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Sherry Hazel
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Audit and Attest Standards
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Proposed Statement on Auditing Standards, *Related Parties* (Redrafted)

Dear Ms. Hazel:

The Accounting Principles and Auditing Standards Committee (the AP&AS Committee) of the California Society of Certified Public Accountants (CALCPA) is pleased to provide our comments to the Auditing Standards Board (the "Board") on the proposed standard.

The AP&AS Committee is the senior technical committee of the CALCPA. CALCPA has approximately 32,000 members. The Committee is comprised of 50 members, of whom 67 percent are from local or regional firms, 23 percent are sole practitioners in public practice, 5 percent are in industry and 5 percent are in academia.

Following is a summary of the Committee's responses to the proposed SAS for your consideration.

With the exception of certain matters included as requirements rather than application and other explanatory material as outlined below, our committee feels that the redraft is appropriate and strongly supports it. A substantial part of the guidance is already followed by many firms as what they consider not only best practice, but necessary.

The committee was split as to whether the elements in paragraph 22 should be included as requirements rather than application guidance. Specifically, that paragraph would require, in all cases when the auditor identifies any related party or significant related party transactions that management has not previously identified or disclosed, that the auditor should:

- a.* promptly communicate the relevant information to the other members of the engagement team.
- b.* request management to identify all transactions with the newly identified related parties for the auditor's further evaluation.
- c.* inquire why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions.
- d.* perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions. (Ref: par. A37)

- e. reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor and perform additional audit procedures as necessary.
- f. evaluate the implications for the audit if the nondisclosure by management appears intentional (and, therefore, indicative of a risk of material misstatement due to fraud). (Ref: par. A38)

However, many on the committee consider that this would be a change from existing standards and that such guidance is very appropriate in some circumstances, but that it is not necessary in situations where the related party noted has no significant impact on the financial statements.

For example, from time to time in preparing information for IRS Form 990 a nonprofit organization may find in canvassing board members that they have a business relationship because two of them may have overlapping memberships on other nonprofit boards that are new and the organization was not aware of. In considering that information, auditors currently evaluate such situations, and without going through all of the procedures that the standard would newly require, they may conclude that there is neither any financial impact nor indicative of a significant deficiency in the organization's internal control. In other situations where a related party is discovered, auditors already perform the procedures that would be required as well as many others, especially when the circumstance might appear to be a result of concealment and fraud.

Another consideration, especially for audits of smaller entities, is that those entities have little guidance on precisely what is meant by the term related party and what internal controls, including monitoring controls, they should implement.

The result of this, especially with this not being noted as a change from existing standards, would be that firms will not consider all such procedures necessary in all cases and will not follow what the redraft would require.

FASB Codification 850 on Related Parties concentrates on significant related party transactions and certain common control relationships which could result in significantly different operating results or financial position. However, paragraph 22 concentrates on significant related party transactions and *all* related parties, regardless of their significance or potential impact on the financial statements. If the requirements of paragraph 22 are not moved to application guidance, at least the paragraph should be rewritten and clarified.

Specific Questions

1. Are the objectives of the auditor appropriate?

The committee believes the objectives are appropriate.

2. Are the revisions made to converge the existing standards with ISA 550 appropriate?

The committee believes the revisions are appropriate.

3. Are the differences between the proposed SAS and ISA 550 identified in the exhibit, and other language changes, appropriate?

The committee believes the differences between the proposed SAS and the ISA, and other language changes, are appropriate.

4. Have considerations for audits of smaller, less complex entities and governmental entities been dealt with appropriately?

The committee believes that smaller, less complex entities have been dealt with appropriately.

We thank you for the opportunity to comment on this matter. We would be glad to discuss our comments with you further should you have any questions or require additional information.

Very truly yours,

A handwritten signature in cursive script that reads "JoAnn Guattery". The signature is written in black ink and is positioned above the typed name.

JoAnn Guattery, Chair
Accounting Principles and Auditing Standards Committee
California Society of Public Accountants