

THE PPC ACCOUNTING AND AUDITING UPDATE

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FASB Delays Effective Dates on Revenue Recognition and Leases Standards



In April 2020, to address challenges relating to the coronavirus pandemic, the FASB proposed a one-year deferral for the effective dates of FASB ASC 606, *Revenue from Contracts with Customers*, and FASB ASC 842, *Leases*, for certain nonpublic companies that hadn't already adopted these standards (see the May 2020 edition of the PPC Accounting and Auditing Update). In June 2020, the FASB issued ASU 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*, delaying the effective dates of Topics 606 and 842 by one year for certain entities. Early implementation of both standards is allowed.

For all entities that haven't yet issued (or made available for issuance) their financial statements in which they adopted Topic 606, Topic 606's implementation is deferred to annual reporting periods beginning after December 15, 2019, and interim reporting periods within annual reporting periods beginning after December 15, 2020. The proposed delay was originally applied only to nonpublic

franchisors, but FASB revised the original proposal and widened the scope based on feedback from stakeholders.

For private companies and private non-profit organizations, Topic 842's effective date is deferred to fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. For public nonprofit organizations (issuers or conduit bond obligors of publicly traded securities) that haven't yet issued their financial statements, the effective date is deferred to fiscal years beginning after December 15, 2019, including interim periods within those years.

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Practical Consideration:

The ASU is available on the FASB's website at https://www.fasb.org/cs/ContentServer?c=Document_C=1176174696379==FASB%2FDocument_C%2FDocumentPage.



PCAOB Issues Inspection Reports

The Public Company Accounting Oversight Board (PCAOB) issued 2018 annual inspection reports on June 1 for each of the Big Four firms, Grant Thornton, and BDO. Audit deficiency rates for the Big Four firms and Grant Thornton and BDO for 2018 ranged from a low of 11.5% to a high of 47.8%. Following are some of the significant findings and areas of frequent noncompliance noted in these inspection reports. These findings can be helpful for both private company and public auditors when planning and performing audits.

PCAOB Auditing Standards

The auditing standard that appeared to give most inspected firms difficulty was AS 2201, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*. Common related deficiencies identified in many of the reports included the following:

- Testing controls over accuracy and completeness of data or reports.
- Testing design and/or operating effectiveness of controls selected for testing.
- Identifying and testing controls related to a significant account or relevant assertion.
- Overreliance on controls when performing substantive testing.
- Performing substantive testing to address the risk of material misstatement.

Auditing estimates was another area with many deficiencies. A frequent comment was that auditors didn't evaluate significant assumptions or data used by the issuer to develop estimates.

Other auditing standards that were frequently noted for deficiencies included AS 1105, *Audit Evidence*; AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*; AS 2315, *Audit Sampling*; and AS 2502, *Auditing Fair Value Measurements and Disclosures*.

Financial Statement Accounts

The financial statement related deficiencies that appeared most frequently were the following:

- *Revenue and related accounts*—testing controls and substantive testing of revenue, including controls over IT systems associated with revenue and controls over accuracy and completeness of data and reports.
- *Business combinations*—evaluating the reasonableness of assumptions used to determine the fair value of assets acquired and liabilities assumed, testing controls over the issuer's review of the assumptions used to determine fair values, and substantive testing of data used to value acquired intangibles (including controls over accuracy and completeness of data).
- *Investments*—testing the design effectiveness of controls over valuation of securities.
- *Inventory*—testing controls over accuracy and completeness of data or reports, substantive procedures to test the existence and valuation of inventory, testing cycle counts, and evaluating reasonableness of excess and obsolete inventory reserves.
- *Loans and related accounts*—identifying and testing controls over loans, substantive testing, testing related to confirmation requests, testing assumptions and data used to estimate the allowance for loan losses, and testing controls over the completeness and accuracy of data used for the allowance.
- *Long-lived assets*—evaluating the reasonableness of assumptions used in the impairment analysis, testing controls, and substantive procedures to test the existence of assets.
- *Insurance-related assets and liabilities, including reserves*—testing controls and substantive testing of the accuracy of claims data used to estimate liabilities.
- *Income taxes*—testing controls and substantive testing of the issuer's review of income taxes (including the tax provision and uncertain tax positions).

Other Areas of Noncompliance

Some other areas where deficiencies were noted include:

- Failure to include all relevant workpapers in the audit documentation.
- Not assembling final audit documentation within 45 days of the report release date.

- Failure to make fraud inquiries of the audit committee.
- No written communication to the audit committee about potential effects of permissible tax services on the firm's independence.
- Failure to document communication to the audit committee about changes to significant risks initially identified.
- Incomplete communication about another accounting firm's participation in the audit (in the case of these reports, omitting the information from or misrepresenting it on PCAOB Form AP, *Auditor Reporting of Certain Audit Participants*).

Practical Consideration:

The PCAOB's Inspection Reports for each of the six firms are available in their entirety on the PCAOB's website at <https://pcaobus.org/News/Releases/Pages/PCAOB-issues-six-largest-US-firm-inspection-reports-new-user-friendly-format-guide-to-reading-reports.aspx>.



SAS 139 Aligns the AU-C 800 Series with SAS 134

SAS 139, *Amendments to AU-C Sections 800, 805, and 810 to Incorporate Auditor Reporting Changes From SAS No. 134*, was issued in March 2020. SAS 139 amends the following AU-C sections to incorporate changes from SAS 134.

Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*. When financial statements are prepared using special purpose frameworks other than GAAP, such as a regulatory or contractual or other basis of accounting, and the auditor

restricts use of the audit report under AU-C 905, the auditor's report should include an emphasis-of-matter paragraph which includes a statement that the financial statements are prepared using a special purpose framework and a reference to the note to the financial statements that describes that framework. SAS 139 amends Section 800 to require that a statement be added to the audit report's emphasis-of-matter paragraph that the financial statements may not be suitable for another purpose.

Section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. This section includes the factors for auditors to consider in determining whether a matter included in the audit report on the complete set of financial statements is relevant to the audit of the single financial statement or specific element and to the auditor's report on it. The consideration is a matter of professional judgment. SAS 139 indicates factors that may be relevant for auditors to consider include a modified opinion, an emphasis-of-matter or other-matter paragraph, going concern, communication of key audit matters, or uncorrected material misstatements.

Section 810, *Engagements to Report on Summary Financial Statements*. SAS 139 adds application guidance to clarify that although auditors are required to include a statement in the audit report on the summary financial statements when their audit report on the audited financial statements includes communication of key audit matters, they aren't required to describe or repeat in the audit report on the summary statements the individual key audit matters in the audit report on the audited financial statements. The intent is that the description in the audit report on the summary financial statements draws attention to the key audit matters and conveys their nature.

The SAS 139 amendments also reflect applicable changes resulting from SAS 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, and SAS 137, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*.

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SAS 139, as issued, was effective for periods ending on or after December 15, 2020, and early implementation wasn't permitted. However, in May, the ASB issued SAS 141, *Amendment to the Effective Dates of SAS Nos. 134–140*, that delays the effective date of SAS 139 for one year in response to the coronavirus pandemic. It also lifts the prior prohibition on early implementation, although the ASB recommends that SASs 134–140 be implemented concurrently. SAS 139 will now be effective for audits of private company financial statements for periods ending on or after December 15, 2021.

Practical Consideration:

SAS 139 is available on the AICPA's website at <https://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/sas-139.pdf>.

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