

July 5, 2013

Mr. Martin F. Baumann
Chief Auditor and Director of Professional
Standards
Public Company Accounting Oversight Board
c/o Office of the Secretary
1666 K Street, N.W.
Washington, D.C. 20006-2803
USA

By E-mail: comments@pcaobus.org

Dear Mr. Baumann,

**Re.: PCAOB Rulemaking Docket Matter No. 038:
PCAOB Release No. 2013-004, May 7, 2013
Proposed Auditing Standard – Related Parties
Proposed Amendments to Certain PCAOB Auditing Standards
Regarding Significant Unusual Transactions
And Other Proposed Amendments to PCAOB Auditing Standards**

The IDW would like to thank you for the opportunity to comment on the PCAOB's Re-Proposed Auditing Standard – Related Parties and Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions And Other Proposed Amendments to PCAOB Auditing Standards (hereinafter collectively referred to as the "re-proposed standard").

We refer to our letter dated May 15, 2012, in which we had previously commented on the original proposal.

We are pleased to note that the PCAOB has now addressed a significant concern we had pointed out in the afore-mentioned letter, i.e., the need to recognize that it is a company's management and not the auditor that has a responsibility to identify related parties. Rather the auditor should take a risk-based approach to evaluate whether the company has properly identified related parties and relationships and transactions with related parties. This is a significant improvement to the standard and clarifies to the public the respective roles of management and the auditor in this regard. We had also commented on

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inconsistencies in the explanation of the term “significant unusual transactions” and had suggested the term be defined. We are pleased to note that, although the Board did not define the term as such, it has agreed to the need for consistency.

In this letter we have chosen not to respond to individual questions raised, but comment instead on those areas with which we have concerns. We submit our comments as follows:

Alignment with Auditing Standards Promulgated by the IAASB

We had also repeated our fundamental concerns as to the differences between the PCAOB’s and the IAASB’s sets of standards, citing the PCAOB’s adoption of a more rules-based approach as opposed to the IAASB’s principles-based approach specifically. In this context we had also questioned the prescriptive nature of certain requirements as well as the lack of specific guidance material, e.g., equivalent to paragraphs A16 and A18 of ISA 550. In our opinion, the inclusion of a note similar to that included under paragraph 18 of the re-proposed standard regarding arm’s-length transactions would be appropriate to draw attention to potential issues regarding related party relationships and transactions.

We note that in re-proposing the standard these concerns have not been addressed, and thus remain concerned that the Standard may result in a public perception that auditors are in a position to obtain more assurance in relation to related parties than is attainable in practice.

Furthermore, in regard to the question of whether Standards could include certain guidance material, we note that the PCAOB has retained its previous stance i.e., “to include performance requirements in the standard and to provide additional discussion and examples in an appendix to the release” (page A4-35). However, both the length of the PCAOB’s release(s) and the nature of the discussions therein make it difficult for practitioners to be sure of having located all relevant guidance. We would therefore urge the Board to consider whether a more efficient approach to guidance, such as that adopted by the IAASB throughout its Clarity Project, would be more appropriate.

Prescription of Substantive Procedures

In our previous letter we had expressed our general concern about the level of prescription of requirements in the proposed standard, by stating: “In comparing the proposed standard with the IAASB’s corresponding standards we note a

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number of instances where the relevant ISAs require the auditor to perform procedures directed toward a certain aim, but provide flexibility by guiding the auditor with application material suggesting possible ways in which it might be appropriate for the auditor to tackle this, rather than prescribing a list of procedures to be performed. In contrast, the proposed standard often specifies outright certain, or all, of these possibilities as required procedures.”

On page A4-23 the Board recognizes that: “Depending on the facts and circumstances, risks of material misstatement associated with related parties and relationships and transactions with related parties might also represent fraud risks or other significant risks.” Thus, the Board also recognizes that there may be cases in which risks of material misstatement associated with related parties and relationships and transactions with related parties do not represent fraud risks or other significant risks.

The various paragraphs of AS-13 that deal with fraud risks and other significant risks require substantive procedures responsive to those assessed risks so classified. Where, however, the assessed risk is neither a fraud risk nor other significant risk there is no such stipulation, and thus, depending on the individual engagement circumstances, the auditor may determine that tests of controls suffice. The level of prescription for substantive procedures in paragraph 12 of the re-proposal – whilst likely constituting appropriate responses where there is a fraud risk or other significant risk – may be to some extent excessive for related party transactions that do not represent such risks. As we observed in our previous letter, the re-proposed new paragraph 10A of AS-12 is also one such example. It therefore appears to us that the PCAOB has either effectively “earmarked” some risks as always posing significant risks without being clear as to its intention, or may need to give greater consideration as to the necessity for certain requirements. We note the discussion on pages A4-26 et seq. in regard to comments received, and would like to suggest the wording of the re-proposed Standard be revised to clarify more explicitly – as explained in the text towards the bottom of A4-31 concerning aggregated related party disclosures and at the top of A4-32 regarding the use of auditor judgement – that the procedures required by section a.-d. do not apply to individual related party transactions when the assessed risk is neither a fraud risk nor other significant risk (i.e., in these circumstances the procedures would be used to test the effectiveness of controls) and that more in-depth procedures required by section e. are intended to be supplemental procedures commensurate with the auditor’s evaluation of the company’s facts and circumstances, and thus the auditor will exercise professional judgement in determining the appropriate audit procedures in each case.

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Purpose and Scope of the Objective

In its introduction to the release, the PCAOB has again repeatedly emphasized the significance of related party transaction in numerous prominent financial reporting frauds over the last few decades.

In our previous letter we had commented on the difference between the PCAOB's objective and that of ISA 550. The latter specifically mentions fraud risk factors that may be associated with related parties and related party transactions, whereas the former does not. We had expressed our concern that when an auditor considers whether the procedures he or she has performed in accordance with the relevant standards are sufficient to meet the objective applicable to related parties, the absence of any mention of fraud risk factors in the objective could be counterproductive. Furthermore, such absence might lead to public perceptions that related party relationships and transactions form a relatively straightforward aspect of an audit.

However, in making the re-proposal, the PCAOB has chosen not to change the objective at all. Indeed, we note that the Board has proposed instead to remove the requirement to perform other procedures as appropriate to meet the objectives of the standard (compare proposed paragraph 15d. with re-proposed paragraph 14e.), which does not alleviate this particular concern. We do not believe that the explanation given on Page A4-8 sufficiently justifies the continued exclusion of a particular mention of fraud as a potential audit risk factor that may be associated with related parties. The very limited mention of fraud in the re-proposal is, at the very least, a mismatch with the amount of coverage in the accompanying material. In our opinion, it would be helpful to practitioners and the public if further material were included in this standard.

If you have any further questions about our comments, we would be pleased to discuss our comments with you.

Yours very truly,

Klaus-Peter Feld
Executive Director

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Technical Manager