



July 1, 2013

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

Dear Board Members:

The Audit and Assurance Services Committee of the Illinois CPA Society (“Committee”) is pleased to comment on the Reproposed Auditing Standard, *Related Parties, Proposed Amendment to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions and Other Proposed Amendments to PCAOB Auditing Standards* (Docket Matter No. 38). The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These comments and recommendations represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which such members are associated.

The Committee reviewed and commented on the original proposal in 2012. We thank the PCAOB for considering our comments and specifically addressing them on page A4-46 of Appendix 4. We also thank the PCAOB for considering all comments received, editing the original proposal, and reproposing this standard. We fully believe that this open process and full discourse leads to a superior set of standards.

Our committee studied the reproposed standard and all of the release materials. The documentation is thorough, but quite lengthy. We agree with Board Member Steven Harris’ encouragement to look for ways to streamline future releases. Accordingly, our comments do not follow the prescribed set of questions; instead we include some comments on the docket in this letter. Additionally because of the lengthy materials, we urge the Board to reconsider the effective date. We recommend that the effective date be no earlier than fiscal years beginning on or after June 15, 2014.

Related Parties

We support the PCAOB’s efforts to create a standard responsive to risks associated with related parties and significant unusual transactions. Overall, we agree with the PCAOB’s comments on page A4-46 and believe that auditors should perform specific procedures “to determine whether related parties and relationships and transactions with related parties have been identified, accounted for, and disclosed in the company’s financial statements.” However, we diverge over the extent of investigative procedures necessary as part of a financial statement audit. As written, the reproposed standard’s objective appears, to us, to require performance of procedures equivalent to a stand-alone forensic engagement to uncover all related parties and transactions regardless of quantitative or qualitative risk factors.

The release documentation states that one of the reasons for replacing AU sec. 334 is alignment with the risk assessment standards. We support this goal. We agree that auditor judgment is paramount when performing audit procedures over related parties. We agree that only certain related party transactions may rise to the level of a “significant risk.” This scaled approach is both effective and cost-sensitive.

Regardless of the risks assessed, the reproposed standard includes a requirement (paragraph 14) for the auditor to evaluate whether management identified all of the related parties. We disagree with this requirement on every audit engagement as it does not allow for auditor judgment that the Board incorporated in other areas. We agree that inquiring of management and obtaining representations about the existence of related parties is one way to identify their existence. If the requirement is retained, we urge the Board to include additional methods auditors can use to test for the existence of related parties. For example, we particularly like Appendix A, which includes examples for the auditors to consider. If possible, we request the Board to expand this Appendix to include additional examples and guidance. (We recommend including this type of guidance whenever possible as part of all future standards.)



We support increased discourse between the auditor and the audit committee, which will hopefully lead to increased audit committee knowledge and responsibility. The repropoed standard includes a requirement (paragraph 19) for the auditor to communicate the results of the related party procedures and a requirement (paragraph 7) for the auditor to inquire of the audit committee about related party relationships as part of the risk assessment procedures both which we believe are positive improvements.

The repropoed standard includes five required procedures (paragraph 12) that the auditor should perform for transactions required to be disclosed or determined to be a significant risk. While we agree that the auditor should perform procedures for both of these situations, we do not agree that the same response is sufficient for both situations. From our reading, it is also unclear as to whether the auditor should perform additional procedures beyond those in paragraph 12 if a significant risk associated with related parties is identified.

Additionally, paragraph 12 includes a requirement at d for the auditor to “evaluate the financial capability of the related parties.” We agree that evaluating a related party’s financial health can be an appropriate response to related party risks. However, the auditor should be able to use judgment to determine whether or not this procedure is necessary. Due to the difficulty in obtaining such information, the auditor should be allowed to select a more effective or more economical response. Additionally, we request the Board to add guidance regarding appropriate alternative procedures if information regarding the related parties’ financial capability is not readily available.

Paragraph 14 includes a requirement for the auditor to evaluate the sufficiency of the company’s related party identification. As written, this requirement suggests that an auditor needs to perform a forensic audit of all transactions to search for any and all related party transactions, regardless of risk (qualitative factors) or materiality (quantitative factors). The risk assessment and response sections of the repropoed standard allow the auditor to use judgment as part of the risk assessment process (one of the adjustments we support). Additionally, the required procedures are not sufficient to draw a conclusion that all related parties were identified. We think this requirement will mislead investors. The paragraph includes a requirement to read the minutes of applicable meetings. We agree with this requirement, but we do not think it is sufficient to identify all related party transactions.

Unusual Transactions and Other Comments

The Committee believes the repropoed amendments related to unusual transactions are aligned with the risk assessment standards. We think these procedures are properly responsive and could assist the auditor in identifying a related party.

The adjustments with respect to understanding the company’s financial relationships with its executives as part of risk assessment appear appropriate to the Committee. However, the Committee strongly believes auditors should not be responsible for assessing the appropriateness of executive compensation. This type of assurance is not required to opine on whether or not the financial statements are fairly stated. If the executive compensation plans do not warrant an audit response based upon the risk assessment procedures performed, the auditor should not be required to perform any additional procedures.

The Committee thanks the PCAOB for considering companies other than the Fortune 500 when developing its standards. These companies are critical to the success of the economy. We believe the auditing standards should apply to all entities. We do not support carve-out or add-on pieces for entities of differing sizes. The standards should be written to allow for auditor judgment in determining the appropriate related party and unusual transaction response. Small companies may have many related parties and large companies may have very few related party transactions.



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The financial thresholds that make sense for scalable financial reporting does not transfer to audit scope because each entity is unique.

The Illinois CPA Society appreciates the opportunity to express its opinion on this matter. We would be pleased to discuss our comments in greater detail if requested.

Sincerely,

James J. Gerace, CPA

Chair, Audit and Assurance Services Committee

Elizabeth J. Sloan, CPA

Vice Chair, Audit and Assurance Services Committee



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APPENDIX A

AUDIT AND ASSURANCE SERVICES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2013 – 2014

The Audit and Assurance Services Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members. The Committee seeks representation from members within industry, education and public practice. These members have Committee service ranging from newly appointed to almost 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of audit and attestation standards. The Committee’s comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of audit and attestation standards. The Subcommittee develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

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