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THE PPC
ACCOUNTING AND AUDITING UPDATE

AUGUST 2021, VOLUME 30, NO. 8

FASB Seeks Feedback on Future Standard Setting

The FASB staff issued an Invitation to Comment (ITC) on June 24, 2021, to request feedback about its future standard-setting agenda.

In December 2020, the FASB's new Chair, Richard Jones, announced a 2021 agenda consultation process to help the Board decide how best to allocate resources, including whether current agenda projects should still be a priority and whether additional topics should be added and in what order. The FASB met with over 200 stakeholders in the first half of 2021 from public companies, private companies, and not-for-profits and identified over 40 areas for potential improvement.

This initial feedback generally fell into one of the following categories:

- **Disaggregation of Financial Reporting Information.** Provide more useful and granular information for decision-making on the face of the financial statements or in notes. Examples include operating expenses; income taxes; business combinations; environmental, social and governance matters; equity investments; and foreign currencies.
- **Emerging Areas in Financial Reporting.** Consider emerging transactions where there is no specific accounting or disclosure guidance in GAAP to reduce diversity in practice. Topics include digital assets, derivatives, ESG transactions, intangibles, and government grants.
- **Reduction of Unnecessary Complexity in Current GAAP.** Reevaluate specific areas that are unnecessarily complex and costly. These include consolidation, distinguishing liabilities from equity, and determining materiality for disclosures.
- **Improvement to FASB Processes.** Increase transparency and education about standard setting, including FASB's cost-benefit analysis for proposed GAAP changes. Additional topics include making the Codification easier to search and navigate and simplifying transition requirements for accounting changes.

The discussions included within the ITC are based on input received in the stakeholder meetings. The FASB requested comments on the ITC by September 22. The ITC and agenda consultation

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process are in addition to the FASB's existing agenda request process, where stakeholders can submit agenda requests for consideration.

Practical Consideration:

The ITC is available on the FASB's website at **www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176176828145&acceptedDisclaimer=true** .

Peer Review Board Releases Examples of Matters in Peer Reviews

The AICPA Peer Review Board issued *Examples of Matters in Peer Reviews, Engagements with Year-Ends between 1/1/2019 and 4/1/2020* early this year. The examples come from matters for further consideration (MFCs) prepared during peer reviews and are intended to help firms improve quality.

The examples are in two categories—

1. Professional standards, which includes FASB and AICPA standards (audit, accounting and review, attest, code of professional conduct, and quality control).
2. Practice areas (PCAOB, not-for-profit, banking, broker-dealers, governmental, ERISA, and SOC reports).

Following are highlights of some of the matters noted.

Professional Standards

Clarified Auditing Standards. Failures to—

- Document planning procedures.
- Support and document assessed level of risk.
- Address fraud.
- Include sufficient audit documentation.
- Follow established quality control policies and procedures.
- Obtain management representation letters.
- Communicate with those charged with governance.

Compilations. Failures to—

- Prepare reports conforming to current professional standards.
- Obtain engagement letters containing all required elements.

Reviews. Failures to—

- Prepare reports conforming to current professional standards.
- Obtain engagement letters and management representation letters containing all required elements.
- Document analytical procedure expectations or the comparison of recorded amounts to expectations.

Code of Professional Conduct. Failures to—

- Establish and document understanding with clients regarding nonattest services provided.
- Address management's responsibilities for overseeing and evaluating results of services performed.

Statements on Quality Control. Failures in—

- Firm leadership responsibilities for quality, including documentation of EQCR and monitoring.
- Firm resources and training in quality control policies and standards.
- Engagement performance, including proper use of practice aids and performing EQCR.

FASB Codification. Failures to—

- Disclose omissions in areas such as goodwill, operating leases, inventory, capital stock, fair value, pensions, income taxes, and subsequent events.
- Properly present cash flow statements.
- Correctly implement FASB ASC 606.

Practice Areas

PCAOB. Failures to—

- Properly document independence, sampling, and risk assessment.

Not-for-profit. Failures in—

- Knowledge of current standards and training.
- Documenting independence considerations and SKE assessments for nonattest services.
- Documenting walk through procedures and risk assessments.
- Including all required elements in engagement letters and management representation letters.

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The PPC Technology Update

by Roman H. Kepczyk, CPA.CITP, CGMA

Summer Assurance Tune Up

When grinding through busy times, it's easy to fall back into comfortable work patterns to "just get the work out the door," as opposed to adopting and working through transformative changes that will make your practice more effective in the long run. Summer-time is an ideal time for stepping back, re-evaluating and re-invigorating your processes beyond the application implementation and training that most firms focus on. Below we target nine areas to tune up your practice by bringing them to front of mind and discussing them with your team today!

- **Remote Focus.** One of the continuing remnants of COVID-19 will be the acceptance of remote audit work. Stay-at-home orders forced nonessential businesses to have employees work from home. This remote work environment pointed out that an entire engagement team doesn't need to be at the client's site every day in order to complete work successfully. Only those individuals who are performing tasks better performed in person, such as physical inventories, need to be scheduled on site. Microsoft Teams/Zoom calls should be set up daily, weekly, or biweekly, as appropriate, and at key points during the engagement with appropriate team members to monitor progress and discuss issues.
- **Hybrid Collaboration.** Audit progress often suffers when key people aren't available to respond to or approve information. Prescheduling Microsoft Teams/Zoom meetings as part of the planning process helps eliminate time conflicts and allows onsite and remote personnel to work collaboratively. All members should be fluent in sharing screens, real-time editing, and inviting clients and other firm members to participate on the fly.
- **Formalize Planning.** "If you don't have time to do it right the first time, when will you have time?" Unfortunately, this is reality for many assurance practices during busy times and one of the reasons that audits have inefficiencies. A lack of comprehensive planning involving all team members and the client leads to falling back to "same as last year" thinking, usually resulting in over-auditing in noncritical areas. Formalize the audit planning process to ensure all team members are present (physically or virtually), understand the scope and risks inherent in the engagement, and their roles in getting the work done. Start each engagement by targeting the most difficult/complex items first (to ensure thorough coverage) and leave the easier, more transactional items for later. Formally, do some of the planning of similar engagements concurrently to leverage firm expertise and expand auditor knowledge within targeted niches.
- **Schedule Down Days.** Too often firms schedule engagements back-to-back only to find one setback cascades into an ongoing string of impacted engagements, late nights, and long weekends spent trying to recover. Proactively scheduling down days strategically interspersed between engagements allows for proper wrap ups and preparation for future engagements as well as reduces auditor burnout.
- **Client Responsibilities.** Clients not being prepared is one of the most cited reasons for audit schedules falling behind. Client meetings should discuss the agreed-upon listing of files to be provided by the client, including backups of entire accounting databases to be used for data extraction and analysis. There should also be agreement on the method of delivery (portal), and the specific date the firm must have possession to begin the engagement (i.e. one week before commencement). Firms should utilize a workflow tool or portal with workflow capabilities to apprise the auditors and client of their status in meeting deadlines, as well as using automated reminders to keep the client on track.

- **Client Consequences.** Are clients really aware of the consequences when they aren't ready? Audit team members should participate in client planning calls to not only introduce themselves to the client, but to also to ensure the client is aware of the consequences if they don't meet their obligation to be ready. Clients must be made aware that if they don't meet their due dates they will be responsible for the delay in the start of the engagement and the resulting delay in the delivery of the financial report. If there is additional work required beyond the scope of the engagement letter, the client must acknowledge that they are responsible for paying for this additional work with a change order.

- **Application Training.** Summer conferences and A&A meetings allow team members to attend update sessions on the firm's key applications, including audit work program automation, modern portals, electronic signature, data extraction and analysis, and to pilot potential solutions. Firms should proactively expand training to include written and video documentation to permanently capture new capabilities. This not only protects the knowledge in the event the firm's application expert leaves, but also promotes accountability for everyone to adhere to firm standards.

- **Field Equipment.** Are you bringing out the necessary tools for fieldwork? The majority of auditors today carry a laptop, a mobile monitor, and internet access via digital cellular access through their smartphone or standalone hotspot. According to the latest CPAFMA Digitally Driven Firm survey, a significant percentage of auditors are still carrying scanners (and some, even printers) into the field. Mandating the use of a portal or secure email solution in the initial engagement letter (and providing training for the client to utilize these tools) eliminates the need for printers, scanners, and even USB flash drives (which should be immediately disallowed due to cybersecurity risks).

- **Advisory Opportunities.** One of the most effective ways to grow the firm's advisory services is to identify opportunities with existing clients that already trust the firm. Schedule client debrief meetings after completing each engagement and task each member with identifying two or three areas of opportunity where the firm can provide advisory services to improve the client's business. Notify the client about these opportunities during report delivery and then schedule time on their calendar to specifically discuss the most compelling items in the near future.

The summer lull is the perfect time to take a break and re-tool audit processes, taking advantage of not only the technology components of the practice but the strategic management components as well.

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Banking. Failures to—

- Comply with independence rules.
- Include all required elements in reports on internal controls.
- Disclose loan servicing fees, allowance for loan losses and impaired loans.

Practical Consideration:

The full text of the *Examples of Matters in Peer Reviews, Engagements with Year-Ends between 1/1/2019 and 4/1/2020* document can be downloaded from the AICPA's website at **www.aicpa.org/content/dam/aicpa/interestareas/peer-review/community/peerreviewers/downloadabledocuments/matters-in-pr.pdf.**

FASB Clarifies Accounting for Modifications or Exchanges of Equity-classified Written Call Options

FASB issued ASU 2021-04, *Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options—a consensus of the FASB Emerging Issues Task Force*, in May 2021. It addresses stakeholder concerns and provides specific accounting guidance to reduce diversity in practice in accounting for modifications or exchanges of instruments, like warrants, that continue to be classified as equity after a modification or exchange transaction.

The amendments apply to all entities that issue freestanding written call options classified as equity and that remain equity-classified after they are modified or exchanged. The amendments don't affect the accounting for freestanding call options by the holder or the modifications or exchanges of financial instruments in the scope of other topics.

The modification of the terms or conditions or an exchange of a freestanding written call option that is equity-classified and remains equity-classified after its modification or exchange should be treated as an exchange of the original instrument for a new instrument. The amendments apply whether a modification is executed by amending an existing instrument or replacing it with a new one. The ASU provides a principles-based framework and indicates all relevant circumstances of the transaction should be considered to determine whether it's related to a financing or other arrangement and whether it falls within the scope of another topic. If ASU 2021-04 applies, the transaction is recognized in the same manner as if cash had been paid, as follows:

- In a financing transaction to raise equity, equity issuance cost should be recognized under Topic 340, *Other Assets and Deferred Costs*. An example would be the reduction of the exercise price of warrants for a period of time to induce the holders to exercise them.
- In a financing transaction to issue or modify debt, the debt issuance cost or debt discount should be recognized under Topic 470, *Debt*, and Topic 835, *Interest*.
- If the transaction includes both debt and equity financing, the modification effect should be allocated to the respective elements.
- In a transaction to compensate for transferring goods or services, the cost should be recognized under Topic 718, *Stock Compensation*. An example would be the reduction of the exercise price of warrants as consideration for services received from the holder of the warrants. However, the amendments don't apply to modifications or exchanges to compensate grantees in a share-based payment arrangement.
- In other transactions not related to financings or compensation, the cost (change in fair value) should be recognized as a dividend. An example would be extending the term of outstanding warrants held by a nonemployee investor where there are no other contemporaneous transactions involved.
- For entities that present earnings per share under Topic 260, where modifications or exchanges of freestanding equity-classified written call options are recognized as dividends, the dividends are adjustments to net income or net loss available to common stockholders when calculating basic earnings per share.

If the modification or exchange is part of, or directly related to, a modification or exchange of an existing debt instrument or line-of-credit or revolving debt arrangement, the effect of the modification or exchange should be measured as the difference between the fair value of the modified or exchanged option and the fair

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value of that option immediately before the modification or exchange. The guidance states that entities should include an increase or decrease in the fair value of the written call option when applying the 10 percent cash flow test and/or calculating fees paid and received between debtor and creditor under FASB ASC 470-50, and an increase (not a decrease) in the fair value of the written call option when calculating third-party costs under FASB ASC 470-50.

For all other modifications or exchanges, a modification or exchange should be measured as the excess, if any, of the fair value of the modified option over the fair value of that option immediately before the modification or exchange.

ASU 2021-04 requires additional disclosures about the nature and amount of the modification or exchange transaction and the manner in which it was recognized. In the period of adoption, the required disclosures under Topic 250 for accounting changes should be made.

The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2021. The amendments should be applied prospectively to transactions occurring on or after the effective date. Early application is permitted, including in an interim period. If adopted in an interim period, the amendments should be applied as of the beginning of the fiscal year that includes the interim period.

Practical Consideration:

ASU 2021-04 is available on the FASB's website at **www.fasb.org** and on Checkpoint at **checkpoint.riag.com**.