

May 17, 2012

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

Submitted via email to: [comments@pcaobus.org](mailto:comments@pcaobus.org)

**Re: PCAOB Release No. 2012-001 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. 38**

The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 28,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above captioned release.

The NYSSCPA's Auditing Standards, International Accounting and Auditing, and SEC Practice Committees deliberated the release and prepared the attached comments. If you would like additional discussion with us, please contact Jan C. Herringer, Chair of the Auditing Standards Committee at (212) 885-8133, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

  
Richard E. Piluso  
President

Attachment

**NEW YORK STATE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON**

**PCAOB RELEASE NO. 2012-001  
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. 38**

**MAY 17, 2012**

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**New York State Society of Certified Public Accountants Comments on  
PCAOB Release No. 2012-001 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. 38**

**Overall Comments**

We welcome the Public Company Accounting Oversight Board's (Board's) efforts to improve Auditing Standards applicable to related party relationships and transactions and significant unusual transactions. Overall, we agree with the above referenced Release ("the proposal").

In particular, we agree with the Board's decision to adopt a "framework neutral" approach and to allow the relevant financial reporting framework to provide the definition of a related party. We believe that the Board's consideration of both related party transactions and significant unusual transactions in tandem (creating a linkage between these two audit areas) is an intelligent way of addressing this limitation.

Related party transactions cannot be presumed to represent "arms-length" transactions. Therefore, the Accounting Standards bodies have emphasized the need for disclosure of such transactions so that the user of a company's financial statements is aware that the economic implications of such transactions may not represent otherwise expected economic results.

Similarly, certain other relationships, other than related party, may result in transactions that are not carried out at "arms-length" terms, for example, where the benefits to one or both parties to a transaction are unusual due to their timing, size or nature. Such unusual transactions do not meet the accounting framework definition of a related party. However, the recognition in the Release that the financial statements are impacted by such transactions that may be carried out at "non-arms-length" terms has significant implications on the utility of those financial statements and the financial picture that they portray. Therefore, we recognize the importance of emphasizing in Auditing Standards the identification of significant unusual transactions. Only then can the auditor identify and assess the risks with which a material misstatement and the appropriate accounting recognition and disclosure issues can be dealt. We believe that this is the fundamental objective and purpose for identifying both related party transactions and significant unusual transactions.

One overriding concern, however, is that no Auditing Standard will insure that all related parties will be identified. While an auditor can and should be vigilant in attempting to identify related parties, addressing the completeness assertion is normally difficult because it involves searching for the unknown. This inherent limitation on the ability of an auditor to detect material misstatements, particularly as it relates to related parties, is due in part to the greater opportunity for collusion, concealment or manipulation by management, resulting in an unavoidable risk that not all related parties will be identified. Similarly, some transactions may not appear to be unusual because oral commitments or side agreements may not be made known to the auditor and the existence of such may be extremely difficult to detect. We agree that a well-designed and executed audit (using the guidance set forth in the proposal) should identify many related party

and significant, unusual transactions. However, we are concerned that the standard implies that the auditor will always be able to identify all such transactions.

### **Additional Comments**

We have certain comments which we hope will be useful to the Board as it deliberates this issue. Where applicable, the comments are referenced to the specific paragraph of the proposal.

### Examples of Transactions

While the definition of a related party is contained in Generally Accepted Accounting Principles (GAAP) literature, it may be useful to auditors for the Board's Auditing Standards to contain illustrative examples of the types of transactions which may either be related party transactions or unusual transactions. Obviously, it would be impossible to provide a comprehensive list of such transactions.

### Identifying Related Parties and Obtaining an Understanding of Relationships and Transactions with Related Parties

Identification—Paragraph 3 of Appendix 1, Proposed Standard, *Related Parties*, indicates that “[T]he procedures performed should be designed to identify...transactions with related parties... previously undisclosed to the auditor.” We agree that such a statement is appropriate as an objective of the standard, but may be problematic as a requirement because the ability to assess the unknown, regardless of the care in planning and designing procedures and the diligence in executing those procedures, may not in all cases identify related parties that management has not disclosed to the auditor. For this reason, we suggest revising this paragraph accordingly. See our comments under “Overall Comments.”

Internal Control—We agree with the requirement of paragraph 5, *Obtaining an Understanding of Internal Control over Financial Reporting*, paragraph 5 of Appendix 1, Proposed Standard, *Related Parties* that requires the auditor to obtain an understanding of the controls management has established. However, we believe that the proposed standard would be strengthened by including additional guidance that explains that in certain situations controls over related party relationships and transactions may be deficient, may more readily be overridden by senior management or may not exist. In these situations, the auditor may not be able to rely, in any way, on the control structure in designing audit procedures to obtain adequate audit evidence.

Inquiries—The principal way in which related parties will be identified remains inquiries. The proposal should make clear that the provisions of *Performing Inquiries*, paragraphs 6 to 8 of Appendix 1, Proposed Standard, *Related Parties*, are merely illustrative of the procedures to be employed, and that inquiries should be made of any individuals from whom relevant information may be obtained. Management officials could include, for example, the CEO, the CFO, general counsel, senior marketing and sales personnel and senior operating officials.

Previously Undisclosed Relationships—Related Parties or Relationships or Transactions with Related Parties Previously Undisclosed to the Auditor, Paragraphs 16 and 17 of Appendix 1, Proposed Standard, *Related Parties*, discusses what an auditor should do if the auditor becomes aware of additional potential related parties. As part of the assessment, the auditor should carefully consider whether the failure to disclose this information originally provides evidence that the veracity of management can no longer be trusted. In many cases inquiries will be the only way to identify related parties. When the responses prove to be incomplete, or worse, misleading, the auditor should assess the impact of this on the auditor’s ability to form an overall opinion on the financial statements. This potential should be emphasized in the proposal and reporting guidance provided for such circumstances. It should be noted in the Standard that even though the SEC may not accept such a report modification, the auditor’s obligation is, nevertheless, to issue only the type of report that is warranted by the circumstances.

### Evaluating Financial Capability

We recognize the current guidance in paragraph 10c of AU Section 334, *Related Parties Disclosure*, indicates that evaluating the financial capabilities of the related parties with respect to significant uncollected balances, *etc.* should be considered. However, we are concerned that an absolute requirement as stated in *Responding to the Risks of Material Misstatement*, paragraph 15c of Appendix 1, Proposed Standard, *Related Parties*, of the proposal may be difficult to perform when the related party is privately held and not controlled by the audit client.

Further, the assessment that the audit client has the ability to exercise significant influence over the related party (or *vice versa*) may have been made, but that does not necessarily equate to management of the audit client having sufficient influence over the related party to demand the receipt of non-public information (*e.g.*, the related party’s income tax return). When management does not have sufficient information to make an appropriate assessment of collectability, management must assess whether it has met the requirement for revenue recognition under GAAP.

The auditing procedures set forth in *Responding to the Risks of Material Misstatement*, paragraph 15d. are very broad. It appears to be an indication that, absent the procedures designed to identify related party transactions specified in *Identifying Related Parties and Obtaining an Understanding of Relationships and Transactions with Related Parties*, paragraphs 3 to 8 of Appendix 1, Proposed Standard, *Related Parties*, of the proposal, the Board believes that all related party transactions should be identified. See our previous comments under “Overall Comments” and “Identifying Related Parties.”

Please consider the impact of these comments on Appendix 2, *Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions*, pages A2-6 to 8.

### Audit Committee Communication

We agree with the requirement of *Communications with the Audit Committee*, paragraph 20. We believe, however, that the cohesiveness of the proposal could be improved by adding communication with the audit committee to the objective of the proposal. Also, we suggest

adding the following to the end of paragraph 6 of Appendix 1, Proposed Standard, *Related Parties*:

See the requirements of *Communications with the Audit Committee*, paragraph 20d where management is unable to convince the auditor of the validity of the business reasons for the transactions.

Comment on Appendix A to Appendix 1, Proposed Standard, *Related Parties*:

Are the sources of information set forth in paragraph A3, Page A1-11, contingent on the indications that related party transactions may exist? If not, is the auditor expected to plan the audit to search for all sources of information set forth in paragraph A3, Page A1-11? This could result in a significant expansion of the audit.

Comment on Appendix 2 Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions

We recommend inserting the term “significant” before the word “infrequent” on page A2-5 under “AU sec. 722, *Interim Financial Information*.” The bullet point, as revised, would state:

The occurrence of significant infrequent or significant unusual transactions.

Comments on Appendix 3—Other Proposed Amendments

On page A3-3, we recommend changing “understanding of” to “knowledge about.”

On page A3-3, we note that the additional audit work paper sections that the Board is suggesting the predecessor auditor “should ordinarily permit” the successor auditor to review are sections that could involve significant matters of auditor judgment. Because the decision to provide the successor access to work papers is a matter of the predecessor auditor’s judgment, the successor may find it difficult to obtain access to such work paper sections.

On page A3-4, the Board has proposed an amendment to AU sec. 330, *The Confirmation Process*, to replace the footnote to paragraph 27. In addition to this amendment, we believe guidance should be provided that explains that, with respect to confirmation requests of related parties, the auditor should consider the reliability of the response to a confirmation request and that the auditor should obtain further audit evidence to resolve any doubts, if any exist, about the reliability of such a response.

On page A4-5, in the second to last paragraph, does the Board expect the procedures applicable to inter-company transactions be applied to those which are eliminated in consolidation? If so, this should be explained more fully in the proposed standard.

On page A4-36, the ability to evaluate the financial capabilities of an unrelated other party to a transaction may be difficult, if not impossible to do. See our comments under “Evaluating Financial Capability.”

## Comments on Appendix 5

We appreciate the PCAOB's efforts to review the differences and similarities regarding this proposed standard and amendments with the existing analogous standards of the International Auditing and Assurance Standards Boards (IAASB) and Auditing Standards Board (ASB). Audits involving international entities have an inherent risk in this area due to the variances in practice methodology and evolving standards, and private companies do not have the same reporting obligations as public companies. Outlining the variance in these standards can be very helpful to auditors seeking to develop audit processes when dealing with international subsidiaries or understanding the requirements of a foreign parent or a private entity and we encourage continuing this practice.

In particular, as noted by the PCAOB, various proposed standards and amendments do not have the equivalent or similar standards internationally: page A5-16, (Section A of Appendix 2 ) *Significant Unusual Transactions, Identifying Significant Unusual Transactions*; page A5-19, (Appendix 3) Auditing Standards No. 12, *Identifying and Assessing Ricks of Material Misstatement* and AU sec 315, *Communications Between Predecessor and Successor Auditors*; page A5-20, AU sec. 333, *Managements Representations*; page A5-22, AU sec. 722, *Interim Financial Information* or obligations under either international standards or for private companies; and, page A5-20 AU sec 316, *Consideration of Fraud in a Financial Statement Audit*. These differences will require the auditors to assess the different level of audit work performed at the various local levels in order to determine overall adequacy of the procedures performed relating to related parties and significant unusual transactions.