



Agenda Item 2A

Draft SAS

Auditor Involvement with Exempt Offerings

Introduction

Scope of This Section

.01

This proposed Statement on Auditing Standards (SAS) addresses the auditor's responsibilities when

- a. the auditor's report on financial statements or the auditor's review report on interim financial information of an entity is included or incorporated by reference in an offering document of a security exempt from registration under the Securities Act of 1933 or a franchise offering regulated by the Federal Trade Commission (hereafter, such offerings are referred to as "exempt offerings"), and
- b. the auditor performs one or more of the activities in paragraph .08 with respect to the offering document.

In such situations, the auditor is deemed to be involved with the offering document. (Ref: par. .A1—.A3)

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Exempt offerings are made pursuant to federal or state securities or franchise laws and regulations, including the antifraud provisions thereof. Exempt offerings include, but are not limited to:

- Transactions that are exempt from the registration requirements of Section 5 of the Securities Act of 1933, including private placement offerings; exempt public offerings; and municipal securities offerings
- Offerings of securities issued or backed by governmental, municipal, banking, tax-exempt, or other entities that are exempt from registration under the Securities Act of 1933
- Franchise offerings.

Effective Date

.03

This section is effective for offering documents with which the auditor is involved that are initially distributed, circulated, or submitted to potential investors on or after June 15, 2018. (Ref: par. .A4)

Objective

.04

The objective of the auditor when involved in an exempt offering is to perform specified procedures and respond appropriately to information included in an offering document that could undermine the credibility of the auditor's report. (Ref: par. A5—.A6)

Definitions

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For purposes of this section, the following terms have the meanings attributed as follows:

Inclusion letter. A letter, requested by the entity, addressed to the entity and signed and dated by the auditor indicating 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 offering document. This letter is not considered to be part of the offering document. (Ref: par. .A7)

Involved. The auditor is involved when the auditor's report is included or incorporated by reference in an offering document and the auditor performs one or more of the activities in paragraph .08 with respect to that offering document.

Offering Document. The disclosure document that provides financial and nonfinancial information related to the issuer of the exempt offering and the offering itself.

Security. Security is used with the meaning defined in Section 2(a)(1) of the Securities Act of 1933 of the U.S. Securities and Exchange Commission (SEC).

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References in this section to an *auditor's report* are to be read to encompass an auditor's report in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or an auditor's review report on interim financial information in accordance with section 930, *Interim Financial Information*.

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References in the remainder of this section to an auditor's report that is *included* in an offering document are to be read to also encompass an auditor's report that is *incorporated by reference* in an offering document.

Requirements

Involvement

.08

The auditor should apply the requirements of this section in connection with an exempt offering when

- a. the auditor's report is included in the offering document, and
- b. the auditor is engaged to perform, or otherwise performs, one or more of the following activities with respect to the offering document (Ref: par. .A8):
 - i. Assisting the entity in preparing information included in the offering document (Ref: par. .A9—.A10)
 - ii. Reading a draft of the offering document at the entity's request (Ref: par. .A11)
 - iii. Issuing a letter in accordance with section 920, *Letters for Underwriters and Certain Other Requesting Parties*, or an attestation engagement report in lieu of a comfort or similar letter on information included in the offering document (Ref: par. A12—.A14)
 - iv. Participating in due diligence discussions with underwriters, broker-dealers, or other financial intermediaries in connection with an offering document (Ref: par. .A15)
 - v. Issuing a report on an attestation engagement relating to the offering document (Ref: par. .A16—.A17)
 - vi. Providing written agreement (for example, an inclusion letter) for the use of the auditor's report in a specific offering document (Ref: par. .A18)
 - vii. Signing a copy of the auditor's report for inclusion in a specific offering document (Ref: par. .A19)

Other Information Included in the Offering Document

.09

When the auditor is deemed to be involved with the offering document, the auditor should perform the procedures described in section 720, *Other Information in Documents Containing Audited Financial Statements*, on the offering document (including material that is incorporated by reference into the offering document) at or shortly before the date of the distribution, circulation, or submission of the offering document.

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When revision of the other information is necessary due to a material inconsistency or a material misstatement of fact that management refuses to correct and the auditor intended to agree to inclusion

of the auditor's report in a specific offering document as discussed in paragraph .08bvi, the auditor should determine whether to withhold such permission. (Ref: par. .A20)

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When performing the procedures required by paragraph .09, the auditor should determine that the auditor's name is not being used in a way that indicates that the auditor's responsibility is greater than the auditor intends. (Ref: par. .A21—.A24)

Subsequent Events Procedures

.12

When the auditor is involved in an exempt offering, the auditor should perform the following procedures described in section 560, *Subsequent Events and Subsequently Discovered Facts*, at or shortly before the date of the distribution, circulation, or submission of the offering document:¹

- a. Audit procedures designed to identify events occurring between the date of the auditor's report and the date of the distribution, circulation, or submission of the offering document that require adjustment to, or disclosure in, the financial statements. Such procedures, which take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, should include
 - i. Obtaining an understanding of any procedures that management has established to ensure that such events are identified
 - ii. Inquiring of management and, when appropriate, those charged with governance about whether any such events have occurred that might affect the financial statements
 - iii. Reading minutes, if any, of the meetings of the entity's owners, management, and those charged with governance that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available
 - iv. Reading the entity's most recent subsequent interim financial statements, if any
- b. Obtain updated written representations from management at or shortly before the date of the distribution, circulation, or submission of the offering document, 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.

¹ Paragraphs .09—.10 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

- ii. any events have occurred subsequent to the date of the financial statements that would require adjustment to, or disclosure in, those financial statements; make the financial statements inaccurate or misleading; or cause any material changes in the subsequent financial position or results of operation.)
- iii. minutes of the meetings of shareholders, directors, and committees of directors are complete and authentic records of proceedings at all such meetings held since previous representations were provided. (Ref: par. .A25—.A27)

.13

When the auditor's report is included in the offering document and

- a. the entity has been acquired by another entity,
- b. the acquirer's audited financial statements included in the offering document reflect a period that includes the date of acquisition,
- c. the auditor is a predecessor auditor because the auditor is not the continuing auditor of the entity, and,
- d. the predecessor auditor has met one (or more) of the criteria in paragraph .08b,

the auditor may be unable to perform all of the procedures in paragraph .12. In such circumstances, the auditor should obtain written representations from management and the successor auditor as described in section 560 at or shortly before the distribution, circulation or submission of the offering document.²

.14

If a predecessor auditor's report on a prior period is included in the offering document but the predecessor auditor did not audit the entity's separate financial statements for the most recent audited period for which the entity's audited financial statements are included in the offering document, and the predecessor auditor is involved with the offering, then the predecessor auditor should perform the following procedures described in section 560 through a date at or shortly before the distribution, circulation or submission of the offering document:³

- a. Reading the financial statements of the subsequent period to be presented on a comparative basis
- b. Comparing the prior period financial statements that the predecessor auditor reported on with the financial statements of the subsequent period to be presented on a comparative basis

² Paragraph .19c–d of section 560.

³ Paragraph .19 of section 560.

- c. Obtaining written representations from management at or shortly before the date of the distribution, circulation, or submission of the offering document
- d. Obtaining a representation letter from the successor auditor stating whether the successor auditor's audit revealed any matters that, in the successor auditor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor.

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If the auditor becomes aware of subsequently discovered facts, the auditor should not agree to the inclusion of his or her report until the auditor's consideration of the subsequently discovered facts, including the effect on the auditor's report on the financial statements, has been satisfactorily evaluated in accordance with section 560.⁴

.16

If management does not revise the financial statements in circumstances when the auditor believes they need to be revised, in addition to the requirements in section 560, the auditor should not agree to the inclusion of his or her auditor's report in the offering document.⁵

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1

Securities and franchise offerings may be offered by means other than a registered offering through exemptions afforded under federal and state securities laws based on the size and nature of the offering or the issuing entity. Securities and franchise offerings offered through means other than a registration statement under the Securities Act of 1933 are within the scope of this standard. The appendix, "Examples of Exempt Offerings" provides examples of types of offerings within the scope of this section. Section 925 *Filings With the U.S. Securities and Exchange Commission* provides guidance on the auditor's responsibilities when financial statements of an entity are included or incorporated by reference in a registration statement under the Securities Act of 1933.

.A2

Although an auditor is not required to become involved in an offering document except through the performance of procedures noted in par. .08, some auditors include a provision in the terms of the engagement requiring the entity to obtain permission from the auditor before using the auditor's report

⁴ Paragraphs .15–.18 of section 560.

⁵ Paragraphs .17–.18 of section 560.

in connection with an exempt offering. Such a provision may be used by the auditor to establish a requirement that the auditor become involved with the entity's exempt offerings. An example provision for an engagement letter may read as follows:

The Entity may wish to include our report on these financial statements in a registration statement proposed to be filed under the Securities Act of 1933 or in some other securities offering. You agree that the aforementioned audit report, or reference to our Firm, will not be included in any such offering without our prior permission or consent. Any agreement to perform work in connection with an offering, including an agreement to provide permission or consent, will be a separate engagement.

Clarification in the Offering Document When There Is No Auditor Involvement

.A3

The auditor may include in the terms of the engagement a requirement that any offering document issued by the entity with which the auditor is not involved clearly indicates the auditor is not involved with the contents of such offering document. An example disclosure related to an exempt offering document may read as follows:

[Name of Firm], our independent auditor, has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. [Name of Firm] also has not performed any procedures relating to this offering document.

Effective Date

Distributed, Circulated, or Submitted (Ref: par. .03)

.A4

Exempt offerings often have multiple stages including a preliminary offering and a final offering. Throughout the process, draft offering documents may be distributed, circulated, or submitted to the auditor or others. The requirements of this statement pertain to situations where the offering document is distributed, circulated, or submitted to potential investors or a regulator.

Objective (Ref: par. .04)

.A5

As discussed in paragraph .A4, exempt offerings often have multiple stages. Involvement with a preliminary offering document establishes involvement with the issuance thus requiring the application of the requirements of this section at subsequent stages of the offering. Thus, there could be multiple applications of this standard related to a single offering.

.A6

Requesting management to keep the auditor advised of the progress of the offering document proceedings through the final distribution, circulation, or submission of the offering document is important so that the auditor's consideration of events occurring after the date of the auditor's report up to the final distribution, circulation, or submission of the offering document can be completed.

Definitions (Ref: par. .05)

.A7

An inclusion letter may also be referred to as an *agree-to-include letter*, an *acknowledgement letter*, or an *awareness letter*. Note that awareness letter is defined in section 925 with a different meaning in that context.

Involvement (Ref: par. .08)

.A8

Auditors may become aware of an offering through a communication from an entity or through the receipt of a draft offering document from an underwriter, broker-dealer or a client. Awareness of an offering does not constitute involvement unless the auditor performs one or more of the activities in paragraph .08.

Preparing Information (Ref: par. 8bi)

.A9

Information does not include the annual financial statements, interim financial information covered by the auditor's report, or the required supplementary information or supplementary information other than required supplementary information accompanying those financial statements that the auditor already considered during his or her audit of the financial statements or review of interim financial information.

.A10

When a member provides corporate finance consulting services to an attest client, self-review, management participation, and advocacy threats to a covered member's compliance with the Independence Rule (ET sec. 1.200.001) of the AICPA Code of Professional Conduct may exist. ET sec. 1.295.130. 02f. provides that a member may assist the attest client in drafting its offering document or memorandum, without impairing independence, so long as the member applies the General Requirements for Performing Nonattest Services interpretation [1.295.040] of the "Independence Rule" [1.200.001]. ET 1.295.130.03 also lists examples of types of corporate finance consulting services that would impair a member's independence in connection with an offering.

Reading the Offering Document (Ref: par. .8bii)

.A11

Reading a draft of the offering document encompasses situations where the auditor requests or receives a request from the client to read and provide feedback on the offering document. Paragraphs .09 — .11 discuss the auditor's responsibility to read the offering document as part of required procedures when the auditor is deemed to be involved.

Issuing a Comfort Letter or an Attestation Report (Ref: par. .8biii)

.A12

Underwriting agreements between an entity and its underwriters may include a request for the entity's auditor to prepare a comfort letter that will assist the underwriters with their due diligence in connection with the offering. Comfort letters may also be requested by parties other than the underwriters. Section 920 provides guidance related to the issuance of comfort letters.

.A13

An auditor may issue a comfort letter that provides negative assurance to a requesting party (as defined in section 920) only if the requesting party provides the required representation letter described in section 920.⁶ If the requesting party does not provide the required representation letter, the auditor may issue a modified comfort letter that does not provide negative assurance.⁷

.A14

When a comfort letter is requested by a party other than a requesting party (as defined in section 920), the auditor should not provide that party with a comfort letter or letter described in section 920.⁸ Instead, the auditor may perform procedures requested by that party and issue a report on agreed-upon procedures.⁹

Due Diligence Discussions (Ref: par. .08biv)

.A15

As part of their due diligence process on a specific exempt offering, underwriters and their counsel may ask to interview the entity's auditors. The meetings at which such interviews occur are often referred to as oral due diligence meetings. The interview typically focuses on the audit engagement, the entity's financial statements, and the entity's system of internal controls over financial reporting. Auditors use

⁶ Paragraphs .07, .11b and .A92 of section 920, *Letters for Underwriters and Certain Other Requesting Parties*.

⁷ Paragraphs .12 and .A93, Example Q of section 920.

⁸ Paragraph .13 of section 920.

⁹ AT section 201, *Agreed-Upon Procedures Engagements*.

professional judgment in determining whether to participate in oral due diligence meetings if the underwriter has not provided the representation letter described in paragraph .A14. If the auditor agrees to participate, auditors use professional judgment in determining which questions in an oral due diligence meeting can be addressed.

Offering-Related Attestation Engagements (Ref: par. .08bv)

.A16

During the offering process, management or other involved parties may engage practitioners to provide certain needed information through an attestation engagement. For example, in a debt offering, management or its legal advisors may engage a practitioner to review the entity's compliance with the revenue coverage requirements on outstanding debt securities or to verify the calculation of escrow account requirements for an advance refunding of debt securities. If the auditor whose report accompanies the financial statements included in the offering document also provides an attestation engagement report relating to a debt offering, the auditor is deemed to be involved. If the practitioner engaged to perform the attestation engagement is not the financial statement auditor, the practitioner engaged to perform the attestation engagement is not deemed to be involved with the offering document in the manner discussed in this section.

.A17

An attestation engagement report relating to an offering exempt from the Securities Act of 1933 need not be referred to or included in the offering document to involve the auditor of the financial statements with the offering. Sometimes, the attestation engagement report may only be included in the closing documents for the offering.

Inclusion Letter (Ref: par. .08bvi)

.A18

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.¹⁰ If the auditor is asked to provide an inclusion letter, the auditor may provide a letter indicating that the auditor agrees to the inclusion of the auditor's report in the offering materials. This letter would typically not be included in the offering materials. The following example language may be used to indicate that the auditor agrees to inclusion:

We agree to the inclusion in the offering document of our report, dated February 5, 20X3, on our audit of the financial statements of [Name of Entity].

¹⁰ Exhibit A paragraphs .19—.20 of section 925, *Filings With the U.S. Securities and Exchange Commission*.

Signing an Auditor's Report for Specific Inclusion in an Offering Document (Ref: par. .08bvii)

.A19

Signing the auditor's report involves an original manual or electronic signature on the auditor's report, not a reproduction of an auditor's report that was manually or electronically signed. For example, the underwriter or bond counsel may require a copy of the auditor's report with an original manual or electronic signature to file with the official closing documents for the offering.

The Offering Document and Other Information

Withholding the Auditor's Agreement to Include the Auditor's Report (Ref: par. .10)

.A20

In making the determination whether to withhold the auditor's agreement to include his or her report, the auditor may consider it appropriate to obtain legal advice.

References to the Auditor as an Expert (Ref: par. .11)

.A21

The term *expert* has a specific statutory meaning under the Securities Act of 1933. Outside the Securities Act of 1933 context, the term *expert* is typically undefined. Accordingly, except as described in paragraph .A24, when an issuer wishes to make reference to the auditor's role in connection with an exempt offering, the caption to that section of the document would generally be titled "Independent Auditors" (or something similar) rather than "Experts," with no reference to the auditor as an expert anywhere in the document.

.A22

The following is an example of a typical description of the auditor's role when an entity wishes to make reference to the auditor in an exempt offering.¹¹

Independent Auditors

The financial statements of Entity X as of December 31, 20X2 and for the year then ended, included in this offering document, have been audited by[Name of Firm], independent auditors, as stated in their report appearing herein.

If the auditor is not involved with the offering document and the terms of the engagement require disclosure of this fact, additional disclosure similar to that illustrated in paragraph .A4 may be considered.

¹¹ Exhibit B of section 925.

.A23

If the entity refuses to delete references to the auditor as an “expert,” the auditor may consider whether to permit inclusion of the auditor’s report, based on the auditor’s professional judgment and an evaluation of liabilities the auditor may be assuming. In such situations, the auditor may consider it appropriate to obtain legal advice.

.A24

There may be situations in which the term *expert* is sufficiently defined such that the auditor may agree to be referred to as an expert outside the context of a registration statement filed under the Securities Act of 1933. For example, if the term *expert* is defined under applicable state law, the auditor may agree to be named as an expert in an offering document in an intrastate offering. The auditor may also agree to be named as an expert, as that term is used by the Office of Thrift Supervision (OTS), in offering documents that are subject to the jurisdiction of the OTS. An understanding of any auditor liability provisions that may be included in the applicable federal or state statutes is an important consideration.¹²

Subsequent Events Procedures (Ref: par. .12)

.A25

In addition to the procedures discussed in paragraph .12, the auditor may consider it necessary and appropriate to inquire of, or extend previous oral or written inquiries to, the entity’s legal counsel concerning litigation, claims, and assessments, as described in section 501, *Audit Evidence—Specific Considerations for Selected Items*.

.A26

An illustrative updating management representation letter is included in section 580, *Written Representations*.¹³

Considerations Specific to Governmental Entities

.A27

The auditor, in determining the extent of procedures to conduct, may consider the structure of the government offering the debt and which component units relate to the debt offering. A component unit not guaranteeing the repayment is ordinarily not a relevant entity to the users of the bond offering. Alternatively, if the debt is offered by a particular component unit, the scope of subsequent event procedures would likely be limited to the applicable component unit responsible for the repayment of the debt. However, if the full set of financial statements for the reporting entity were included, the scope of subsequent event procedures would likely also encompass the primary government.

¹² Paragraph .18 of Exhibit A of section 925.

¹³ Exhibit C of section 580, *Written Representations*.

Appendix – Examples of Exempt Offerings

.A28

.A28—1 Examples of securities exempt from registration under the Securities Act of 1933, include:

- a. Municipal securities – Section 3(a)(2)
- b. Intrastate offerings – Section 3(a)(11)
- c. Small issues – Section 3(b)(1)
 - i. Regulation D Rule 504 exemption (“Seed capital” exemption)
 - ii. Regulation D Rule 505 exemption
 - iii. Regulation A exemption
- d. Transactions by an issuer not involving any public offering (e.g., private placements, nonpublic offerings, private sales) –Section 4(a)(2)
 - i. Regulation D Rule 506 offering
 - ii. Rule 144A offering exemption
- e. Securities sold for employee benefit plans (Rule 701)
- f. Other classes of securities specifically exempted
 - i. Securities issued by religious, charitable, educational and other nonprofit organizations
 - ii. Securities issued or guaranteed by banks. Note however that issuances of bank securities may be subject to other regulators, for example, the Office of Thrift Supervision.
 - iii. Miscellaneous other securities such as short-term notes, drafts and bills of exchange; insurance policies; certificates issued by a receiver or trustee in bankruptcy; interests in a railroad equipment trust
 - iv. Crowdfunding – allows for limited-size offerings to be sold in small amounts to a large number of investors (e.g., over the Internet)

A.28—2 Franchise offerings regulated by the Federal Trade Commission:

Franchise offerings are regulated at the federal and state level. Federal regulation occurs through the Federal Trade Commission under the *Disclosure Requirements and Prohibitions Concerning Franchising* (the FTC Rule). The FTC Rule requires franchisors to provide a franchise disclosure document (FDD) to each prospective buyer, but does not require FDDs to be filed or registered with the Federal Trade Commission. At the state level, regulations vary widely. Some states have franchise statutes and regulations that are more stringent than the Federal Trade Commission requirements, and which may require a franchisor to file or register its offering with state franchise authorities.