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May 31, 2012

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

**Re: *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. 038**

Deloitte & Touche LLP (“D&T”) is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) on its *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 “proposed amendments”)*, PCAOB Release No. 2012-001; PCAOB Rulemaking Docket Matter No. 038 (February 28, 2012).

### **OVERALL COMMENTS**

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We support the Board’s efforts to strengthen audit quality by enhancing the auditing standards relating to the auditor’s consideration and evaluation of:

- A Company’s identification of, accounting for, and disclosure of its relationships and transactions with related parties,
- Significant unusual transactions, and
- The other matters addressed in the proposed amendments, including executive compensation.

In responding to the Board’s request for comments on the proposed standard and proposed amendments, we offer the following observations:

**Clarity of Requirements and Implementation Guidance.** In Appendix 4, the Board provides additional discussion and background information regarding certain of the proposed requirements in the proposed standard and proposed amendments, and discusses the basis for the proposals. In many cases, the discussion in Appendix 4 clarifies a requirement, makes its intended purpose more readily apparent or provides useful implementation guidance. We therefore recommend that the Board incorporate, wherever possible, the additional clarity and implementation guidance included in

Appendix 4 into the final standard and conforming amendments. Included below are some specific recommendations for including material from Appendix 4 into the final standard and conforming amendments. We also encourage the PCAOB to consider whether additional aspects of Appendix 4 should be similarly incorporated into the final standard.

## **RELATED PARTIES PROPOSED AUDITING STANDARD**

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- 1. Clarity of Requirements and Linkage to Objective.** We agree with the premise that management is responsible for the identification of, accounting for, and disclosure of relationships between a company and its related parties with appropriate oversight by the company’s audit committee. We note that this premise underpins the introductory paragraph of the proposed standard as well as the objective of the auditor described in paragraph 2.

We are, however, concerned that the first sentence of paragraph 3, in requiring the auditor “to perform procedures to identify the company’s related parties” could infer that the auditor is primarily responsible for doing so, thereby holding the auditor to a higher level of responsibility than that described in the introductory paragraph and the overall objective paragraph. We propose that this sentence be modified to be more consistent with the introductory paragraph and the objective as follows:

“The auditor should perform procedures to **evaluate the company’s identification of its** ~~identify the company’s~~ related parties, obtain...”

- 2. Performing Inquiries about Related Party Relationships and Transactions.** Paragraphs 6, 7 and 8 of the proposed standard address the auditor’s responsibilities for making inquiries of management, the audit committee, and others within the company, regarding related party relationships and transactions with related parties. The purpose of these inquiries is not clearly apparent from the language of the proposed standard. We observe that the guidance on pages A4-8 and A4-9 of Appendix A is however helpful in explaining their intended purpose. We also observe that some of the requirements do not appear to allow for the appropriate use of auditor judgment in determining the parties most likely to provide the best information, and the nature of the inquiries to be made of each party identified. We believe this will result in inquiries having to be made that would add effort and cost to the audit that might not have a commensurate benefit.

Accordingly, we have the following recommendations:

- a. Incorporate the guidance from A4-8 and A4-9 into the final standard to provide the appropriate context for the auditor’s inquiries.
- b. Include an appropriate qualifier in the first sentence of paragraph 7 (e.g., “as appropriate, and to the extent necessary”) to allow auditors to exercise appropriate professional judgment in making appropriate inquiries to address the risks in this area.

- 3. Responding to Related Party Transactions Required to Be Disclosed or Deemed a Significant Risk.** We agree that when performing risk assessment procedures, including making the inquiries of management, the audit committee and any others within the company (in accordance with paragraphs 6-8 of the proposed standard), it is appropriate for risk

assessment procedures and inquiries to encompass all such parties and transactions. However, when the auditor is performing procedures to address risks of material misstatement related to identified related parties or related party transactions, we do not believe that it is necessary, in accordance with the Board’s risk assessment standards<sup>1</sup>, to perform procedures on *each* and *every* individual related party transaction, especially transactions that are of a similar type and subject to the same or similar risks of material misstatement. We also note that there is useful implementation guidance in Appendix 4 about how to apply this requirement, and additionally about what kind of additional procedures the auditor might perform. We are concerned that if it remains in the Appendix only, the requirements within the proposed standard itself could be misinterpreted.

Accordingly, we have the following recommendations:

- a. Modify paragraphs 15.a, 15.b and 15.d to incorporate the guidance in Appendix 4 on page A4-19, which discusses how aggregation of similar transactions may be appropriate under the applicable financial reporting framework, thereby providing the auditor the ability to exercise judgment in planning and performing procedures to address “types” of related party transactions.
- b. Incorporate into the final standard the additional guidance in Appendix 4, at pages A4-20 and A4-21, which contains useful information about additional procedures that might be appropriate for the auditor to perform, depending on the nature of the transaction and the risks of material misstatement to the financial statements.

**4. Addressing Undisclosed Related Parties and Related Party Transactions.** We agree that the identification of previously undisclosed related parties and related party transactions may be indicative of increased risk, and potentially fraud risk, and therefore such identification frequently will warrant increased auditor focus. Paragraph 17 addresses the auditor’s responsibilities in this regard. We observe that, as drafted, paragraph 17 does not however provide the auditor with the ability to exercise judgment in determining whether previously undisclosed related parties and related party transactions are of such significance to warrant the performance of additional procedures, and, if so, which of the procedures enumerated in the bulleted list would be necessary and appropriate in the circumstances. Rather, as proposed, paragraph 17 would require the auditor to perform *all* such procedures in *all* cases, and *all* previously undisclosed related party relationships and transactions would be treated as significant risks (thereby requiring the performance of the additional procedures set forth in paragraph 15). To be consistent with the Board’s risk assessment standards that are premised upon audit responses being tailored to the significance of the risks of material misstatement that they are intended to address, we have the following recommendations:

- a. Revise the requirement in paragraph 17 to make it applicable to “significant” related party relationships or transactions that were not previously disclosed. The use of the term “significant” in this manner would enable the auditor to exercise appropriate judgment in deciding which of the previously undisclosed related party relationships or transactions pose risks of material misstatement to the financial statements, thereby warranting the performance

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<sup>1</sup> PCAOB Auditing Standards 8–15.

of the procedures enumerated in the lettered points within paragraph 17.

- b. Amend paragraph 17e to require that the auditor *consider* whether a previously undisclosed related party relationship or transaction poses a significant risk of material misstatement, and, if so, perform the procedures in paragraph 15, i.e., instead of requiring such procedures in *all* cases.

**5. Communicating With the Audit Committee.** We support open dialogue between the auditor and the audit committee on matters that will better enable the audit committee to exercise their oversight role over a company’s financial reporting. We therefore support the requirements in the proposed standard addressing required auditor communications about related party relationships and transactions. In order to assist with the implementation of these required communications, we have the following observations and recommendations:

- a. As a practical matter, audit committees often find it challenging to have “full” attendance, especially at in-person meetings. Paragraph 20 requires that significant matters be communicated to the full audit committee prior to issuance of the auditor’s report. Some of these matters might be communicated orally as opposed to in writing (i.e., where it is easier to deliver communications to all members of the audit committee), and may also be communicated during in person meetings. We suggest the Board remove the word “full” in order to provide for the situation when a quorum of members is present at a meeting where matters are being discussed, but not necessarily the entire audit committee.
- b. When defining “audit committee” in the proposed standard, we recommend the Board align such definition with the Board’s Proposed Auditing Standard on Communications with Audit Committees to allow for alternative corporate governance structures, such as those in non-issuer brokers and dealers where there might not be a board or audit committee.

## **PROPOSED AMENDMENTS TO OTHER AUDITING STANDARDS**

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**1. Auditing Significant Unusual Transactions.** We agree that significant unusual transactions warrant increased auditor attention due to the possibility of misstatements, whether due to error or fraud. We observe that there is useful implementation guidance included in Appendix 4 about the additional procedures that might be appropriate, depending on the nature of the significant unusual transaction and the risks of material misstatement of the financial statements (page A4-37). Consistent with our comments above, we recommend that this guidance be incorporated into the final amendments to the PCAOB’s risk assessment standards.

**2. Understanding Financial Relationships and Transactions with Executive Officers and Senior Management.** We agree executive officers may be in a unique position to perpetrate fraud, and that the motivation to do so may be influenced, in part, by their financial relationships and transactions with the company. We are therefore supportive of the Board’s efforts to strengthen audit quality through enhancing the existing requirements relating to understanding financial relationships with senior management and the specific procedures set forth in paragraph 10A of the proposed amendments. We have the following observations and recommendations in this regard:

- Executive officers are defined in paragraph 3 of Appendix A of the proposed amendments; this definition makes reference to the applicable Securities and Exchange Commission Rules (“SEC Rules”) that address the identification of executive officers and contain the

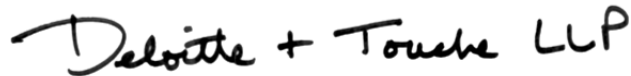
requirements as to what information is required to be disclosed in the company's securities filings.

- Appendix 4 (pages A4-41 and A4-42) specifically notes that, “[t]he population for the proposed procedures required by paragraph 10A is the list of executive officers disclosed [by the company] in securities filings...” This additional discussion makes it clear that it is the company's responsibility to prepare the list of executive officers, and, therefore, that the auditor's responsibilities with respect to the procedures in paragraph 10A of the proposed amendments is limited to the persons included on such list. We therefore recommend that this additional clarification be included in the final amendments. It should be clear that the auditor does not have responsibility for auditing whether the list of executive officers provided by the company complies with the SEC Rules.

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D&T appreciates the opportunity to provide our perspectives on these important topics. Our comments are intended to assist the PCAOB in analyzing the relevant issues and potential impacts. We encourage the PCAOB to engage in active and transparent dialogue with commenters as the proposed standard is evaluated and changes are considered. If you have any questions or would like to discuss these issues further, please contact William Platt at 203-761-3755 or Megan Zietsman at 203-761-3142.

Very truly yours,

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, flowing style.

cc: James R. Doty, PCAOB Chairman  
Lewis H. Ferguson, PCAOB Member  
Jeanette M. Franzel, PCAOB Member  
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