



Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington DC 20006-2803  
USA

15 May 2012

Ref.: AUD/PRJ/HBL/LAN/SHA

Dear Sir or Madam,

**Re: FEE Comments on PCAOB Rulemaking Docket Matter No. 038 - Proposed Auditing Standard on Related Parties - Proposed Amendments to Certain PCAOB Auditing Standards regarding Significant Unusual Transactions and Other Proposed Amendments to PCAOB Auditing Standards**

FEE (the Federation of European Accountants) is pleased to provide you with its comments on the PCAOB Rulemaking Docket Matter No. 038 - Proposed Auditing Standard on Related Parties - Proposed Amendments to Certain PCAOB Auditing Standards regarding Significant Unusual Transactions and Other Proposed Amendments to PCAOB Auditing Standards.

Our general comments on the issues raised in the PCAOB proposed standard that are relevant from a European or international perspective are set out in the appendix attached and can be summarised as follows:

1. In general, FEE believes that alignment in auditing standards worldwide, to the maximum degree possible, is beneficial for capital market participants with cross-border interests and global activities. The new proposed standard on related parties introduces a closer alignment with the equivalent ISA issued by the IAASB. However, differences remain as displayed in the comparative analysis. Given that related parties often have cross-border elements in large companies, FEE believes that differences in audit standards regarding the audit of related parties should be kept to a minimum with differences only arising from specific national requirements.
2. It would be appropriate to explicitly include fraud risk in the objective of an audit standard on related parties.
3. Throughout the standard, it should be highlighted that the responsibility to identify related parties is the one of the company in line with the objective of the standard, and not of the auditor.
4. A true two-way communication between the auditor and the audit committee regarding related parties should be further highlighted. This additional focus on two-way communication in a PCAOB audit standard would give due consideration to a global solution on the matter, in light of the current European debate on strengthening the role of audit committees and the communication between the auditor and the audit committee.

For further information on this FEE<sup>1</sup> letter, please contact Lotte Andersen at +32 2 285 40 80 or via email at [lotte.andersen@fee.be](mailto:lotte.andersen@fee.be) from the FEE Secretariat.

Yours sincerely,



Philip Johnson  
President

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<sup>1</sup> FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 45 professional institutes of accountants and auditors from 33 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level.

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Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

## Appendix: Responses to the specific questions

### International alignment

International alignment of auditing standards enhances the quality of audits based on globally accepted auditing standards at national level, including the acceptance of audit reports beyond home jurisdictions. In addition, aligning requirements worldwide regarding communication with audit committees facilitates the participation of non-national members in audit committees which is a corporate governance consideration that multinational companies face.

The new proposed standard on related parties introduces a closer alignment with the equivalent ISA issued by the IAASB. In this context, FEE welcomes the comparison between the proposed standard and the ISAs included in Appendix 5. Currently, this appendix is mainly descriptive with references to the requirements in each set of standards. Although the comparison with equivalent ISAs is useful, it would be beneficial to users if the PCAOB provided detailed comments as to why the PCAOB believes that specific differences remain necessary. Given that related parties often have cross-border elements in large companies, FEE believes that differences in audit standards regarding the audit of related parties should be kept to a minimum with differences only arising from specific national requirements.

In future projects, increased transparency regarding the standard setting process would facilitate those commenting on the proposals performing an analysis of the proposals as well as the application of the PCAOB audit standards by auditors of multinational companies that normally operate in an ISA environment. This would altogether lead to higher quality standards. Such transparency could be achieved by providing markup texts of the proposals and through providing further arguments as to why the amendments proposed would lead to higher audit quality. In this context, it should be borne in mind that higher audit quality is only achieved through changing of behaviour by auditors, which is not necessarily achieved by setting standards, but through their application.

Appendix 4 is quite extensive and could benefit from having more concise conclusions that clearly set out the reasons for the decision to amend a specific provision. With these amendments to Appendix 4, FEE recommends that it is published as a “Basis for Conclusions”. Such Basis for Conclusions is found very useful in practice, as acknowledged by other standard setters, such as the IASB and the IAASB.

### Framework neutral approach and need for definitions (paragraphs 1 and 18) – Questions 1 and 10

The proposed standard does not contain any specific definitions, but refers in footnote 1 of paragraph 1 to the relevant requirements of the US Securities and Exchange Commission (SEC) for the company under audit.

It would be clearer if this reference to SEC requirements in footnote 1 is replaced by a reference to “*Applicable financial reporting framework*” similar to the approach used in paragraph 18. Such a

reference highlights that financial statements audited in accordance with PCAOB audit standards can be prepared under other financial reporting frameworks besides US GAAP. Furthermore, this would be aligned with current practice, as the current PCAOB audit standard AU 334 *Related Parties*, refers to other frameworks, including IFRS, as referred to in footnote 3 of Appendix 4.

As financial statements in the US audited in accordance with PCAOB audit standards, at some point in the future, may be prepared in accordance with other financial reporting frameworks than US GAAP, FEE recommends that footnote 1 is transformed into an explicit definition of “Related parties”. This definition should preferably refer to “Applicable financial reporting framework” in addition to US GAAP. This would align footnote 1 with the proposed paragraph 18 and would facilitate the applicability of the standard<sup>2</sup>. It would also entail that the audit standard on related parties is sustainable, given future changes in the applicable financial reporting framework.

### **Objective and fraud risk (paragraph 2) – Question 2**

The objective of the proposed standard on related parties does not refer to fraud risk. Since fraud by related parties can be viewed as a major risk factor, FEE believes that it would be appropriate to explicitly include fraud risk in the objective of an audit standard on related parties.

### **Auditor responsibility for identification of related parties (paragraphs 3-5) – Question 3**

According to paragraph 3, the auditor is required to “... *perform procedures to identify the company’s related parties ...*” (emphasis added). A similar approach appears in paragraph 4 and in paragraph 20 in relation to communication with the audit committee.

However, according to the objective of the standard (which is similar to the requirement regarding “... *obtaining an understanding of the internal control ...*” in paragraph 5), it is under the responsibility of the company to identify related parties. The task of the auditor is subsequently to assess whether the related parties have been appropriately identified by the company. This assigns the requirement for identification of related parties to the company and not to the auditor.

FEE finds that the requirement to identify related parties should be on the company in line with the objective in paragraph 2. Furthermore, the requirement should refer to the internal control systems of the company in relation to identification of related parties. The auditor is subsequently, as required by the last sentence of paragraph 3 required to assess the risk of material misstatement for non-identified related parties. Therefore, the first part of the first sentence in paragraph 3 with a corresponding amendment in paragraph 4 should appropriately read:

*“The auditor should perform procedures to assess whether the company’s internal control systems have appropriately identified related parties, ...”*

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<sup>2</sup> Inspiration for such a definition can be found in the equivalent international standard, ISA 550 Related Parties, paragraph 10 (b).

### **Audit procedures and examples in Appendix A (paragraph 11) – Question 5**

Paragraph 11 requires the auditor to “... *evaluate whether information that comes to the auditor’s attention during the audit indicates ...*”. Examples of such information are included in Appendix A with lists of sources of information in paragraphs A2 and A3.

Appendix A appears to be quite prescriptive. A more principles-based approach in line with the common risk-based audit involving professional judgement is preferable. FEE understands the requirement in paragraph 11 combined with the examples in Appendix A in the way that the auditor is to assess these sources of information if reviewed during an audit, but not if these documents are considered as not relevant to the audit in question. It may be beneficial to clarify that there is a threshold for what kind of information or transaction the auditor is expected to act upon in this way.

### **Intercompany account balances (paragraph 14)**

Paragraph 14 refers to audit procedures regarding intercompany account balances, but does not specify which procedures.

FEE recommends that the paragraph explicitly states that the audit procedures performed should ensure that the intercompany account balances are appropriately reconciled by the company.

### **Financial capability of related parties (paragraph 15)**

Paragraph 15 (c) requires the auditor to “...*evaluate the financial capability of the related parties with respect to significant uncollected balances, ...*”. An identical requirement has been proposed as an amendment to the audit standard on “Considerations of Fraud in Financial statements”.

It should be made clearer what threshold “significant” refers to, especially whether it is just in respect of material balances.

### **Procedures regarding undisclosed related parties (paragraphs 16-17) – Questions 11-12**

The split between paragraphs 16 and 17 is not clear, as paragraph 17 contains the procedures mentioned in paragraph 16. The two paragraphs could therefore be merged. In addition, paragraph 17 (e) makes reference to the fact that all related parties that have been identified by the auditor and not by management should be treated as a significant risk. FEE believes that there should be some assessment of these related party transactions to ensure that they are not clearly immaterial and thus do not need to be assessed any further.

### **Communication with the audit committee (paragraph 20) – Question 15**

The requirements regarding communication with the audit committee are in our view appropriate.

Communication with the audit committee is in paragraph 8 proposed to take place during the planning phase of the audit. However, given the current European debate on strengthening the role of audit committees and the communication between the auditor and the audit committee, which also is being debated by the PCAOB, FEE recommends that a true two-way communication between the auditor and the audit committee is further highlighted. This is also mentioned in our response to the active PCAOB project on Communications with Audit Committees.

Such additional highlighting could be done through the use of the terminology “... communicate with ...” instead of “... communicate to ...”, but also by adding a “Note” in paragraph 20 highlighting the need for two-way communication between the auditor and the audit committee regarding the issue of related parties.

### **Audit standard on related parties to change the audit report – Question 16**

FEE believes that any requirements regarding the content of the audit report should be addressed in the standard on audit reports.

As mentioned in previous consultations, FEE supports the current PCAOB initiative to improve the communicative value of the audit report and believes that all aspects of the future content of the audit report should be addressed together in that project. It is essential, given the political focus that audit and audit reports attract at the moment, in particular in Europe, to achieve coherent and sustainable responses to the criticism expressed on the current structure and content of the audit report. Therefore, FEE does not find it appropriate to consider piecemeal amendments to the content of the audit report in separate active PCAOB projects, but would instead encourage the PCAOB to develop an overall strategy for its standard setting activities resulting in an appropriate split between the various projects.