



Audit Flash Report

No. 2010-04

To:	All Assurance Professionals	Date:	April 15, 2010
Re:	PCAOB Issues Staff Audit Practice Alert on Auditor Considerations of Significant Unusual Transactions	From:	National Assurance

On April 7, 2010, the PCAOB issued Staff Audit Practice Alert No. 5 (“Alert No. 5” or “the Alert”), *Auditor Considerations Regarding Significant Unusual Transactions*. This Alert does not introduce any new requirements or obligations for the auditor, but rather compiles relevant requirements from existing PCAOB auditing standards regarding significant unusual transactions into one document to assist auditors in performing reviews of interim financial information and audits of financial statements.

The focus of the Alert is to remind us that during the course of the audit or review, we may become aware of significant transactions that are outside of the company’s normal course of business, or that otherwise appear to be unusual given our understanding of the company and its environment, and that these transactions, especially those close to period end, may pose difficult “substance over form” questions and provide opportunities for companies to engage in fraudulent financial reporting.

Alert No. 5 can be found at http://pcaobus.org/Standards/QandA/04-07-2010_APA_5.pdf and should be read by all assurance professionals. The following summary does not substitute for a full reading of the Alert.

The Alert highlights guidance relating to six broad categories as set out below.

1. Identifying and Assessing Risks of Material Misstatement

As part of obtaining knowledge about the company’s business, industry, and the environment in which it operates, we are reminded to consider whether the information obtained indicates that one or more fraud risk factors are present. The existence of significant unusual transactions may be considered to be a fraud risk factor. In addition, the Alert emphasizes that when performing preliminary analytical review procedures, one of our objectives is to identify significant unusual transactions and we should consider the results of these procedures in identifying the risks of material misstatement due to fraud.

Further, in our controls assessment we should evaluate whether the company’s controls (including controls over significant unusual transactions, particularly those that result in late or unusual journal entries) sufficiently address the risks of material misstatement due to fraud and whether controls intended to address the risk of management override of other controls are appropriately designed and implemented and, where controls are tested, operate effectively.

2. Responding to Risks of Material Misstatement

As part of the overall responses to the risks of material misstatement due to fraud, Alert No. 5 emphasizes the need to consider management’s selection and application of significant accounting principles, including those related to significant unusual

transactions. Additionally, it points out that consideration should be given to whether the collective application of accounting policies indicates a bias that could result in a material misstatement.

In evaluating whether significant unusual transactions may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets, we should consider:

- Whether the form of the transaction is overly complex
- Whether management has discussed the transaction with the audit committee or board
- Whether management is emphasizing a particular accounting treatment instead of focusing on the underlying economics of the transaction
- Whether transactions with unconsolidated related parties (including special purpose entities) have been approved by the audit committee or board
- Whether the transactions involve previously unidentified related parties or parties that do not have the financial strength and substance to support the transaction

Further, significant findings or issues, including significant unusual transactions, must be documented in an engagement completion document (our MRC), which should be reviewed by the engagement quality control reviewer.

3. Consulting With Others

Alert No. 5 points out that consultations with others may be appropriate when considering significant unusual transactions.

4. Evaluating Financial Statement Presentation and Disclosure

Judgments concerning the “fairness” of the overall presentation of financial statements are applied within the framework of generally accepted accounting principles, which recognizes the importance of reporting transactions and events in accordance with their substance. As such, Alert No. 5 reminds us to consider whether the substance of transactions or events, including significant unusual transactions, differ materially from their form.

5. Communicating With Audit Committees

Communications with the audit committee about the methods used to account for significant unusual transactions are emphasized in the Alert. In addition, it highlights the need for us to discuss with the audit committee our judgments about the quality, not just the acceptability, of the company’s accounting principles applied in its financial reporting.

6. Reviewing Interim Financial Information

During a review of interim financial information, we are reminded to make inquiries of members of management who have responsibility for financial and accounting matters about, among other things, significant unusual transactions that may have an effect on the interim financial information, and significant unusual transactions occurring or recognized in the last several days of the interim period.

If you have any questions related to this Audit *Flash* Report, please contact Sue Lister at 305-8375 (internal) or 212-885-8375 (external).