



Agenda Item 2G

This agenda item shows all proposed amendments in AU-C section order. Please note the following:

- The agenda item that is the source of the proposed amendment is shown in bracketed green highlighted text, solely for purposes of this agenda item (the green highlighted text will not be included in the proposed Omnibus SAS).
- Amendments to AU-C sections proposed in the Auditor Reporting/Disclosures Exposure Draft have been incorporated into this document.

AU-C Section 550, *Related Parties* [source: AS18: agenda item 2A]

[No amendment 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](#))
- b. The nature of the relationships between the entity and these related parties, *and the business purpose of entering into a transaction with a related party versus an unrelated party*
- c. Whether the entity entered into 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^{fn 11} considered appropriate to obtain an understanding of the controls, if any, that management has established to (Ref: [par. .A15-.A20](#))

- a. identify, account for, and disclose related party relationships and transactions.

^{fn 11} Paragraph .06 of section 315.

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- b. authorize and approve significant transactions and arrangements with related parties. (Ref: [par. .A21](#))
- 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 company's established policies or procedures regarding the authorization and approval of transactions with related parties.*
- b. *for which exceptions to the company's established policies or procedures were granted and the reasons for granting those exceptions.*

- .16** *The auditor should inquire of those charged with governance regarding:*
- a. *Their understanding of the company's relationships and transactions with related parties that are significant to the company; 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 for Related Party Information When Reviewing Records or Documents

- .17** During the audit, the auditor should ~~remain alert~~ *evaluate whether the entity has properly identified its related parties and relationships and transactions with related parties by performing procedures to test the accuracy and completeness of the related parties and relationships and transactions with related parties identified by the company, taking into account the information gathered during the audit* ~~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](#))

- 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*

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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](#))

- a. The nature of these transactions (Ref: [par. .A27](#))
- b. Whether related parties could be involved (Ref: [par. .A28](#))

[No amendment to paragraph .18, renumbered as paragraph .20.]

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

~~.19~~ **.21** 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.^{fn 12} 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.

[No amendment to paragraph .20, renumbered as paragraph .22.]

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

~~.23~~ **.24** As part of the requirement in section 330 that the auditor respond to assessed risks, the ***auditor should evaluate whether the company 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 company, taking into account the information gathered during the audit.***^{fn 14} (Ref: [par. .A34–.A37](#))

^{fn 12} Paragraph .26 of section 315.

^{fn 14} Paragraphs .05–.06 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

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[No amendment to paragraphs .22-28, renumbered as paragraphs .24-30. No amendment 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.^{fn 22} 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.

[No amendment 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.*

[No amendment to paragraph .A14, renumbered as paragraph .A15.]

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

.A1615 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 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

^{fn 22} Paragraph .40c of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

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

[No changes to paragraphs .A16-.A20, renumbered as .A17-.A21.]

~~.A21~~**.A22** *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

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

Records or Documents That the Auditor May Inspect (Ref: [par. .16](#))

~~.A22~~**.A23** *Evaluating whether a company has properly identified its related parties and relationships and transactions with related parties involves more than assessing the process used by the company.* During the audit, the auditor may inspect records or documents that indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. Examples of those records or documents include the following:

...

[No changes to paragraphs .A23-.A24, renumbered as .A24-.A25.]

Identification of Significant Unusual Transactions Outside the Normal Course of Business (Ref: [par. .17](#))

~~.A25~~**.A26** 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.

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~~.A2627~~ Examples of **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

~~.A2728~~ *Understanding the nature of significant **unusual** transactions ~~outside the normal course of business~~ (Ref: [par. .17a](#)). Inquiring into the nature of the significant **unusual** transactions ~~outside the entity's normal course of business~~ involves obtaining an understanding of the business rationale of the transactions and the terms and conditions under which these have been entered into.*^{fn 27}

~~.A2829~~ *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.*

[No changes to paragraphs .A29-.A34, renumbered as .A30-.A35.]

~~.A3536~~ 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).

^{fn 27} Paragraph .32c of section 240.

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- 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 changes to paragraphs .A36-.A51, renumbered as .A37-.A52.]

Communication With Those Charged With Governance (Ref: [par. .27](#))

.A5253 Communicating significant findings and 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.^{fn 33}
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 or approved, which may give rise to suspected fraud.
- The identification of significant related party transactions that have not been appropriately authorized and approved, which may give rise to suspected fraud.

^{fn 33} Paragraph .A10 of section 230 provides further guidance on the nature of significant findings or issues arising during the audit.

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- Disagreement with management regarding the accounting for, and disclosure of, significant related party transactions .
- 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
- ***If applicable, 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 and the evidence obtained by the auditor to support or contradict such an assertion.***
- ***The identification of significant related party transactions that appear to the auditor to lack a business purpose.*** [AS18]

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AU-C Section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*

[No amendment to paragraphs .01-.08]

Reporting

.09 When the entity presents the supplementary information with the financial statements, the auditor should report on the supplementary information in either (a) an other-matter paragraph in accordance with [section 706](#), *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, or (b) in a separate report on the supplementary information.^{fn 2} The other-matter paragraph or separate report should include the following elements:

- a. A statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole
- b. A statement that the supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements
- c. A statement that the supplementary information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements
- d. A statement that the supplementary information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, ***performing procedures to test the completeness and accuracy of the information presented in the supplementary information***, and other additional procedures, in accordance with auditing standards generally accepted in the United States of America
- e. ***A statement that in forming the auditor's opinion, the auditor evaluated whether supplemental information, including its form and content, complies, in all material respects, with the specified regulatory requirements or other criteria, if applicable***

^{fn 2} [Paragraph .08](#) of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

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- f. A statement, if applicable, that the supplemental information is presented on a basis that differs from the financial statements and is not prescribed by regulatory requirements. When such a statement is made, the report should describe the basis for the supplemental information presentation.*
- g. If the auditor issues an unmodified opinion on the financial statements and the auditor has concluded that the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, a statement that, in the auditor's opinion, the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole*
- fh. If the auditor issues a qualified opinion on the financial statements and the qualification has an effect on the supplementary information, a statement that, in the auditor's opinion, except for the effects on the supplementary information of (refer to the paragraph in the auditor's report explaining the qualification), such information is fairly stated, in all material respects, in relation to the financial statements as a whole [AS17; agenda item 2C]*

[No amendment to paragraphs .10-.A12]

.A13 In evaluating the appropriateness and completeness of the supplementary information as required by paragraph 07*f*, the auditor may consider testing accounting or other records through observation or examination of source documents or other procedures ordinarily performed in an audit of the financial statements, *as well as evaluating misstatements regarding the supplemental information identified during performance of audit procedures in accordance with section 450, Evaluation of Misstatements Identified During the Audit.* [AS17; agenda item 2C]

[No amendment to paragraphs .A14-.A16]

A17. If the supplemental information consists of two or more schedules, and the auditor is able to obtain sufficient appropriate audit evidence to support an opinion on some but not all schedules, the auditor is permitted to express an opinion on only those schedules for which sufficient appropriate evidence was obtained and disclaim an opinion on the other schedules. [AS17; agenda item 2C]

Exhibit — Illustrative Reporting Examples When the Auditor Is Reporting on Supplementary Information in Relation to the Financial Statements as a Whole

.A178

Illustration 1 — An Other-Matter Paragraph When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

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[Illustration 2](#) — An Other-Matter Paragraph When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

[Illustration 3](#) — An Other-Matter Paragraph When the Auditor Is Disclaiming an Opinion on the Financial Statements

[Illustration 4](#) — An Other-Matter Paragraph When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

[Illustration 5](#) — A Separate Report When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

[Illustration 6](#) — A Separate Report When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

[Illustration 7](#) — A Separate Report When the Auditor Is Disclaiming an Opinion on the Financial Statements

[Illustration 8](#) — A Separate Report When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

Illustration 1 — An Other-Matter Paragraph When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The *[identify accompanying supplementary information]* is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, *performing procedures to test the completeness and accuracy of the information presented in the information*, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. *In forming our opinion on the information, we evaluated whether the [supplementary information], including its form and content, is presented in conformity with [specify the relevant regulatory requirement or other criteria, if any].* In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

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Illustration 2 — An Other-Matter Paragraph When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The [*identify accompanying supplementary information*] is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, *performing procedures to test the completeness and accuracy of the information presented in the [supplementary information]*, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. *In forming our opinion on the information, we evaluated whether the [supplementary information], including its form and content, is presented in conformity with [specify the relevant regulatory requirement or other criteria, if any].* In our opinion, except for the effect on the supplementary information of [*describe reason for qualification of the auditor's opinion on the financial statements and reference the other-matter paragraph*], the information is fairly stated in all material respects in relation to the financial statements as a whole.

[No amendment to Illustration 3 and Illustration 4]

Illustration 5 — A Separate Report When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

We have audited the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated [*date of the auditor's report on the financial statements*] which contained an unmodified opinion on those financial statements. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. The [*identify supplementary information*] is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, *performing procedures to test the completeness and accuracy of the information presented in the [supplementary information]*, and other additional procedures in

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accordance with auditing standards generally accepted in the United States of America. *In forming our opinion on the information, we evaluated whether the [supplementary information], including its form and content, is presented in conformity with [specify the relevant regulatory requirement or other criteria, if any].* In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Illustration 6 — A Separate Report When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

We have audited the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated [*date of the auditor's report on the financial statements, the nature of the opinion expressed on the financial statements, and a description of the report modifications*]. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. The [*identify supplementary information*] is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, *performing procedures to test the completeness and accuracy of the information presented in the [supplementary information]*, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. *In forming our opinion on the information, we evaluated whether the [supplementary information], including its form and content, is presented in conformity with [specify the relevant regulatory requirement or other criteria, if any].* In our opinion, except for the effect on the accompanying information of the qualified opinion on the financial statements as described above, the information is fairly stated in all material respects in relation to the financial statements as a whole.

[No amendment to Illustration 7 and Illustration 8]

[AS17; agenda item 2C]

Proposed Amendments, AU-C Section 240

AU-C Section 260, *The Auditor's Communication With those Charged With Governance*, 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*

[No amendment to paragraphs .01-.11]

.12 The auditor should communicate with those charged with governance (Ref: par. ~~A23A25–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, **and significant unusual transactions**. When applicable, the auditor should (Ref: par. ~~A24A27–25A29~~)
 - i. explain... [AS16; agenda item 2B]

Uncorrected Misstatements

.13 The auditor should communicate with those charged with governance (Ref: par. A37-A38)

- 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 possible implications of uncorrected misstatements for future financial statements**. [AS16; agenda item 2B]

[No amendment to paragraphs .14-.A34]

A35. *The auditor may communicate, among other matters, 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.* [AS16; agenda item 2B]

[No amendment to paragraph .A35, renumbered as .A36]

.A367 To the extent not already addressed by the requirements in paragraph .12(a)–(d) 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,

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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).¹⁵

¹⁵ Paragraphs .21–.22 of AU-C section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards (AICPA, Professional Standards).
[AS16; agenda item 2B]

[No amendments to paragraphs .A38–.A54, renumbered as .A39–.A55]

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

~~.A475556~~ 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.* [AS16; agenda item 2B]

~~.A485657~~ Appendix—Qualitative Aspects of Accounting Practices

The communication required by paragraph .12a and discussed in paragraphs .A24–.A25 may include such matters as the following:

Significant Unusual Transactions

- *The policies and practices management used to account for significant unusual transactions.*
- *The auditor's understanding of the business rationale for significant unusual transactions.* [AS16; agenda item 2B]

[No amendment to paragraph .A57 renumbered as .A58]

Proposed Amendments, AU-C Section 260

AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*

[No amendment 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 company or that otherwise appear to be unusual due to their timing, size, or nature. [AS18CA; agenda item 2D]

[No amendment to paragraphs .12-.16.]

.17 The auditor should make inquiries of management regarding

- 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.* [AS18CA; agenda item 2D]

Proposed Amendments, AU-C Section 260

[No amendment to paragraph .18.]

.19 For those entities that have an internal audit function, fn 6 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. **[AS18CA; agenda item 2D]**

[No amendment 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 ***or 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. **[AS18CA; agenda item 2D]**

[No amendment 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

- a. test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, including entries posted directly to financial statement drafts. In designing and performing audit procedures for such tests, the auditor should (Ref: par. .A47-.A50 and .A55)
 - i...
 - b. review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor should
 - ...
 - 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 rationale (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*** (Ref: par. .A54)

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- 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 company'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; and*
- iv. evaluating whether significant unusual transactions that the auditor has identified have been properly accounted for and disclosed in the financial statements.*

[AS18CA; agenda item 2D]

[No amendment 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, a significant unusual transaction, 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 [AS18CA; agenda item 2D]

[No amendment to paragraphs .A18-.A53.]

~~.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.

Proposed Amendments, AU-C Section 260

- Transactions that involve previously unidentified related parties or parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit.
- *The transaction lacks commercial or economic substance, or is part of a larger series of connected, linked, or otherwise interdependent arrangements that lack commercial or economic substance individually or in the aggregate (e.g., the transaction is entered into shortly prior to period end and is unwound shortly after period end).*
- *The transaction occurs with a party that falls outside the definition of a related party (as defined by the accounting principles applicable to that company), with either party able to negotiate terms that may not be available for other, more clearly independent, parties on an arm's-length basis.*
- *The transaction enables the company to achieve certain financial targets.* [AS18CA]

[No amendment 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

- 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 amendment to paragraphs .A72-.A74.]

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

.A75

Proposed Amendments, AU-C Section 260

...

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 (e.g., a significant related party transaction outside the normal course of business)***
- ***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.

Proposed Amendments, AU-C Section 260

- 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.* [AS18CA]

The organizational structure is complex or unstable, as evidenced by the following:

- ...

Proposed Amendments, Other AU-C Sections

AU-C section 210, *Terms of Engagement*, as proposed to be amended by a Exposure Draft *Proposed Statements on Auditing Standards: Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*

[No amendment to paragraphs .01-.A30]

.A3133 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
- *The predecessor auditor's understanding of the nature of the company's relationships and transactions with related parties and significant unusual transactions*¹³

¹³ See paragraph .11 of section 240 for the definition of significant unusual transactions [AS18CA; agenda item 2D]

[All subsequent footnotes renumbered]

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

Proposed Amendments, Other AU-C Sections

AU-C section 265, *Communicating Internal Control Deficiencies Identified in an Audit*

[No amendment 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
- 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 amendment to AU-C section 265]

Proposed Amendments, Other AU-C Sections

AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, 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*

[No amendment to paragraphs .01-.28]

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

- a. whether the risk is a risk of fraud;
- b. whether the risk is related to recent significant economic, accounting, or other developments and, therefore, requires specific attention;
- c. the complexity of transactions;
- d. whether the risk involves significant transactions with related parties;
- e. the degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- 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](#))¹

¹ **See paragraph .11 of section 240 for the definition of significant unusual transactions]**
[AS18CA; agenda item 2D]

[Subsequent footnotes are renumbered.]
[No amendment to paragraphs .30-.A35]

.A3536 An understanding of the entity's selection and application of accounting policies may encompass such matters as

- the methods the entity uses to account for significant ~~and~~ unusual transactions.
[AS18CA; agenda item 2D]
- the effect of significant accounting policies in controversial or emerging areas for which a lack of authoritative guidance or consensus exists.

Proposed Amendments, Other AU-C Sections

- significant changes in the entity's accounting policies and disclosures and the reasons for such changes.
- financial reporting standards, and laws and regulations that are new to the entity and when and how the entity will adopt such requirements.
- the financial reporting competencies of personnel involved in selecting and applying significant new or complex accounting standards.

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

Proposed Amendments, Other AU-C Sections

AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

[No amendments to paragraphs .01-.A57]

.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 transaction can affect the risks of material misstatements 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.*** **[AS18CA]**

.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 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. **[AS18CA]**

[No amendments to paragraphs .A58-A76, renumbered .A59-.A77]

Proposed Amendments, Other AU-C Sections

AU-C 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*

[No amendment 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*.¹

¹ See paragraph .11 of section 240 for the definition of significant unusual transactions [AS18CA; agenda item 2D].

Footnotes 1-3 will be renumbered 2-4.

[No further amendment to section 510.]

Proposed Amendments, Other AU-C Sections

AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*

[No amendment 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 company's related parties.***
- ***Whether there have been any significant new related party transactions.***
- ***Whether the company has entered into any significant unusual transactions.***⁷

⁷ See paragraph 11 of section 240 for the definition of significant unusual transactions.

[AS18CA; agenda item 2D]

[Subsequent footnotes will be renumbered.]

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

Proposed Amendments, Other AU-C Sections
AU-C section 580, *Written Representations*

[No amendment to paragraphs .01-.16.]

.17 The auditor should request management to provide written representations that (Ref: [par. .A15-.A16](#))

- a. it has 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. **[AS18CA; agenda item 2D]**

[No amendment 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*** **[AS18CA]**
- When they have financial or other interests in the related parties or the related party transactions

[No amendment 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

Proposed Amendments, Other AU-C Sections

- 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*** [AS18CA; agenda item 2D]

Proposed Amendments, Other AU-C Sections

AU-C Section 600, *Special Considerations — Audits of Group Financial Statements*
(Including the Work of Component Auditors)

[No amendment 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:

...

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. [AS18; agenda item 2A]

[No further amendment to AU-C section 600.] [AS18; agenda item 2A]

Proposed Amendments, Other AU-C Sections
AU-C section 930, *Interim Financial Information*

[No amendment to paragraphs .016-.20.]

.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](#))

a. ...

...

m. that management has 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.

n. ... **[AS18CA; agenda item 2D]**

n. that all events occurring subsequent to the date of the interim financial information and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

[No amendment to paragraphs .21-.A29.]

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

- 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.* **[AS18CA]**

[No amendment 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

Proposed Amendments, Other AU-C Sections

- 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~~
- *The occurrence of infrequent transactions*
- *The occurrence of 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 [AS18CA]

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

Proposed Amendments, Other AU-C Sections

AU-C section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*

.A25 Section 240 addresses the auditor's identification and assessment of the risks of material misstatement due to fraud.^{fn 13} Controls that might address these risks include

- controls over significant, unusual transactions, particularly those that result in late or unusual journal entries;^{fn14}
- 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; and
- controls that mitigate incentives for, and pressures on, management to falsify or inappropriately manage financial results.

^{fn14} See paragraph .11 of section 240 for the definition of significant unusual transactions
[AS18CA; Agenda item 2D]

^{fn 13} Paragraphs .25-.27 of section 240.