



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
425 Fifth Avenue North, Cordell Hull Building
NASHVILLE, TENNESSEE 37243

PHONE (615) 401-7897
FAX (615) 532-2765

April 25, 2018

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

Dear Ms. Hazel:

On behalf of the Tennessee Department of Audit, Division of State Audit, we thank you for the opportunity to comment on the Exposure Drafts (ED), *Auditor Reporting and Proposed Amendments – Addressing Disclosures in the Audit of Financial Statements, Omnibus Statement on Auditing Standards – 2018, and The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports*. We generally agree with the amendments proposed in the EDs. However, we do have some suggested improvements for the board’s consideration.

Auditor Reporting and Proposed Amendments – Addressing Disclosures in the Audit of Financial Statements

Requests for Comment and/or Issues for Consideration:

1. Are the proposed revisions to existing requirements clear and understandable, and is the application material helpful in supporting the application of those requirements? **We generally agree that the proposed revisions are clear and understandable.**
2. Are the descriptions of the responsibilities of management and the auditor relating to going concern (paragraphs 31b and 36biv) useful and understandable, in view of the calls for more information in the auditor’s report about their respective responsibilities in this area? Would any modifications to the descriptions of management’s responsibility be necessary for any specific financial reporting framework? Are there any concerns about possible confusion or misinterpretation about the auditor’s responsibilities, in particular the requirement to conclude on the entity’s ability to continue as a going concern, recognizing that the description is consistent with the requirement in paragraph .20 of AU-C section 570 (SAS No. 132)? **We agree that the descriptions are useful and understandable and that no further modifications are necessary.**
3. Will the requirement to identify those responsible for the oversight of the financial reporting process present any practical difficulties when those responsible for the oversight of the financial reporting process are also responsible for preparation of the financial statements (as may be the case, for example, in a small owner-managed entity)? **This scenario might occur in smaller governments, but we believe it will present no practical difficulties.**

4. Does the expanded description of the auditor’s responsibilities, including the key features of the audit, provide useful information and greater transparency into what an audit is and what the auditor does? Are there any aspects of the auditor’s responsibilities that should be added? **We agree that the information is useful and will provide greater transparency; however, the language is likely to become boiler plate whereby only the sophisticated users will truly know the meaning. We believe the language is necessary to mitigate the expectation gap.**
5. What are your views regarding whether the requirements and guidance in the proposed SAS will be helpful for auditors in determining and communicating KAMs? **We believe the guidance is clear, except for one notion. We believe the intent of the KAM, emphasis-of-a-matter (EOM), and other-matter concepts is to establish a hierarchy. However, this intent is not clear in each of those proposed AU-C sections (¶A5-A6 on page 96 ¶A-1 on page 185). Those paragraphs indicate that, “When proposed SAS *Communicating Key Audit Matters in the Independent Auditor’s Report* applies, the use of emphasis-of-matter paragraphs is not a substitute for a description of individual key audit matters.” We believe a better way to describe the requirement is that if the auditor chooses, is engaged to, or is required by law or regulation to present KAM, the presentation in the auditor’s report would be in the order of KAM, EOM, and other matter paragraphs. For example, when an item meets the definition of both KAM and EOM, the requirement is that the item should be presented in a KAM paragraph, not an EOM paragraph. If the board agrees, we believe Illustration 2 (page 201) needs to be amended to present KAM before the EOM paragraph.**
6. Is it sufficiently clear that the communication of KAMs is not required for audits of nonissuers? **Yes**
7. Are the revisions to existing requirements clear and understandable, and is the application material helpful in supporting the application of those requirements? **Yes, except for our comment in #5 above.**
8. Are the revisions to existing requirements clear and understandable, and is the application material helpful in supporting the application of those requirements? **Yes**
9. Is the interrelationship between emphasis-of-matter or other-matter paragraphs and KAMs clear and understandable, recognizing that the communication of KAMs is not required for audits of nonissuers? If not, what additional guidance would be helpful? **See #5 above.**

Issue 1—Timing of Communications With Those Charged With Governance

10. Should the requirement in AU-C section 260 be more specific regarding the timing of communication about certain matters with those charged with governance, including whether there should be a requirement for certain communications to be made prior to issuance of the auditor’s report? **We agree with the PCAOB AS 1301 requirement, which is similar to that in Government Auditing Standards and the Office of Management and Budget’s Uniform Grant Guidance. We believe communications of significant deficiencies and material weaknesses to those charged with governance should be made prior to the issuance of the auditor’s report. We believe this still provides plenty of flexibility for whatever circumstances the auditor might face.**

Issue 2—Addressee in the Auditor’s Report

11. Please provide your views on the following:

- a. Would including the city and state of the addressee in the auditor's report be beneficial to users of the financial statements? **Including the city and state of the issuing auditor appears appropriate. We are not sure what benefit the user obtains from this information though.**
- b. What would the practical implications be if such a requirement were adopted? **We do not believe there are any practical implications, especially in the state and local government environment.**
12. Are the proposed changes appropriate and sufficient for purposes of enhancing the focus of the auditor on disclosures and, thereby, further enhancing audit quality? **Yes**
13. Are there any specific areas where, in your view, additional enhancements to either the requirements or application material would be necessary for purposes of effective auditing of disclosures as part of a financial statement audit? **We believe the proposal is sufficient.**
14. Will the proposed changes to the assertions in AU-C section 315 help appropriately integrate the auditor's audit approach to the risk of material misstatement in the disclosures with the audit work on the underlying amounts, thereby promoting a more effective audit of disclosures? **Yes**

The Auditor's Responsibilities Relating to Other Information Included in Annual Reports

Specific Request for Comment 1

Do the proposed revisions clarify the scope of documents required to be subjected to the auditor's procedures? If you believe additional revisions or guidance is necessary, please be specific and provide reasons why additional revisions or guidance is necessary. **We believe the proposed revisions clarify the scope as the annual report. We believe this is a significant improvement and will reduce confusion and inefficiencies in the audit process.**

Specific Request for Comment 2

Does the proposed requirement for the auditor to determine, through discussion with management, and obtain management's written acknowledgment regarding, which document or documents make up the annual report, and the entity's planned manner and timing of the issuance of such documents appropriately achieve the intent of ensuring that both the auditor and management understand the documents that are considered to constitute the entity's annual report and therefore are subject to the auditor's procedures required by the proposed SAS? **We emphatically agree that obtaining management's written acknowledgement, especially in the engagement letter, of what constitutes other information in the annual report and the issuance of such documents will enhance the audit process and reduce misunderstandings with the client about auditor and management responsibilities related to other information.**

Specific Request for Comment 3

- Will the work effort required by the proposed standard, in view of the proposed definitions, result in an improvement of the auditor's understanding of the auditor's responsibility for other information and, as a result, enable the auditor to perform a more thorough reading and challenging of statements included in (or omitted from) the other information that are inconsistent with the audited financial statements or the auditor's knowledge obtained as part of the audit? **This will very clearly result in more efficiencies and a better-quality audit.**

- Does the proposed SAS provide adequate guidance with respect to the auditor's consideration of omitted or obscured information? Yes

Specific Request for Comment 4

Does the proposed SAS provide adequate guidance for group auditors when a group auditor decides to make reference to a component auditor in the auditor's report on the group financial statements? Yes

Specific Request for Comment 5

Does the proposed requirement for the auditor to include a separate section in the auditor's report addressing other information appropriately convey the nature and extent of the auditor's consideration of other information without inappropriately implying that the auditor has obtained assurance on or is expressing an opinion or conclusion on the other information? Yes

Omnibus Statement on Auditing Standards – 2018

Issue 1: Significant Unusual Transactions

Please provide your views on the use of the phrase “significant unusual transactions” instead of the phrase “significant transactions that are outside the normal course of business or that otherwise appear to be unusual” consistently throughout GAAS. **Because the term *significant unusual transactions* is proposed to be defined, we prefer to use the term throughout the AU-C, rather than using its description. However, the definition does not appear to contemplate that transactions could be both significant and unusual. We believe using the term would provide more consistency throughout GAAS.**

Issue 2: Proposed Amendment to AU-C section 240

Please provide your views on whether requiring these procedures, in particular the procedure of “evaluating the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees, and other obligations, if any,” is appropriate for audits of financial statements of nonissuers or whether these procedures would be better placed as application material. **For this particular procedure, we disagree with the focus of the procedure. We believe the proper focus should be on management's internal controls over their own evaluation of the financial capability of the other parties. Then, the auditor could evaluate management's methodologies and significant assumptions being used for the evaluation.**

Should you have questions or need clarification on any of our comments, please contact Gerry Boaz (615) 747-5262 (Gerry.Boaz@cot.tn.gov) or me at (615) 747-5251.

Sincerely,

Deborah V. Loveless, CPA
Director, Division of State Audit