



Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: +1 212 773 3000
ey.com

Ms. Sherry Hazel
Audit & Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

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Proposed Statement on Auditing Standard, Auditor Involvement With Exempt Offering Documents

Dear Ms. Hazel:

Ernst & Young LLP is pleased to submit this comment letter to the Auditing Standards Board (ASB) in response to the ASB's request for comment on this proposed Statement on Auditing Standards (SAS).

We support the issuance of the proposed SAS. Prior to the ASB's clarity project, the AICPA's Audit and Accounting Guides for *State and Local Governments* and *Health Care Entities* provided industry specific requirements on when an auditor was deemed to be involved in an exempt offering. Because the clarity project softened the language in these guides to remove the industry-specific requirements, we believe a standard is necessary to clarify when an auditor is required to be involved in an exempt offering and the auditor's resulting responsibilities. The size and number of these offerings also indicate that a standard is needed.

We agree with the proposed language about when an auditor would be considered involved in an exempt offering document and with the procedures that the auditor would be required to perform. However, as discussed in the attachments to this letter, we believe certain changes should be made to the proposed SAS.

Attached is our response to the ASB's questions and other comments for your consideration. We would be pleased to discuss our comments with members of the ASB or its staff.

* * * * *

Very truly yours,

Attachment A

Views on the Issues Presented in the Explanatory Memorandum

Issue 1: Commenters are asked to provide feedback on the types of offerings included in the scope of the standard, specifically whether franchise offerings should be included in the scope of the proposed SAS.

We agree with the types of offerings included within the scope of the proposed standard. Further, we believe that franchise offerings should be within scope of the proposed standard because they are exempt offerings.

Issue 2: Commenters are asked to provide feedback on (a) whether they believe the activities that have been identified should trigger involvement and (b) whether additional activities should be considered as triggers for involvement.

We believe the activities listed in paragraph 8b should trigger auditor involvement. We could not identify any other activities that should trigger auditor involvement.

However, we recommend clarifying that if the auditor read a draft of the offering document even if the auditor was not requested to do so by the entity and provided comments and/or edits to the entity, that would trigger involvement under paragraph 8bi.

In addition, we recommend the following edit to paragraph A17:

Signing an updated auditor's report when, for example, the financial statements are revised
~~restated~~ does constitutes a signing of the auditor's report.

We believe an auditor would sign an updated auditor's report any time the entity's financial statements are revised (e.g., due to a change in accounting principle, a change in reportable segments, a discontinued operation). We believe "restated" is generally thought of in the context of an error. We recommend using the term "revised" to capture more transactions.

Issue 3: Commenters are asked to provide their views regarding the proposed requirement for subsequent event procedures to be performed when the auditor is deemed involved with an exempt offering document.

We agree with the proposed requirement to perform subsequent event procedures when an auditor is involved in an exempt offering document. We think the performance of subsequent event procedures serves the public interest and addresses compliance with the antifraud provisions of these offerings.

However, paragraph 12(a) provides a different time period for "subsequent events" than the time period in the definition of subsequent events in AU-C Section 560, *Subsequent Events and Subsequently Discovered Facts*. Further, paragraph 16 uses the term "subsequently discovered facts" without

providing a time period over which a subsequently discovered fact may occur. We believe it would be inappropriate to use the period of time in the definition of subsequently discovered facts in AU-C 560. We therefore recommend that the ASB provide definitions of “subsequent events” and “subsequently discovered facts” in any final SAS.

We also recommend the following edits to align the guidance in paragraph 13c with the guidance in paragraph 19c of AU-C Section 560, *Subsequent Events and Subsequently Discovered Facts*.

- c. Inquire of and request ~~Obtain~~ written representations from management of the former client, at or near the date of reissuance, about whether
 - i. any information has come to management's attention that would cause management to believe that any of the previous representations should be modified
 - ii. any events have occurred subsequent to the date of the latest prior period financial statements reported on by the predecessor auditor that would require adjustment to, or disclosure in, those financial statements

Additional recommendations

Timing of procedures

Paragraph 9 states “[w]hen an auditor is involved with an offering document, the auditor should perform the procedures in paragraphs 10-17 at or shortly before the date of distribution, circulation or submission of the offering document, and as appropriate upon any subsequent distribution, circulation or submission of the offering document.” Based on current industry practice, we believe the term “shortly” means days (e.g., five days) rather than weeks, but the term is open to interpretation. We therefore recommend that the ASB add application guidance to clarify the time period in which the auditor should perform the required procedures.

Scope of the proposed standard

Paragraph A2 states “[t]he auditor may include a provision in the engagement letter requiring the entity to obtain permission from the auditor before using the auditor’s report in connection with an exempt offering.” It is not clear whether the term “permission” refers to oral and/or written permission and whether oral permission would trigger auditor involvement under paragraph 8b. We believe this paragraph should specify that the written permission from the auditor should be in writing.

In addition, this paragraph states “[t]he existence of such a provision in an engagement letter does not establish involvement unless the auditor is engaged to perform or otherwise performs one or more of the activities in paragraph 8b with respect to the offering document.” We do not agree with this sentence. If the auditor is required to provide written permission for the use of its report in the offering document, we believe this would trigger involvement pursuant to paragraph 8bvi.

We therefore recommend the following changes to this paragraph:

A2. The auditor may include a provision in the terms of the engagement requiring the entity to obtain written permission from the auditor before using the auditor's report in connection with an exempt offering. The existence of such a provision would trigger involvement pursuant to paragraph 8bvi in an engagement letter does not establish involvement unless the auditor is engaged to perform or otherwise performs one or more of the activities in paragraph 8b with respect to the offering document. An example provision for an engagement letter may read as follows:

The Entity may wish to include our report on these financial statements in an exempt offering document. The Entity agrees that the aforementioned audit report, or reference to our Firm, will not be included in any such offering document without our prior written permission or consent. Any agreement to perform work in connection with an offering document, including an agreement to provide written permission or consent, will be a separate engagement.

Comfort letter application guidance

We recommend removing paragraphs A11 and A12, which provide further guidance about the issuance of a comfort letter. We believe these paragraphs are incomplete and, therefore, could be misunderstood by auditors. We believe auditors should go to AU-C Section 920, *Letters for Underwriters and Certain Other Requesting Parties*, (as suggested in paragraph A10) to review the comfort letter guidance in its proper context. If the ASB agrees with this change, the reference to paragraph A11 in paragraph A13 will need to be replaced with AU-C section 920.

Attachment B**Other Editorial comments**

Reference	Observation
Explanatory Memorandum – Background	<p><i>We recommend the following edit to clarify that there are certain exempt offerings that are regulated by the SEC:</i></p> <p>The U.S. Securities and Exchange Commission (SEC) cannot often does not directly regulate such offerings, so there is no may not be a requirement by the SEC for auditor involvement with exempt offerings.¹</p> <p>¹ There are exceptions where the SEC may require auditor involvement in certain exempt offerings. For example, Regulation A may require consent from the auditor for use of the auditor’s report in connection with amended financial statements that are included in the offering document.</p>
Throughout proposed standard	<p><i>We recommend replacing “offering document” with “exempt offering document” throughout the proposal to make it clear that the offering document relates to an exempt offering.</i></p>
Paragraph 5	<p><i>We recommend the following edits for clarity:</i></p> <p>Inclusion letter. A letter requested by and addressed to the entity that is, addressed to the entity, and signed and dated by the auditor indicating that the auditor agrees to the inclusion of the auditor’s report on financial statements (or the auditor’s review report on interim financial information) in the <u>exempt</u> offering document. This letter is not considered to be part of the <u>exempt</u> offering document.</p>
Paragraph 14	<p><i>We recommend the following edits for clarity:</i></p> <p>(b) the auditor of <u>the acquired entity</u> is not the continuing auditor of the acquiring entity, the auditor may be unable to perform all of the procedures in paragraph 12 of this SAS.</p>
Paragraph A4	<p><i>We recommend the following edit for clarity:</i></p> <p>A4. Exempt offerings may have multiple stages, for example distribution of a preliminary offering document and a final offering document. The effective date relates to the initial distribution of an exempt offering <u>document</u> on or after June 15, 2018.</p>
Paragraph A7	<p><i>We recommend the following edit for clarity:</i></p> <p>Information does not include the audited financial statements <u>or</u> , interim financial information covered by the auditor’s report</p>

Reference	Observation
Heading preceding paragraph A9	<p><i>We recommend the following edits to conform the language to paragraph 8bii:</i></p> <p>Reading a <u>draft</u> of the <u>Exempt</u> Offering Document (Ref: par. 8bii)</p>
Paragraph A13	<p><i>We recommend the following edits for clarity:</i></p> <p>Auditors use professional judgment in determining whether to participate in oral due diligence meetings if the underwriter has not provided the <u>written opinion from external legal counsel</u> or representation letter <u>as described in AU-C Section 920^{FN} paragraph A11</u> or if <u>external legal counsel has not provided the required written opinion</u>.</p> <p><u>FN – 12 Paragraphs .07, .11, and .A92 of AU-C section 920, Letters for Underwriters and Certain Other Requesting Parties</u></p>
Paragraph A14	<p><i>The example procedures in this paragraph appear to be agreed-upon procedures. Pursuant to AT-C 215, Agreed-Upon Procedures Engagements, “verify” is a term that is generally not acceptable. Therefore, we recommend replacing this term with recompute.</i></p> <p>For example, in a debt offering, management or its legal advisors may engage a practitioner to perform procedures on the entity’s compliance with the revenue coverage requirements on outstanding debt securities or to verify <u>recompute</u> the calculation of escrow account requirements for an advance refunding of debt securities.</p>
Footnote 15	<p><i>We recommend updating this footnote to conform to the clarified attest standards.</i></p> <p>AT section 201AT-C section 215, Agreed-Upon Procedures Engagements.</p>
Paragraph A16	<p><i>The language below implies that paragraphs 19-20 of exhibit A, “Background,” of AU-C Section 925 will describe the exceptions, which it does not. Therefore, we recommend deleting this language.</i></p> <p>When an auditor’s report is used in connection with an exempt offering, it is not usually necessary for the auditor to provide any type of written agreement, but some exceptions exist.</p>
Paragraph A23	<p><i>The Office of Thrift Supervision was merged into the Office of the Comptroller of the Currency in 2011. Therefore, this paragraph should be updated to refer to the proper agency or department.</i></p>