



## Agenda Item 2

# The Auditor's Involvement with Offering Documents Other than Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933

### Objective of Agenda Item

To consider the proposed Statement on Auditing Standards addressing the auditor's involvement with exempt offerings.

### Background

Exempt Securities Task Force members are:

- Chris Smith – BDO (Chair)
- Martha Garner – PwC
- Jeffrey Markert – KPMG
- Christine Piché – CliftonLarsonAllen
- Kim Tredinnick – Baker Tilly Virchow Krause

Additional assistance provided by:

- Jack Fuchs – Thompson Hine LLP
- Seth Friedman & Chris Paci – DLA Piper

See Agenda Item 2D –Background of the Task Force & Summary of ASB Discussions to Date

### Issues for Discussion (arranged in order of the proposed SAS)

#### *Introduction: Scope of This Section (.01-.02)*

The scope of the proposed SAS is intended to include all non-registered securities and franchise offerings. The proposed SAS is drafted as follows, “an offering of an investment that is not registered with the U.S. Securities and Exchange Commission (SEC) under the Securities Act of 1933 (offering document).” The Task Force has compiled a list of offerings that would be encompassed by the scope appears in Agenda Item 2C - Listing of Offerings Included in Scope of Proposed SAS. The Task Force has engaged the help of securities attorneys in drafting the scope, however the Task Force has some concern that there may be unintended consequences as to the

breadth of the scope. For example, crowdfunding offerings may not have a traditional offering document.

The proposed SAS provides a two benchmark model to require auditor involvement with an offering document:

1. The auditor's report on financial statements (or the auditor's review report on a review of interim financial information) is included or incorporated by reference in an offering document; and
2. The auditor performs one of the defined trigger activities (refer to paragraph .07. of the proposed SAS) or the terms of the engagement require involvement.

Item (1) was specifically drafted to reference the auditor's report as the Task Force thought that referencing financial statements or audited financial statements was insufficiently precise. It is the inclusion or incorporation by reference of the auditor's report that is the key filter leading to auditor involvement.

This proposed SAS uses the term nonissuer in the scope and objective sections, similar to AU-C 925, *Filings With the U.S. Securities and Exchange Commission*. As defined in the AU-C Glossary, nonissue is any entity not subject to the Sarbanes-Oxley Act of 2002 or the rules of the SEC. The use of the term in this proposed SAS seems appropriate given its use in AU-C 925, however the Task Force had some concerns in that the antifraud provisions of the SEC rules apply to nonregistrants and SEC Rule 15c2-12 applies to municipal securities disclosure. The Task Force questions whether nonissuer, as defined in the AU-C, is appropriate for this context.

The ASB discussed in the May 2015 meeting what is meant by included or incorporated by reference. The Task Force conducted a review of the professional standards and the following definitions exist in the Glossary of the AU-C:

- **included (in the context of section 920)**. References to information that is included in a document are to be read to also encompass information that is incorporated by reference in that document.
- **included or the inclusion of (in the context of section 925)**. References to included or the inclusion of in a registration statement means included or incorporated by reference in a registration statement filed under the 1933 Act
- **incorporated by reference**. See included and included or the inclusion of

Based on these definitions, the definition of included (first bullet) could be amended to make reference to the section of this proposed SAS.

The Task Force also discussed at length whether the inclusion of the financial statements in an offering document would constitute a reissuance of the financial statements either from an accounting or an auditing perspective. There does not appear to be a change to disclosures with respect to subsequent events in the financial statements from an accounting perspective (e.g., ASC 855, GASB Statement No. 56). Further, there would be no change to the date of the auditor's report without an imposed requirement. The acknowledgement or inclusion letter would be dated as of or later than the report date.

The Task Force also considered the notion of use/reuse of a report and whether there were any requirements. Reuse of a report is discussed in extant AU 530 but was not a concept carried into the clarified AU-Cs.

Thus, the Task Force did not identify an accounting or auditing pronouncement that would indicate that the inclusion of the financial statements in an offering as a reissuance.

*Issues for ASB Discussion*

1. Does the ASB agree the proposed scope covering an offering of an investment that is not registered with the SEC under the Securities Act of 1933?
2. Does the ASB have concerns with the breadth of scope?
3. Does the ASB agree with two benchmark model:
  - a. Auditor's report accompanies financial statements which is included or incorporated by reference in the offering AND
  - b. Performing certain procedures related to the offering or terms of the engagement letter require involvement?
4. Is the AU-C Glossary definition of *nonissuer* appropriate for this proposed SAS?
5. Is the AU-C Glossary definition of *included* appropriate for this proposed SAS?
6. Does the ASB agree with the Task Force conclusion that the inclusion of financial statements in an offering does not constitute a reissuance from an auditing perspective?

*Introduction: Effective Date (.03)*

Most AU-C sections tie the effective date of a new audit standard to financial statements for periods ending on or after a specified date. For purposes of this proposed SAS, the Task Force believes it is more appropriate to align the effective date to the distribution, circulation, or submission of an offering document occurring after the to be established effective date.

Issues for ASB Discussion

7. Does the ASB agree with aligning the effective date and all relevant procedures to the date of the distributions, circulations, or submissions of offering documents occurring after the established effective date of the proposed SAS?

**Objective (.04)**

The Task Force believes that the objective of this proposed SAS is to respond appropriately when the auditor, who is involved, becomes aware that offering documents include information that could undermine the credibility of those financial statements and the auditor's report. The objective is similar to that of AU-C 720. The Task Force believes the when involved, an auditor has a responsibility to evaluate the continuing propriety of his or her report that is included in the offering document, and determine that no subsequent events require adjustment of, or disclosure in, the financial statements (or interim financial information). As there is no regulatory requirement to involve auditors in these offerings, the objective applies only to those situations in which the auditor is involved.

In the application guidance there is a discussion of management keeping the auditor advised of the progress of the offering document proceedings through the closing date. The Task Force would appreciate input from ASB members as to whether there are gap periods (between date of document and effective date of transaction) to be considered in the various types of offerings. If such a gap period exists, guidance similar to AU-C 925.06 will need to be considered in this proposed SAS.

Issues for ASB Discussion

8. Does the ASB agree with the objective of the proposed SAS to respond appropriately when an offering includes information that could undermine the credibility of the financial statements and the auditor's report?
9. Is guidance necessary to address the gap period between the date of document and effective date of transaction.

***Definitions (.05-.06)***

In developing the definitions relevant to this proposed SAS, the Task Force included discussion in the application guidance to expand upon “inclusion letter” to include other terms often used for this letter. Some of these terms are closely associated with the Securities Act of 1933. The Task Force has some concern that using such terms that have a specific meaning in the SEC realm could cause some confusion.

*Issues for ASB Discussion*

10. Does the ASB have concerns with the guidance in .A8?

***Requirements: Involvement (.07)***

The trigger activities establish parameters to the proposed SAS so as to avoid an auditor from unknowingly becoming subject to the proposed SAS. At the May 2015 meeting, the ASB generally agreed that the triggers either result in an engagement (7a-7e) or an acknowledgement (7f-h) that the auditor’s report will be used in an offering. There has been a sense from some that the mere act of providing a revised report or signing a copy of a report for inclusion in an offering should not constitute involvement as these actions would be governed by the audit engagement. However, the majority of the Task Force believes that the acknowledgement driven triggers expose the auditor to liability under securities laws so these triggers would be appropriate to include.

Additionally, the Task Force was asked at the May 2015 ASB meeting to consider situations which could arise due to a change in auditor as to how the proposed standard might impact both auditors (i.e. a predecessor auditor issued an audit report on the financial statements to be included in an offering document and the successor auditor performs a review of interim financial information which is also included in the offering document). As currently drafted either or both the predecessor or current auditor could be involved as the scope addressees both audit and review reports.

*Issues for ASB Discussion*

11. Does the ASB support the inclusion of both engagement triggers (a-e) and acknowledgement triggers (f-h) to establish involvement?

***Requirements: Securities Offering Document and Other Information (.08-.09)***

Given the breadth of offerings that are covered by the scope, the Task Force has concerns over what will constitute the offering document for which the other information procedures apply. For example, the Task Force questioned what document would be used for a crowd funding offering (if the auditor is involved)?

*Issues for ASB Discussion*

12. What are ASB's thoughts or concerns regarding the nature of offering documents to which this proposed SAS would apply?

***Requirements: Subsequent Event Procedures (.10-.13)***

When the auditor is involved in an offering, the Task Force believes there should be a requirement to determine if any material events occurred subsequent to the report date that could call the auditor's report into question. The limited set of procedures related to subsequent events when an auditor is involved serves the public interest and also addresses compliance with the antifraud provisions to which these offerings are subject.

Some have argued that given the absence of a regulatory requirement for subsequent event procedures, the decision whether to perform such procedures is a risk management decision for firms to decide. There is also a question whether the issuer has requirements to update their financial statements with these types of offerings. If a preparer has no requirement to perform subsequent event procedures, some have argued it would not be appropriate to require the auditor perform subsequent event procedures. The Task Force feels strongly that the need to serve the public interest and comply with the antifraud provisions outweigh these concerns.

*Issues for ASB Discussion*

13. Does the ASB believe subsequent event procedures should be a requirement in the proposed SAS?

***Requirements: Unaudited Annual Financial Statements or Unaudited Interim Financial Information (.14-.17)***

This section tracks very closely to AU-C 925. The Task Force has no significant issues or discussion on this portion of the proposed SAS.

## **Items Presented**

Agenda Item 2 – Issues Paper

Agenda Item 2A – Draft SAS

Agenda Item 2B – Draft SAS Marked with Sources

Agenda Item 2C – Listing of Offerings Included in the Scope of Proposed SAS

Agenda Item 2D – Background of the Task Force & Summary of ASB Discussions to  
Date

Mr. Smith will refer to the Items 2 and 2A in leading the discussion. Item 2B is presented to the ASB as a reference as to where various sections of the proposed SAS were sourced (e.g., AU-C 925). Item 2C provides a listing of offerings included in the proposed SAS to provide a sense of the scope. Item 2D is also included for reference to provide new ASB members a brief background on the Task Force and issued discussed to date and to refresh continuing members as this Task Force last presented at the May 2015 meeting.