

# THE PPC ACCOUNTING AND AUDITING UPDATE

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## FASB Issues Improvements for Financial Instruments



In April 2019, the FASB issued ASU 2019-04, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*, which provides amendments to the financial instruments guidance introduced a few years ago, through three ASUs [ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, and ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*]. This article provides a summary of the ASU 2019-04 amendments applicable to hedging and recognition and measurement. A future article will discuss the ASU 2019-04 amendments applicable to credit losses.

ASU 2019-04 provides the following Codification improvements for the recognition and measurement of financial

instruments by clarifying that—

- Health and welfare plans aren't within the scope of FASB ASC 320, *Investments—Debt Securities*, and FASB ASC 321, *Investments—Equity Securities*.
- Only public business entities must disclose the aggregate fair value and gross unrecognized holding gains and losses for held-to-maturity securities measured at amortized cost basis.
- An entity must remeasure an equity security that is accounted for using the measurement alternative if the entity identifies an orderly transaction for an identical or similar investment of the same issuer. The measurement alternative is a nonrecurring fair value measurement and the entity must provide the related disclosures under FASB ASC 820, *Fair Value Measurement*.
- Foreign-denominated equity securities without readily determinable fair values accounted for under the measurement alternative will continue to be remeasured at historical exchange rates (i.e., the rate as of the date on which the security was acquired or most recently adjusted to fair value).

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ASU 2019-04 provides the following Codification improvements for the hedging of financial instruments by clarifying that:

- FASB ASC 815-25-35-13B, which allows an entity to use the assumed maturity date to measure the change in fair value of the hedged item in a partial-term fair value hedge, only applies to hedges of interest rate risk. An entity, however, may also apply this paragraph when it designates a hedged item in a hedge of both interest rate risk and foreign exchange risk.
- When amortizing a fair value hedge basis adjustment, an entity may begin to amortize the basis adjustment before it discontinues the fair value hedging relationship.
- An entity should disclose hedged available-for-sale debt securities at amortized cost.
- An entity should consider the contractually specified interest rate being hedged when an entity uses the hypothetical derivative method.
- A not-for-profit entity that doesn't separately report earnings can't elect the amortization approach for amounts that are excluded from an entity's effectiveness assessment of a fair value hedging relationship.
- A private company that is not a financial institution should document its analysis supporting a last-of-layer hedge designation at the inception of the hedge. Also, certain nonprofit entities are allowed the timing relief for quarterly hedge effectiveness assessment documentation previously provided to certain private companies.
- Entities may continue to apply the first-payments-received technique to changes in the overall cash flows on a group of variable interest payments.

ASU 2019-04 also amends many ASU 2017-02 transitional provisions.

The ASU 2019-04 amendments related to the recognition and measurement of financial instruments under ASU 2016-01 are effective for annual periods beginning after December 15, 2019, including interim periods within those annual periods. Early adoption is permitted in an interim period following the issuance of ASU 2019-04 if the reporting entity has adopted ASU 2016-01.

An entity should apply the ASU 2019-04 amendments related to the hedging of financial instruments under ASU 2017-02—

- Concurrently with ASU 2017-02 if that ASU hasn't already been adopted.
- As of the beginning of the first annual period after the issuance of ASU 2019-04 if the entity has already adopted ASU 2017-02. (January 1, 2020, for calendar

year entities.) Early adoption is allowed for any date on or after the issuance ASU 2019-04.

### Practical Consideration:

For the full ASU 2019-04 transition requirements applicable to hedging and recognition and measurement of financial instruments, see FASB ASC 815-20-65-5 and FASB ASC 825-10-65-5, respectively. The ASU is available at [www.fasb.org](http://www.fasb.org) and on Checkpoint at [checkpoint.riag.com](http://checkpoint.riag.com).

## Big Changes Are Coming to the Auditor's Report

On May 8, 2019, the AICPA issued SAS 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, a suite of auditor reporting standards. This suite of auditor reporting standards is the result of the AICPA's ongoing Auditor's Report project. SAS 134 supersedes and replaces, adds, and amends the following:

- Supersedes and replaces—
  - AU-C 700, *Forming an Opinion and Reporting on Financial Statements*;
  - AU-C 705, *Modifications to the Opinion in the Independent Auditor's Report*; and
  - AU-C 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.
- Adds—
  - AU-C 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.
- Amends—
  - AU-C 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*;
  - AU-C 210, *Terms of Engagement*;
  - AU-C 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*;
  - AU-C 230, *Audit Documentation*;

- AU-C 240, *Consideration of Fraud in a Financial Statement Audit*;
- AU-C 260, *The Auditor's Communication With Those Charged with Governance*;
- AU-C 300, *Planning an Audit*;
- AU-C 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*;
- AU-C 320, *Materiality in Planning and Performing an Audit*;
- AU-C 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*;
- AU-C 450, *Evaluation of Misstatements Identified During the Audit*;
- AU-C 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*;
- AU-C 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*;
- AU-C 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*;
- AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors), as amended*; and
- AU-C 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*.

### Practical Consideration:

The professional standards section of the AICPA materials in Checkpoint now reflect the replaced standards under SAS 134 for AU-C 700, AU-C 705, and AU-C 706. For extant guidance, see AU-C 700A, AU-C 705A, and AU-C 706A in Checkpoint at [checkpoint.riag.com](http://checkpoint.riag.com).

## Changes to the Standard Auditor's Report

The following changes are made to the standard auditor's report (AU-C 700) (Revised)—

- Requires the first section of the auditor's report to have the heading "Opinion" and to include the auditor's opinion on the financial statements, followed directly by the "Basis for Opinion" section (unless a different order is prescribed by law or regulation).
- Requires the "Basis for Opinion" section to include an affirmative statement about the auditor's independence and fulfillment of the other ethical

responsibilities in accordance with relevant ethical requirements.

- Adds an option to communicate Key Audit Matters.
- Expands the description of management's responsibilities for the financial statements. It requires a section with the heading "Responsibilities of Management for the Financial Statements" that, in addition to the description of management's responsibilities now included in auditor's reports, also is required to state management's responsibility for assessing the entity's ability to continue as a going concern and whether use of the going concern basis of accounting is appropriate.
- Expands the description of the auditor's responsibilities for the audit and of key features of an audit. It requires a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements" that, in addition to the description of the auditor's responsibilities and the audit now included in auditor's reports, also is required to state that (1) the auditor's objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement whether due to fraud or error and to issue a report that includes the auditor's opinion, (2) reasonable assurance is a high level of assurance, but not absolute assurance, and isn't a guarantee that an audit will detect a material misstatement when it exists, (3) the risk of not detecting a material misstatement resulting from fraud is higher than one resulting from error, (4) misstatements can arise from fraud or error and are considered material if they could reasonably be expected to influence the economic decisions users make based on the financial statements, (5) the auditor exercises professional judgment and maintains professional skepticism throughout the audit, and (6) the auditor's responsibilities include concluding on the entity's ability to continue as a going concern.
- Requires the section of the auditor's report that describes the auditor's responsibilities to state that the auditor is required to communicate with those charged with governance about, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control matters identified.
- Requires, when applicable, the auditor's report to include a separate section when the auditor concludes there is substantial doubt about the entity's ability to continue as a going concern.

## Modifications to the Report

AU-C 705 (Revised) makes changes to the form and content of the auditor's report when the auditor's opinion is modified. These changes are to conform to the

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changes in AU-C 700 (Revised). The criteria for when modification to the auditor's opinion is required and the type of modification required are unchanged by the AU-C 705 revisions. AU-C 705 (Revised) now clarifies that along with emphasis-of-matter and other-matter paragraphs, communication of KAMs doesn't constitute a report modification.

## Emphasis-of-Matter and Other-Matter Paragraphs

AU-C 706 (Revised) was primarily modified to clarify the relationship between matters included in emphasis-of-matter paragraphs and communicating key audit matters in the auditor's report. AU-C 706 (Revised) now clarifies that an emphasis-of-matter paragraph isn't a substitute for describing key audit matters in the auditor's report when AU-C 701 applies. The revised guidance also now requires that, when key audit matters are included in the auditor's report, the heading of any emphasis-of-matter sections should include the term "Emphasis of Matter." AU-C 706 (Revised) otherwise leaves existing guidance on other-matter paragraphs essentially unchanged.

## Going Concern

The ASB also revised certain provisions of AU-C 570 with respect to disclosure in the auditor's report when the auditor concludes there is substantial doubt about the entity's ability to continue as a going concern (after considering relevant conditions and events and management's plans). The revisions require the auditor's conclusion about substantial doubt to be expressed in a separate section in the auditor's report, rather than in an emphasis-of-matter paragraph. In addition, the

revisions make certain changes to the form and content of the separate section.

The revised standard clarifies that if the auditor expresses a qualified or adverse opinion because of inadequate disclosure of going concern uncertainties, the auditor's "Basis for Qualified (Adverse) Opinion" section of the report is required to state either that substantial doubt exists or that substantial doubt has been alleviated, as appropriate, and that the financial statements fail to adequately disclose those matters.

## Auditor Communications

In addition, SAS 134 includes amendments to AU-C 260 to require, among other things, the auditor to communicate with those charged with governance about (a) significant risks identified by the auditor and (b) circumstances that affect the form and content of the auditor's report.

## Effective Date

SAS 134 is effective for audits of financial statements for periods ending on or after December 15, 2020, with no early adoption.

### Practical Consideration:

SAS 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, is available at [www.aicpa.org](http://www.aicpa.org) or in the Advanced and Proposed Documents section of the AICPA Professional Standards on Checkpoint at [checkpoint.riag.com](http://checkpoint.riag.com).

