Agenda Item 3

Discussion Memorandum: Review Engagement Guidance

Objective of Agenda Item

To discuss whether guidance should be developed and issued to address recently disseminated new accounting standards on revenue recognition, leases, financial instruments, and credit losses (ASUs 2014-09[1], 2016-02[2], 2016-01[3], and 2016-13[4], as amended), among others.

Background

The Financial Accounting Standards Board (FASB) has been active with respect to accounting standards setting over the past several years. Accountants performing review engagements on financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) often look to the AICPA Guide, *Preparation, Compilation, and Review Engagements* (the "2019 Guide") for guidance with respect to review procedures that the accountant can consider in obtaining limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for them to be in accordance with GAAP. Limited assurance is obtained primarily through the performance of analytical procedures and inquiries.

The ARSC is asked to consider whether any revisions are necessary to the authoritative guidance included in the Guide (which would be included in the 2019 update of the Guide) or if guidance should be developed and issued sooner.

Issues for ARSC Consideration

Overall Question for the ARSC

What are the ARSC members initial thoughts with respect to how the adoption of the aforementioned significant new accounting principles issued by the FASB might affect the performance of review engagements?

[1] ASU 2014-09 is available at https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176164076069&acceptedDisclaimer=true

[2] ASU 2016-02 is available at https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176167901010&acceptedDisclaimer=true

[3] ASU 2016-01 is available at https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176167762170&acceptedDisclaimer=true

[4] ASU 2016-13 is available at https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168232528&acceptedDisclaimer=true

The following represents the illustrative inquiries included in paragraph 1.144 of the 2019 Guide with respect to revenue:

1.144 The following list of inquiries is for illustrative purposes only. These inquiries will not necessarily be applicable in every review engagement, nor are these inquiries meant to be all-inclusive. These illustrative inquiries are not intended to serve as a program or checklist to be utilized in performing a review engagement; rather, they address general areas where inquiries might be made in a review engagement. Also, the accountant may believe that it is necessary to make several inquiries in an effort to obtain adequate responses related to the issues addressed in these illustrative inquiries. The specific inquiries to be made are ultimately determined by the accountant's professional judgment:

…

- Revenue and Expenses
  - — What is the entity's revenue recognition policy? How does management ensure that the policy is consistently applied and appropriately disclosed in the financial statements?
  - — How does management determine that revenues from sales of products and rendering of services are recognized in the appropriate reporting period (that is, when the products have been delivered and when the services have been performed)?
  - — For any sales recorded under a "bill and hold" arrangement, how did management determine that the criteria has been met to record the transaction as a sale?
  - — How does management determine that purchases and expenses are recognized in the appropriate reporting period (that is, matched against revenue) and properly classified in the financial statements?
  - — How are amounts associated with discontinued operations displayed in the income statement?
  - — How are gains or losses that would necessitate the display of comprehensive income (for example, gains or losses on available-for-sale securities or cash flow hedge derivatives displayed?

Question for the ARSC
Should additional guidance be developed with respect to obtaining review evidence regarding revenue recognition in light of ASU 2014-09? If so, in what form should that guidance take (an update to the illustrative inquiries in the Guide or other)?

The following represents the illustrative inquiries included in paragraph 1.144 of the 2019 Guide with respect to property and equipment:

- Property and Equipment

  - What is the entity's capitalization policy? What is management's process for ensuring that such criteria has been consistently and appropriately applied? How does management ensure that property and equipment items are properly stated at depreciated cost or other proper value?

  - When was the last time a physical inventory of property and equipment was taken?

  - What is management's process for determining that all items reflected in property and equipment are held for use?

  - What are management's procedures to ensure that gains or losses on disposal of property and equipment have been properly reflected in the financial statements?

  - What is management's process for ensuring that repairs and maintenance costs are properly reflected as an expense in the income statement?

  - What depreciation methods and rates are utilized in the financial statements? What is management's process for determining that those methods and rates are appropriate and applied on a consistent basis?

  - What is management's procedures to ensure that there are no unrecorded additions, retirements, abandonments, sales, or trade-ins?

  - Describe any fully depreciated assets still in service.

  - What is management's process for determining whether material lease agreements have been properly evaluated for financial statement presentation purposes?

  - What is management's process for determining the proper recording of asset retirement obligations associated with tangible long-lived assets

  - How does management ensure that all components of cost associated with property and equipment items constructed by the entity have been reflected in measuring these items for purposes of financial statement presentation including, but not limited to, capitalized interest?

  - Describe any significant impairment in value of property and equipment items and how any impairment loss been reflected in the financial statements.

  - How are property and equipment items which are mortgaged or otherwise encumbered disclosed in the financial statements?

Question for the ARSC
Should additional guidance be developed with respect to obtaining review evidence regarding property and equipment in light of ASU 2016-02? If so, in what form should that guidance take (an update to the illustrative inquiries in the Guide or other)?

Written Representations
The illustrative representation letter from the Guide is included as an Exhibit to this discussion memorandum. The illustrative engagement letter is the same as that included in AR-C section 90.

In addition, the following examples of representations are included in paragraph 1.159 of the Guide:

1.159 The specific written representations obtained will depend on the circumstances of the engagement and the nature and basis of presentation of the financial statements. The following are examples of conditions (and the resultant representation) of which the accountant may become aware during the review engagement:

General	
Condition	***Illustrative Examples***
The effect of a new accounting principle is not known.	We have not completed the process of evaluating the impact that will result from adopting FASB Accounting Standards Update (ASU) No. [*20X1-XX*], as discussed in note X. The company is therefore unable to disclose the impact that adopting FASB ASU No. [*20X1-XX*] will have on its financial position and the results of operations when such statement is adopted.
Justification exists for a change in accounting principles.	We believe that [describe the newly adopted accounting principle] is preferable to [describe the former accounting principle] because [describe management's justification for the change in accounting principles].
The accountant believes that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time.	We have appropriately disclosed a description of management's plans that are intended to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and the

	probability that those plans will be adequately implemented. Note X to the financial statements discloses all of the matters of which we are aware that are relevant to the company's ability to continue as a going concern for a reasonable period of time, including principal conditions or events and management's plans.
The possibility exists that the value of specific significant long-lived assets or certain identifiable intangibles may be impaired.	We have reviewed long-lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable and have appropriately recorded the adjustment.
The entity has a variable interest in another entity.	Variable interest entities (VIEs) and potential VIEs and transactions with VIEs and potential VIEs have been properly recorded and disclosed in the financial statements in accordance with accounting principles generally accepted in the United States of America. We have considered both implicit and explicit variable interests in (*a*) determining whether potential VIEs should be considered VIEs, (*b*) calculating expected losses and residual returns, and (*c*) determining which party, if any, is the primary beneficiary. We have provided you with lists of all identified variable interests in (*a*) VIEs, (*b*) potential VIEs that we considered but judged not to be VIEs, and (*c*) entities that were afforded the scope exceptions of FASB *Accounting Standards Codification* (ASC) 810, *Consolidation*. We have advised you of all transactions with identified VIEs, potential VIEs, or entities afforded the scope exceptions of FASB ASC 810. We have made available all relevant information about financial interests and contractual arrangements with related

	parties, de facto agents, and other entities, including but not limited to, their governing documents, equity and debt instruments, contracts, leases, guarantee arrangements, and other financial contracts and arrangements. The information we provided about financial interests and contractual arrangements with related parties, de facto agents, and other entities includes information about all transactions, unwritten understandings, agreement modifications, and written and oral side agreements. Our computations of expected losses and expected residual returns of entities that are VIEs and potential VIEs are based on the best information available and include all reasonably possible outcomes. Regarding entities in which the company has variable interests (implicit and explicit), we have provided all information about events and changes in circumstances that could potentially cause reconsideration about whether the entities are VIEs or whether the company is the primary beneficiary or has a significant variable interest in the entity. We have made and continue to make exhaustive efforts to obtain information about entities in which the company has an implicit or explicit interest, but that were excluded from complete analysis under FASB ASC 810 due to lack of essential information to determine one or more of the following: • Whether the entity is a VIE. • Whether the company is the primary beneficiary. • The accounting required to consolidate the entity.

The work of a specialist has been used by the entity.	We agree with the findings of specialists in evaluating the [describe assertion] and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on the independence or objectivity of the specialists.
Supplementary information is required.	We are responsible for the fair presentation of the additional information [supplemental schedules] accompanying the basic [consolidated] financial statements that is [are] presented for the purpose of additional analysis of the basic [consolidated] financial statements.
Management has used accounting conventions.	We have disclosed to you the accounting conventions used when preparing our financial statements. The effect of applying these accounting conventions and the use of such applications is immaterial to the financial statements.
Financial statement misstatements in the current period relate to the prior period*[*s*]*.	We believe the effects of the uncorrected financial statement misstatements detected in the current [*specify period; for example*, year] that relate to the prior [*specify period; for example*, year] presented, when combined with those misstatements aggregated by you during the prior-[*specify period; for example*, year] review engagement and pertaining to the prior [*specify period; for example*, year] presented, are immaterial, both individually and in the aggregate, to the financial statements for the [*specify period(s); for example,* the year ended [*date*]] taken as a whole.

Assets	
Condition	***Illustrative Examples***

Cash Disclosure is required of compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements.	Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements have been properly disclosed.
Financial Instruments Management intends to and has the ability to hold to maturity debt securities classified as held to maturity.	Debt securities that have been classified as held to maturity have been so classified due to the company's intent to hold such securities to maturity and the company's ability to do so. All other debt securities have been classified as available for sale or trading.
Management considers the decline in value of debt or equity securities to be temporary.	We consider the decline in value of debt or equity securities classified as either available for sale or held to maturity to be temporary.
Management has determined the fair value of significant financial instruments that do not have readily determinable market values.	The methods and significant assumptions used to determine fair values of financial instruments are as follows: [*describe methods and significant assumptions used to determine fair values of financial instruments*]. The methods and significant assumptions used result in a measure of fair value appropriate for financial statement measurement and disclosure purposes.
Financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk exist.	The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the financial statements: 1. The extent, nature, and terms of financial instruments with off-balance-sheet risk 2. The amount of credit risk of financial instruments with off-balance-sheet risk and information about the collateral supporting such financial instruments

	3. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments
Receivables Receivables have been recorded in the financial statements.	Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance sheet date and have been appropriately reduced to their estimated net realizable value.
Inventories Excess or obsolete inventories exist.	Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value.
Investments Unusual considerations are involved in determining the application of equity accounting.	[For investments in common stock that are either nonmarketable or of which the entity has a 20 percent or greater ownership interest, select the appropriate representation from the following:] • The equity method is used to account for the company's investment in the common stock of [investee] because the company has the ability to exercise significant influence over the investee's operating and financial policies. • The cost method is used to account for the company's investment in the common stock of [investee] because the company does not have the ability to exercise significant influence over the investee's operating and financial policies.
Deferred Charges	

Material expenditures have been deferred.	We believe that all material expenditures that have been deferred to future periods will be recoverable.

Liabilities	
Condition	***Illustrative Examples***
Debt Short-term debt could be refinanced on a long-term basis and management intends to do so.	The company has excluded short-term obligations totaling $[amount] from current liabilities because it intends to refinance the obligations on a long-term basis. [Complete with appropriate wording detailing how amounts will be refinanced as follows:] The company has issued a long-term obligation [debt security] after the date of the balance sheet but prior to the issuance of the financial statements for the purpose of refinancing the short term obligations on a long term basis. The company has the ability to consummate the refinancing, by using the financing agreement referred to in note [X] to the financial statements.
Tax-exempt bonds have been issued.	Tax exempt bonds issued have retained their tax-exempt status.
Taxes Management intends to reinvest undistributed earnings of a foreign subsidiary.	We intend to reinvest the undistributed earnings of [name of foreign subsidiary].
Special tax status exists under Subchapter S.	The Company has claimed a special tax status under Subchapter S of the Internal Revenue Code. The Company has met all of the eligibility requirements, and the election remained in effect through [*the end of the review period*].
A deferred tax asset exists at the balance sheet date.	The valuation allowance has been determined pursuant to the provisions of FASB ASC 740, including the company's estimation of future taxable income, if necessary, and is adequate to reduce the total deferred tax asset to an amount that will more likely than not be realized.

	[Complete with appropriate wording detailing how the entity determined the valuation allowance against the deferred tax asset.] or A valuation allowance against deferred tax assets at the balance sheet date is not considered necessary because it is more likely than not that the deferred tax asset will be fully realized.
The entity does not have income tax contingencies.	We do not have (*a*) asserted and unsettled income tax contingencies or (*b*) unasserted income tax contingencies caused by uncertain tax positions taken in our income tax returns filed with the Internal Revenue Service and state, [and] local [, and foreign] tax authorities that are probable of assertion by such tax authorities under the provisions of FASB ASC 450, *Contingencies*. Furthermore, we have not received either written or oral tax opinions that are contrary to our assessment.
Contingencies Estimates and disclosures have been made of environmental remediation liabilities and related loss contingencies.	Provision has been made for any material loss that is probable from environmental remediation liabilities associated with [name of site]. We believe that such estimate is reasonable based on available information and that the liabilities and related loss contingencies and the expected outcome of uncertainties have been adequately described in the company's financial statements.
Agreements may exist to repurchase assets previously sold.	Agreements to repurchase assets previously sold have been properly disclosed.
Pension and Post-retirement Benefits An actuary has been used to measure pension liabilities and costs.	We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.

Involvement with a multi-employer plan exists.	We are unable to determine the possibility of a withdrawal liability in a multi-employer benefit plan. or We have determined that there is the possibility of a withdrawal liability in a multi-employer plan in the amount of $[XX].
Post-retirement benefits have been eliminated.	We do not intend to compensate for the elimination of post-retirement benefits by granting an increase in pension benefits. or We plan to compensate for the elimination of post-retirement benefits by granting an increase in pension benefits in the amount of $[XX].
Employee layoffs that would otherwise lead to a curtailment of a benefit plan are intended to be temporary.	Current employee layoffs are intended to be temporary.
Management intends to either continue to make or not make frequent amendments to its pension or other post-retirement benefit plans, which may affect the amortization period of prior service cost, or has expressed a substantive commitment to increase benefit obligations.	We plan to continue to make frequent amendments to pension or other post-retirement benefit plans, which may affect the amortization period of prior service cost. or We do not plan to make frequent amendments to pension or other post-retirement benefit plans.

Equity	
Condition	***Illustrative Example***
Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements exist.	Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements have been properly disclosed.

Income Statement	
Condition	***Illustrative Example***

There may be a loss from sales commitments.	Provisions have been made for losses to be sustained in the fulfillment of or from inability to fulfill any sales commitments.
Nature of the product or industry indicates the possibility of undisclosed sales terms.	We have fully disclosed to you all sales terms, including all rights of return or price adjustments and all warranty provisions.

Question for the ARSC
Should revisions be made to the examples of representations from the Guide or the illustrative representation letter in the Guide and AR-C section 90 with respect to the adoption of new accounting principles issued by the FASB?

No Additional Agenda Items are Presented

Exhibit - Illustrative Representation Letter From the Guide

1.236 The following illustrative letter is intended as an illustration that may be used to comply with the requirements of AR-C section 90. The representation letter will vary according to individual requirements and circumstances.

1.237 It is assumed in this illustration that the applicable financial reporting framework is accounting principles generally accepted in the United States of America, that no conditions or events exist that might be indicative of the entity's inability to continue as a going concern, and that no exceptions exist to the requested written representations. If circumstances differ from these assumptions, the representations would need to be modified to reflect the actual circumstances.

(Entity Letterhead)

(To Accountant)

(Date)

This representation letter is provided in connection with your review of the financial statements of ABC Company (the Company), which comprise the balance sheets as of December 31, 20X2 and 20X1, 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, for the purpose of obtaining limited assurance as a basis for reporting whether you are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We represent that [*to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves*] [*as of* (*date of accountant's review report*)]:

Financial Statements

- We acknowledge our responsibility and have fulfilled our responsibilities for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America.

- We acknowledge our responsibility and have fulfilled our responsibilities 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.

- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America.

- Guarantees, whether written or oral, under which the company is contingently liable have been properly accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America.

- Significant estimates and material concentrations known to management that are required to be disclosed in accordance with FASB *Accounting Standards Codification* (ASC) 275, *Risks and Uncertainties*, have been properly accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America. [Significant estimates *are estimates at the balance sheet date that could change materially within the next year*. Concentrations *refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year*.]

- All events occurring subsequent to the date of the financial statements and for which accounting principles generally accepted in the United States of America requires adjustment or disclosure have been properly accounted for.

- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole.

- The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America.

[*Any other matters that the accountant may consider appropriate*.]

Information Provided

- We have responded fully and truthfully to all inquiries made to us by you during your review.

- We have provided you with

  — access to all information, of which we are aware, that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;

- minutes of meetings of stockholders, directors, and committees of directors or summaries of actions of recent meetings for which minutes have not yet been prepared;
- additional information that you have requested from us for the purpose of the review; and
- unrestricted access to persons within the entity from whom you determined it necessary to obtain review evidence.

- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have [*no knowledge of any*] [*disclosed to you all information that we are aware of regarding*] fraud or suspected fraud that affects the Company and involves
    - management,
    - employees who have significant roles in internal control, or
    - others when the fraud could have a material effect on the financial statements.
- We have [*no knowledge of any*] [*disclosed to you all information that we are aware of regarding*] allegations of fraud, or suspected fraud, affecting the Company's financial statements as a whole communicated by employees, former employees, analysts, regulators, or others.
- We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.
- We have disclosed to you all known instances of noncompliance or suspected noncompliance with laws or regulations whose effects should be considered when preparing financial statements.
- We [*have disclosed to you all known actual or possible*] [*are not aware of any pending or threatened*] litigation and claims whose effects should be considered when preparing the financial statements [*and we have not consulted legal counsel concerning litigation or claims*]
- We have disclosed to you any other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450, *Contingencies*.
- We have disclosed to you the identity of the Company's related parties and all the related party relationships and transactions of which we are aware.
- We have disclosed to you all information relevant to use of the going concern assumption in the financial statements.

- No material losses exist (such as from obsolete inventory or purchase or sale commitments) that have not been properly accrued or disclosed in the financial statements.

- The Company has satisfactory title to all owned assets, and no liens or encumbrances on such assets exist, nor has any asset been pledged as collateral, except as disclosed to you and reported in the financial statements.

- We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

- We are in agreement with the adjusting journal entries that you have recommended, and they have been posted to the company's accounts (if applicable).

[*Any other matters that the accountant may consider necessary*.]

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[*Name of Chief Executive Officer and Title*]

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[*Name of Chief Financial Officer and Title*]

1.238 Representation letters ordinarily are tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry.