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8 Accounting and Auditing Issues You Can't Afford to Ignore

Financial reporting realm
has seen significant changes.

by Ken Tysiac

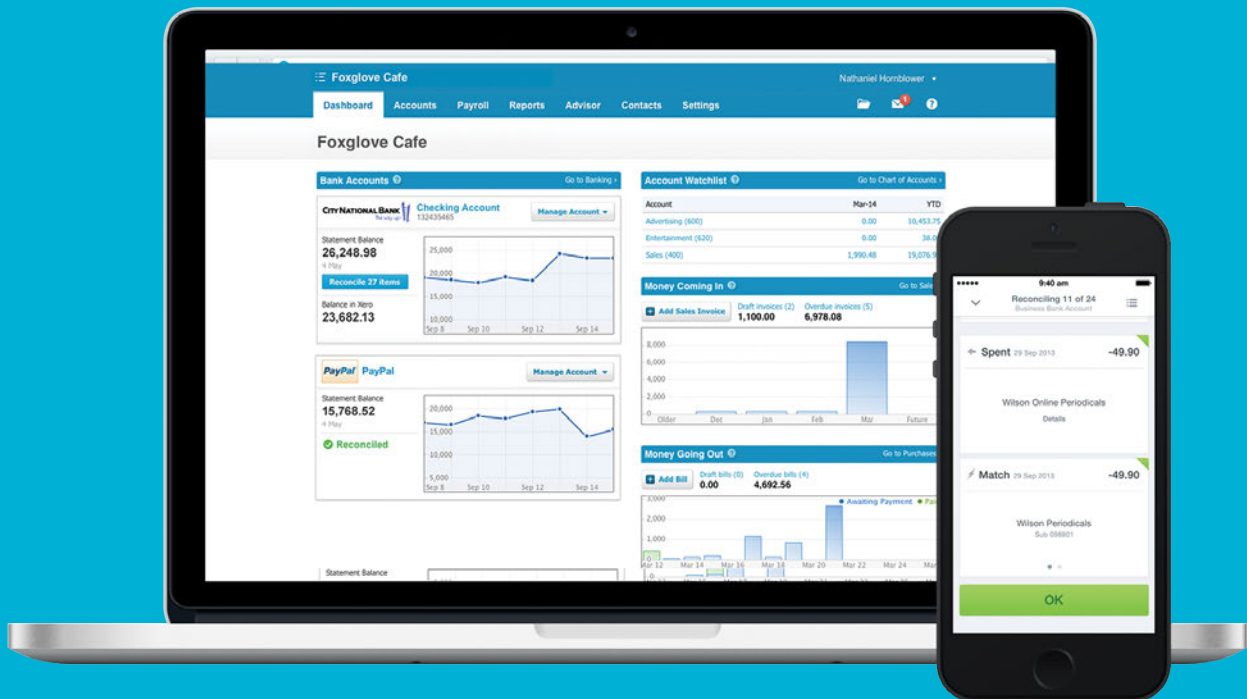




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The past few years have seen monumental changes in the requirements that affect CPAs in accounting and auditing. They include a new global standard for how organizations report one of their most important metrics (revenue), long-awaited new accounting alternatives for private companies, and a significant update for accountants who prepare and present financial statements to their clients or to third parties.

Here is an overview of some of the most important changes accountants and auditors are facing today:

1. **Revenue recognition.** The new revenue recognition standard is considered the crowning achievement of the convergence efforts undertaken by FASB and the International Accounting Standards Board (IASB). The standard creates a more principles-based approach than U.S. GAAP filers are accustomed to using for their financial reporting and is designed to promote consistency in reporting across industries and jurisdictions. The transfer of control of the goods or services to the customer is the underlying principle governing the standard.

But in the United States, the standard is having difficulty getting off the ground because preparers have had questions about how to apply it in certain areas. Consider the comments of SEC Chief Accountant James Schnurr in December at the AICPA Conference on Current SEC and PCAOB Developments. Schnurr said that in speaking with various parties about the standard, the SEC became aware of many application questions. He said some of those questions may have a significant and widespread impact, and he suggested that FASB and the IASB address them as they evaluate whether additional time is needed to address implementation matters. He said well-defined principles should yield consistent results when applied to similar facts and circumstances.

“If there is significant diversity in practice for similar transactions, then it raises the question as to whether the principles in the standard are adequately articulated,” Schnurr said.

Some of the questions do not appear to have easy answers. As a result, FASB has been considering delaying the implementation date. But the IASB has not appeared eager for such a delay. The boards’ transition resource group has referred specific questions to the boards for further guidance, and FASB’s staff has been researching these issues.

Financial statement preparers and auditors will want to remain tuned in to these issues, as they pertain to one of the most critically important metrics in an organization’s financial reporting.

2. **Alternatives for private companies.** The Private Company Council (PCC) has played an important role in FASB’s efforts under its chairman, Russell Golden, to make GAAP sim-

pler while continuing to provide financial statement users the information they need.

Thanks to some of the PCC’s earliest work, private companies have alternatives they can use to bypass some of the items in GAAP that have been most troublesome for preparers and that have provided limited benefits for financial statement users.

PCC-initiated topics have led to the following options for private companies:

- An exemption from having to perform annual impairment tests for goodwill subsequent to a business combination. A private company that elects the alternative should amortize goodwill over 10 years, or less than 10 years if the entity can demonstrate that another useful life is more appropriate.
- The ability to elect not to recognize certain intangible assets acquired in a business combination separately from goodwill.
- A simplified hedge accounting approach for certain interest rate swaps that private companies other than financial institutions enter to convert variable-rate debt to fixed-rate debt.
- An exemption from the requirement to consolidate variable-interest entities in common-control leasing agreements.

Some private companies have long sought such alternatives to GAAP that help them avoid standards that seem tailored for public companies. And there’s a chance the discussion of these alternatives may someday help public companies, too.

PCC discussions also have sparked consideration of other changes that FASB has examined for all entities, such as a standard released in June that relaxed financial reporting requirements for development-stage entities. Goodwill impairment is another area where FASB has been considering whether PCC changes—or other amendments—could apply to public companies, too.

3. **Simplification initiative.** Part of Golden’s campaign against unnecessary complexity is this initiative to rid GAAP of standards that cause preparers difficulty but provide little relevant information for financial statement users.

The initiative is designed to remove such narrow-scope trouble areas from GAAP. Its results include a standard removing the concept of extraordinary items from GAAP. Other simplification activities FASB has undertaken include projects that would affect the measurement of inventory, the presentation of debt-issuance cost, and the measurement date of defined benefit plan assets.

This is an area where change can be a relief rather than a burden for preparers and auditors. For example, removing the concept of extraordinary items from GAAP means that preparers won’t have to take the time to assess whether items



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are extraordinary. And auditors won't have to evaluate whether a preparer treated an unusual and/or infrequent item properly with respect to the extraordinary items concept.

4. Pensions in government reporting and auditing. Preparers and auditors of state and local government financial statements—and government-administered pension plans—are seeing significant change as a result of two new GASB standards. GASB Statement No. 67, *Financial Reporting for Pension Plans—an Amendment of GASB Statement No. 25*, establishes new accounting and reporting requirements for government-administered pension plans and took effect for periods beginning after June 15, 2013. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an Amendment of GASB Statement No. 27*, contains new requirements for state and local government reporting and takes effect for periods beginning after June 15, 2014.

Statement No. 68 was designed to increase transparency for users of state and local government financial statements. The standard requires state and local governments to report:

- Their total pension liability.
- The fair value of plan assets available to pay pension benefits.
- A net pension liability, which is the difference between the total pension liability and the assets available to pay benefits.

Government preparers, pension plan administrators, and auditors will need to coordinate their efforts in order to comply with the standards. The AICPA Auditing Standards Board has issued auditing interpretations as guidance for auditors as they implement the standard. White papers issued by the AICPA State and Local Government Expert Panel also can be used to assist with implementation. The auditing interpretations, white papers, and other resources related to GASB's pensions project are available at tinyurl.com/lv6szzg.

5. Internal control over financial reporting (ICFR). This is a huge area of focus for preparers, auditors, and regulators.

The many parties paying close attention to this subject in the financial reporting realm include the PCAOB, which issued a report on inspection observations related to audits of ICFR in 2012 and a staff audit practice alert on ICFR auditing in 2013.

"To achieve the assurance over ICFR that investors and the market rely on, all participants must do their part to fulfill their responsibilities for implementing, evaluating, and auditing internal control," PCAOB member Jeanette Franzel said during a speech last year at the Institute of Internal Auditors' conference on general audit management.

Improvement in organizations' internal control environment is anticipated as a result of the 2013 update of the internal control framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The framework is updated in response to technological advances and other changes in the business environment, and users need to im-

plement it properly to reap the benefits of the changes reflected in the update.

Some companies have struggled with the update in the area of outsourced service providers. According to the COSO framework, management is responsible for the design and operation of its ICFR, including the controls provided by outsourced service providers. Obtaining access to and visibility of outsourced service providers' controls can be a challenge. But verifying those controls is an essential step for companies whose CEOs and CFOs sign regulatory statements attesting to their ICFR environment. The procurement process is a good place to consider the necessity of obtaining access to outsourced service providers' controls. Management may wish to insist that outsourced providers be willing to agree to a right-to-audit clause that would authorize the organization or an auditor to perform testing on the outsourced service provider's controls.

6. Lease accounting. This project has been on FASB's agenda since 2006 but still hasn't yielded a final standard as the board has been unable to agree with the IASB on a path forward.

Both boards agree that leases need to be placed on the balance sheet, but their preferred methods for achieving this are different. The IASB has expressed a preference for lessees to account for all leases as a purchase of a right-of-use asset on a financed basis. FASB prefers a dual-recognition approach for lessees whereby capital leases would use an interest-and-amortization method, and operating leases would be expensed on a straight-line basis.

The release dates of final standards on this topic remain uncertain, but it's important for preparers and management to pay close attention because leases affect a large percentage of organizations, and significant changes may be on the horizon.

Meanwhile, for government preparers, GASB has issued a preliminary views document (i.e., a step toward an exposure draft), which presents the board's preliminary views on leases and related disclosures. The document is based on the principle that all leases are financings of the right to use an underlying asset.

7. SSARS No. 21. The most substantial update in years for accountants who prepare and present financial statements to their clients or to third parties was issued in October by the AICPA Accounting and Review Services Committee.

The changes are contained in Statement on Standards for Accounting and Review Services (SSARS) No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*.

The standard eliminates submission to management as the trigger for a compilation service, instead requiring a compilation to be performed when the accountant is engaged to perform a compilation service.

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This change is designed to eliminate diversity in practice that has occurred as a result of technological changes that have made the concept of “submission” as envisioned in SSARS No. 1 in 1978 almost archaic.

SSARS No. 21 also creates a bright line between accounting services (preparation) and reporting services (compilation or review). The standard requires a report for all compilation engagements, and the standard report consists of just one paragraph with no headings. SSARS No. 21 is effective for reviews, compilations, and engagements to prepare financial statements for periods ending on or after Dec. 15, 2015; however, early adoption is permitted.

8. **Going concern.** The responsibility for deciding whether there is doubt about an entity’s ability to continue as a going concern has been largely in the domain of auditors, with the notable exception of state and local government reporting, as going-concern responsibilities were incorporated into GASB’s standards with the issuance in 2009 of GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*.

But in August, FASB issued a standard describing management’s responsibilities related to going concern. The new accounting standard requires management to make an evaluation in every reporting period, including interim periods, about the entity’s ability to continue as a going concern over a period of one year after the date that the financial statements are issued, or are available to be issued. If management identifies substantial doubt for that period about an entity’s ability to continue as a going concern, management is required to consider whether its plans will alleviate the substantial doubt.

If the plans will alleviate that substantial doubt, management will be required to make certain disclosures. If the substantial doubt will not be alleviated, management will be required to include a statement in the footnotes indicating that there is a substantial doubt about the entity’s ability to continue as a going concern within one year after the financial statements are issued or are available to be issued, as well as to make certain other disclosures.

FASB’s standard takes effect in annual periods ending after Dec. 15, 2016, and interim periods within annual periods beginning after Dec. 15, 2016. Early application is permitted.

Meanwhile, auditors’ responsibilities are expected to evolve in response to the new management requirements. The PCAOB is contemplating changes that would align its standards with FASB’s, and the AICPA Auditing Standards Board has issued auditing interpretations to address some of the consequential effects of the new FASB accounting standard (see tinyurl.com/n5k3366) and plans a more comprehensive project to align its requirements in AU-C Section 570 with various accounting and auditing standards. ❖

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AICPA RESOURCES

More information on these topics is available in the following *JofA* articles:

Revenue recognition

- “Revenue Recognition Implementation: What Are FASB’s Plans?” Jan. 27, 2015, tinyurl.com/lineoz6s
- “Keep Pushing Forward on Revenue Recognition Implementation, Experts Say,” Dec. 10, 2014, tinyurl.com/kntjk7g
- “FASB Considering Revenue Recognition Delay to Reduce Uncertainty,” Dec. 9, 2014, tinyurl.com/nsvplx6
- “Do Preparers Have Answers to Revenue Recognition Questions?” Dec. 8, 2014, tinyurl.com/qefv6y9
- “Revenue Recognition: No Time to Wait,” July 2014, page 40

Alternatives for private companies

- “FASB Issues Private Company Alternative for Certain Intangible Assets,” Dec. 23, 2014, tinyurl.com/kz4uwux
- “FASB Issues Private Company VIE Alternative,” March 20, 2014, tinyurl.com/lzr7oqb
- “Private-Company GAAP Alternatives Could Unlock Savings,” Jan. 16, 2014, tinyurl.com/jwxnsc

Simplification initiative

- “No More Extraordinary Items: FASB Simplifies GAAP,” Jan. 13, 2015, tinyurl.com/lyumns9
- “Reducing Unnecessary Complexity Remains a Key Focus of FASB,” Oct. 21, 2014, tinyurl.com/kxrzsho

Pensions in state and local government reporting

- “GASB Pension Changes: Are You Ready?” Jan. 2015, page 48

Internal control over financial reporting

- “How to Use COSO to Assess IT Controls,” May 2014, page 34
- “Checklist: Put COSO Update to Work,” July 2013, page 20

Lease accounting

- “GASB Gives Preliminary Views on Leases, Fiduciary Responsibilities,” Nov. 20, 2014, tinyurl.com/mp4hwx2
- “Boards Remain Split on Lease Expense Recognition,” March 19, 2014, tinyurl.com/oqobggh

SSARS No. 21

- “A Bright Line in SSARSs,” Dec. 2014, page 32
- “How SSARS No. 21 Became a Standard,” Oct. 28, 2014, tinyurl.com/lra9ftn

Going concern

- “ASB Issues Auditing Interpretations to SAS No. 126 on Going Concern,” Jan. 23, 2015, tinyurl.com/pz92ho7
- “PCAOB to Seek Comments on Going Concern,” Jan. 9, 2015, tinyurl.com/k474ast
- “FASB Defines Management’s Going-Concern Responsibilities,” Aug. 27, 2014, tinyurl.com/q9vnet2

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