large accelerated filer status as follows:

- Increase the public float transition threshold for accelerated and large accelerated filers to become a non-accelerated filer from $50 million to $60 million.
- Increase the threshold for exiting large accelerated filer status from $500 million to $560 million in public float.
- Allow an accelerated or large accelerated filer to become a non-accelerated filer if it becomes eligible to be a smaller reporting company under the smaller reporting company revenue test.

Audit committee tool: Preparing for the new credit losses standard

On May 7, the Center for Audit Quality issued Preparing for the New Credit Losses Standard: A Tool for Audit Committees, which is designed to help audit committees in their oversight responsibilities related to the implementation of Financial Accounting Standards Board Accounting Standards Update (ASU) 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The tool includes an overview of the standard and questions for audit committees to ask management and the auditor related to a company’s implementation efforts.
For public business entities that are SEC filers, ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. RSM US LLP’s Current expected credit loss resource center provides information about the new guidance.

Emerging technologies, risk and the auditor’s focus
Emerging technologies, such as the following, can bring about great opportunities for a business but also may present risks to financial reporting:

- The concept of connecting any device to the internet and to other devices
- Artificial intelligence tools that use advanced algorithms and machine learning to predict activity and manage business processes, such as projecting inventory levels, managing cash flow needs and enhancing internal audit activities
- The ability to execute smart contracts that facilitate, validate and enforce the performance of an agreement or transaction on blockchains
- Artificial intelligence used in developing accounting estimates

To provide an understanding of emerging technologies and an awareness of the risks they present to financial reporting, the Center for Audit Quality recently published a resource for auditors, audit committees and management: Emerging Technologies, Risk, and the Auditor’s Focus. This publication sheds light on issues such as the following, among others:

- How technology affects:
  - A company’s business
  - Internal controls over financial reporting
  - Audit committee oversight of financial reporting
- What auditors should focus on when assessing technology risks:
  - Gaining a holistic understanding of changes in the industry and the information technology environment to effectively (a) evaluate management’s process for initiating, processing and recording transactions and (b) design appropriate auditing procedures
  - Considering risks resulting from the implementation of new technologies and how those risks may differ from those that arise from more traditional systems
  - Considering whether specialized skills are necessary to determine the impact of new technologies and to assist in the risk assessment and understanding of the design, implementation and operating effectiveness of controls

Highlights of recent SEC Regulations Committee meeting
In a recent meeting of the Center for Audit Quality SEC Regulations Committee with SEC staff members, the following emerging financial reporting issues, among others, were discussed:

- The SEC staff has considered certain registrant disclosures of non-GAAP financial measures to not be appropriate because they utilized individually tailored accounting principles. Registrants with questions regarding the appropriateness of non-GAAP financial measures should reach out to the Corporation Finance Office of the Chief Accountant.
- Committee and SEC staff members discussed various transition issues for registrants with changes in emerging growth company status.
• Issuers may contact the Corporation Finance Office of the Chief Accountant to discuss challenges in applying the Regulation S-K guidance for the contractual obligations table in light of the adoption of Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 842, *Leases*.

• The SEC staff will object to a non-GAAP measure presented by a U.S. GAAP registrants that adjusts EBITDA to add back operating lease expense since it is not recorded as “depreciation” or “interest” under ASC 842.

• Committee and SEC staff members discussed certain matters related to S-X Rule 3-05, *Financial statements of businesses acquired or to be acquired*.

• Financial statement schedules specified by Regulation S-X Article 12 are required for the investee under S-X Rule 3-09, *Separate financial statements of subsidiaries not consolidated and 50 percent or less owned persons*.

**CAQ Guide to Internal Control Over Financial Reporting**

The Center for Audit Quality (CAQ) recently updated its *Guide to Internal Control Over Financial Reporting*. This guide provides for the general public a high-level overview of internal control over financial reporting (ICFR), briefly explaining, among other matters:

• The statutory internal accounting control requirement

• Key ICFR concepts, including:
  - A summary of the *COSO Internal Control – Integrated Framework*’s five integrated components of internal control
  - The concept of reasonable assurance
  - Controls and service organizations
  - The hierarchy of ICFR deficiencies

• ICFR roles and responsibilities for management, audit committees and independent auditors

• What ICFR means for companies, investors and markets