



July 3, 2013

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Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, D.C. 20006-2803

***Re: Request for Public Comment: Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards, PCAOB Rulemaking Docket Matter No. 038***

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants.

The CAQ welcomes the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) *Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* (the Reproposal). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

Consistent with our May 25, 2012 letter<sup>1</sup> to the PCAOB, we continue to support the Board's efforts to improve audit quality through strengthening the requirements relating to the auditor's evaluation of a company's identification of, accounting for, and disclosure of its relationships and transactions with related parties, and through the related amendments included in the Reproposal. We commend the PCAOB for considering the comment letters it has received from the CAQ and others in developing the Reproposal. We have identified additional suggestions for the Board's consideration, primarily related to the proposed auditing standard, *Related Parties* (the Reproposed Standard), that we believe will improve the Reproposal.

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<sup>1</sup> See CAQ letter at: <http://www.thecaq.org/newsroom/pdfs/CAQCommentLetter-RelatedParties.pdf>.

## **Related Parties**

The CAQ appreciates the revisions to the Reproposed Standard, which result in improved alignment with the PCAOB's risk assessment standards,<sup>2</sup> and consistent with such standards, reflect greater use of auditor judgment. However, we believe that the Reproposed Standard still includes some prescriptive requirements that may restrict the auditor's ability to adjust the nature and extent of audit procedures based on the auditor's risk assessment. Included below are some recommendations and suggested edits that we believe reflect an appropriate level of auditor judgment and help achieve the Board's goal of promoting audit quality and investor protection, while avoiding unnecessary costs and implementation issues.

### ***Evaluating Whether the Company Has Properly Identified Its Related Parties and Relationships and Transactions with Related Parties***

Footnote 14 of paragraph 14 in the Reproposed Standard requires the auditor, as part of evaluating whether a company has properly identified its related parties and relationships and transactions with related parties, to “perform procedures to test the accuracy and completeness of the related parties and relationships and transactions with related parties identified by the company.” We believe that paragraph 14 should be modified as follows to reflect this requirement in the body of the standard, rather than as a footnote:

“The auditor should evaluate whether the company has properly identified its related parties and relationships and transactions with related parties.<sup>14/</sup> ~~In making that evaluation, the auditor should take into account the information gathered during the audit.~~<sup>1514/</sup> Evaluating whether a company has properly identified its related parties and relationships and transactions with related parties involves more than assessing the process used by the company. This evaluation requires the auditor to perform procedures to test the accuracy and completeness of the related parties and relationships and transactions with related parties identified by the company, taking into account information gathered during the audit. As part of ~~that~~ this evaluation, the auditor should read minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.”

Additionally, the Note in paragraph 14 makes reference to Appendix A, which describes examples of information and sources of information that could indicate that related parties or relationships or transactions with related parties previously undisclosed to the auditor might exist. This reference, coupled with the requirement currently in footnote 14, might create the impression that the auditor is required to perform specific auditing procedures to identify undisclosed related parties or transactions with related parties with respect to each type or source of information listed in Appendix A. As discussed in the Reproposal, this does not appear to be the Board's intent;<sup>3</sup> therefore, in order to clarify the auditor's responsibilities, we believe that the Note in paragraph 14 should include the sentence added below. We also recommend that the last sentence of paragraph A1 be modified to include this additional language:

“Note: Appendix A describes examples of information and sources of information that could indicate that related parties or relationships or transactions with related parties previously undisclosed to the auditor might exist. Appendix A is not intended to represent a comprehensive listing, nor is the auditor required to perform procedures with respect to each type or source of information referenced in Appendix A.”

Paragraph 16 of the Reproposed Standard requires the auditor to perform certain steps “[i]f the auditor determines that a related party or relationship or transaction with a related party previously undisclosed to the auditor exists.” This could result in the auditor executing procedures (e.g., inquiry, evaluation, and communication) with respect to related party *transactions* which do not merit such procedures based on the auditor's risk assessment. This

<sup>2</sup> See PCAOB Auditing Standards Nos. 8-15 at: <http://pcaobus.org/Standards/Auditing/Pages/default.aspx>.

<sup>3</sup> See Reproposal, page A4-39.

could be remedied by indicating that the procedures in paragraph 16 do not need to be applied to related party transactions that are deemed by the auditor to be “clearly trivial” as described in PCAOB Auditing Standard No. 14, *Evaluating Audit Results*.

Furthermore, we believe that item (e) of paragraph 16 could be misunderstood as requiring the auditor to perform the procedures listed in paragraph 12 of the Reproposed Standard for each “related party or relationship or transaction with a related party previously undisclosed to the auditor,” instead of only for those matters that are, “required to be disclosed in the financial statements or determined to be a significant risk.” Therefore, we suggest the following revisions to item (e) of paragraph 16:

~~“Perform the procedures required by paragraph 12 of this standard f~~For each related party transaction previously undisclosed to the auditor that is required to be disclosed in the financial statements or determined to be a significant risk, perform the procedures required by paragraph 12 of this standard.”

### ***Communications with the Audit Committee***

Paragraph 19 requires the auditor to communicate to the audit committee “other significant matters arising from the audit regarding the company's relationships and transactions with related parties including, but not limited to (a) [t]he identification of related parties or relationships or transactions with related parties that were previously undisclosed to the auditor.” This could be interpreted as suggesting that *all* related parties or relationships or transactions with related parties that were previously undisclosed to the auditor are significant; therefore, we recommend that the word “significant” be added before the first occurrence of the phrase “related parties” in item (a) of paragraph 19 to allow for the exercise of auditor judgment in tailoring these important communications and to align item (a) with items (b)-(e) of paragraph 19.

### **Scalability and Scope**

We believe the Reproposal is scalable in that the level of audit effort will generally correlate with the number, nature, and complexity of a company's related party relationships and transactions; its significant unusual transactions, financial relationships and transactions with executive officers; and the process a company has in place to identify such matters and provide that they are appropriately reflected in the financial statements.

The CAQ believes that the final standard and amendments should be applicable to the audits of Emerging Growth Companies and audits of brokers and dealers that are required to be conducted in accordance with PCAOB standards. The CAQ believes that the financial reporting risks that the Reproposal is designed to target also exist at these entities and in some cases more prevalently.<sup>4</sup> Additionally, this would avoid bifurcation of the rules applied to financial statement audits performed in accordance with PCAOB standards, which could be confusing to investors and other stakeholders.

### **Effective Date and Transition**

The Board anticipates that the final standard and amendments would be effective, subject to approval by the Securities and Exchange Commission (SEC), for audits of financial statements for fiscal years beginning on or after December 15, 2013. We believe this anticipated effective date is reasonable if the SEC approves the Board's final standard no later than October 31, 2013. Many of the requirements of the Reproposal are focused on planning and risk assessment; it is important to allow sufficient time for auditors to incorporate the new requirements into their audit methodologies and programs, provide necessary training to audit engagement


<sup>4</sup> Financial reporting risks that are targeted by the Reproposal can be more prevalent with Emerging Growth Companies and brokers and dealers because of the size, nature, and complexity of the business model, capital structure, business processes and controls, and regulatory environment associated with these companies.

personnel, and communicate with audit committees and company personnel responsible for the preparation of the company's financial statements and disclosures.

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The CAQ supports the Board's efforts to improve audit quality through the Reproposal. We welcome the opportunity to respond to any questions regarding the views expressed in this letter.

Sincerely,



Cynthia M. Fornelli  
Executive Director  
Center for Audit Quality

cc:

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