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AICPA Issues Another New SAS

SAS 137, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, supersedes AU-C 720, *Other Information in Documents Containing Audited Financial Statements*. The superseded standard is now codified in AU-C 720A and SAS 137 is codified in AU-C 720. In accordance with the ASB's strategic objective to converge its standards with those of the International Auditing and Assurance Standards Board (IAASB), the new SAS is modeled after International Standard on Auditing (ISA) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*. The revised standard clarifies, but doesn't significantly change, existing guidance on the auditor's responsibility for other information. Some of the clarifications and changes are discussed in the following paragraphs.

Narrows Other Information. Under the extant standards, the ASB believes the auditor's procedures are frequently applied too broadly to other information, so SAS 137 seeks to clarify the scope of documents that would be subject to the auditor's procedures. The title of the revised standard is changed to focus the auditor on other information included in *annual reports*. AU-C 720.12 defines an *annual report* as a document (or documents) prepared by management or those charged with governance, generally annually as required by law, regulation, or custom, to provide owners and/or other stakeholders with information about the entity's operations, financial results, and financial position. It contains, accompanies, or incorporates by reference the financial statements, the auditor's report thereon, and often includes information about other developments, the entity's future outlook, risks and uncertainties, a statement from the entity's governing body, and reports covering governance matters. AU-C 720.A9 notes that even if a document is referred to as an *annual report*, it might not meet the new definition. AU-C 720.13 requires the auditor to have a discussion with management and obtain a written acknowledgment as to which document(s) comprise the annual report and the manner and timing of issuance of those document(s).

Read and Consider the Other Information. After reading the other information,

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AU-C 720.11 indicates that the auditor's objectives are to consider if there are material inconsistencies between (a) the other information and the financial statements and (b) the information and the knowledge that the auditor obtained during the audit. If one or more material inconsistencies exist or if the auditor becomes aware that the other information appears to be materially misstated, the auditor should respond appropriately. The SAS provides guidance on what constitutes a misstatement of other information. The SAS states at AU-C 720.18 that the auditor is NOT responsible for testing the completeness of the other information.

Effect on the Report. The new SAS requires the auditor's report to include a separate section with an appropriate heading such as "Other Information." Extant standards don't require the auditor to reference the other information in the auditor's report. The other information report section should include the following information:

- A statement that management is responsible for the other information.
- Identification of the other information, specifically noting that it doesn't include the financial statements or auditor's report.
- A statement that the auditor's opinion doesn't cover the other information and the auditor expresses no opinion or assurance on it.
- A statement that the auditor is responsible for reading the other information, considering any material inconsistency with the audited financial statements or other material misstatements.
- A statement that any uncorrected material misstatements of the other information are required to be described in the auditor's report.
- If applicable, a statement that the auditor has concluded that an uncorrected material misstatement of the information exists and a description thereof.

Effective Date. SAS 137 is effective for audits of financial statements for periods ending on or after December 15, 2020. Early implementation isn't permitted.

PCAOB Amends Standards on Use of Specialists

On December 20, 2018, the PCAOB issued Release 2018-006, *Amendments for Auditor's Use of the Work of Specialists*. The amended auditing standards, which were approved by the SEC on July 1, 2019, will be effective for audits of financial statements for fiscal years ending on or after December 15, 2020.

The objectives of the new amendments are to strengthen the requirements for evaluating the work of specialists engaged or employed by the company and to implement a more risk-based approach to supervision of auditor-employed or engaged specialists. Because specialists are often employed to assist in developing or auditing significant estimates, the PCAOB closely coordinated development of these amendments with their new standard for auditing estimates, including fair value measurements.

The use of the work of specialists in audits is becoming more common. The Board's oversight activities have revealed areas in need of improvement in engagements involving the work of specialists, and the PCAOB issued a staff consultation paper soliciting public comment on issues related to the use of specialists in May 2015. Based on an analysis of comments received, as well as feedback from SAG and IAG meetings, the PCAOB issued proposed revisions to current standards in June 2017 for further public comment. Those comments were further analyzed when drafting the final amendments.

PCAOB inspections have identified diversity in practice regarding the use of specialists. Furthermore, the Board observed that existing standards currently vary significantly for supervision of specialists employed or engaged by the company versus those employed or engaged by the audit firm, although both play similar roles in providing audit evidence. On the other hand, auditor responsibilities with regard to both company and auditor specialists are the same, despite their fundamentally different purposes. The amendments aim to reduce inconsistencies and enhance the risk-based approach to the use of specialists as follows:

- Strengthen requirements for evaluating the work of a company's specialist.
- Implement a risk-based approach to supervising and evaluating the work of a specialist engaged or employed by the audit firm.

The amendments (a) revise AS 1105, *Audit Evidence*, by adding a new Appendix A to address using the work of a company's specialist as audit evidence, including procedures for evaluating the data, assumptions, and methods used by a company specialist; (b) replace AS 1210, *Using the Work of a Specialist*, and rename it *Using the Work of an Auditor-Engaged Specialist*; and (c) amend AS 1201, *Supervision of the Audit Engagement*, to provide guidance when auditors use a specialist employed by the auditor. In addition, the amendments revise the following:

- AS 2101, *Audit Planning*.
- AS 2110, *Identifying and Assessing Risks of Material Misstatement*.
- AS 2505, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*.
- Other conforming amendments.

Despite the significant revisions to the standards, the definition of a specialist doesn't change from the extant guidance and is the same regardless of whether the specialist is a company specialist, an auditor-engaged specialist, or a specialist employed by the auditor. A *specialist* continues to be defined as a person (or firm) possessing special skill or knowledge in a particular field other than accounting or auditing. Also consistent with current standards, income taxes and information technology are considered specialized areas of accounting and auditing and, thus, continue to be governed by the requirements in AS 1201 (as amended) rather than the auditing standards for specialists. In addition, a company's attorney who provides information to the auditor concerning the company's litigation, claims, and assessments isn't considered to be a specialist; auditors' responsibilities for this are still provided in AS 2505 (as amended).

Practical Consideration:

The full text of Release 2018-006 is available at **https://pcaobus.org/Rulemaking/Docket044/2018-006-specialists-final-rule.pdf**

FASB Issues Goodwill Alternatives for Nonprofit Organizations

In May 2019, the FASB issued ASU 2019-06, *Intangibles—Goodwill and Other* (Topic 350), *Business Combinations* (Topic 805), and *Not-for-Profit Entities* (Topic 958). The ASU extends the private-company accounting alternatives provided in ASU 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill* and ASU 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination* to nonprofit organizations.

Why Was the ASU Issued?

In 2014, the FASB issued ASU 2014-02 and ASU 2014-18 to provide all entities except for public entities, nonprofit entities, and employee benefit plans an accounting alternative simplifying the subsequent accounting for goodwill and certain identifiable intangible assets in a business combination. When ASUs 2014-02 and 2014-18 were issued, the amendments excluded nonprofit entities, even though FASB acknowledged that the issues addressed in those ASUs weren't limited to private companies. As a result, the FASB issued ASU 2019-06 to extend the accounting alternatives to nonprofit entities. The accounting alternatives should simplify the accounting and reporting for nonprofit organizations by reducing both the costs of preparing financial statements and the complexity associated with accounting for goodwill and the measurement of certain identifiable intangible assets.

Accounting Alternative for Accounting for Goodwill

Scope. The accounting alternative in Topic 350 applies only to: (a) goodwill recognized in a business combination after initial recognition and measurement, (b) amounts recognized as goodwill in applying the equity method of accounting, and (c) the excess reorganization value recognized by entities that adopt fresh-start reporting under GAAP for reorganizations.

Once elected, an organization must apply all the alternative's subsequent measurement, derecognition, presentation, and disclosure requirements to existing goodwill and all future additions to goodwill that fall within the scope of the accounting alternative.

Amortization of Goodwill. The accounting alternative requires the amortization of goodwill on a straight-line basis over ten years (or less if a shorter useful life is more appropriate). A nonprofit organization may revise the remaining useful life of an amortizable unit of goodwill, if events or changes in circumstances warrant a change and the cumulative amortization period doesn't exceed ten years. Once the remaining useful life is revised, the remaining carrying amount of goodwill should be amortized prospectively on a straight-line basis over the revised remaining useful life.

Testing for Impairment. Although goodwill is amortized under the accounting alternative, a nonprofit organization must test goodwill for impairment using qualitative and/or quantitative tests. Upon the adoption

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of ASU 2019-06, the nonprofit organization must make an accounting policy election to test goodwill at either the entity level or the reporting unit level. Annual impairment testing isn't required. Rather, testing for impairment is only required if a triggering event occurs that indicates that the fair value of the nonprofit entity (or the reporting unit) may be below its carrying amount.

Other Presentation Matters and Disclosures. The accounting alternative clarifies that the aggregate amount of goodwill should be presented as a separate line item in the statement of financial position, net of accumulated amortization and impairment, and states a tabular reconciliation isn't required. The alternative requires additional disclosures about amortization periods, amortization expense, and accumulated amortization.

Accounting Alternative for Identifiable Intangible Assets in a Business Combination

Scope. The accounting alternative in Topic 805 applies to nonprofit organizations that are required to recognize or consider fair value of intangible assets when: (a) applying the acquisition method for a business combination, (b) evaluating the nature of a difference between an investment's carrying amount and the underlying equity in the net asset of an investee when applying the equity method of accounting, or (c) adopting fresh start accounting for reorganizations.

Simplifying Accounting. When elected, the accounting alternative allows a nonprofit organization to bypass the separate recognition of (a) customer-related intangible assets unless they can be sold or licensed independently from other assets of a business, and (b) noncompetition agreements. In other words, such items would be considered part of goodwill. Thus, as a result of electing the accounting alternative, entities would recognize fewer intangible assets in a business combination.

Practical Consideration:

If a nonprofit organization decides to elect the accounting alternative for accounting for identifiable intangible assets, it must also adopt the accounting alternatives for goodwill. However, a nonprofit organization that elects to adopt the accounting alternative for goodwill isn't required to adopt the accounting alternative for accounting for identifiable intangible assets.

Effective Date and Transition

The guidance in ASU 2019-06 was effective upon issuance. If elected, a nonprofit organization should apply the goodwill accounting alternative prospectively to all existing goodwill and for all new goodwill generated in acquisitions. If the nonprofit organization elects to apply the accounting alternative for accounting for identifiable intangible assets, it should be applied prospectively upon the occurrence of the first transaction within the scope of the alternative.

Practical Consideration:

The ASU is available at **www.fasb.org** and on Checkpoint at **checkpoint.riag.com**.