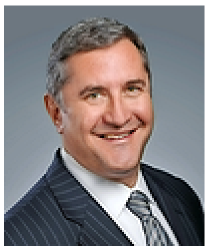
Auditing

Recent Developments in Auditor Guidance—PCAOB Form AP and Going Concern Considerations

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Since its earliest days, the audit profession has been in constant evolution. The expectations of auditors as gatekeepers and the increasing complexity of financial information lead regulators and governing agencies to periodically update audit rules over time. Two recent developments include the issuance of the Public Company Accounting Oversight Board's long-discussed Form AP and the PCAOB guidance, and American Institute of CPAs' proposed guidance, regarding the auditor's consideration of an entity's ability to continue as a going concern. Highlights and potential consequences of these developments are addressed below.

The PCAOB, whose rules apply to accounting firms performing audits of publicly traded companies, has been considering ways to increase financial statement audit transparency since 2009. One manifestation of that effort has been to provide information about key participants responsible for performing the audit. Throughout the six year-period it explored this guidance, the PCAOB weighed transparency considerations against potential costs to the audit profession, such as increased auditors' liability and litigation risk, confusion about the role of the firm in the audit, and additional administrative costs. Additionally, the PCAOB noted that 16 out of the 20 countries with the largest market capitalization already require disclosure of the name of the engagement partner in the auditor's report.

Finally, in December 2015, the PCAOB issued Release No. 2015-008, *Improving The Transparency Of Audits: Rules To Require Disclosure Of Certain Audit Participants On A New PCAOB Form And Related Amendments To Auditing Standards*, which was approved by the Securities and Exchange Commission in May 2016. With respect to disclosure of the engagement partner, Release No. 2015-008 is effective for audit reports issued on or after Jan. 31, 2017, while the disclosure of other accounting firms participating in the audit is effective for audit reports issued on or after June 30, 2017—with the later date providing firms time to develop a methodology to gather pertinent information regarding participation. Under the new guidance, accounting firms issuing an audit report on the financial statements of publicly traded entities will be required to disclose the following on a newly created Form AP:

- The name of the engagement partner; and
- For other accounting firms participating in the audit with:
    - greater than or equal to five percent participation: the name, city and state (or, if outside the United States, the country and city), and the percentage of total audit hours attributable to each other accounting firm whose participation in the audit was at least five percent of total audit hours; and
    - less than five percent participation: the number of other accounting firms that participated in the audit whose individual participation was less than five percent of total audit hours, and the aggregate percentage of total audit hours of such firms.

Form AP is generally required to be filed within 35 days after the date the auditor's report is first included in a document filed with the SEC. In Initial Public Offering (IPO) situations, Form AP is required to be filed within 10 days after the date the auditor's report is first included in a document filed with the SEC.

The disclosures on Form AP will provide users of financial statements visibility into those charged with leading the audit, the reporting audit firm's use of other accounting firms with significant participation, and the extent to which the audit's total hours are divided between other accounting firms. Over time, a database of Form AP information may be valuable to investors and other stakeholders in understanding the past performance of engagement partners and audit firms in the performance of audits across clients and industries—especially noting their involvement in any deficient audits in the past. It is anticipated that the disclosures added on Form AP will increase auditors' sense of accountability, and perhaps a heightened level of care in connection with the review, supervision and oversight of the audit. PCAOB Release No. 2015-008 requires audit partners to report their name consistently on all Forms AP filed with the PCAOB, as well as a 10-digit ID number which is to be assigned by each audit firm, to the partner. Such requirements provide integrity to the Form AP reporting process, and look to stem issues in partner name changes under common circumstances (i.e., marriage).

Another development in the audit community involves the consideration of an entity's ability to continue as a going concern.

In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*, which is effective for annual periods ending after Dec. 15, 2016. This standard requires management to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for up to one year from the date the financial statements are issued. If management determines that substantial doubt exists, appropriate disclosures should be made in the footnotes to the financial statements, including whether the factors raising substantial doubt have been alleviated.

As ASU 2014-15 is effective for 2016 calendar year-end entities, auditors will need to asses a client's application of this new standard during the current busy season. Following the issuance of this ASU, in September 2014 the PCAOB issued Staff Audit Practice Alert No. 13, *Matters Related to the Auditor's Consideration of a Company's Ability to Continue as a Going Concern*. Practice Alert No. 13 essentially reminds auditors of publicly traded entities to continue following existing PCAOB standards when considering a company's ability to continue as a going concern. Needless to say, this may result in additional time being incurred during the audit, particularly where an entity has known going concern risk factors or is in an industry experiencing a high degree of bankruptcies.

On a related topic, in July 2016, the AICPA's Auditing Standards Board (ASB) issued its Exposure Draft seeking comment on the Proposed Statement on Auditing Standards, *The Auditor's*

Consideration of an Entity's Ability to Continue as a Going Concern (the “Proposed SAS”). The most significant proposed changes from current standards is whether existing going concern guidance should be applicable in connection with audits of single financial statements and specific elements, accounts or items of a financial statement. The comment period ended Sept. 5, 2016. Although the ASB has not yet publicly addressed feedback it received, a view shared by a number of firms was the challenge to provide users information regarding an entity's ability to continue as a going concern when only a single financial statement or accounts, elements or items thereof are being audited, due to the nature of audit procedures not being designed to address such issues. The concept of “substantial doubt” regarding an entity's ability to continue as a going concern is relevant to users of a complete set of financial statements, whereas single financial statements are narrower in focus and not necessarily intended to provide users that pervasive a view. Auditors would need to significantly expand scope (and likely fees) well beyond the procedures generally considered necessary under the circumstances in order to evaluate an entity's ability to continue as a going concern. In summary, a common recommendation was that audits of single financial statements and accounts, elements or items thereof, not be included under the Proposed SAS.

As noted above, the audit profession is constantly evolving to meet the needs of its stakeholders in the ever-changing landscape of financial information. Form AP will be required for reports issued on or after Jan. 31, 2017. We will wait to see how the ASB reacts to comments it received on its Proposed SAS. The impact of these rules and discussions will likely impact the audit community for years to come.

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