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Via E-mail: [comments@pcaobus.org](mailto:comments@pcaobus.org)

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

**Re: Request for Public Comment: PCAOB Release No. 2013-004, Rulemaking Docket Matter No. 038, *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 Office of the Secretary:

BDO USA, LLP appreciates the opportunity to respond to the request for comments on the Public Company Accounting and Oversight Board's (the "PCAOB" or the "Board") *Proposed Auditing Standard - Related Parties* (the "Proposed Standard"), *Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* (the "Release"). Consistent with our letter dated May 31, 2012, on the Board's prior release on this same topic, we continue to support the Board's efforts to update and strengthen the work the auditor does with respect to related party relationships and transactions, as well as significant unusual transactions and financial relationships and transactions with executive officers, through alignment with the standards of the International Auditing and Assurance Standards Board, the Auditing Standards Board ("ASB") of the American Institute of Certified Public Accountants, and the PCAOB's own risk assessment standards. While overall, we believe the enhancements described in the Release will contribute to the quality of public company audits, we have provided additional suggestions that we believe would further advance audit quality.

#### **Responsibility of the Auditor to Evaluate the Company's Identification of Related Parties**

We support the change from the previously proposed related party standard that now recognizes that while the auditor is responsible for evaluating the company's identification of related parties, the company is responsible for establishing and maintaining a process to support that identification. However, while we agree that the auditor's 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, we believe this guidance more appropriately belongs within the body of the standard, rather than within a footnote to paragraph 14 of the Proposed Standard. In our view, auditor requirements are best understood if they are included within the body of the Proposed Standard, to mitigate any possibility that such guidance is either inadvertently overlooked or misunderstood to be of lesser importance. Including required procedures within the body of the standard would clearly communicate the significance of the required procedure. For this



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reason, we suggest deleting footnote 14 and modifying paragraph 14 as follows: (additions are in bold italics and deletions are in strikethrough text)

The auditor should evaluate whether the company has properly identified its related parties and relationships and transactions with related parties *by assessing the process used by the company and performing procedures to test the accuracy and completeness of the related parties and relationships and transactions with related parties identified.* In making ~~this~~that evaluation, the auditor should take into account the information gathered during the audit, ~~As part of that evaluation, the auditor should~~ *including* reading minutes of the meetings of stockholders, directors, or summaries of actions of recent meetings for which minutes have not yet been prepared *and such other records or documents as the auditor considers necessary in the circumstances.*

Furthermore, we believe that the auditor's responsibility to perform specific procedures with respect to each type or source of information listed in Appendix A should be clarified. We believe that the intent of paragraph 14 and the related footnote 14 is that auditors should remain alert for arrangements or other information that may indicate the existence of related party relationships or transactions previously undisclosed by management, when inspecting records or documents in the performance of other audit procedures. Accordingly, we suggest revising the Note to paragraph 14 as follows:

Note: *During the course of the audit, the auditor may inspect records or documents that may provide information about related party relationships and transactions.* 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.

#### Exercise of Professional Judgment

We support the changes from the previous release that now emphasize the use of professional judgment, in particular the revisions that (1) clarify that the auditor exercises discretion in making inquiries of certain individuals within the company regarding the company's relationships and transactions with its related parties, and (2) recognize that each related party transaction previously undisclosed to the auditor by management may not result in a significant risk. However, we believe that the effectiveness of the Proposed Standard could be improved through greater use of professional judgment and an alignment with PCAOB risk standards as described below.

For example, paragraph 16 of the Proposed Standard requires the auditor to perform certain procedures if the auditor determines that a related party or relationship or transaction with a related party previously undisclosed to the auditor exists without regard to the significance of the matter. We believe that an approach that considers the auditor's risk assessment would provide for a more effective and targeted method of addressing the risk of material misstatement. For this reason, we believe that the procedures in paragraph 16 of the



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Proposed Standard should be performed for related party transactions that are not clearly trivial<sup>1</sup> rather than for all such transactions.

Another area where we believe expanding the auditor's use of professional judgment would be appropriate is with respect to communications with the audit committee. Paragraph 19 of the Proposed Standard requires the auditor to communicate to the audit committee significant matters arising from the audit regarding the company's relationships and transactions with related parties including, but not limited to, certain matters listed in the standard. The matters described in items (b) - (e) of paragraph 19 require the auditor to exercise judgment about the significance of the matter; however, item (a) requires the auditor to communicate "the identification of related parties or relationships or transactions with related parties that were previously undisclosed to the auditor" without regard to significance. Accordingly, we suggest adding the concept of significance to item (a).

#### **Inclusion of Application Guidance from the Release into the Proposed Standard**

We recognize that the Board has explained in Appendix 4 of the Release that examples and other application guidance are not included within the Proposed Standard in order to promote a clear separation between required procedures and application guidance. However, we believe that including such guidance within the Proposed Standard itself could be clearly differentiated from required procedures without too much difficulty. For example, the International Standards on Auditing (the "ISAs") and the ASB's Clarified Auditing Standards provide application guidance and examples after the requirements section of the standard and precede each application paragraph with an "A" to differentiate it from a required procedure. Furthermore, providing application guidance and examples within the Proposed Standard, rather than within a separate Appendix to the Release, would make the relevant guidance easily accessible and understandable in the context of the requirements.

As noted above, we support the use of auditor judgment, as appropriate, and note that paragraph 6 of the Proposed Standard provides for the exercise of auditor judgment in determining those individuals to whom to make inquiries such that they are likely to have knowledge of the matters set out in paragraph 5. We believe that the intent of the requirement would be clarified if examples of "others within the company to whom inquiries should be directed" were provided as application guidance within the Proposed Standard. For example, it may be helpful to include guidance such as that provided in paragraph .A15 of ISA 550, *Related Parties*, which explains that others within the entity likely to have knowledge of the entity's related party relationships and transactions and the entity's controls over such relationships and transactions may include: those charged with governance; personnel in a position to initiate, process, or record transactions that are both significant and outside the entity's normal course of business and those who supervise or

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<sup>1</sup> The phrase "clearly trivial" is explained in PCAOB Auditing Standard No. 14, *Evaluating Audit Results*. The Note to paragraph 10 of that standard explains that clearly trivial is not another expression for not material and that matters that are clearly trivial will be of a smaller magnitude than the materiality level established for planning and performing the audit, and will be inconsequential whether taken individually or in the aggregate and whether judged by any criteria of size, nature, or circumstances.



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monitor such personnel; internal auditors; in-house legal counsel; and the chief ethics officer or equivalent person.

Furthermore, we recommend that the discussion in Appendix 4 of the Release, regarding intercompany transactions, be included within the Proposed Standard as application guidance.

### Economic Considerations and Emerging Growth Companies

We believe the incremental costs to implement this Proposed Standard would be difficult to measure prior to implementation, and for this reason we have no comment on costs. However, while the costs may be difficult to measure at this time, we believe the Proposed Standard strengthens the existing PCAOB Auditing Standards in a scalable way such that the level of audit effort will vary in proportion to the number and nature of a company's related party relationships and transactions, its significant unusual transactions, financial relationships and transactions with executive officers, and the company's process to identify and reflect such matters in its financial statements. Consequently, we believe the Proposed Standard should apply to all public company audits.

### Audits of Brokers and Dealers

The nature of the broker and dealer industry is such that there are often significant related party transactions, including but not limited to commissions and fees charged between affiliated companies. Accordingly, we support the application of the Proposed Standard to the audits of brokers and dealers at such time as the SEC directs that audits of brokers and dealers are to be conducted in accordance with PCAOB standards.

Further, we do not believe that an exception is necessary with respect to audit committee communications for non-issuer broker dealers, as the definition of audit committee is sufficiently broad within Auditing Standard No. 16, *Communications with Audit Committees*, to accommodate the governance structure of non-issuer broker-dealers.

### Paragraph-level Comments

The following paragraph-level comments represent clarifications that we believe will strengthen the Proposed Standard.

- Paragraph 5.d. of the Proposed Standard requires the auditor to "inquire of management regarding the transactions entered into, or terminated, with its related parties during the period under audit and the terms and business purposes (or the lack thereof) of such transactions." However, modifications to transactions during the period may also give rise to a risk of material misstatement, and for this reason we suggest adding the word "modified" after the phrase "the transactions entered into."



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- Paragraph 16.f. of the Proposed Standard states that the auditor should "evaluate the implications on the auditor's assessment of internal control over financial reporting, if applicable." We believe the phrase "if applicable" should be deleted from the requirement since controls are assessed for purposes of assessing risk, regardless of whether or not the engagement contemplates auditor attestation on the effectiveness of internal control.

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We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct any questions to Chris Smith, National Accounting & Auditing Professional Practice Leader at 310-557-8549 ([chsmith@bdo.com](mailto:chsmith@bdo.com)) and Susan Lister, National Director of Auditing at 212-885-8375 ([slister@bdo.com](mailto:slister@bdo.com)).

Very truly yours,

/s/ BDO USA, LLP

BDO USA, LLP