

May 31, 2012

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

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Re: PCAOB Rulemaking Docket Matter No. 38, Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards

**Dear Board Members and Staff:** 

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or 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.* Due to the significance to investors of investee relationships and transactions with related parties and those with executive officers and the importance of appropriately considering significant unusual transactions, we support strengthening PCAOB standards related to these matters and respectfully submit our comments and recommendations on the Board's proposals.

Overall, we agree with the broad objective for the auditor to obtain sufficient appropriate audit evidence to determine whether related parties and relationships and transactions with related parties have been properly identified, accounted for, and disclosed in the financial statements based on the applicable financial reporting framework (a framework neutral approach). We have some concerns, however, with the clarity of the supporting requirements to identify related parties, obtain an understanding of relationships and transactions with related parties, and respond to the risks of material misstatement as set forth in the proposed standard. These concerns are expressed below.

Identifying related parties and understanding relationships and transactions

The proposed standard, in paragraph 3, requires the auditor to "...perform procedures to identify the company's related parties, obtain an understanding of the nature of the relationships between the company and its related parties, and understand the terms and business purposes (or the lack thereof) of the types of transactions involving related parties." Because management has the primary responsibility for the financial statements and identifying related party relationships and transactions, we do not fully agree with how this requirement is worded. We are primarily concerned with the statement "the auditor should perform procedures to identify the company's related parties." This statement not only infers that the



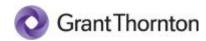
auditor has the same responsibility as management, but it also seems contradictory to the objective of the auditor in paragraph 2, which is to obtain sufficient appropriate audit evidence to determine whether related parties and relationships and transactions with related parties have been properly identified, accounted for, and disclosed in the financial statements by management. Accordingly, we suggest that the Board modify the requirement so that it properly focuses on the auditor's responsibility to "perform procedures to determine whether management has properly identified the company's related parties" (the completeness assertion).

We also believe that the procedures required by paragraphs 5 through 8 could be better linked to the more general, overarching requirement in paragraph 3 and the identification and assessment of risks in paragraph 12, meaning that the auditor performs the procedures in paragraphs 5 through 8 and any other risk assessment procedures considered appropriate. Ultimately, these procedures support the requirement in paragraph 12 to identify and assess the risks of material misstatement.

## Responding to the risks of material misstatement

The proposed standard, in paragraphs 15 and 17, includes fairly prescriptive audit requirements for each related party transaction, or type of related party transaction, that is either required to be disclosed in the financial statements or determined to be a significant risk and for a previously undisclosed related party or relationship or transaction with a related party. Although we generally agree with the nature of those procedures, we believe that the proposal does not appropriately take into account the auditor's risk assessments for a particular related party or transaction, nor does it seem to allow for the use of professional judgment based on the nature of the related party relationship or transaction. For example, with respect to paragraph 15, we would expect the auditor to perform substantive procedures on material related party transactions or types of transactions; however, the types of procedures to be performed may vary based on the risk of material misstatement due to fraud or error, including consideration of whether the transaction is recurring, complex, or unusual. In this regard, to focus the auditor's attention on areas that pose greater risk of material misstatement, we believe that the Board should consider revising the proposed requirements to differentiate the auditor's responsibilities for related party transactions that are deemed to be significant risks from those that are material but otherwise do not pose such risks. This would allow the auditor's procedures to be commensurate with the identified risks.

Likewise, we are concerned with certain requirements in paragraph 17, which requires the auditor to perform specific procedures if the auditor identifies previously undisclosed related party relationships or transactions. Particularly, paragraph 17e assumes that all previously undisclosed related party transactions are significant risks, requiring the auditor to perform all of the procedures required by paragraph 15 without consideration of the auditor's reassessment of the risk of material misstatement required by paragraph 17g. Accordingly, we request the Board to incorporate paragraph 17e within paragraph 17g, thereby requiring the auditor to determine whether the previously undisclosed related party transaction represents a significant risk for which the procedures in paragraph 15 would then apply. We also suggest that the Board combine the requirements in paragraphs 17b and 17f as well as the requirements in paragraphs



17d and 17g. Combining paragraphs 17b and 17f would provide a better link between understanding why the relationship or transaction was previously undisclosed and the related implications on the auditor's assessment of internal control over financial reporting. Similarly, combining paragraphs 17d and 17g would more clearly indicate that the auditor's reassessment of the risk of material misstatement would need to take into account the need to perform procedures to identify other potential undisclosed relationships.

## Understanding relationships and transactions with executive officers

The proposed amendments require auditors to perform procedures to obtain an understanding of the company's financial relationships and transactions with its executive officers. The purpose of such procedures is to identify conditions that could result in risks of material misstatement, including fraud risks and undisclosed related party relationships and transactions. We support these proposed amendments and have provided specific comments for the Board's consideration below. Nevertheless, we believe that there is a misperception by some that the procedures are intended to influence executive compensation programs, and therefore, we strongly encourage the Board to address this misunderstanding through discussion in the final release or in other communications.

## Additional discussion and guidance

Appendix 4 – Additional Discussion of the Proposed Standard and Proposed Amendments and Questions for Public Comment (Appendix 4) provides a detailed discussion of the proposed standard and proposed amendments and includes some additional requirements and additional guidance in the form of suggested procedures. We believe that the discussion assists auditors in understanding the intent of the proposed requirements and that it will be essential to carry forward key matters to the final release. In particular, the additional discussion in Appendix 4 emphasizes the risk of fraud and fair presentation, which are not as prominently discussed in the proposed standard. Appendix 4 also provides several examples of additional procedures that the auditor may perform in certain circumstances. We are very concerned that the Board's construct in setting its standards by excluding essential guidance from those standards hinders an auditor's ability to comply. We encourage the Board to consider this matter in finalizing its proposal and in the development of its codification of the entire body of standards and guidance.

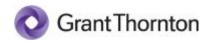
## Other comments

The following offers more specific comments related to the proposed standard and the proposed amendments for the Board's consideration.

Paragraph	Comment		
Appendix 1 – Proposed Standard, Related Parties			
7	We agree that the auditor should inquire of others within the company regarding relationships and transactions with related parties. We also believe that paragraph 7 appropriately acknowledges that the extent of those inquiries may vary. However, the first sentence in this paragraph requires the auditor to inquire of others regarding the matters in paragraph 6. This can be misconstrued to mean that all inquiries in paragraph 6 are required, but the auditor determines the extent of those inquiries. We believe that all of the inquiries may not apply to all of the individuals listed in paragraph 7.		



Paragraph	Comment
8	To corroborate management's responses to the auditor's inquiries in paragraph 6, we propose expanding the inquiries of the audit committee to include the audit committee's understanding of the business reasons or business purposes of significant related party transactions.
11	We understand the purpose of this requirement and agree that the auditor should apply professional scepticism and be aware of information coming to the auditor's attention that contradicts other evidence obtained, including related parties previously undisclosed to the auditor. We question, however, the grammatical accuracy and clarity of the requirement. Information may come to the auditor's attention that requires further evaluation by the auditor. The requirement, however, indicates that the auditor evaluates <i>whether</i> information that comes to the auditor's attention indicates that previously undisclosed matters might exist. This essentially infers a separate evaluation of all information obtained by the auditor. Accordingly, we question the appropriate use of the phrase "evaluate whether" and, in consideration of the requirement in paragraph 16, propose an alternative requirement for the auditor to "remain alert" for information or other conditions that indicate related parties or relationships and transactions with related parties previously undisclosed to the auditor might exist. This would be consistent with the discussion in Appendix 4.
14	Although we recognize that the requirement to perform procedures on intercompany account balances as of concurrent dates is based on an existing requirement, we believe that additional context is necessary to more fully describe the auditor's responsibilities. We believe that the procedures performed by the auditor would depend on the type of account balance, its materiality and whether it is eliminated in consolidation, the requirements of the applicable financial reporting framework, and the risk of material misstatement. We also believe that, when fiscal years differ, testing could be performed at a concurrent interim date; the requirement, as proposed, may be read to infer that testing is required as of period end. Further, it would be helpful to recognize the coordination of activities with other auditors involved in the audit.
19	We believe that the requirement to express a qualified or adverse opinion presumes that the statement by management regarding arm's length transactions is material to the financial statements. The Board may consider clarifying this requirement to include the assessment of materiality to the overall financial statements. In addition, it may also be helpful to indicate the reason why the lack of evidence could result in an adverse opinion, rather than a disclaimer of opinion; that is, generally accepted accounting principles in the United States of America and International Financial Reporting Standards as issued by the International Accounting Standards Board require management to substantiate arm's length representations, resulting in a departure from generally accepted accounting principles. Other foreign accounting frameworks, however, may not be as explicit.
20	This paragraph addresses the auditor's responsibility to communicate certain matters regarding the auditor's evaluation of relationships and transactions with related parties to the audit committee. Although we understand that the primary communication in the first sentence of paragraph 20 is aligned with the scope of the proposed standard in paragraph 1, it is unclear what the Board expects the auditor to communicate beyond the significant matters that are specifically identified. Accordingly, in lieu of the two separate requirements related to these audit committee communications, we suggest that the Board retain the requirement in the second sentence of paragraph 20, while eliminating the first sentence and replacing it with a separate item (e) such as follows "Other significant matters, if any, related to the auditor's evaluation of the company's identification of, accounting for, and disclosures of its relationships and transactions with related parties."
Appendix A	Appendix 4 indicates that an auditor would not be required to review each source of information referenced in Appendix A, but may be required to perform auditing procedures with respect to certain of those sources. We suggest that the Board include this discussion within Appendix A.



Paragraph	Comment	
Appendix 2 – Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions		
AU sec. 316 66A(c)	Paragraph 66A requires auditors to design and perform procedures to obtain an understanding of the business purpose (or lack thereof) of each significant unusual transaction. Specifically, paragraph 66A(c) requires an evaluation of the financial capability of the other parties with respect to significant uncollected balances, guarantees, and other obligations, if any. We agree that this is an important auditor consideration, and we also agree with the examples of information that were provided that might be relevant to the auditor's evaluation. We are concerned, however, with situations that may arise in which information related to an unrelated third party is not available for the auditor to make such an evaluation. It would be helpful for the Board to acknowledge such circumstances and the related auditor response. We have the same observation with respect to the requirement in paragraph 15c of the proposed standard.	
AU sec. 316 67	Paragraph 67 includes a list of matters that the auditor should evaluate when making an evaluation as to whether the business purpose (or lack thereof) indicates that a significant unusual transaction may have been entered into to engage in fraudulent financial reporting. For the most part, we agree with the matters listed. However, we request the Board to consider whether certain matters should be included within paragraph 66A, which requires the auditor to understand the business purpose (or lack thereof). For instance, to obtain an understanding of the business purpose (or lack thereof) of each significant unusual transaction, we would expect auditors to understand the form and complexity of the transaction, the related and unrelated parties involved and their financial capability, and the economic or commercial substance of the transaction. Such understanding would then influence the auditor's evaluation related to fraud risk, in addition to certain of the other matters listed in paragraph 67	
Appendix 3 – Other Proposed Amendments to PCAOB Auditing Standards		
AS 12 11, A3A	It may be possible that executive officers, as defined, and senior management may be the same individuals for certain entities, particularly for non-issuer brokers and dealers. Thus, we believe that it would be helpful to recognize this point within the final standard. Similarly, we note that PCAOB standards are also applied to other types of non-issuer entities, such as those that are subsidiaries of issuers. The definition of executive officer, however, does not seem to fully contemplate the application of PCAOB standards to these non-issuer entities. We believe that understanding compensation arrangements with senior management may be sufficient when performing separate audits of such non-issuer entities.	
AU sec. 315 09	We request the Board to reconsider the form of inquiry of the predecessor auditor regarding the company's relationships and transactions with related parties and significant unusual transactions. Because relationships and transactions with related parties and significant unusual transactions should be appropriately reflected and disclosed within the financial statements and because the inquiries in paragraph 09 primarily pertain to the auditor's acceptance of the audit engagement, we believe that any required inquiry of the predecessor auditor could be focused on the predecessor auditor's views related to the risk of fraud related to these matters. The specific inquiries proposed by the Board, however, would be more appropriate during the review of the predecessor's audit documentation.	
AU sec. 333 06	We suggest that the Board consider combining the management representations concerning related parties and related party transactions; in particular, those related to arm's-length transactions (subparagraph I and paragraph 11A). We believe that this will help streamline and clarify the auditor's responsibilities.	
AU sec. 9543 05	Paragraph 05 is being amended to require the other (component) auditor to inquire of the principal (group) auditor as to matters significant to the audit. First, we believe that the Board should clarify the requirement to indicate that the matters significant to the auditor are those transactions, adjustments, or other matters that have come to the group auditor's attention that may require adjustment to or disclosure in the financial statements of the component. Second, we note that paragraphs 06 and 07 are not being amended; these paragraphs still infer that the inquiry is based on the component auditor's judgment.	



Paragraph	Comment
AU sec. 722 24	The amendment to subparagraph g indirectly infers that the auditor should be obtaining the names of all related parties and all relationships and transactions with related parties on a quarterly basis, while there is no equivalent required inquiry of management to do so. Although we recognize that this may be appropriate in an initial review of interim financial information, it may be best to amend paragraph 18(c) to require inquiries of management regarding changes in related parties or significant new related party transactions. The representation itself can then be focused on management's disclosure of such changes to the auditor.

We would be pleased to discuss our letter with you. If you have any questions, please contact Karin A. French, National Managing Partner of Professional Standards, at (312) 602-9160.

Frank Thanto SP

Sincerely,