



May 18, 2018

Ms. Sherry Hazel
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Hazel:

On behalf of the National State Auditors Association, we appreciate the opportunity to respond to the AICPA Auditing Standards Board's exposure draft titled, *Proposed Statements on Auditing Standards—Auditor Reporting*, and *Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*.

Our responses to the specific requests for comment posed in the exposure draft, and some additional comments, follow.

1. *Are the proposed revisions to existing requirements clear and understandable, and is the application material helpful in supporting the application of those requirements?*

The proposed revisions to the existing requirements appear clear and understandable, and the application material is helpful in supporting the application of those requirements. However, we do have two suggestions we believe would improve clarity, as follows:

- Paragraph 2 – We suggest the first sentence state that proposed AU-C 701 applies only when the auditor is engaged to communicate key audit matters in the auditor's opinion. This would make it clear in AU-C 700 that AU-C 701 is applicable only in specific audit engagements.
 - Paragraph 26.c – The term "relevant ethical requirements" as included in this paragraph is defined in the application guidance as the AICPA Code of Professional Conduct. Paragraph A38 discusses other relevant ethical requirements and suggests that these could be named in the opinion. We question why these other relevant ethical requirements would need to be named in the opinion when the AICPA Code of Professional Conduct is not specifically named in the illustrations. We suggest that the guidance be modified to require the auditor to determine the independence and ethical requirements followed on the audit and that the phrase "relevant ethical requirements relating to the audit" as included in the opinion, would represent this determination. Otherwise, we suggest additional guidance or an illustration of suggested wording be provided for how auditors can clearly report that both the AICPA Code of Professional Conduct and other ethical and independence rules were followed on the audit.
2. *Are the descriptions of the responsibilities of management and the auditor relating to going concern (paragraphs 31.b and 36.b.iv) 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 aren't convinced that including going concern language in every report, when there is no substantial doubt about the ability to continue as a going concern, will be useful and understandable to readers for the following reasons:

- The term going concern basis (versus liquidation basis) is often confused with bases of accounting (accrual, cash basis, etc.), and we are concerned whether the language will be clear to an average reader. We believe there is a risk of misunderstanding or misinterpretation of what auditors are trying to communicate by using technical audit terminology in the audit report.
- Going concern connotes a negative situation versus the true negative situation of substantial doubt about the entity's ability to continue as a going concern. A user unfamiliar with the going concern basis of accounting may assume that if it is appropriate for the entity to use the going concern basis of accounting, the entity may be ceasing operations.
- Most entities do not have substantial doubt about their ability to continue as a going concern. As such, requiring the auditor to report every year that the entity is a going concern will merely become boilerplate language, and be glossed over by the reader when an entity does actually report that there is substantial doubt about being a going concern.

Accordingly, we strongly suggest the Board reconsider putting this language in every report. However, if the Board chooses not to remove this requirement, we encourage the requirement paragraphs (27, 31(b) and 36(b)(iv)) and the report illustrations (paragraph A83), including required wording for the auditor's report, be revised to address the first two bullets above to clarify to the average reader what a going concern is.

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)?*

Because paragraph A43 provides for **no reference** to oversight responsibilities in the report when those responsible for oversight of the financial reporting process **are the same as** those responsible for the preparation of the financial statements, we do not see any practical difficulties.

However, we do question the value of this new proposed requirement in paragraph 32. We question whether including a statement in the auditor's report adds value for the reader in those situations where those responsible for the oversight of the financial reporting process **differ from** those responsible for preparation of the financial statements. First, we believe some auditors will use generic terms like "those charged with governance" while others will use specific titles of individuals, creating inconsistency in practice. But ultimately, we don't believe this information is critical to the reader in understanding the information communicated in the auditor's report.

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?*

Except for our concerns addressed in our response to question #2 above, the expanded description of the auditor's responsibilities, including the audit's key features, may be useful information. However, providing a specific list may be misleading if users assume the list is all-inclusive. To address this, paragraph 36 could be revised to state "...that the auditor's report should further describe the following main responsibilities:". In addition, the illustrative report could include a sentence before the bulleted list of responsibilities that is expanded from "We also:" to something such as, "Our main responsibilities also include:" (with appropriate grammatical changes to the bulleted list to accommodate this new lead sentence).

In addition, although the information may be useful, we believe it could become boilerplate, whereby only the sophisticated users will truly understand the verbiage in the report. Page 8 of the exposure draft noted that other than the opinion, users believed much of the audit report was “boilerplate in nature and provided little transparency into the audit.” We are concerned that users will also deem this additional language as boilerplate.

Following are other comments relating to the proposed auditor responsibilities:

- Paragraph 35(a)(i) – We encourage the Board to consider including additional application guidance for audits governmental entities within the proposed SAS. Specifically, related to paragraph 35.a.i on page 47 and in Illustration 1 on page 68, under the heading “Auditor’s Responsibilities for Audit of Financial Statements”, a governmental auditor would not opine on the financial statements “as a whole” since auditors establish opinion units for governmental entities.
 - Paragraph 35(b) – We believe that using the word “guarantee” in describing the level of assurance provided through an audit could lower a reader’s perception of the reliance that can be placed on the audit. We suggest rewording the paragraph as follows, “State that reasonable assurance is a high level of assurance but is not absolute assurance and, therefore, *there is an unavoidable risk that an audit conducted in accordance with GAAS may not detect a material misstatement that exists.*”
 - Paragraph 37 – In an audit conducted in accordance with *Government Auditing Standards*, we are required to prepare a separate report describing internal control deficiencies that would be considered a significant deficiency or material weakness. This report would be referenced in the Other Reporting Responsibilities of the audit opinion. For audits conducted under these standards, we suggest that the standard be modified to allow for the statement required in paragraph 37 to be included in the Other Reporting Responsibilities (paragraph 38) section of the report.
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 are pleased that communicating key audit matters is not required for nonissuers.

Regarding whether the requirements and guidance in the proposed SAS will be helpful for auditors in determining and communicating KAMs, some of our members consider the requirements and guidance too prescriptive, while others believe they are too subjective. Because of this, we question whether the requirements will be consistently applied as it requires much judgment and subjectivity on the part of the auditor.

We do have a suggestion regarding hierarchy. We believe the intent of the KAM, emphasis-of-a-matter, and other-matter concepts is to establish a hierarchy. However, this intent is not clear in each of those proposed AU-C sections (paragraphs A5-A6 on page 96 and paragraph A1 on page 185). Those paragraphs state, “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) should 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?*

We believe the requirements could be clearer. The fact that KAMs are not required for audits of nonissuers is so important that we encourage the Board to explicitly state this fact in the first paragraph of this standard. To make it sufficiently clear, we recommend the Board:

- Move the information in proposed paragraph A7 to paragraph 1 or move paragraph A7 to be paragraph A1 and reference it from paragraph 1.
- Revise paragraph 6 by adding language such as "...when the auditor is engaged to do so...." so as not to indicate that it would be applicable to all audits.
- Add application guidance to explain that an audit of an issuer is an example of when the auditor would be engaged to report on key audit matters.

We also believe the Board should clarify what the auditor should do if engaged to communicate KAMs and the client subsequently decides they do not want the KAMs included in the report. Paragraph A25 on page 218 provides that, in situations when there is a change in expectations about these communications, the auditor should update the engagement letter accordingly. We assume this is addressing instances early in the audit process when management and/or those charged with governance re-evaluates its needs or based on a change in a law or regulation. In reading the guidance, however, it is not clear how an auditor should approach a scenario when the auditor is engaged to report on KAMs and the auditee decides to change the terms of the engagement because the auditee doesn't want certain KAMs to be included in the report.

7. *Are the revisions to existing requirements clear and understandable, and is the application material helpful in supporting the application of those requirements?*

We believe the revisions to existing requirements are clear and understandable, and the application material is helpful in supporting the application of those requirements.

8. *Are the revisions to existing requirements clear and understandable, and is the application material helpful in supporting the application of those requirements?*

We believe the revisions to existing requirements are clear and understandable, and the application material is helpful in supporting the application of those requirements.

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?*

Please see our response to question# 5 above regarding establishing a hierarchy for KAM, EOM, and other-matter paragraphs.

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 do not believe the requirement in AU-C section 260 should be more specific regarding the timing of communication about certain matters with those charged with governance. We appreciate the flexibility to use our professional judgment to determine the most appropriate timing of communications.

Additionally, we believe the amendment to paragraph 11 to communicate significant risks the auditor identified seems inconsistent with the extant requirement. Specifically, the extant requirement relates to communicating the planned scope and timing, which substantially occurs in the beginning of an audit, but the new language relates to communicating significant risks the auditor identifies. While certain significant risks might be identified in the planning stages, the auditor identifies risks throughout the audit. We suggest the Board consider revising or removing the amendment to paragraph 11 and consider whether auditor communication about significant risks might be incorporated into extant AU-C section 260 paragraph 12. In addition, the Board should consider clarifying in paragraph A20 that the communication would include significant risks the auditor identified during the planning stages and throughout the audit.

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?*

We don't believe including the city and state of the addressee in the auditor's report would be beneficial to the users of the financial statements.

- b. *What would the practical implications be if such a requirement were adopted?*

We know of no practical implications if such a requirement were adopted.

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?*

We believe the proposed changes are appropriate and sufficient for purposes of enhancing the auditor's focus on disclosures and, thereby, further enhancing audit quality.

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 did not identify any areas where additional enhancements are necessary.

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?*

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. We do not have any concerns.

In addition to our comments above, we believe the Board should consider these additional comments as it finalizes the standards.

- We are concerned with the effective date of these changes. For audit effectiveness and to ensure compliance with the updated standards, through updated policies and procedures and audit tools, we believe an effective date of audits of financial statements for periods ending on or after June 15, 2020 would be more feasible and appropriate.

Ms. Sherry Hazel
May 18, 2018
Page 6

- The discussion of internal control and communication of significant matters with the governing body is proposed to be removed from AU-C 260.A13. These seem like relevant and important matters that should be retained. We suggest the Board reconsider this change.
- We are unsure why “disclosure” and “including the related note disclosures” were removed from AU-C 330.26 and A72. We recommend that these requirements be retained and that the concept of presentation be inclusive of disclosures.

We appreciate the opportunity to respond to such an important document. Should you have any questions or need additional information regarding our response, please contact Sherri Rowland of NSAA at (859) 276-1147 or me at (601) 576-2641.

Sincerely,

A handwritten signature in black ink, appearing to read "Stacey E. Pickering". The signature is fluid and cursive, with a large, sweeping flourish at the end.

Stacey E. Pickering
President, NSAA