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# EXPOSURE DRAFT

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## PROPOSED STATEMENT ON AUDITING STANDARDS

### OMNIBUS STATEMENT ON AUDITING STANDARDS— 2018

- *Amends the following sections of SAS No. 122, Statements on Auditing Standards: Clarification and Recodification:*
  - *Section 210, Terms of Engagement (AICPA, Professional Standards, AU-C sec. 210) as proposed to be amended by Exposure Draft Proposed Statements on Auditing Standards: Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*
  - *Section 240, Consideration of Fraud in a Financial Statement Audit, as amended (AICPA, Professional Standards, AU-C sec. 240)*
  - *Section 260, The Auditor’s Communication With Those Charged With Governance (AICPA, Professional Standards, AU-C sec. 260) as proposed to be amended by Exposure Draft Proposed Statements on Auditing Standards: Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*
  - *Section 265, Communicating Internal Control Deficiencies Identified in an Audit (AICPA, Professional Standards, AU-C sec. 265)*
  - *Section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, as amended (AICPA, Professional Standards, AU-C sec. 315) as proposed to be amended by Exposure Draft Proposed Statements on Auditing Standards: Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*

- **Section 330, Performing Audit Procedures in Responses to Assessed Risks and Evaluating the Audit Evidence Obtained (AICPA, Professional Standards, AU-C sec. 330)**
- **Section 510, Opening Balances—Initial Audit Engagements, Including Reaudit Engagements (AICPA, Professional Standards, AU-C sec. 510)**
- **Section 550, Related Parties, as amended (AICPA, Professional Standards, AU-C sec. 550)**
- **Section 560, Subsequent Events and Subsequently Discovered Facts (AICPA, Professional Standards, AU-C sec. 560)**
- **Section 580, Written Representations (AICPA, Professional Standards, AU-C sec. 580)**
- **Section 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors), as amended (AICPA, Professional Standards, AU-C sec. 600)**
- **Section 930, Interim Financial Information (AICPA, Professional Standards, AU-C sec. 930)**
- **Amends SAS No. 130, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements (AICPA, Professional Standards, AU-C sec. 940)**

**November 28, 2017**

**Comments are requested by May 15, 2018**

**Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and reporting issues**

**Comments should be addressed to Sherry Hazel at [Sherry.Hazel@aicpa-cima.com](mailto:Sherry.Hazel@aicpa-cima.com).**



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## Explanatory Memorandum

### Introduction

This memorandum provides background to the proposed Statement on Auditing Standards (SAS) *Omnibus Statement on Auditing Standards—2018*. If adopted as final, this proposed SAS will amend the following SASs:

- SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*
  - The following sections are also proposed to be amended by exposure draft Proposed Statements on Auditing Standards *Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*. This document assumes those revisions as final. Please refer to that exposure draft in conjunction with considering the proposed amendments of this exposure draft:
    - Section 210, *Terms of Engagement* (AU-C sec. 210)<sup>1</sup>
    - Section 260, *The Auditor’s Communication With Those Charged With Governance* (AU-C sec. 260)
  - The following sections are amended only by this exposure draft:
    - Section 240, *Consideration of Fraud in a Financial Statement Audit*, as amended (AU-C sec. 240)
    - Section 265, *Communicating Internal Control Deficiencies Identified in an Audit* (AU-C sec. 265)
    - Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, as amended (AU-C sec. 315)
    - Section 330, *Performing Audit Procedures in Responses to Assessed Risks and Evaluating the Audit Evidence Obtained* (AU-C sec. 330)
    - Section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements* (AU-C sec. 510)
    - Section 550, *Related Parties*, as amended (AU-C sec. 550)
    - Section 560, *Subsequent Events and Subsequently Discovered Facts* (AU-C sec. 560)
    - Section 580, *Written Representations* (AU-C sec. 550)
    - Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, as amended (AU-C sec. 600)
    - Section 930, *Interim Financial Information* (AU-C sec. 930)

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<sup>1</sup> All AU-C sections can be found in AICPA *Professional Standards*.

- SAS No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements* (AU-C sec. 940)

## **Background**

The mission of the Auditing Standards Board (ASB) is to serve the public interest by developing, updating, and communicating comprehensive standards and practice guidance that enable practitioners to provide high-quality, objective audit and attestation services to nonissuers in an effective and efficient manner. The ASB accomplishes this mission in part by developing auditing, attestation, and quality control standards that inspire public trust in the profession. In developing and updating auditing standards, the ASB considers the standards of other standard-setters, such as the International Auditing and Assurance Standards Board (IAASB), the PCAOB, and the General Accounting Office (GAO).

Since the ASB completed its auditing standards clarity project, which clarified generally accepted auditing standards (GAAS) and converged them with the International Standards on Auditing (ISAs) issued by the IAASB, the PCAOB has issued Auditing Standard (AS) 1301, *Communication With Audit Committees*; AS 2701, *Supplementary Information*; and AS 2410, *Related Parties* (AICPA, *PCAOB Standards and Related Rules*). The release of these auditing standards included conforming amendments to other PCAOB auditing standards. The ASB Disclosures Task Force was asked to also consider whether these three standards included material that, if included in the requirements or application material of GAAS, would enhance audit quality for audits of financial statements of nonissuers in an effective and efficient manner.

The ASB reviewed the three PCAOB auditing standards and, for each requirement in a PCAOB auditing standard that the ASB believes does not have an equivalent in GAAS, considered whether an amendment to GAAS was appropriate.

With regard to its evaluation of material from AS 2701 no changes to GAAS are being proposed. Release No. 2013-008, *Auditing Standard No. 17—Supplementary Information Accompanying Audited Financial Statements*, explains that a primary consideration in developing AS 2701 related to the PCAOB's oversight of brokers and dealers in securities. After consideration of the PCAOB's objective and evaluating the sufficiency of the procedures and reporting in existing GAAS, the ASB concluded that no amendments to GAAS are necessary.

## **Effective Date**

If issued as final, the proposed SAS will be effective for audits of financial statements for periods ending on or after June 15, 2019. This date is provisional but will not be earlier than June 15, 2019.

## **Explanation of Proposed Changes**

### **AS 1301, *Communication With Audit Committees***

The proposed amendments to GAAS for material from AS 1301 are to AU-C section 260, *The Auditor's Communication With Those Charged With Governance*. Proposed amendments add requirements to communicate the auditor's views relating to the entity's significant unusual transactions, and the potential effects of uncorrected misstatements on future-period financial statements. Proposed amendments to application material provide guidance about communicating the possible implications of uncorrected misstatements, matters for which the auditor consulted outside the engagement team, and complaints or concerns about accounting or auditing matters that have come to the auditor's attention. Additionally, an amendment is proposed to provide application material addressing documentation when management has communicated some or all the matters the auditor is required to communicate with those charged with governance.

### **AS 2410, *Related Parties***

The proposed amendments to GAAS for material from AS 2410 are primarily to AU-C section 550, *Related Parties*. The proposed amendments to AU-C section 550 add or amend requirements and application material to heighten the auditor's focus on related parties and relationships and transactions with related parties. The proposed amendments accomplish the following:

- Enhance requirements to identify previously unidentified or undisclosed related parties or significant related party transactions.
- Enhance the auditor's response to the risks of material misstatement associated with related party relationships and transactions, including procedures to test the accuracy and completeness of the related parties and relationships and transactions with related parties identified by the entity, taking into account the information gathered during the audit.
- Provide application material regarding the enhanced requirements, as well as additional examples of significant related party findings and issues that may be communicated to those charged with governance.

The other proposed amendment is to AU-C section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, to include, in the required communication to the component auditor, the nature of the entity's relationships and transactions with those related parties in the list of related parties prepared by group management and any other related parties of which the group engagement team is aware.

### *Conforming Amendments*

Appendixes 2 and 3 of PCAOB Release No. 2014-002, *Auditing Standard No. 18—Related Parties*, comprise conforming amendments to other PCAOB standards.

*Significant Unusual Transactions:* Appendix 2 of Release No. 2014-002 contains amendments regarding significant unusual transactions. Proposed amendments addressing appendix 2 accomplish the following:

- Amend AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*, to define *significant unusual transactions* as significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature
- Include, in AU-C section 240, requirements for basic procedures for obtaining information for evaluating significant unusual transactions
- Include conforming changes to have consistent usage of *significant unusual transactions* throughout GAAS

*Other Amendments:* Appendix 3 of Release 2014-002 contains amendments other than those related to “significant unusual transactions.” Related proposed amendments include changes to various AU-C sections to enhance guidance for (1) obtaining information about related parties and significant unusual transactions from predecessor auditors and when performing procedures related to subsequent events and (2) requesting representations about related party transactions. In addition, the phrase “business rationale” was changed to “business purpose” when used throughout GAAS for consistency with the language used in the PCAOB auditing standards.

### **Relationship With the Auditor Reporting Exposure Draft**

Issued simultaneously with this exposure draft is Proposed Statements on Auditing Standards *Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements (auditor reporting exposure draft)*. The auditor reporting exposure draft proposes four new SASs and proposes amendments to various AU-C sections to address auditor reporting related to those sections and to heighten auditor focus on disclosures throughout the performance of an audit of financial statements.

As mentioned previously in the introduction, both this omnibus SAS exposure draft and the auditor reporting exposure draft have proposed amendments for some of the same AU-C sections. In particular, the text and paragraph numbering of AU-C section 260 is affected by both exposure drafts. To help make your review easier, the proposed amendments from the auditor reporting exposure draft have been incorporated into the relevant paragraphs in this SAS as if they had been finalized. We encourage you to consider the proposed amendments in this exposure drafts in conjunction with the proposed amendments in the auditor reporting SAS, particularly with respect to AU-C section 260.

In evaluating amendments proposed to AU-C section 260 as part of the auditor reporting project, the ASB also considered whether there should be a more specific requirement for the timing of the communication of certain matters. AS 1301, *Communications with Audit Committees*, states that all audit committee communications required by that standard should be made in a timely manner and prior to the issuance of the auditor's report; it also states that the appropriate timing of a particular communication to the audit committee depends on factors such as the significance

of the matters to be communicated and corrective or follow-up action needed, unless other timing requirements are specified by PCAOB rules or standards or the securities laws. The auditor reporting exposure draft asks respondents to provide their views on whether the requirement in AU-C section 260 should be more specific regarding the timing of the communication with those charged with governance about certain matters, including requiring certain communications to be made prior to issuance of the auditor’s report. If you have not otherwise provided your views on this matter to the ASB, we ask that you do so in response to this omnibus SAS exposure draft.

## **Issues for Consideration**

In addition to overall views on the proposed amendments described previously, the ASB would like you to respond on the following issues.

### **Issue 1: Significant Unusual Transactions**

As described previously, amendments are proposed to define *significant unusual transactions* and to use the term consistently throughout GAAS. The ASB believes that audit quality may be enhanced if the use of the term *significant unusual transactions* were to be consistent between GAAS and PCAOB standards. A definition of *significant unusual transactions* as “significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature” is proposed as an amendment to AU-C section 240. Alternatively, the phrase “significant transactions that are outside the normal course of business or that otherwise appear to be unusual” could be used consistently throughout GAAS; currently the phrase “that otherwise appear to be unusual” is not always included.

Please provide your views on the use of the phrase “significant unusual transactions” instead of the phrase “significant transactions that are outside the normal course of business or that otherwise appear to be unusual” consistently throughout GAAS.

### **Issue 2: Proposed Amendment to AU-C section 240**

PCAOB Release No. 2014-002 includes conforming amendments to AS 2401 to require specified procedures for the auditor to evaluate fraud risks arising from significant unusual transactions. A proposed amendment to GAAS would amend paragraph .32 of AU-C section 240. Paragraph .32 requires the auditor, among other things, to evaluate whether the business purpose (or the lack thereof) of significant unusual transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. The proposed amendment would require that the evaluation include the following procedures:

1. Reading the underlying documentation and evaluating whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction
2. Determining whether the transaction has been authorized and approved in accordance with the entity’s established policies and procedures

3. Evaluating the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees, and other obligations, if any
4. Evaluating whether significant unusual transactions that the auditor has identified have been properly accounted for and disclosed in the financial statements

Please provide your views on whether requiring these procedures, in particular the procedure of “evaluating the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees, and other obligations, if any,” is appropriate for audits of financial statements of nonissuers or whether these procedures would be better placed as application material.

### **Guide for Respondents**

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. If you agree with proposals in the exposure draft, it will be helpful if you make the ASB aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available on the AICPA’s website after May 15, 2018, until a final standard is issued. Please send responses to Sherry Hazel at [Sherry.Hazel@aicpa-cima.com](mailto:Sherry.Hazel@aicpa-cima.com) by May 15, 2018.

### **Comment Period**

The comment period for this exposure draft ends on May 15, 2018.

## **Auditing Standards Board Members**

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# Proposed Statement on Auditing Standards, Omnibus Statement on Auditing Standards—2017

## Proposed Amendment to SAS No. 122, Section 260

AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, addresses the auditor's responsibility to communicate with those charged with governance in an audit of financial statements. If issued as final, the proposed amendments in this exposure draft will amend AU-C section 260 to include material from PCAOB AS 1301 that the ASB believes will enhance the quality of audits of financial statements of non-issuers. Requirements are proposed to add communications about the auditor's views relating to the entity's significant unusual transactions, and about the potential effects of uncorrected misstatements on future-period financial statements. Proposed amendments to application material provide guidance about communicating the possible implications of uncorrected misstatements and complaints or concerns about accounting or auditing matters that have come to the auditor's attention. Additionally, an amendment is proposed to provide application material addressing documentation when management has communicated some or all of the matters the auditor is required to communicate with those charged with governance.

As mentioned previously, the proposed amendments are not to extant AU-C section 260, but rather to AU-C section 260 as proposed to be amended by the auditor reporting exposure draft. In the following text, the proposed amendments from the auditor reporting exposure draft are incorporated as if they had been issued as final, including the paragraph numbering. For example, the auditor reporting exposure draft added list item (d) under paragraph 12. This omnibus SAS exposure draft rennumbers that list item as item (e) under paragraph 12. We urge you to consider the proposed amendments to AU-C section 260 in this exposure draft in conjunction with the proposed amendments to AU-C section 260 in the auditor reporting exposure draft. Supplementary material is available to aid you in tracking changes. This material shows extant AU-C section 260 marked for proposed amendments from both the auditor reporting and omnibus SAS exposure drafts and is available on the AICPA website at <https://www.aicpa.org/research/exposedrafts/accountingandauditing.html>.

***Boldface italic*** denotes new language. Deleted text is in ~~strikethrough~~.

[No amendments to paragraphs .01–.11]

**.12** The auditor should communicate the following with those charged with governance:  
(Ref: par. .A25–.A26)

*a.* The auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. When applicable, the auditor should do the following:(Ref: par. .A27–.A29)

*i.* Explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the entity.

*ii.* Determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates.

- b. Significant unusual transactions, if any. (Ref: par. .A30)*
- ~~*bc.*~~ Significant difficulties, if any, encountered during the audit. (Ref: par. ~~.A30~~*A31*)
- ~~*cd.*~~ Disagreements with management, if any. (Ref: par. ~~.A31~~*A32*)
- ~~*de.*~~ Circumstances that affect the form and content of the auditor's report, if any; and (Ref: par. ~~.A32, A33~~*–A33.A34*)
- f.* Other findings or issues, if any, arising during the audit that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process. (Ref: par. ~~.A34, A35~~*–A36.A38*)

*Uncorrected Misstatements*

**.13** The auditor should communicate the following with those charged with governance: (Ref: par. ~~.A37–A38.A39–~~*A40*)

- a.* Uncorrected misstatements accumulated by the auditor and the effect that they, individually or in the aggregate, may have on the opinion in the auditor's report. The auditor's communication should identify material uncorrected misstatements individually. The auditor should request that uncorrected misstatements be corrected.
- b.* The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole ***and that those uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.***

[No amendments to paragraphs .14–.A29]

*Significant Unusual Transactions (Ref. par. .12b)*

- .A30** *The communication of significant unusual transactions may include*
- *the auditor's views on the policies and practices management used to account for significant unusual transactions; and*
  - *the auditor's understanding of the business purpose for significant unusual transactions.*

[No amendments to paragraphs .A30–.A34, renumbered as .A31–.A35]

**.A36** *The auditor may communicate, among other issues, complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.*

[Paragraph .A37 is renumbered from .A35. The content is unchanged.]

**.A36A38** To the extent not already addressed by the requirements in paragraph .12a-~~af~~ and related application material, the auditor may consider communicating about other matters *for which the auditor consulted outside the engagement team or that were* discussed with, or considered by, the engagement quality control reviewer, if one has been appointed, in accordance with AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards (AICPA, Professional Standards)*.<sup>15</sup>

<sup>15</sup> [Footnote omitted for purposes of this proposed SAS.]

[Paragraphs .A37-.A54 are renumbered as .A39-.A56. The content is unchanged.]

### **Documentation (Ref: [par. .20](#))**

**.A55A57** Documentation of oral communication may include a copy of minutes prepared by the entity as part of the audit documentation if those minutes are an appropriate record of the communication. *If, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, and as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor may include a copy or summary of management's communications provided to those charged with governance in the audit documentation.*

[Paragraphs .A56-.A57 are renumbered as .A58-.A59. The content is unchanged.]

This amendment is effective for audits of financial statements for periods ending on or after June 15, 2019.\*

## **Amendment to SAS No. 122, AU-C section 550**

AU-C section 550, *Related Parties*, addresses the auditor's responsibility relating to related party relationships and transactions in an audit of financial statements. The proposed amendments add material from PCAOB AS 2410, *Related Parties*, that the ASB believes will enhance the quality of audits of financial statements of non-issuers.

The proposed amendments to AU-C section 550 add or amend requirements and application material to heighten the auditor's focus on related parties and relationships and transactions with related parties. The proposed amendments accomplish the following:

- Enhance requirements to identify previously unidentified or undisclosed related parties or significant related party transactions.
- Enhance the auditor's response to the risks of material misstatement associated with related party relationships and transactions, including procedures to test the accuracy and completeness of the related parties and relationships and transactions with related parties identified by the entity, taking into account the information gathered during the audit.

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\* This effective date is provisional but will not be earlier than June 15, 2019.

- Provide application material regarding the enhanced requirements, as well as additional examples of significant related party findings and issues that may be communicated to those charged with governance.

[No amendments to paragraphs .01–.13]

***Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions***

**.14** The auditor should inquire of management ***and others within the entity*** regarding the following:

- a. The identity of the entity’s related parties, including changes from the prior period (Ref: par. ~~.A9–.A14~~**A15**)
- b. The nature of the relationships between the entity and these related parties
- c. ***The business purpose of entering into a transaction with a related party versus an unrelated party***
- d. Whether the entity entered into, ***modified, or terminated*** any transactions with these related parties during the period and, if so, the type and ***business*** purpose of the transactions

**.15** The auditor should inquire of management and others within the entity and perform other risk assessment procedures <sup>fn11</sup> considered appropriate to obtain an understanding of the controls, if any, that management has established to (Ref: par. ~~.A15–.A20~~**.A16–.A21**)

- a. identify, account for, and disclose related party relationships and transactions.
- b. authorize and approve significant transactions and arrangements with related parties. (Ref: par. ~~.A21~~**A22**)
- c. authorize and approve significant ***unusual*** transactions and arrangements ~~outside the normal course of business.~~

***Inquiries should include asking about any related party transactions***

- a. ***that have not been authorized and approved in accordance with the entity’s established policies or procedures regarding the authorization and approval of transactions with related parties.***
- b. ***for which exceptions to the entity's established policies or procedures were granted and the reasons for granting those exceptions.***

fn 11 [Footnote omitted for purposes of this proposed SAS.]

- .16 ***The auditor should inquire of those charged with governance regarding***
- a. their understanding of the entity's relationships and transactions with related parties that are significant to the entity and***
  - b. whether any of those charged with governance have concerns regarding relationships or transactions with related parties and, if so, the substance of those concerns.***

***Maintaining Alertness*** ~~Evaluating Accuracy and Completeness of~~ ***for Related Party Information When Reviewing Records or Documents***

~~.16~~17 During the audit, the auditor should remain alert when inspecting records or documents for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. In particular, the auditor should inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor: (Ref: par. ~~.A22-.A24.A23-.A25~~)

- a. Bank and legal confirmations obtained as part of the auditor's procedures*
- b. Minutes of meetings of shareholders and of those charged with governance **and summaries of actions of recent meetings for which minutes have not yet been prepared***
- c. Such other records or documents as the auditor considers necessary in the circumstances of the entity*

*.18 The auditor should perform procedures on account balances with affiliated entities as of concurrent dates, even if fiscal years of the respective entities differ. The procedures performed should address the risks of material misstatement associated with the entity's accounts with affiliates.*

~~.17~~19 If the auditor identifies significant **unusual** transactions ~~outside the entity's normal course of business~~ when performing the audit procedures required by paragraph .17 or through other audit procedures, the auditor should inquire of management about the following: (Ref: par. ~~.A25-.A26.A26-.A27~~)

- a. The nature of these transactions (Ref: par. ~~.A27.A28~~)*
- b. Whether related parties could be involved (Ref: par. ~~.A28.A29~~)*

[Paragraph .18 is renumbered as paragraph .20. The content is unchanged.]

**Identification and Assessment of the Risks of Material Misstatement Associated With Related Party Relationships and Transactions**

~~.1921~~ In meeting the requirement of section 315 to identify and assess the risks of material misstatement, the auditor should identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks. In making this determination, the auditor should treat identified significant *unusual* related party transactions ~~outside the entity's normal course of business~~ as giving rise to significant risks.

[Paragraph .20 is renumbered as paragraph .22. The content is unchanged.]

### **Responses to the Risks of Material Misstatement Associated With Related Party Relationships and Transactions**

~~.2123~~ As part of the requirement in section 330 that the auditor respond to assessed risks, the *auditor should evaluate whether the entity has properly identified its related parties and relationships and transactions with related parties. The auditor should design and perform further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions, including procedures to test the accuracy and completeness of the related parties and relationships and transactions with related parties identified by the entity, taking into account the information gathered during the audit.*<sup>fn 14</sup> (Ref: par. ~~.A34–.A37.A35–.A38~~)

<sup>fn 14</sup> [Footnote omitted for purposes of this proposed SAS.]

[Paragraph .22–.23 are renumbered as paragraphs .24–.25. The content is unchanged.]

### ***Identified Significant Unusual Related Party Transactions ~~Outside the Entity's Normal Course of Business~~***

~~.2426~~ For identified significant *unusual* related party transactions ~~outside the entity's normal course of business~~, the auditor should

- a. inspect the underlying contracts or agreements, if any, and evaluate whether
  - i. the business ~~rational~~*purpose* (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.<sup>fn 15</sup> (Ref: par. ~~.A41–.A42.A42–.A43~~)
  - ii. the terms of the transactions are consistent with management's explanations.
  - iii. the transactions have been appropriately accounted for and disclosed.

- b. obtain audit evidence that the transactions have been appropriately authorized and approved. (Ref: par. ~~A43–A44.A44–A45~~)

<sup>fn 15</sup> [Footnote omitted for purposes of this proposed SAS.]

[Paragraphs .25–.28 are renumbered as paragraphs .27–.30. The content is unchanged. No amendments to paragraphs .A1–.A10.]

- .A11 In the context of a group audit, section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, requires the group engagement team to provide each component auditor with a ~~list of~~ **information about** related parties prepared by group management and any other related parties of which the group engagement team is aware.<sup>fn 22</sup> When the entity is a component within a group, this information provides a useful basis for the auditor’s inquiries of management regarding the identity of the entity’s related parties.

<sup>fn 22</sup> [Footnote omitted for purposes of this proposed SAS.]

[No amendments to paragraphs .A12–.A13.]

- .A14 ***The inquiry about the identity of the entity’s related parties may include background information concerning the related parties, for example, physical location, industry, size, and extent of operations.***

[Extant paragraph .A14 is renumbered as paragraph .A15. The content is unchanged.]

*The Entity’s Controls Over Related Party Relationships and Transactions (Ref: par. .15)*

- ~~.A15~~16 Others within the entity are those considered likely to have knowledge of the entity’s related party relationships and transactions and the entity’s controls over such relationships and transactions, ***as well as the existence of related parties or relationships or transactions with related parties previously undisclosed to the auditor.*** These may include, to the extent that they do not form part of management, the following:

- Those charged with governance
- Personnel in a position to initiate, authorize, process, or record ***significant unusual*** transactions ~~that are both significant and outside the entity’s normal course of business~~ and those who supervise or monitor such personnel
- The internal audit function
- In-house legal counsel

- The chief ethics officer or equivalent person
- Chief compliance officer

**.A16**~~17~~ The audit is conducted on the premise that management and, when appropriate, those charged with governance, have acknowledged and understand that they have responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.<sup>fn 24</sup> Accordingly, the preparation of the financial statements requires management, with oversight from those charged with governance, to design, implement, and maintain adequate controls over related party relationships and transactions so that these are identified and appropriately accounted for and disclosed. In their oversight role, those charged with governance monitor how management is discharging its responsibility for such controls. Those charged with governance may, in their oversight role, obtain information from management to enable them to understand the nature and business ~~rationale~~**purpose** of the entity's related party relationships and transactions.

<sup>fn 24</sup> [Footnote omitted for purposes of this proposed SAS.]

**.A17**~~18~~ In meeting the requirement of section 315 to obtain an understanding of internal control, the auditor may consider features or elements relevant to mitigating the risks of material misstatement associated with related party relationships and transactions, such as the following:<sup>fn 25</sup>

- Internal ethical codes, appropriately communicated to the entity's personnel and enforced, governing the circumstances in which the entity may enter into specific types of related party transactions
- Policies and procedures for open and timely disclosure of the interests that management and those charged with governance have in related party transactions
- The assignment of responsibilities within the entity for identifying, recording, summarizing, and disclosing related party transactions
- Timely disclosure and discussion between management and those charged with governance of significant **unusual** related party transactions ~~outside the entity's normal course of business~~, including whether those charged with governance have appropriately challenged the business ~~rationale~~**purpose** of such transactions (for example, by seeking advice from external professional advisers)

- Clear guidelines for the approval of related party transactions involving actual or perceived conflicts of interest, such as approval by a subcommittee of those charged with governance comprising individuals independent of management
- Periodic reviews by the internal audit function, when applicable
- Proactive action taken by management to resolve related party disclosure issues, such as by seeking advice from the auditor or external legal counsel
- The existence of whistle-blowing policies and procedures, when applicable

<sup>fn 25</sup> [Footnote omitted for purposes of this proposed SAS.]

[Paragraph .A18 is renumbered as .A19. The content is unchanged.]

**.A19**20 Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. <sup>fn 26</sup> The risk of management override of controls is higher if management has relationships that involve control or significant influence with parties with which the entity does business because these relationships may present management with greater incentives and opportunities to perpetrate fraud. For example, management’s financial interests in certain related parties may provide incentives for management to override controls by (a) directing the entity, against its interests, to conclude transactions for the benefit of these parties, or (b) colluding with such parties or controlling their actions. Examples of possible fraud include the following:

- Creating fictitious terms of transactions with related parties designed to misrepresent the business ~~rational~~ *purpose* of these transactions
- Fraudulently organizing the transfer of assets from or to management or others at amounts significantly above or below market value
- Engaging in complex transactions with related parties, such as entities formed to accomplish specific purposes, that are structured to misrepresent the financial position or financial performance of the entity

<sup>fn 26</sup> [Footnote omitted for purposes of this proposed SAS.]

[Paragraph .A20 is renumbered as .A21. The content is unchanged.]

**.A21**22 *Authorization and approval of significant transactions and arrangements (Ref: par. .15b)*. Authorization involves the granting of permission by a party or

parties with the appropriate authority (whether management, those charged with governance, or the entity's shareholders) for the entity to enter into specific transactions in accordance with predetermined criteria, whether or not judgmental. Approval involves those parties' acceptance of the transactions the entity has entered into as having satisfied the criteria on which authorization was granted. Examples of controls the entity may have established to authorize and approve significant transactions and arrangements with related parties or significant **unusual** transactions ~~and arrangements outside the normal course of business~~ include the following:

- Monitoring controls to identify such transactions and arrangements for authorization and approval
- Approval of the terms and conditions of the transactions and arrangements by management, those charged with governance, or, when applicable, shareholders

[Paragraphs .A22–.A24 are renumbered as .A23–.A25. The content is unchanged.]

*Identification of Significant **Unusual** Transactions ~~Outside the Normal Course of Business~~ (Ref: par. .A719)*

~~.A25~~**26**Obtaining further information on significant **unusual** transactions ~~outside the entity's normal course of business~~ enables the auditor to evaluate whether fraud risk factors, if any, are present and to identify the risks of material misstatement due to fraud.

~~.A26~~**27**Examples of transactions *that may be significant unusual transactions* ~~outside the entity's normal course of business~~ may include the following:

- Complex equity transactions, such as corporate restructurings or acquisitions
- Transactions with offshore entities in jurisdictions with less rigorous corporate governance structures, laws, or regulations
- The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged
- Sales transactions with unusually large discounts or returns
- Transactions with circular arrangements (for example, sales with a commitment to repurchase)
- Transactions under contracts whose terms are changed before expiration

~~.A27~~**28***Understanding the nature of significant **unusual** transactions ~~outside the normal course of business~~ (Ref: par. ~~.171~~**18a**). Inquiring into the nature of the significant **unusual** transactions ~~outside the entity's normal course of business~~ involves obtaining an understanding of the business ~~rational~~ **purpose** of the transactions and the terms and conditions under which these have been entered into.*<sup>fn 27</sup>

<sup>fn 27</sup> [Footnote omitted for purposes of this proposed SAS.]

~~.A28~~**29***Inquiring into whether related parties could be involved (Ref: par. .17b). A related party could be involved in a significant **unusual** transaction ~~outside the entity's normal course of business~~ not only by directly influencing the transaction by being a party to the transaction but also by indirectly influencing it through an intermediary. Such influence may indicate the presence of a fraud risk factor.*

[Paragraphs .A29–.A33 are renumbered as .A30–.A34. The content is unchanged.]

### **Responses to the Risks of Material Misstatement Associated With Related Party Relationships and Transactions (Ref: par. ~~.21~~**23**)**

~~.A34~~**35***Evaluating whether an entity has properly identified its related parties and relationships and transactions with related parties involves more than assessing the process used by the entity.* The nature, timing, and extent of the further audit procedures that the auditor may select to respond to the assessed risks of material misstatement associated with related party relationships and transactions depend upon the nature of those risks and the circumstances of the entity.

~~.A35~~**36** Examples of substantive audit procedures that the auditor may perform when the auditor has assessed a significant risk that management has not appropriately accounted for or disclosed specific related party transactions (whether due to fraud or error) include the following:

- Confirming the **business** purposes, specific terms, or amounts of the transactions with the related parties (this audit procedure may be less effective when the auditor judges that the entity is likely to influence the related parties in their responses to the auditor).
- Inspecting evidence in possession of the other party or parties to the transaction.
- Confirming or discussing significant information with intermediaries, such as banks, guarantors, agents, or attorneys, to obtain a better understanding of the transaction.
- Referring to financial publications, trade journals, credit agencies, and other information sources when there is reason to believe that unfamiliar

customers, suppliers, or other business enterprises with which material amounts of business have been transacted may lack substance.

- With respect to material uncollected balances, guarantees, and other obligations, obtaining information about the financial capability of the other party or parties to the transaction. Such information may be obtained from audited financial statements, unaudited financial statements, income tax returns, and reports issued by regulatory agencies, taxing authorities, financial publications, or credit agencies.

[No amendment to paragraphs .A36–.A40, renumbered as .A37–.A41.]

***Identified Significant Unusual Related Party Transactions Outside the Entity's Normal Course of Business***

*Evaluating the Business ~~Rationale~~ Purpose of Significant Related Party Transactions (Ref: par. .2426a(i))*

- . ~~A41~~42 In evaluating the business ~~rationale~~ **purpose** of a significant **unusual** related party transaction ~~outside the entity's normal course of business~~, the auditor may consider the following:

[The content of list items is unchanged.]

. ~~A42~~43 The auditor also may seek to understand the business ~~rationale~~ **purpose** of such a transaction from the related party's perspective because this may help the auditor to better understand the economic reality of the transaction and why it was carried out. A business ~~rationale~~ **purpose** from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor.

- . ~~A43~~44 Authorization and approval by management, those charged with governance, or, when applicable, the shareholders of significant **unusual** related party transactions ~~outside the entity's normal course of business~~ may provide audit evidence that these have been duly considered at the appropriate levels within the entity, and that their terms and conditions have been appropriately reflected in the financial statements. The existence of transactions of this nature that were not subject to such authorization and approval, in the absence of rational explanations based on discussion with management or those charged with governance, may indicate risks of material misstatement due to fraud or error. In these circumstances, the auditor may need to be alert for other transactions of a similar nature. Authorization and approval alone, however, may not be sufficient in concluding whether risks of material misstatement due to fraud are absent because authorization and approval may be ineffective if there has been collusion between the related parties or if the entity is subject to the dominant influence of a related party.
- . ~~A44~~45 *Considerations specific to smaller entities.* A smaller entity may not have the same controls provided by different levels of authority and approval that may exist in a larger entity. Accordingly, when auditing a smaller entity, the auditor may rely to a lesser

degree on authorization and approval for audit evidence regarding the validity of significant *unusual* related party transactions ~~outside the entity's normal course of business~~. Instead, the auditor may consider performing other audit procedures, such as inspecting relevant documents, confirming specific aspects of the transactions with relevant parties, or observing the owner-manager's involvement with the transactions. The discussion of management domination in paragraph .A32 and the fraud considerations discussed in paragraph .A8 provide further relevant guidance.

[Paragraphs .A45–.A50 are renumbered as .A46–.A51. The content is unchanged.]

### **Communication With Those Charged With Governance (Ref: par. .2729)**

~~.A51~~<sup>52</sup> Evaluating the related party disclosures means considering whether the facts and circumstances of the entity's related party relationships and transactions have been appropriately summarized and presented so that the disclosures are understandable. Disclosures of related party transactions may not be understandable if

- a. the business ~~rational~~ *purpose* and the effects of the transactions on the financial statements are unclear or misstated.
- b. key terms, conditions, or other important elements of the transactions necessary for understanding them are not appropriately disclosed.

~~.A52~~<sup>53</sup> Communicating significant findings ~~and~~ *or* issues arising during the audit in connection with the entity's related parties helps the auditor establish a common understanding with those charged with governance of the nature and resolution of these matters. <sup>Fn 33</sup> Examples of significant related party findings and issues include the following:

- Nondisclosure (whether or not intentional) by management to the auditor of related parties or significant related party transactions, which may alert those charged with governance to significant related party relationships and transactions of which they may not have been previously aware
- The identification of significant related party transactions that have not been appropriately authorized and approved *or that appear to lack a business purpose*, which may give rise to suspected fraud
- Disagreement with management regarding the accounting for, and disclosure of, significant related party transactions, *including disagreements regarding the inclusion of a statement in the financial statements that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction*

- Noncompliance with applicable laws or regulations prohibiting or restricting specific types of related party transactions
- Difficulties in identifying the party that ultimately controls the entity.

<sup>fn 33</sup> [Footnote omitted for purposes of this proposed SAS.]

This amendment is effective for audits of financial statements for periods ending on or after June 15, 2019.\*

## Amendment to SAS No. 122, AU-C section 210

AU-C section 210, *Terms of Engagement*, addresses the auditor's responsibilities in agreeing upon the terms of the audit engagement with management and, when appropriate, those charged with governance. The proposed amendment to AU-C section 210 is intended to enhance guidance relating to obtaining information about related parties and significant unusual transactions from predecessor auditors.

As mentioned previously, the proposed amendments to AU-C section 210 in this SAS assume as final the proposed amendments in the auditor reporting exposure draft. Amendments proposed to AU-C section 210 by the auditor reporting exposure draft result in paragraph .A31 in extant AU-C section 210 being renumbered as paragraph .A33.

[No amendments to paragraphs .01–.A30]

**.A33** The communication with the predecessor auditor may be either written or oral. Matters subject to the auditor's inquiry of the predecessor auditor may include the following:

- Information that might bear on the integrity of management
- Disagreements with management about accounting policies, auditing procedures, or other similarly significant matters
- Communications to those charged with governance regarding fraud and noncompliance with laws or regulations by the entity
- Communications to management and those charged with governance regarding significant deficiencies and material weaknesses in internal control
- The predecessor auditor's understanding about the reasons for the change of auditors

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\* This effective date is provisional but will not be earlier than June 15, 2019.

- ***The predecessor auditor's understanding of the nature of the entity's relationships and transactions with related parties and significant unusual transactions***

[No further amendments to AU-C section 210.]

This amendment is effective for audits of financial statements for periods ending on or after June 15, 2019.\*

## Amendment to SAS No. 122, AU-C section 240

AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*, addresses the auditor's responsibilities relating to fraud in an audit of financial statements. Proposed amendments define *significant unusual transactions* as significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature and include requirements for basic procedures for obtaining information for evaluating significant unusual transactions. Amendments also include guidance and conforming changes related to significant unusual transactions.

[No amendments to paragraphs .01–.10]

**.11** For purposes of GAAS, the following terms have the meanings attributed as follows:

**Fraud.** An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception that results in a misstatement in financial statements that are the subject of an audit.

**Fraud risk factors.** Events or conditions that indicate an incentive or pressure to perpetrate fraud, provide an opportunity to commit fraud, or indicate attitudes or rationalizations to justify a fraudulent action. (Ref: par. .A11, .A30, and .A56)

**Significant unusual transactions.** *Significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature.*

[No amendments to paragraphs .12–.16.]

**.17** The auditor should make inquiries of management regarding

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\* This effective date is provisional but will not be earlier than June 15, 2019.

- a. management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent, and frequency of such assessments; (Ref: par. .A14–.A15)
- b. management's process for identifying, responding to, and monitoring the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist; (Ref: par. .A16)
- c. management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; ~~and~~
- d. management's communication, if any, to employees regarding its views on business practices and ethical behavior; *and*
- e. *whether the entity has entered into any significant unusual transactions and, if so, the nature, terms, and business purpose (or the lack thereof) of those transactions and whether such transactions involved related parties.*

[No amendments to paragraph .18.]

**.19** For those entities that have an internal audit function, the auditor should make inquiries of appropriate individuals within the internal audit function to obtain their views about the risks of fraud; determine whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity; *whether the entity has entered into any significant unusual transactions*; whether they have performed any procedures to identify or detect fraud during the year; and whether management has satisfactorily responded to any findings resulting from these procedures.

[No amendments to paragraph .20.]

**.21** Unless all of those charged with governance are involved in managing the entity, the auditor should make inquiries of those charged with governance (or the audit committee or, at least, its chair) to determine their views about the risks of fraud, ~~and~~ whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity, *and whether the entity has entered into any significant unusual transactions*. These inquiries are made, in part, to corroborate the responses received from the inquiries of management.

[No amendments to paragraphs .22–.31.]

**.32** Even if specific risks of material misstatement due to fraud are not identified by the auditor, a possibility exists that management override of controls could occur. Accordingly, the auditor should address the risk of management override of controls

apart from any conclusions regarding the existence of more specifically identifiable risks by designing and performing audit procedures to **accomplish the following**:

[No changes to list items *a–b*.]

c. Evaluate, ~~for significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual~~ given the auditor's understanding of the entity and its environment and other information obtained during the audit, whether the business ~~rational~~ **purpose** (or the lack thereof) of **significant unusual transactions** ~~the transactions~~ suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. **The procedures should include the following:** (Ref: par. .A54)

- i. Reading the underlying documentation and evaluating whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction*
- ii. Determining whether the transaction has been authorized and approved in accordance with the entity's established policies and procedures*
- iii. Evaluating the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees, and other obligations, if any*
- iv. Evaluating whether significant unusual transactions that the auditor has identified have been properly accounted for and disclosed in the financial statements*

[No amendments to paragraphs .33–.A18.]

.A19 Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include the following:

- Operating personnel not directly involved in the financial reporting process
- Employees with different levels of authority
- Employees involved in initiating, processing, or recording complex or unusual transactions (**for example, a sales transaction with multiple elements or a significant related party transaction**) and those who supervise or monitor such employees
- In-house legal counsel
- Chief ethics officer or equivalent person
- The person or persons charged with dealing with allegations of fraud

[No amendments to paragraphs .A18–.A53.]

**Business Rationale Purpose** for Significant Transactions (Ref: par. .32c)

**.A54** Indicators that may suggest that significant **unusual** transactions ~~that are outside the normal course of business for the entity, or that otherwise appear to be unusual~~, may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets include the following:

- The form of such transactions appears overly complex (for example, the transaction involves multiple entities within a consolidated group or multiple unrelated third parties).
- Management has not discussed the nature of and accounting for such transactions with those charged with governance of the entity, and inadequate documentation exists.
- Management is placing more emphasis on the need for a particular accounting treatment than on the underlying economics of the transaction.
- Transactions ~~that~~ involve nonconsolidated related parties, including special purpose entities, have not been properly reviewed or approved by those charged with governance of the entity.
- Transactions ~~that~~ involve ~~previously unidentified~~ related parties or ***relationships or transactions with related parties previously undisclosed to the auditor.***
- ***Transactions involve other*** parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit.
- ***Transactions lack commercial or economic substance or are part of a larger series of connected, linked, or otherwise interdependent arrangements that lack commercial or economic substance individually or in the aggregate (for example, a transaction is entered into shortly prior to period end and is unwound shortly after period end).***
- ***Transactions occur with a party that falls outside the definition of a related party (as defined by the accounting principles applicable to that entity), with either party able to negotiate terms that may not be available for other, more clearly independent parties on an arm's-length basis.***
- ***Transactions exist to enable the entity to achieve certain financial targets.***

[No amendments to paragraphs .A55–.A70.]

**.A71** Other matters related to fraud to be discussed with those charged with governance of the entity may include, for example, ***the following***:

- Concerns about the nature, extent, and frequency of management’s assessments of the controls in place to prevent and detect fraud and of the risk that the financial statements may be misstated
- A failure by management to appropriately address identified significant deficiencies or material weaknesses in internal control or to appropriately respond to an identified fraud
- The auditor’s evaluation of the entity’s control environment, including questions regarding the competence and integrity of management
- Actions by management that may be indicative of fraudulent financial reporting, such as management’s selection and application of accounting policies that may be indicative of management’s effort to manage

earnings in order to deceive financial statement users by influencing their perceptions concerning the entity's performance and profitability

- Concerns about the adequacy and completeness of the authorization of **significant unusual** transactions ~~that appear to be outside the normal course of business.~~

[No amendments to paragraphs .A72–.A74.]

## **Appendix A—Examples of Fraud Risk Factors (Ref: par. .11, .24, and .A30)**

### **.A75**

[No amendments to prior sections of this appendix.]

#### ***Opportunities***

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

- ~~Significant related party transactions not in the ordinary course of business or with related entities not audited or audited by another firm~~
- ***Related party transactions that are also significant unusual transactions***
- ***Significant transactions with related parties whose financial statements are not audited or are audited by another firm***
- A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions
- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate
- Significant, ~~unusual~~, or highly complex transactions ***or significant unusual transactions***, especially those close to period end that pose difficult “substance over form” questions
- Significant operations located or conducted across jurisdictional borders where differing business environments and regulations exist
- Use of business intermediaries for which there appears to be no clear business justification

- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification
- ***Contractual arrangements lacking a business purpose***

The monitoring of management is not effective as a result of the following:

- Domination of management by a single person or small group (in a nonowner-managed business) without compensating controls.
- Oversight by those charged with governance over the financial reporting process and internal control is not effective.
- ***The exertion of dominant influence by or over a related party.***

[No further amendments to this appendix.]

This amendment is effective for audits of financial statements for periods ending on or after June 15, 2019.\*

### Amendment to SAS No. 122, AU-C section 265

AU-C section 265, *Communicating Internal Control Deficiencies Identified in an Audit*, addresses the auditor's responsibility to appropriately communicate to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements. Proposed amendments are conforming amendments for the use of the term *significant unusual transactions*.

[No amendments to paragraphs .01– .A7.]

**.A8** Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, in internal control will result in a misstatement of an account balance or disclosure. The factors include, but are not limited to, the following:

- The nature of the financial statement classes of transactions, account balances, disclosures, and assertions involved
- The cause and frequency of the exceptions detected as a result of the deficiency, or deficiencies, in internal control
- The susceptibility of the related asset or liability to loss or fraud
- The subjectivity, complexity, or extent of judgment required to determine the amount involved

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\* This effective date is provisional but will not be earlier than June 15, 2019.

- The interaction or relationship of the control(s) with other controls
- The interaction with other deficiencies in internal control
- The possible future consequences of the deficiency, or deficiencies, in internal control
- The importance of the controls, such as the following, to the financial reporting process:
  - General monitoring controls (such as oversight of management)
  - Controls over the prevention and detection of fraud
  - Controls over the selection and application of significant accounting policies
  - Controls over significant transactions with related parties
  - Controls over significant *unusual* transactions ~~outside the entity's normal course of business~~
  - Controls over the period-end financial reporting process (such as controls over nonrecurring journal entries)

[No further amendments to AU-C section 265.]

This amendment is effective for audits of financial statements for periods ending on or after June 15, 2019.\*

## Amendment to SAS No. 122, AU-C section 315

AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, addresses the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements through understanding the entity and its environment, including the entity's internal control. Proposed amendments are conforming amendments for the use of the term *significant unusual transactions*.

[No amendments to paragraphs .01– .29.]

**.29** In exercising professional judgment about which risks are significant risks, the auditor should consider the following at least

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\* This effective date is provisional but will not be earlier than June 15, 2019.

[No amendments to list items *a–e*.]

- f.* whether the risk involves significant ***unusual*** transactions ~~that are outside the normal course of business for the entity or that otherwise appear to be unusual~~. (Ref: par. .A139–.A143)

[No further amendments to AU-C section 315.]

This amendment is effective for audits of financial statements for periods ending on or after June 15, 2019.\*

### Amendment to SAS No. 122, AU-C section 330

AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, addresses the auditor’s responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and to evaluate the audit evidence obtained in an audit of financial statements. Proposed amendments are conforming amendments for the use of the term *significant unusual transactions*.

[No amendments to paragraphs .01–.A57. Paragraph .A58 is amended to include new text and is split into two paragraphs.]

- .A58** Paragraph .22 requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. ***Because significant unusual transactions can affect the risks of material misstatement due to error or fraud, substantive audit procedures that take into account the types of potential misstatements that could result from significant unusual transactions may be necessary, including procedures performed pursuant to paragraph .32 of section 240.***

- .A59** Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, a risk may exist that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmation

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procedures not only to confirm outstanding amounts but also to confirm the details of the sales agreements, including date, any rights of return, and delivery terms. In addition, the auditor may find it effective to supplement such external confirmation procedures with inquiries of nonfinancial personnel in the entity regarding any changes in sales agreements and delivery terms.

[Paragraphs .A59–.A76 are renumbered as .A60–.A77. The content is unchanged.]

This amendment is effective for audits of financial statements for periods ending on or after June 15, 2019.\*

## Amendment to SAS No. 122, AU-C section 510

AU-C section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, addresses the auditor’s responsibilities relating to opening balances in an initial audit engagement, including a reaudit engagement. The proposed amendment is intended to enhance guidance relating to obtaining information about related parties and significant unusual transactions from predecessor auditors.

[No amendments to paragraphs .01–.A4.]

**.A5** It is customary for the predecessor auditor to make himself or herself available to the auditor and to make available for review certain audit documentation. The predecessor auditor determines which audit documentation is to be made available for review and which may be copied. The predecessor auditor ordinarily permits the auditor to review audit documentation, including documentation of planning; risk assessment procedures; further audit procedures; audit results; and other matters of continuing accounting and auditing significance, such as the schedule of uncorrected misstatements, working paper analysis of balance sheet accounts, and those relating to contingencies, *related parties, and significant unusual transactions*.

[No further amendments to AU-C section 510.]

This amendment is effective for audits of financial statements for periods ending on or after June 15, 2019.\*

## Amendment to SAS No. 122 Section 560,

AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses the auditor’s responsibilities relating to subsequent events and subsequently discovered facts in an audit of financial statements. The proposed amendment to AU-C section 560 is intended to enhance guidance relating to obtaining information about related parties and significant unusual transactions from predecessor auditors.

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[No amendments to paragraphs .01–.A5.]

**.A6** In inquiring of management and, when appropriate, those charged with governance about whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire about the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matters:

- Whether new commitments, borrowings, or guarantees have been entered into
- Whether sales or acquisitions of assets have occurred or are planned
- Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned
- Whether any assets have been appropriated by the government or destroyed (for example, by fire or flood)
- Whether there have been any developments regarding contingencies
- Whether any unusual accounting adjustments have been made or are contemplated
- Whether any events have occurred or are likely to occur that will bring into question the appropriateness of accounting policies used in the financial statements, as would be the case, for example, if such events call into question the validity of the going concern assumption
- Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements
- Whether any events have occurred that are relevant to the recoverability of assets
- ***Whether there have been any changes in the entity's related parties***
- ***Whether there have been any significant new related party transactions***
- ***Whether the company has entered into any significant unusual transactions***

[No further amendments to AU-C section 560.]

This amendment is effective for audits of financial statements for periods ending on or after June 15, 2019.\*

## Amendment to SAS No. 122 AU-C section 580

AU-C section 580, *Written Representations*, addresses the auditor's responsibilities to obtain written representations from management and, when appropriate, those charged with governance in an audit of financial statements. Proposed amendments to AU-C section 580 are intended to enhance guidance relating to obtaining representations about related parties and related party transactions.

[No amendments to paragraphs .01–.16.]

**.17** The auditor should request management to provide written representations that (Ref: par. .A15–.A16)

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\* This effective date is provisional but will not be earlier than June 15, 2019.

- a. it has *adequately* disclosed to the auditor the identity of *all* the entity's related parties and all the related party relationships and transactions of which it is aware and
- b. it has appropriately accounted for and disclosed such relationships and transactions.

[No amendments to paragraphs .18–.A14.]

**.A15** Circumstances in which it may be appropriate to obtain written representations about related parties from those charged with governance in addition to management include the following:

- When they have approved specific related party transactions that (a) materially affect the financial statements or (b) involve management
- When they have made specific oral representations to the auditor on details of certain related party transactions, *including support for any assertion that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction*
- When they have financial or other interests in the related parties or the related party transactions

[No amendments to paragraphs .A16–.A17.]

**.A18** In addition to the written representations required by paragraphs .10–.18, the auditor may consider it necessary to request other written representations about the financial statements. Such written representations may supplement, but do not form part of, the written representations required by paragraphs .10–.18. They may include representations about the following:

- Whether the selection and application of accounting policies are appropriate
- Whether matters such as the following, when relevant under the applicable financial reporting framework, have been recognized, measured, presented, or disclosed in accordance with that framework:
  - Plans or intentions that may affect the carrying value or classification of assets and liabilities
  - Liabilities, both actual and contingent
  - Title to, or control over, assets and the liens or encumbrances on assets and assets pledged as collateral
- Aspects of laws, regulations, and contractual agreements that may affect the financial statements, including noncompliance

- ***The absence of side agreements or other arrangements (either written or oral) undisclosed to the auditor***

This amendment is effective for audits of financial statements for periods ending on or after June 15, 2019.\*

## Amendment to SAS No. 122, AU-C section 600

AU-C section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, addresses special considerations that apply to group audits, in particular those that involve component auditors. The proposed amendment is intended to enhance requirements relating to obtaining information about related parties.

[No amendments to paragraphs .01–.40.]

- .41** The group engagement team should communicate its requirements to a component auditor on a timely basis. This communication should include the following:

[No amendments to list items *a–b*.]

*c.* A list of related parties prepared by group management and any other related parties of which the group engagement team is aware, ***including the nature of the company's relationships and transactions with those related parties***. The group engagement team should request the component auditor to communicate on a timely basis related parties not previously identified by group management or the group engagement team. The group engagement team should identify such additional related parties to other component auditors.

[No further amendments to AU-C section 600.]

This amendment is effective for audits of group financial statements for periods ending on or after June 15, 2019.\*

## Amendment to SAS No. 122, AU-C section 930

AU-C section 930, *Interim Financial Information*, addresses the auditor's responsibilities when engaged to review interim financial information under specified conditions. Proposed amendments are intended to enhance guidance relating to obtaining information about related parties and significant unusual transactions.

[No amendments to paragraphs .01–.20.]

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**.21** For all interim financial information presented and for all periods covered by the review, the auditor should request management to provide written representations, as of the date of the auditor's review report (Ref: par. .A29–.A30)

[No amendments to list items *a–l*.]

*m.* that management has ***adequately*** disclosed to the auditor the identity of ***all*** the entity's related parties and all the related party relationships and transactions of which it is aware, and it has appropriately accounted for and disclosed such relationships and transactions.

[No amendments to list item *n*.]

[No amendments to paragraphs .21–.A29.]

**.A30** The auditor may request additional representations, ***including representations regarding the following:***

- Matters specific to the entity's business or industry
- ***Support for any assertion that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction***
- ***The absence of side agreements or other arrangements (either written or oral) that have not been disclosed to the auditor***

[No amendments to paragraphs .A31–.A54.]

## **Appendix B—Unusual or Complex Situations to Be Considered by the Auditor When Conducting a Review of Interim Financial Information (Ref: par. .A18)**

**.A55** The following are examples of situations about which the auditor may inquire of management:

- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a segment of a business
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity
- Adoption of new stock compensation plans or changes to existing plans
- Restructuring charges taken in the current and prior quarters

- ~~Significant, unusual, or infrequently occurring transactions~~
- *Infrequent transactions*
- *Significant unusual transactions*
- Changes in litigation or contingencies
- Changes in major contracts with customers or suppliers
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates, such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges
- Compliance with debt covenants
- Changes in related parties or significant new related party transactions
- Material off-balance-sheet transactions, special purpose entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

[No further amendments to AU-C section 930.]

This amendment is effective for reviews of interim financial information for interim periods of fiscal years ending on or after June 15, 2019.\*

## Amendment to SAS No. 130

AU-C section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, establishes requirements and provides guidance that applies only when an auditor is engaged to perform an audit of internal control over financial reporting that is integrated with an audit of financial statements. The proposed amendment is a conforming amendment for the use of the term *significant unusual transactions*.

[No amendments to paragraphs .01—.A24.]

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\* This effective date is provisional but will not be earlier than June 15, 2019.

**.A25** Section 240 addresses the auditor's identification and assessment of the risks of material misstatement due to fraud.<sup>fn 13</sup> Controls that might address these risks include *the following*:

- Controls over significant, *or* unusual transactions, particularly those that result in late or unusual journal entries
- Controls over journal entries and adjustments made in the period-end financial reporting process
- Controls over related party transactions
- Controls related to significant management estimates
- Controls that mitigate incentives for, and pressures on, management to falsify or inappropriately manage financial results

[No further amendment to AU-C section 940.]

This amendment is effective for integrated audits for periods ending on or after June 15, 2019.\*

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\* This effective date is provisional but will not be earlier than June 15, 2019.