



24 June 2013

Our ref: ICAEW Rep 92/13

Your ref: PCAOB Rulemaking Docket Matter No. 038

Office of the Secretary,  
PCAOB, 1666 K Street,  
N.W., Washington, D.C. 20006-2803.  
USA

Dear Sir

## **Re-Proposed Auditing Standard: Related Parties - Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions and Other PCAOB Amendments to PCAOB Auditing Standards**

ICAEW welcomes the opportunity to comment on the Re-Proposed Auditing Standard: *Related Parties - Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions and Other PCAOB Amendments to PCAOB Auditing Standards* published by the PCAOB on 7 May 2013, a copy of which is available from this [link](#).

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### **Main Comments**

#### **Support for the revised proposals**

We welcome the re-proposed standard which is an improvement on the original proposals published in February 2012.

In particular, we support clarification that the audited entity has the primary responsibility for the collection and disclosure of information about related parties and transactions with them. We also note the importance of alignment with the risk assessment standards.

### **Our outstanding substantive concerns**

We have outstanding concerns in a number of areas which we set out in the remainder of this letter. The requirements of paragraph 13 on intercompany transactions in particular are still unclear. Although we acknowledge that the requirement to perform procedures on intercompany transactions at a concurrent date is an existing requirement, we believe that the standard could provide more insightful guidance. The auditors' response should be based on the assessed risk of material misstatement which will be influenced by *inter alia*, the nature and materiality of the intercompany transactions, whether the intercompany transactions are eliminated on consolidation, whether the auditor is responsible for the audit of both entities, and so on. In our view it would be helpful to include such guidance in the final standard.

We believe a full year is needed for implementation of this standard to allow training to take place in the quieter months for the revision of audit methodologies. If the standard cannot be issued until the third quarter of 2013, it will be too late for implementation in the following audit season.

### **Our continued concern about shortcomings in the transparency of the PCAOB's standard-setting process**

We continue to be disappointed and concerned that the quality of the analysis of differences between the PCAOB's requirements and the related IAASB and AICPA requirements remains so poor. It amounts to little more than statements of the existing positions with no attempt to explain or justify the differences. A significant amount of audit work under these standards will be performed by auditors outside the United States by, among others, non-US accounting firms who are auditors of registrants or auditors of components of US domestic registrants. These auditors will likely have been trained in ISAs and have extensive experience in applying such standards. Furthermore, where companies are either dual listed or have local statutory reporting requirements they will need to be audited in accordance with local auditing standards. Such standards are ISAs in many jurisdictions. These auditors will look to 'bridge the gap' between ISA requirements and PCAOB standards rather than prepare a separate audit file under PCAOB standards, which would be wasteful where differences are very limited. An analysis that clearly articulates the additional requirements of PCAOB standards will likely lead to better execution of PCAOB audit work outside the United States. The absence of a better analysis also compromises the PCAOB's ability to influence the IAASB.

We have made this point in all of our recent responses to the PCAOB's exposures. We are also disappointed that no marked-up version of the repropoed standard has been made available. This lack of transparency compromises the quality of respondent comments and can appear to be a deliberate attempt to discourage detailed scrutiny. We are sure that this is not intended and we encourage the PCAOB to have more confidence in the changes it makes. A move in this direction, even if it amounted to highlighting the significant paragraphs that had changed would elicit better quality responses and ultimately result in better quality standards, audits and investor protection. This method is adopted by most standard-setters including the IAASB.

### **Costs and benefits**

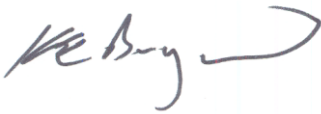
The PCAOB asks several questions about costs and benefits and asks respondents for data supporting cost-benefit analyses. These questions are disingenuous. The PCAOB would very likely already have scrutinised them, if they existed and we do not believe that the PCAOB or other standard-setters can continue to ask questions about costs, benefits or impacts without making some attempt, however rudimentary, to perform such analyses itself, or at least to provide some criteria to guide respondents in this area. Absent a framework, statements about costs, benefits and impacts whether made by standard-setters or respondents, amount to speculation.

We have made very similar points to the IAASB in several recent responses to them.

**Answers to the PCAOB's specific questions**

The appendix to this letter contains our answers to the PCAOB's specific questions. While we understand the PCAOB's desire to solicit comment, we believe that the volume of questions, many of which are repetitive and overlap, risks diminishing the quality of the feedback received. Respondents can always comment on any aspect of a proposal in the absence of a specific question soliciting input. Better responses might also be elicited were the PCAOB to consider focussing the attention of respondents on what they consider to be the key aspects of the proposals.

Yours Faithfully

A handwritten signature in black ink, appearing to read 'K E Bagshaw', with a stylized flourish at the end.

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## APPENDIX

### **1. Are the requirements of the repropoed standard appropriate? Why or why not?**

The requirements of the repropoed standard are an improvement on the original proposals although as set out above and below, we have outstanding concerns on a number of areas.

### **2. Do the changes in the repropoal clarify the relationship of the repropoed standard with the risk assessment standards? Why or why not?**

The changes in the repropoal have helped clarify the relationship of the repropoed standard with the risk assessment standards.

### **3. Does the alignment of the repropoed standard with the risk assessment standards enable the auditor to introduce efficiencies in the audit approach? Why or why not?**

Efficiencies in the audit approach will be facilitated but not guaranteed by the improved alignment.

### **4. Would the procedures required by the repropoed standard improve the auditor's understanding of a company's relationships and transactions with its related parties? Why or why not?**

The procedures required by the repropoed standard should improve the auditor's understanding of a company's relationships and transactions with its related parties to the extent that the proposals now require more of the audited entity. The success of such changes is of course partly contingent on the actions of the audited entity.

### **5. Is the requirement in the repropoed standard to evaluate whether the company has properly identified the company's related parties and relationships and transactions with its related parties appropriate? Why or why not?**

The requirement to evaluate whether the company has properly identified the company's related parties and transactions with them is appropriate. The responsibility for accounting for such transactions lies with the audited entity.

### **6. Does the repropoed standard appropriately allow for the use of auditor judgment? Why or why not?**

### **7. Are the auditor's responsibilities for the examples of information and sources of information contained in Appendix A to the repropoed standard clear? Are there other examples that should be included in the repropoed standard?**

The repropoed standard allows for some use of auditor judgment but it remains prescriptive in its overall tone and does not encourage the exercise of judgement in general. The repropoed standard no longer mandates the treatment of certain transactions as significant risks which allows for some use of auditor judgment. While we welcome clarification that the sources of information in appendix A are not necessarily required to be reviewed in all circumstances, we trust that PCAOB inspectors will also recognise this during inspections.

### **8. Is the objective of the repropoed standard appropriate? Why or why not?**

### **Does the repropoing release clearly articulate that the objective of the repropoed standard works similarly to objectives contained in other PCAOB auditing standards?**

The objective of the repropoed standard is clear although we remain of the view that it would be better, and certainly do no harm, to include a reference to fraud in the objective for the better alignment of

PCAOB standards with ISAs, and in view of the fact that transactions with related parties are a common feature of fraud.

**9. Does the requirement in the repropoed standard to perform specific procedures for each related party transaction required to be disclosed in the financial statements or determined to be a significant risk provide for a scaled approach? Why or why not?**

**10. Does the approach in the repropoed standard for the auditor to perform specific procedures for related party transactions that are required to be disclosed in the financial statements or that are determined to be a significant risk represent a cost-sensitive, yet effective, approach? Why or why not?**

Where these proposals are applied to smaller entities, a scaled, cost-effective approach is difficult to achieve if specific procedures are required. However, it is arguable the pressures to which smaller entities are subjected means that the requirements are just as necessary as they are for larger entities. Cost-sensitivity, effectiveness and scalability cannot always be achieved at the same time, particularly in areas such as these.

**11. What additional guidance, if any, regarding the auditor's responsibility for performing procedures on intercompany account balances pursuant to paragraph 13 of the repropoed standard is necessary?**

As noted in our main comments above, the requirements of paragraph 13 remain unclear. Furthermore the paragraph can be read as requiring reconciliation at the period-end date for the audited entity, at the period-end date for the correspondent entity if different, or both.

**12. Are the repropoed amendments regarding the auditor's identification of significant unusual transactions appropriate? Why or why not?**

Yes.

**13. Are the repropoed amendments regarding the auditor's evaluation of significant unusual transactions appropriate? Why or why not?**

Yes.

**14. Would the procedures required by the repropoed amendments regarding significant unusual transactions improve the auditor's identification and evaluation of a company's significant unusual transactions? Why or why not?**

Possibly.

**15. Are the repropoed amendments regarding significant unusual transactions appropriately aligned with the risk assessment standards? Why or why not?**

Yes.

**16. Do the repropoed amendments regarding significant unusual transactions appropriately allow for the use of auditor judgment? Why or why not? Does the requirement that the auditor perform specific procedures for each significant unusual transaction identified by the auditor provide for a scaled approach? Why or why not?**

Yes.

**17. Is the complementary relationship between the amendments regarding significant unusual transactions and the repropoed standard clear? Why or why not?**

Yes.

**18. Are the other repropoed amendments appropriate to address risks of material misstatement of the financial statements? Why or why not?**

Yes,

**19. Is it sufficiently clear that the auditor (a) should obtain an understanding of the company's financial relationships and transactions with its executive officers as part of the auditor's risk assessment and (b) should not assess the appropriateness of executive officer compensation? Why or why not?**

Yes, it is clear that the auditor should not assess the appropriateness of executive officer compensation.

**20. Are 'executive officers' the appropriate population for the audit procedures designed to provide the auditor with an understanding of the company's financial relationships and transactions as part of its risk assessment process? Why or why not?**

Domestic registrants are required to name their executive officers in filings with the United States Securities and Exchange Commission. Foreign private issuers are not subject to similar requirements. Therefore the auditor would need to separately determine which individuals fall within the definition of executive officers under Rule 3b-7 of the Exchange Act. Since this is ultimately a legal determination we do not believe this is appropriate.

The proposals also do not support all board structures. There may be persons falling outside the definition of 'executive officers' whose compensation arrangements might create incentives and pressures that could create risks of material misstatement. In some companies, such as financial institutions, some of the most highly compensated individuals may not meet the definition of executive officers.

**21. Would improving the auditor's understanding of a company's relationships and transactions with its related parties assist the auditor in obtaining sufficient appropriate evidence necessary to support the audit opinion? Would improving the auditor's understanding promote the exercise of professional skepticism? Would improving the auditor's understanding increase the likelihood of the auditor identifying material misstatements?**

Yes.

**Are there additional benefits that the Board should consider?**

No.

**22. Could the required communications with audit committees in the repropoed standard result in improvements to audit committees' abilities to fulfill their duties?**

Yes.

**23. Could the improved communications between the audit committee and the auditor lead to an improvement in the company's financial statement disclosures about its relationships and transactions with its related parties?**

While the company's financial statement disclosures are for the company, improved communications between the audit committee and the auditor may support higher quality disclosures.

**24. Would improving the auditor's identification and evaluation of significant unusual transactions increase the likelihood of the auditor identifying potential misstatements, including misstatements due to fraud?**

Yes.

**Would improving the auditor's identification and evaluation of significant unusual transactions promote the exercise of professional skepticism by the auditor?**

Possibly.

**Are there additional benefits that the Board should consider?**

No.

**25. Could the repropoed amendments regarding significant unusual transactions lead to an improvement in the company's disclosures about its significant unusual transactions?**

While the company's disclosures about significant unusual transactions are for the company, improved communications between the audit committee and the auditor may support higher quality disclosures.

**26. What benefits are associated with auditors obtaining an understanding of a company's financial relationships and transactions with its executive officers as part of its risk assessment? Are there additional benefits that the Board should consider?**

**27. What benefits are associated with the other repropoed amendments?**

**28. What costs will audit firms incur when implementing the repropoed standard and amendments? Please discuss both initial costs and recurring costs.**

**29. What costs will companies incur as a result of the implementation of the repropoed standard and amendments?**

Please refer to the comments in our covering letter regarding costs and benefits.

**30. Could the repropoed standard and amendments lead to other changes in behavior by the auditor, the company, or the audit committee that the Board should consider?**

No.

**31. Are there considerations relating to smaller companies that the Board should be aware of in considering its repropoal? Do smaller companies share the same risks of material misstatement of the financial statements regarding related party transactions and significant unusual transactions as the broader issuer population? Are related party transactions more common in smaller companies than the broader issuer population? Would the repropoed standard and amendments result in smaller companies experiencing unnecessarily greater or disproportionate costs compared to those experienced by larger companies? If so, how could such costs be controlled while improving audit quality?**

While we have no empirical data to support our view, on the face of it, smaller entities in general seem more likely to be at risk of materially misstated related party transactions than other entities, due to less well developed systems and pressures to perform well. The same procedures should be applied to all audits.

**32. Are there any unique considerations regarding costs for audits of brokers and dealers?**

**33. Are there unique considerations regarding costs for specific types of companies based on characteristics other than size of the transaction (e.g., industry)?**

**34. Are there additional considerations relating to competition, efficiency, and capital formation that the Board should take into account with respect to the repropoed standard and amendments? Specifically, are there benefits in lowered cost of capital from confidence in audits of issuers with related party disclosures?**

We make no comment on the audit of broker-dealers.

35. Should the repropoed standard and amendments be applicable for audits of EGCs? Why or why not? Please provide empirical data, examples and explanations for why the requirements should or should not be applicable for audits of EGCs.

36. Are related party transactions or significant unusual transactions more common at EGCs than the broader issuer population? Do financial relationships and transactions with executive officers at EGCs give rise to increased risks of material misstatements than the broader issuer population? Please provide any data you have to support your views.

37. Are there other characteristics of EGCs (e.g., the size of the company and the length of time it has been a reporting company) that the Board should consider?

38. Would EGCs benefit more or less from the repropoed standard and amendments than other companies? Would inherently riskier EGCs receive benefits relative to other EGCs because the market cannot observe certain undisclosed related party risks that the new standards would otherwise make available through better compliance by management with its disclosure obligations?

39. What costs would firms incur when implementing the repropoed standard and amendments for audits of EGCs? How will those costs differ from the costs for the larger issuer population? Which of the costs are initial or recurring or both?

40. Are there particular costs, benefits, or burdens applicable to EGCs that the Board should consider when determining whether to recommend to the Commission the application of the repropoed standard and amendments to audits of EGCs? For example, do EGCs share the same risk of material misstatement of the financial statements as the broader issuer population due to relationships and transactions with related parties?

41. Regardless of the applicability of the repropoed standard and amendments to audits of EGCs, would an audit firm perform the same procedures for an audit of an EGC and an audit of a non-EGC to ensure a consistency in the training, methodology, and tools in their audit practice or to respond to risks of material misstatement with similar approaches?

42. Would the implementation and training costs that a firm would incur be dependent upon whether the standard is applicable to EGCs?

Would such costs generally be fixed once required to be implemented, regardless of whether the standard is applicable to audits of EGCs?

43. For auditors of both EGCs and other SEC registrants, would it be more costly to not apply the repropoed standard and amendments to audits of EGCs because the firms would need to develop and maintain two audit methodologies?

44. Are there any other considerations relating to competition, efficiency, and capital formation that the Board should take into account when determining whether to recommend to the Commission the application of the repropoed standard and amendments to audits of EGCs?

While we have no empirical data to support our view, on the face of it, EGCs in general seem more likely to be at risk of materially misstated related party transactions than other entities, due to less well developed systems and pressures to perform well. The same procedures should be applied to all audits.

49. Is the Board's anticipated effective date appropriate? Why or why not?

50. Does the new proposed effective date allow sufficient time for firms to incorporate the new requirements into their methodology, guidance and audit programs, and training for staff? Why or why not?

We believe a full year is needed for implementation in order (a) for sufficient training to take place in the typically quieter months and (b) for the development or refinement of audit methodologies to reflect the requirements of the proposed standard and amendments. If the standard cannot be issued until the



third quarter of 2013, it will be too late for implementation in the following audit season. We therefore suggest an effective date of audits of financial periods ending on or after 15 December 2014.

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