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May 16, 2018

Mr. Mike Glynn
Audit and Attest Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement on Auditing Standards, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

Dear Mr. Glynn:

We appreciate the opportunity to comment on the Auditing Standards Board's (the Board) proposed Statement on Auditing Standards, *The Auditor's Responsibility Relating to Other Information Included in Annual Reports* (the Proposed Standard). We support the Board's efforts to benefit users of audited financial statements of non-issuers in an effective and efficient manner by considering the activities of other standard setters, specifically the International Auditing and Assurance Standards Board (IAASB) and the Public Company Accounting Oversight Board (PCAOB).

Considering all available points of view results in stronger comprehensive standards to serve the public interest. However, in this instance, we believe the Board has not made a compelling argument for change other than convergence with the International Standard on Auditing 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* (ISA 720). We are concerned that the Proposed Standard will create additional differences when compared to PCAOB AS 2710, *Other Information in Documents Containing Audited Financial Statements*. Differences between our two national auditing standard setters increases the current expectation gap of financial statement users in the United States (US). We believe the auditor's responsibility for other information included in annual reports (hereafter referred to as Other Information), particularly in annual reports that may be used by investors, donors, or other constituents of varying knowledge about auditing standards, should be substantially similar in the US market.

In our response to the PCAOB's Rulemaking Docket matter No. 34, which included The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report, we expressed concern over certain requirements that are substantially similar to those included in this Proposed Standard.

We are not aware of practice issues with extant AU-C section 720, a fundamental objective of which is reading the Other Information to protect the credibility of the financial statements and auditor's report thereon. We believe the Proposed Standard shifts the objective away from the credibility of the audited financial statements to specific association with Other Information management wishes to share with its stakeholders that may be well beyond the scope of an applicable financial reporting framework. We encourage the Board to conduct its own outreach to determine whether there are practice issues, audit quality issues or issues for users of the financial



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information, and collaborate with the PCAOB, to the extent possible, as they continue with their research agenda¹. Despite our objection to this Proposed Standard, in response to Request for Comment 2, we have included a potential pragmatic alternative that both alleviates many of our concerns, and provides transparency to readers of Other Information about the auditor's responsibilities. Similar to AU-C section 945, *Auditor Involvement With Exempt Offering Documents* (AU-C section 945), auditors could be engaged to perform procedures on Other Information consistent with AU-C section 720 today, and then specifically report on those procedures in the auditor's report included with the Other Information. This change to extant standards would formalize management's understanding and agreement to the auditor's involvement with Other Information.

If the Board determines that it is appropriate to continue with the Proposed Standard, we have provided responses to the specific issues highlighted for respondents and other matters noted to enhance the effectiveness of the Proposed Standard. Specifically:

- The performance requirements should be limited to comparing the Other Information included in an annual report to the amounts in the financial statements and the accounting records that are subject to the audit, or have been derived directly from those accounting records. Requiring the auditor to consider material inconsistencies between Other Information and the auditor's knowledge obtained in the audit is too broad and may be misunderstood by users of the auditor's report as going beyond the scope of a financial statement audit. Our response to Comment 3 expands on this concern.
- The reporting requirements in the Proposed Standard will likely increase the expectation gap related to the auditor's responsibilities. Practice issues are also caused by the timing of the receipt of Other Information and the effect it has on reporting that is not addressed by the requirements and application material. Further, the prominence and proposed wording of the reporting is also inconsistent with the limited procedures performed. Our response to Comments 2 and 5 expands on these concerns.

Our detailed responses to the specific requests for comment include:

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.

The Proposed Standard is generally clear about the scope of documents to be subjected to the auditor's procedures. The following revisions are intended to clarify five paragraphs if the Board proceeds with the Proposed Standard:

- Paragraph 2 states that the Proposed Standard may be "applied, adapted as necessary in the circumstances, to other documents to which the auditor, at management's request, devotes

¹ The PCAOB currently has the "Auditor's Role Regarding Other Information and Company Performance Measures, Including Non-GAAP Measures" on its research agenda.



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attention.” We believe that this paragraph undermines the intent of the Proposed Standard, which serves to define the Other Information on which the auditor is required to perform procedures and in essence leaves auditors where we are today. We recommend that this paragraph be removed so that the Proposed Standard would apply only to annual reports.

- Paragraph A9 states that certain documents when issued alone are not typically part of an annual report. The phrase “issued on a stand-alone basis” is confusing because this could be read to imply that, if not issued on a stand-alone basis, such documents could be part of an annual report. For example, an observed trend is for management to include sustainability reports in documents containing audited financial statements. We recommend that the Proposed Standard explicitly state whether these documents would form an annual report if issued as one document.
- It also occurs that management may periodically update its communications to its stakeholders and include the audited financial statements in each communication or include audited financial statements in several documents with different Other Information. If the intent is to identify the annual report, we recommend adding application material to paragraph 12 such as “In scenarios where an entity publishes more than one document that may be considered an annual report, this Proposed Standard would generally apply to the first version. The communications with management and the reporting within the auditor’s report should be clear in this regard.” Adding this language will reduce the risk of misapplying the Proposed Standard.
- The application material in paragraph A3 should specifically state that this Proposed Standard does not apply to engagements conducted under AU-C section 945.
- In practice, there are situations when the audited financial statements of an entity are required to be included in an annual filing of another entity². We recommend that the application material to paragraph 12 specifically state that this Proposed Standard does not apply when audited financial statements of an entity are included in the annual report of another entity as a result of a regulatory requirement of the other entity.

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 are concerned about implementing the reporting requirements when the Proposed Standard allows for reporting variability driven by the timing of when the Other Information is received.

² Example includes financial statements filed with the Securities and Exchange Commission under Regulation S-X 3-05 and 3-09.



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There is risk of potentially confusing users of the financial statements related to this variability in reporting. For example, the reporting requirement is to be silent in the auditor's report when no Other Information is received at the date of the auditor's report. Users will not know whether the auditor was expecting such information but it was not received nor will the user know whether management included the auditor's report with Other Information and does not notify the auditor.

In contrast, when some or all of the Other Information has been obtained at the date of the auditor's report, the audit report would include reporting related to the auditor's responsibilities and findings about the Other Information received to date. There are practice issues that arise from this, including:

- The same auditor's report may be included at a later date with different Other Information. The language in the auditor's report would be inconsistent with the Other Information in these scenarios.
- Potentially needing to dual date the audit report when multiple annual reports are issued or when Other Information is obtained after the auditor's report has been issued.
- The receipt of discreet pieces of Other Information, for example one year of a multi-year management discussion and analysis section and the effect this may have on the auditor's report.
- The possibility that management amends or updates the Other Information after the date of the auditor's report but before the date of issuance of the Other Information.

This variability, as compared to when no Other Information is received at the date of the auditor's report, will increase the expectation gap of users of annual reports.

The timing of the receipt of Other Information within the Proposed Standard would also lead to potential audit documentation challenges. The Proposed Standard requires completing procedures in circumstances where that information becomes available after the issuance of the auditor's report. It is unclear how this would work in practice as fieldwork could continue indefinitely until the Other Information is completed and the auditor is able to perform and conclude on their procedures on the Other Information, report on the Other Information and comply with the documentation requirements of the Proposed Standard. Further, the Proposed Standard does not provide adequate guidance on how to comply with other requirements of AU-C section 230, *Audit Documentation*, when Other Information is received after both the report release date and documentation completion date.

If transparency of auditor involvement with Other Information is an objective beyond protecting the credibility of the audited financial statements, a potential solution may be to align the timing of the auditor's required procedures and reporting over Other Information to the issuance of the annual report, and not the auditor's report on the financial statements, analogous to the construct of AU-C section 945. If requested, the auditor would be engaged to perform the procedures consistent with the extant standard, and then would agree to include the auditor's report in the



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Other Information by providing either an inclusion letter³ or by reissuing the auditor's report to include a paragraph describing the auditor's involvement. Following this model, an auditor could provide written agreement for using the auditor's report in the annual report and include a modified sentence in the independent auditor's report when issued that clearly states the scope of the agreement for including the auditor's report on the financial statements in management's annual report. For example:

We were engaged to perform procedures over the Annual Report in accordance with the requirements of AU-C section 720, the purpose of which is to read and identify whether any information contained therein is materially inconsistent with the financial statements referred to above. Those procedures do not constitute an audit of the other information included in the Annual Report. Accordingly, we express no conclusion or opinion on such information.

While there may be other practice considerations not addressed by this brief summary, this is one way to achieve an objective whereby both the auditor and management understand the documents that constitute the entity's annual report, provide transparency related to auditor involvement, and continue to safeguard the credibility of the audited financial statements.

If, however, the Board proceeds with this Proposed Standard, we recommend that an illustration similar to ISA 720 Illustration 2 be included to illustrate when certain Other Information has been obtained before the report release date and when certain Other Information is expected to be made available after the report release date. Further recommendations to the reporting requirements are included in response to Comment 5.

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

In current practice, we understand the requirements of extant AU-C section 720, and our engagement letters describe our responsibility to read the Other Information to identify material inconsistencies with the audited financial statements. The additional work effort contemplated in this Proposed Standard does not improve, but rather, confuses our understanding of the auditor's

³ For example, "We agree to the inclusion in the [name of Annual Report] dated [insert issuance date of Annual Report] of our report, dated [insert date of auditor's report on the financial statements], on our audit of the financial statements of [name of Entity] as of December 31, 20X2 [and 20X1], and for the year[s] then ended."



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responsibility. It may be misunderstood by users of the financial statements (as discussed in this response and in our response to Comments 2 and 5), and may restrain the range and nature of information management communicates to stakeholders. An annual report is a management vehicle to provide information that may be well beyond what is required by the applicable financial reporting framework and, consequently, may have appropriately not been subject to audit procedures. We do not support shifting the auditor's objective from the credibility of the audited financial statements to whether management has obscured information in its message to its stakeholders. Our specific concerns include:

Scope of responsibility for Other Information that is unrelated to the financial statements

The Proposed Standard requires the auditor to consider material inconsistencies between the Other Information and the auditor's knowledge obtained in the audit. "Knowledge obtained in the audit" is too broad of a concept and, if not better defined, may be interpreted as anything in the entity's annual report that does not comport with any part of audit documentation, or the understanding of any member of the engagement team whether or not documented. Where the Other Information is not directly related to the financial statements, its relevance to the scope of the audit that was performed is that much less clear. That lack of clear connectivity leaves the auditor subject to varying interpretations of their responsibilities. We recommend the Proposed Standard limit the auditor's responsibility to comparing the Other Information to the amounts in the financial statements and the accounting records that are subject to the audit, or have been derived directly from those accounting records by analysis or computation (similar to concept of supplementary information in AU-C section 725). This would clarify the auditor's responsibility and make it more consistent with current auditing standards and today's practice.

Use of 'evaluate'

Several instances of the uses of the term evaluate in the Proposed Standard suggest the auditor is performing procedures that are more often associated with obtaining audit evidence to express reasonable assurance (an opinion or conclusion on the Other Information). The term creates an expectation gap related to the auditor's responsibility. The table presents suggested edits to replace the term 'evaluate' with a verb more appropriate for the intent of the Proposed Standard.



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Paragraph	Suggested edit (additions are <u>underlined</u> ; deletions are strikethrough)
15(a)	Consider whether there is a material inconsistency between the other information and the financial statements. As the basis for this consideration, the auditor should, to evaluate their consistency, compare selected amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about the amounts or other items in the financial statements) with such amounts or other items in the financial statements. (Ref: par. A30–A34)
A29, third bullet	The degree of judgment involved in addressing the requirements of paragraphs 15–16; for example, performing procedures to <u>evaluate</u> compare the consistency of amounts in the other information that are intended to be the same as amounts in the financial statements may be carried out by less experienced engagement team members
A31	In evaluating <u>comparing</u> the consistency of selected amounts or other items in the other information with the financial statements, the auditor is not required to compare all amounts or other items in the other information that are intended to be the same as, to summarize, or to provide greater detail about the amounts or other items in the financial statements, with such amounts or other items in the financial statements.
A34	Evaluating <u>Comparing</u> the consistency of selected amounts or other items in the other information with the financial statements includes, when relevant given the nature of the other information, the manner of their presentation compared to the financial statements.

Documentation

The requirements detailed in the Proposed Standard increase the required documentation to evidence performance (including the need to perform procedures on Other Information that is not directly related to the financial statements as detailed above). We recommend that the Board include additional guidance related to documentation within the Proposed Standard, to provide an auditor with a basis for documenting and retaining the results of their work.

Omitted or obscured information

We do not believe that the Proposed Standard provides adequate guidance about the auditor’s responsibility related to omitted or obscured information. We recommend that this concept be removed from the standard by deleting “(including because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information)” and the related application paragraphs of A12 and A13. As there is no professional framework that provides guidance about required disclosure in an annual report or Other Information, the auditor cannot determine, through the limited procedures discussed within the Proposed Standard, what



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information may be omitted or obscured by the Other Information. This is a management responsibility and we do not believe that the auditor can properly assess omitted or obscured information based on the limited procedures of the Proposed Standard.

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?

We believe that the Proposed Standard provides adequate guidance for group auditors when the group auditor decides to refer to a component auditor in the auditor's report. However, the guidance is unclear about the responsibilities for component auditors in this scenario (i.e. would a component auditor that is referred to in an auditor's report have increased responsibilities over a component auditor that is not referred to in an auditor's report). We recommend that the Board consider this and include more specific application material to clarify the requirements.

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?

The reporting requirement introduced by the Proposed Standard will lead to an increased expectation gap among the users of financial statements. The proposed language for the auditor's report implies to users negative assurance on the Other Information. Further, the placement and level of prominence of the reporting is inconsistent with the level of assurance relative to the overall audit. We have also expressed our concerns about the timing of the receipt of Other Information and the effect that has on the optionality in reporting in response to Comment 2.

If the Board proceeds with this Proposed Standard, at a minimum, we believe that the statement that the auditor has "nothing to report" should be eliminated from the required reporting in favor of a statement that the auditor is not aware of a material inconsistency with the financial statements, without providing an explicit conclusion or statement about the results of that work. This would also reduce the effect of our timing concerns noted in response to the request for Comment 2.

Other Matters

We include our recommendations and editorial comments that would improve or provide additional clarity (additions are underlined; deletions are ~~strikethrough~~):

- As it is not uncommon for financial statements to be prepared under IFRS and audited using AICPA standards, we believe paragraph A9 of ISA 720 should be included. Further, we think



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this guidance is not dissimilar to proposed A11, and could be part of considerations when framework is not US GAAP.

- To further strengthen the audit response in Paragraph A27 when management has not provided final versions of documents, add an additional point stating:
Consider the effect on the previously issued audit opinion.
- To clarify that communication to those charged with governance does not obviate the requirement to include appropriate language in the auditor's report, we recommend that Paragraph A53 state:

In audits of governmental entities, withdrawal from the engagement or withholding the auditor's report may not be possible under law or regulation. In such cases, in addition to reporting in the auditor's report that a material misstatement of the other information exists, the auditor may issue a report or written communication to those charged with governance and the appropriate statutory body, if applicable, giving details of the inconsistency.

* * * * *

We appreciate the Board's consideration of our comments and observations. If you have any questions regarding our comments included in this letter, please do not hesitate to contact Ilene Kassman (212-909-5667 or ikassman@kpmg.com) or Matt Doyle (267-256-1990 or mrdoyle@kpmg.com).

Sincerely,

KPMG LLP