

New SAS 134, Auditor Opinions on Financial Statements: Additional Disclosure and Reporting Requirements

TUESDAY, OCTOBER 29, 2019, 1:00-2:50 pm Eastern

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New SAS 134, Auditor Opinions on Financial Statements: Additional Disclosure and Reporting Requirements

October 29, 2019

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New SAS 134, Auditor Opinions on Financial Statements: Additional Disclosure and Reporting Requirements

Topics that will be covered

- ▶ Outline of SAS 134
- ▶ New Basis of Opinion section
- ▶ Essential matters to communicate to the audit committee
- ▶ Key audit matters
- ▶ Auditor concerns of ability of the entity to continue as an ongoing concern
- ▶ Suggested reporting formats
- ▶ Implementation timetable

Overview

- ▶ In May 2019, the AICPA Auditing Standards Board (ASB) issued, Statement on Auditing Standards (SAS) No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements* as a final standard.
- ▶ It will benefit users of audited financial statements by placing the auditor's opinion at the front of the report for added visibility and providing necessary transparency into the basis for the auditor's opinion and the responsibilities of both entity's management and auditors.
- ▶ It replaces AU-C sections 700, 705 and 706 and introduces a new section 701.
- ▶ It is effective for audits of financial statements for periods ending on or after December 15, 2020.
- ▶ Early implementation is not permitted.

AU-C 700 Forming an Opinion and Reporting on Financial Statements

► What is changing?

- Opinion section required to be presented first, followed by the Basis for Opinion section.
- Basis for Opinion section required to follow the opinion section, including a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit. (AU-C 700.28)
- Enhanced auditor reporting relating to going concern, including a description of the respective responsibilities of management when required by the applicable financial reporting framework, and the auditor for going concern. (AU-C 700.29, 700.32b)
- Expanded description of the auditor's responsibilities, including the auditor's responsibilities relating to professional judgment and professional skepticism, and the auditor's communications with those charged with governance. (AU-C 700.34-700.40)

AU-700 Example of new auditor's report format

► ***Excerpt from Illustration-1***

An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

AU-700 Example of new auditor's report format (continued)

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

AU-700 Example of new auditor's report format (continued)

Auditor's Responsibilities for the Audit of the Financial Statements

Our 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 an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

AU-700 Example of new auditor's report format (continued)

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

AU-C 701 Key audit matters

Objective of the standard

Effective for audits of financial statements for periods ending on or after 15 December 2020. Early implementation is not permitted.

Key audit matters

- ▶ Communicated to those charged with governance
- ▶ Related to accounts or disclosures that are material to financial statements
- ▶ Involved especially challenging, subjective or complex auditor judgment, considering:
 - ▶ Risks of material misstatement, including significant risks
 - ▶ Degree of auditor subjectivity and judgment
 - ▶ Nature and timing of significant unusual transactions
 - ▶ Nature and extent of audit effort and nature of evidence
- ▶ Auditor's report will identify the key audit matters and include:
 - ▶ Reference to where the matter is disclosed in the financial statements
 - ▶ Why the matter was considered to be one of most significance in the audit
 - ▶ Description of how matters were addressed in the audit

AU-C 701 Key audit matters

Determining key audit matters

- ▶ Considerations in determining those matters that required significant auditor attention
 - ▶ Matters communicated with those charged with governance
 - ▶ Areas of higher assessed risk of material misstatement, or significant risk
 - ▶ Areas of significant auditor judgements
 - ▶ Significant events or transactions that occurred during the period
- ▶ Matters of most significance
 - ▶ Nature and extent of communications with those charged with governance
 - ▶ Importance of matters to intended users' understanding of financial statements
 - ▶ Nature and extent of audit effort
 - ▶ Specialized skill or knowledge
 - ▶ Consultations outside engagement team
 - ▶ Difficulty in applying audit procedures
 - ▶ Severity of control deficiencies

AU-C 701 Key audit matters

Communicating key audit matters

- ▶ Presentation in the auditor's report
 - ▶ Separate "Key Audit Matters" section in the auditor's report
 - ▶ Introductory language in this section should state the following:
 - ▶ *Key audit matters are those matters that were communicated with those charged with governance and, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.*
 - ▶ *These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.*
- ▶ Descriptions of individual key audit matters
 - ▶ Reference to related disclosures
 - ▶ Why the matter was considered to be one of most significance
 - ▶ How the matter was addressed in the audit

AU-C 701 Key audit matters

Communicating key audit matters

► Other key considerations

- Key audit matters not a substitute for expressing a modified opinion
- Circumstances in which a matter determined to be a key audit matter is not communicated in the auditor's report
- Interaction between descriptions of key audit matters and other elements required to be included in the auditor's report
- Form and content of the key audit matters section in other circumstances
- Communication with those charged with governance
- Audit documentation considerations
 - Rationale for whether or not each matter is a key audit matter
 - Rationale for why there are no key audit matters identified
 - Rationale for not communicating in the auditor's report

AU-C 705 Modifications to the opinion of the independent auditor's report

- ▶ What has changed?
 - ▶ Aligns the form and content of the auditor's report with the changes in section 700 of SAS 134
 - ▶ Auditor's report format
 - ▶ Opinion is presented first followed by basis for modified opinion
 - ▶ New information within basis for modified opinion section
 - ▶ Disclaimer of opinion affect on auditor's responsibilities section
 - ▶ Key audit matters considerations for modified opinions
 - ▶ Precluded from communicating when disclaiming an opinion
 - ▶ Precluded from communicating when issuing adverse opinion
 - ▶ When engaged to do so, required to communicate for qualified opinions
- ▶ What has not changed?
 - ▶ Circumstances in which a modification is required
 - ▶ Type of modification to the auditor's opinion

AU-C 705 Modifications to the opinion of the independent auditor's report

An auditor's report containing a qualified opinion due to a material misstatement of the financial statements

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

ABC Company has stated inventories at cost in the accompanying balance sheets. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write down of \$XXX and \$XXX would have been required as of December 31, 20X1 and 20X0, respectively. Accordingly, cost of sales would have been increased by \$XXX and \$XXX, and net income, income taxes, and stockholders' equity would have been reduced by \$XXX, \$XXX, and \$XXX, and \$XXX, \$XXX, and \$XXX, as of and for the years ended December 31, 20X1 and 20X0, respectively.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

AU-C 705 Modifications to the opinion of the independent auditor's report

Auditor's Responsibilities for the Audit of the Financial Statements

Our 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 an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

In performing an audit in accordance with GAAS, we:

- *Exercise professional judgment and maintain professional skepticism throughout the audit.*
- *Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.*
- *Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed*
- *Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.*
- *Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.*

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

AU-C 706 Emphasis-of-matter paragraphs and other-matter paragraphs in the independent auditor's report

- ▶ Requirements have remained unchanged
- ▶ Addresses relationship between key audit matters and any additional communication in the auditor's report
 - ▶ Not a substitute for a description of individual key audit matters
- ▶ Other-matter paragraphs
 - ▶ Considerations when AU-C 701 applies
- ▶ Communication with those charged with governance
- ▶ Placement of paragraphs in auditor's report
 - ▶ Emphasis-of-matter
 - ▶ When AU-C 701 applies, may be presented either directly before or after the "Key Audit Matters" section
 - ▶ Based on auditor's judgment
 - ▶ Other-matter
 - ▶ May add further context to the heading
 - ▶ May be included in the section "Report on Other Legal and Regulatory Requirements"

Amendments to auditing standards

- ▶ AU-C Section 260, *The Auditor's Communication With Those Charged With Governance*
 - ▶ New requirement to communicate significant risks identified by the auditor
 - ▶ Circumstances that affect the form and content of the auditor's report
 - ▶ Communication of Key Audit Matters
 - ▶ Other matters regarding the planned scope and timing of the audit
- ▶ AU-C Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
 - ▶ Will draw attention to management's disclosure in the financial statements
 - ▶ Should be included as a separate section in the auditor's report
 - ▶ Updated requirements for what the paragraph should address
 - ▶ What to include in the auditor's report when there is inadequate disclosure by the entity in the financial statements

Amendments to auditing standards (continued)

- ▶ AU-C Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*

- ▶ Auditor's report presentation
 - ▶ Immediately after the basis for opinion

Substantial Doubt About the Company's Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

- ▶ Presentation when substantial doubt has been alleviated

Emphasis-of-Matter

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.

Amendments to auditing standards (continued)

- ▶ Focus auditor attention on disclosures
 - ▶ AU-C Section 300, *Planning an Audit*
 - ▶ AU-C Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements*
 - ▶ AU-C Section 320, *Materiality in Planning and Performing an Audit*
 - ▶ AU-C Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
 - ▶ AU-C Section 450, *Evaluation of Misstatements Identified During the Audit*
- ▶ Incorporates language for Key Audit Matters (AU-C Section 701)
 - ▶ AU-C Section 510, *Opening Balances-Initial Audit Engagements, Including Reaudit Engagements*
 - ▶ AU-C Section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
- ▶ Incorporates changes in the form and content of the auditor's report (AU-C Section 700)
 - ▶ AU-C Section 600, *Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)*

Amendments to auditing standards (continued)

- ▶ Incorporates changes in the form and content of the auditor's report (AU-C Section 700)
 - ▶ AU-C Section 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*
- ▶ AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*
 - ▶ *Update to definition of financial statements to include additional language around disclosures*
- ▶ AU-C Section 210, *Terms of Engagement*
 - ▶ *Updates to the engagement letter, including management responsibilities, the auditor's responsibilities, and inclusion of key audit matters*
- ▶ AU-C Section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*
 - ▶ *Updates to application guidance related to the engagement quality control reviewer responsibility over key audit matters*

Amendments to auditing standards (continued)

- ▶ AU-C Section 230, *Audit Documentation*
 - ▶ *Updates to include specific documentation requirements related to using the work of internal auditors and communicating key audit matters*
- ▶ AU-C Section 240, *Consideration of Fraud in a Financial Statement Audit*
 - ▶ *Updates to include the consideration of the risk that management may omit, obscure, or misstate disclosures*

Summary

- ▶ The standard is effective for audits of financial statements for periods ending on or after December 15, 2020.
- ▶ Early implementation is not permitted.
- ▶ Replacing existing AU-C sections 700, 705 and 706
- ▶ Introducing a new AU-C section 701
- ▶ Changes in the form and content of the auditor's report
- ▶ Increase the informational value and relevance of auditor's report
- ▶ Auditor's will be required to:
 - ▶ Present the "Opinion" section first in their reports, followed by the "Basis for Opinion" section,
 - ▶ More clearly articulate management's responsibilities for the financial statements and the auditor's responsibilities for the audit.
- ▶ The standard requires the auditor to make certain new communications to those charged with governance, including communicating significant risks the auditor identifies.