

# Hollinger International

## Realities of Audit-Related Litigation

MARK S. BEASLEY · FRANK A. BUCKLESS · STEVEN M. GLOVER · DOUGLAS F. PRAWITT

### LEARNING OBJECTIVES

After completing and discussing this case you should be able to

- |  |   |
|--|---|
| [1] Appreciate the nature and significance of testimony in an alleged financial statement fraud case | [4] Describe auditor responsibilities for identifying related party transactions  |
| [2] Understand the importance of audit documentation   | [5] Understand required auditor communications with those charged with governance |
| [3] Outline GAAP requirements with respect to related party transactions                             |   |

### BACKGROUND

On November 15, 2004, the Securities and Exchange Commission (SEC) filed an enforcement action in the Northern Illinois U.S. District Court against Hollinger Inc., a Toronto-based company, and its former Chairman and CEO, Conrad Black, and the company's former chief operating officer, David Radler.<sup>1</sup> In the SEC's Civil Action Complaint, the SEC alleged that during the period 1999 to at least 2003, Black and Radler engaged in a fraudulent scheme to divert cash and assets from Hollinger International, Inc., a Chicago-based company that owned newspapers such as the *Chicago-Sun Times*, *The Daily Telegraph* in London, and *The Jerusalem Post*, among others. Hollinger International's Class A common stock shares were publicly traded on the New York Stock Exchange under the symbol "HLR" while its Class B common shares were owned by Toronto-based Hollinger Inc.

The SEC alleged in its complaint that Black and Radler diverted millions of dollars for personal use by misrepresenting and omitting material facts from communications with Hollinger International's Audit Committee and Board of Directors regarding a series of related party transactions. These men diverted cash by issuing "non-competition" payments to themselves by including disguised clauses in contracts they negotiated as part of several transactions involving Hollinger International's sale of several of its U.S. and Canadian newspaper properties. In total, at least \$85 million was diverted as disguised non-compete payments, which constituted about 14 percent of Hollinger International's total pretax income and 340 percent of its net earnings for the three-year period from 1999 through 2001.

The fraud was fairly simple. As Black and Radler negotiated contracts for the sale of selected newspaper subsidiaries, they included a clause in each sales contract stating that neither they nor Hollinger Inc. (the Toronto owner of the Class B shares) would compete against the new owner of the newspaper for a period of time. When each transaction was settled, portions of the sales transaction proceeds were allocated to Black, Radler, and Hollinger Inc. as compensation for their willingness to not compete with the new owners of the newspaper. Thus, Black and Radler were able to take advantage of their positions within Hollinger to benefit personally at the expense of Hollinger International and its Class A common shareholders.

<sup>1</sup> Civil Action Complaint, *United States Securities and Exchange Commission, Plaintiff, vs. Conrad M. Black, F. David Radler, and Hollinger, Inc., Defendants*. November 15, 2004 (see [www.sec.gov](http://www.sec.gov)).

The case was prepared by Mark S. Beasley, Ph.D. and Frank A. Buckless, Ph.D. of North Carolina State University and Steven M. Glover, Ph.D. and Douglas F. Prawitt, Ph.D. of Brigham Young University, as a basis for class discussion. It is not intended to illustrate either effective or ineffective handling of an administrative situation.

### Section 3: Professional and Ethical Issues

Because of Black's and Radler's positions, these non-compete transactions constituted "related party transactions." Hollinger International's internal policies required that all related party transactions be reviewed and approved by the Audit Committee of Hollinger International's Board of Directors. However, Black and Radler failed to disclose and they misled the Audit Committee of Hollinger International about the non-competition agreements they negotiated on behalf of Hollinger International. In addition to their misrepresentations and failure to disclose these related-party transactions to the company's Audit Committee for approval, Black and Radler omitted these transactions from the financial statements and proxy documents filed with the SEC. Black and Radler also attempted to disguise these payments from their auditors at KPMG, LLP.

In the SEC's complaint, Stephen M. Cutler, Director of the SEC's Division of Enforcement said, "*Black and Radler abused their control of a public company and treated it as their personal piggy bank. Instead of carrying out their responsibilities to protect the interest of public shareholders, the defendants cheated and defrauded these shareholders through a series of deceptive schemes and misstatements.*"

## THE TRIAL

The trial began in March 2007 in a Chicago federal courtroom, more than two years after the filing of the SEC's complaint. After months of testimony, which included a damaging confession from Black's closest business associate, David Radler, the jury returned to the courtroom hopelessly deadlocked. Instructed by the judge to continue deliberations, the jury returned 12 days later with its verdict. Black was found guilty on four of the 13 charges against him, including obstruction of justice and mail fraud. In December 2007, Black was sentenced to 6.5 years in jail and ordered to report to prison in 12 weeks.

As part of the trial deliberations, representatives from KPMG, LLP were required to testify regarding numerous aspects of their financial statement audits of Hollinger Inc. and Hollinger International. The testimony provided by KPMG partner Marilyn Stitt includes information regarding KPMG's role in performing an audit, detecting fraud, examining related party transactions, and communicating with Hollinger International's Audit Committee.

## TRANSCRIPTS OF MS. STITT'S TESTIMONY

In the text boxes that follow you will find selected excerpts of Ms. Stitt's testimony on the morning of April 23, 2007. Each excerpt is presented verbatim from transcripts of the trial testimony. Different sections of testimony are separated by either a series of asterisks (\*\*\*) or by bold headings indicating a different topic of discussion in the transcript. In the text that follows, "Q" represents the question asked of Ms. Stitt and "A" represents the response. "Witness" refers to Ms. Stitt and "The Court" refers to the judge in the trial. When reading the transcripts, keep in mind that the testimony is captured verbatim. Thus, grammatical errors made by the witness or examiner are captured word-for-word.

As you read the transcripts, pay particular attention to the testimony about KPMG's discussions with some of the members of management about the related party transactions, including discussions with the Hollinger International Audit Committee. One can begin to see examples of how management failed to be forthcoming with details about these transactions in their effort to conceal their fraud and in their attempt to mislead the Audit Committee into thinking these transactions were approved by the Audit Committee when they were not.

While KPMG was not a defendant in this particular trial, imagine the stress felt by Ms. Stitt as she was required to respond under oath in the spring of 2007 to voluminous and incredibly detailed questions regarding audits of Hollinger financial statements dating back to 1999 – 2001. In two days of back-to-back testimony on April 23-24, 2007, Ms. Stitt had to recall events and discussions between KPMG personnel and client personnel and respond to numerous specific questions about detailed working papers prepared by KPMG colleagues not only in Chicago, but also in Toronto and other KPMG offices involved in the engagement.

As you read the trial transcripts, picture yourself in Ms. Stitt's shoes as she sat on the witness stand in a Chicago courtroom. Imagine the difficulty of accurately testifying about events that may have occurred as far back as seven years earlier. Also, think about how important clear, specific audit working papers would be in terms of her ability to testify and respond to cross-examination. You can imagine that Ms. Stitt might have wished that the working paper documentation had been more exact regarding the procedures performed during the 1999-2001 audits.

**APRIL 23, 2007 – AM**

**SELECTED TESTIMONY ABOUT CONCEPT OF “REASONABLE ASSURANCE”<sup>2</sup>**

[Q] Would you state your name, please?

[A] Marilyn Stitt.

[Q] How do you spell your last name?

[A] S-t-i-t-t.

[Q] What's your line of work, Ms. Stitt?

[A] I'm a Chartered Accountant.

[Q] Are you with a firm?

[A] Yes, I'm a partner with KPMG Canada.

[Q] And tell the members of the jury what KPMG is, please.

[A] KPMG is a professional services firm. We provide services in accounting, auditing, taxation and a variety of business advisory services.

\* \* \*

[Q] Describe for us what this concept of “reasonable assurance” means, as it's articulated here, and as you applied it in your conduct for audits of KPMG.

[A] All right. So, “reasonable assurance” isn't necessarily, to the best of my recollection, defined in the standard, but it certainly distinguishes it from “absolute assurance” and says that it is a lower — a lower — level than “absolute assurance.” It's being reasonably comfortable that the financial statements are free of material misstatement. There's a — I think the reasons why it's, you know, distinguished — or, sorry, why we cannot provide absolute assurance or a guarantee — is articulated in the second bullet, which is, “because of a nature of audit evidence and the characteristics of fraud.”

[Q] We're going to come to the characteristics of fraud, again, from an audit perspective in just a moment; but, as for the first part — the nature of audit evidence — tell us why the nature of doing an audit prevents you from giving an absolute assurance or guarantee about the financial statements?

[A] Sure. So, to be able to give absolute assurance, you would need to sort of look at every transaction; every balance that a company would be involved with. And for a company, they may have millions of transactions, millions of sales, millions of receivables. And the whole concept of an audit, as I explained a little bit earlier, is on the premise of selective testing. So, there's a huge amount of judgment that goes in to decide sort of, “What are the areas that we're going to focus on when we're doing our audit?” And even within those we make judgments about, “Well, what kinds of tests are we going to be performing? How much work are we going to do? When are we going to do those tests?” So, there's a lot of judgment. And, then, even when you get audit evidence, there's a fair amount of judgment involved as to, you know, what conclusion you can draw from that audit evidence. So, as an example, if you were going to rely on a particular control in a company, you might test 30 items and go, “It would appear that that control

<sup>2</sup> Trial transcripts of the April 23, 2007 – AM – Testimony of Marilyn Stitt in the federal trial. *United States Securities and Exchange Commission, Plaintiff, vs. Conrad M. Black, F. David Radler, and Hollinger, Inc., Defendants.*

### Section 3: Professional and Ethical Issues

is working.” And you could draw a reasonable conclusion that the control seems to be effective and perhaps could reduce your testing. Well, you may have selected 30 items where it did work, but that’s not to say for the other millions of transactions that the company’s undertaken, that that control has always operated effectively. So –

\* \* \*

**[Q]** Now, you mentioned that the second reason has to do with characteristics of fraud, again, from an audit perspective. If we continue looking at the reasonable assurance standard, it states, “Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement.” Can you explain that for us?

**[A]** Generally, a fraud is an intentional act to deceive. And, so, as a result of that, it may not be apparent to us, because a fraud may involve collusion amongst individuals, concealment of information; it may involve falsification of documentation that we receive; it may involve overriding of internal controls that, based on the testing we did, it appeared as though it was operating effectively, but perhaps there was somebody specifically asking someone to override that control.

\* \* \*

**[Q]** And if we look at the audit description in Auditing Standard 230, Paragraph 12, it states, “Characteristics of fraud include: A, concealment through collusion among management, employees or third parties; B, withheld, misrepresented or falsified documentation; and, C, the ability of management to override or instruct others to override what otherwise appears to be effective controls.” In the course of conducting your financial audits at KPMG, are you trying to detect fraud as it’s described in the auditing standards?

**[A]** An audit requires us to make assessments up front in that planning stage as to where there may be a risk of fraud. We engage in discussions with the client around those. Make — you know, use professional judgment in understanding how those risks may have been mitigated. And we determine from that, you know, “Is there any adjustments that are needed to sort of the planned procedures that we would carry out?” So, we’re generally not necessarily out doing a whole bunch of procedures to find, you know, necessarily fraud or illegal activity; but, we become — keep our radar up, in terms of if there’s something that comes to our attention; and, this general risk assessment upfront as to where the risk of fraud may occur.

#### **APRIL 23, 2007 – AM**

#### **SELECTED TESTIMONY ABOUT CANWEST NON-COMPETE PAYMENTS<sup>3</sup>**

**[Q]** In early 2002, did you become aware of these CanWest non-compete payments to individuals?

**[A]** Yes.

**[Q]** In particular, the \$11.9 million to Mr. Black and Mr. Radler; and, also, the payments to Mr. Boulton, Mr. Atkinson and Ravelston?

**[A]** Yes.

**[Q]** Now, as of early 2002, at the time that you were working on this 10-K, had these CanWest non-compete payments then been disclosed in any 10-Ks that had been audited by KPMG?

**[A]** No, they had not.

**[Q]** Were they included in that 2000 10-K that we were just looking at, Government Exhibit Filing 9-C?

**[A]** No, they were not.

<sup>3</sup> The CanWest transaction represented one of the several sale transactions that triggered non-compete payments to Black and Radler. CanWest represents “CanWest Global Communications Corporation,” a former subsidiary of Hollinger International.

- [Q] Were you planning to include them in the 2001 10-K?
- [A] Yes, when we became aware of them, we had concluded in our view they were material-related party transactions and needed to be disclosed in the company's 2001 financial statements.
- [Q] Did you discuss that at the time with anyone from Hollinger's management?
- [A] Yes.
- [Q] And who did you talk to first?
- [A] The first I spoke to was Jack Boulton.<sup>4</sup>
- [Q] Approximately when was your discussion with Mr. Boulton?
- [A] I believe it was early the first week of February —
- [Q] And where?
- [A] — of 2002.
- [Q] Where did this conversation take place, Ms. Stitt?
- [A] I met with Jack Boulton in his offices at 10 Toronto Street.
- [Q] Was anyone else present besides you and Mr. Boulton?
- [A] No, it was just the two of us.
- [Q] What did Mr. Boulton say to you and what did you say to him?
- [A] I started the conversation by indicating that I had become aware of the CanWest non-compete payments.
- [Q] Keep your voice up, Ms. Stitt.
- [A] Sorry. I had become aware of the 2000 payments — the CanWest non-compete payments — to the Ravelston and to the executives that, in my view, they were material-related party transaction; and, that I was of the view that it needed to be disclosed in 2001, and was concerned that it had not been disclosed in the 2000 financial statements.
- [Q] And, again, you're having this conversation with Mr. Boulton in early '02?
- [A] Early February. So, February 5th or 6th of 2002.
- [Q] When you made these statements to Mr. Boulton, how did he respond?
- [A] I don't remember his exact words, but I do remember Jack indicated that these were not related-party transactions under generally accepted accounting principles; they did not need to be disclosed. I do recall Jack indicating to me that CanWest had demanded the non-compete payments — or, sorry, the Non-Compete Agreements — and that Hollinger International was really acting as an agent in receiving the funds. They were just acting as an agent to take the funds from CanWest and make those payments to the individuals; and, that it was not a related-party transaction that needed to be disclosed under GAAP.
- [Q] What was your response?
- [A] I said I didn't — didn't — didn't agree with him on his conclusion that he had reached; that, in my view, the company was not acting as an agent; that the company — it was the company, not CanWest, who had concluded that the payments would be made to the individuals.
- [Q] Which company are you referring to?
- [A] Sorry, Hollinger International was the company who had decided that the payments would be made to the individuals; that that was not — that was not — CanWest. So, I didn't accept the argument that the company was simply acting as an agent between CanWest and the employees. That it was my view that it was a material related-party transaction; that if it wasn't disclosed, we would probably be in a position where we would need to qualify our audit report; and, that while I couldn't necessarily speak for my U.S. colleagues who issued the opinion on the Hollinger International statements, I was reasonably comfortable that they would reach the same conclusion or be of the same view.
- [Q] Is this what you communicated to Mr. Boulton that day?
- [A] Yes.

<sup>4</sup> From 1995 through 2002, Jack Boulton served as Hollinger International's chief financial officer, and in 1998 he became Executive Vice President of Hollinger International.

**APRIL 23, 2007 – AM  
TESTIMONY ABOUT AUDIT COMMITTEE PRESENTATION**

[Q] Ms. Stitt, I'd like you to turn forward with me and focus on February 20, 2002. So, a couple weeks after these conversations you had with Mr. Boulton and Mr. Kipnis. Okay?<sup>5</sup>

[A] Yes.

[Q] Was there a meeting of Hollinger International's Audit Committee that day?

[A] Yes, there was.

[Q] Did you attend the meeting?

[A] Yes.

[Q] Where did the meeting take place?

[A] It took place in Hollinger International's offices in New York City.

[Q] And who else from KPMG was there besides you?

[A] Pat Ryan, who is a partner with KPMG in Toronto; Jim Winikates, who is the Lead Engagement Partner from Chicago on the Hollinger International audit; and, another partner from KPMG Chicago by the name of Leslie Coolidge, who was the SEC Concurring Review Partner working with Jim on the Hollinger International audit.

[Q] Were there any members of the Audit Committee present?

[A] Yes. Governor Thompson was president — sorry, was present.

[Q] He was present in person?

[A] Yes.

[Q] And do you remember if anybody was on the phone from the Audit Committee?

[A] I know one member of the Audit Committee participated by phone. I don't recall which — whether it was Mr. Burt or Ms. Kravis.

[Q] And in terms of Hollinger International's management, were any representatives of management present?

[A] Yes.

[Q] Do you recall who was there?

[A] Mark Kipnis was there, Jack Boulton, Fred Creasey, David Radler.

[Q] And might there have been others present, as well?

[A] Yeah, there may — Linda Loye may have been present, as well.

[Q] Now, in terms of getting ready for this meeting, Ms. Stitt, what did you understand would be the purpose of the meeting?

[A] At the conclusion of every audit, before we issue our audit report, we would generally meet with — for a public company with — the company's Audit Committee. And in that meeting, our professional standards — so, the book that was shown, one of the standards in there are some required communications. So, there's some things that we mandatorily need to communicate to the Audit Committee. But, in addition to that, we generally outline sort of the scope of the work that we've done; what areas we have focused on; you know, the — our findings; if we had any significant concerns; and, we talk about independence and unrecorded adjustments.

[Q] And this was a meeting that you had annually with the Audit Committee?

[A] Yes.

\* \* \*

[Q] Approximately how long did the meeting last all together?

[A] Hour, hour and ten minutes is what I would recall.

<sup>5</sup> Mr. Kipnis served as Secretary and Vice President — Law for Hollinger International from 1998 through 2003.

[Q] And in terms of the talking points that you had prepared on the related-party transactions in particular, did you, in fact, speak to those items at the meeting?

[A] No, I did not.

[Q] Who did?

[A] Pat Ryan.

\* \* \*

[Q] Once the group reached this portion of the presentation that Mr. Ryan was walking through, did any of the members of management have anything to say on the topic of non-compete agreements?

[A] I recall management sort of interjecting into the Minutes on —

[MR. NEWMAN]

Objection to the form of that response. Management interjecting, Judge.

[THE COURT]

Sustained.

[MS. RUDER]

[Q] Did it — first “Yes” or “No,” did anyone from management make any comments during this portion of the presentation?

[A] Yes.

[Q] Who from management made comments?

[A] Mark Kipnis and Jack Boulton.

\* \* \*

[Q] And when you reached that portion of the presentation, what in particular did Mr. Kipnis say?

[A] I remember Mr. Kipnis leaning over to Governor Thompson going — “You — that is on the agenda for this afternoon’s meeting or the meeting later to formally ratify that.”

[Q] Now, at some other point in the presentation, you said Mr. Boulton made a comment?

\* \* \*

[Q] What did Mr. Boulton say?

[A] I recall Mr. Boulton interjecting into the meeting and saying, “Governor Thompson, you will recall when the CanWest non-compete payments were approved, there was an error in the minutes and that was subsequently rectified.”

[Q] And was Mr. Ryan, in fact, talking about the company’s Minutes with respect to non-compete payments in general, as far as the presentation?

[A] Yes. I mean, we’re — we’re talking about the fact that we were looking for approval of these various payments.

[Q] All right. So, Mr. Kipnis mentioned Osprey and Mr. Boulton mentioned CanWest; is that correct?

[A] That is correct.

[Q] What, if anything, did Mr. Kipnis or Mr. Boulton say during the portion of the comments concerning the U.S. Community non-competes?

[A] Don’t recall them saying anything.

[Q] What, if anything, did Mr. Radler say during that portion of the discussion?

[A] Nothing.

[Q] Did anyone on the Audit Committee speak to any of these issues?

[A] No.

[Q] Were they listening — or only Mr. Thompson was in front of you; is that correct?

[A] Yeah. Mr. Thompson was sitting at the head of the table, yes.

[Q] And did Mr. Thompson say anything during this portion of Mr. Ryan’s presentation?

[A] No.

### Section 3: Professional and Ethical Issues

**[Q]** Now, in terms of the context, I'm putting next to each other Government Exhibit KPMG 19 and Government Exhibit KPMG 5. Before we leave this meeting, I want to understand a little better from you, Ms. Stitt, the context of where the "related-party transactions" discussion fits into the overall meeting. You mentioned that the overall meeting was around an hour, hour and ten minutes?

**[A]** That — that — is my recollection, yes.

**[Q]** It could have been a little longer or a little shorter?

**[A]** Yeah.

**[Q]** In terms of this discussion on related-party transactions, approximately how long did that portion of the discussion take?

**[A]** I would estimate it was somewhere between five to ten minutes.

\* \* \*

**[Q]** Coming away from the meeting — well, before we go away from the meeting, during the meeting was there some — was there anything — different or especially significant about your discussion about the U.S. Community non-competes, as opposed to any of the other topics that were covered during the session?

**[A]** No. We — we — wanted to make sure that the Audit Committee were aware of them. And we wanted — although it's not necessarily required under our auditing standards, we wanted — to ensure — because we thought it was the appropriate thing to do, to make sure — that they had previously been approved and that — and, so, we were there looking for confirmation that there was perhaps some lack of clarity in the original Minutes; and, we were just looking for clarification that, in fact, they had been previously approved.

**[Q]** And coming out of the meeting, what was your understanding of the status of that issue concerning the U.S. Community non-competes?

**[A]** Although they didn't say anything explicit, they didn't — they didn't — raise any concerns; they didn't object; they didn't ask any questions in the general session, in the private session. I — I — took the — you know, there was a pregnant pause as we were sort of waiting for a reaction, and there was none. And we proceeded with the rest of it. And I took away from that meeting that they, basically, confirmed to us that they had previously been approved.

\* \* \*

**[Q]** Why was it, coming away from the meeting — with the interaction that you've described, why were you satisfied coming away from that meeting with the status of the issue?

**[A]** Because nobody objected at the meeting to say these hadn't previously been approved. I mean, I took their silence as meaning that they had — they had — considered them before and they had been approved.

**APRIL 23, 2007 – AM**  
**SELECTED TESTIMONY ABOUT AUDIT WORKING PAPERS**

- [Q] Now, I want to switch topics for a second and just focus on work papers. You mentioned work papers previously?
- [A] Correct.
- [Q] Work papers are the — and we're going to talk about them a lot later, but work papers are the documentation of the work of the auditors, right?
- [A] It's what we've performed and what we found, yeah. The results of our tests.
- [Q] And work papers provide support for the auditor's ultimate conclusion as your evidential matter?
- [A] Yes, that is correct.
- [Q] And work papers are the official records of the audit, right?
- [A] That is correct.
- [Q] And they get prepared by auditors reviewing the records?
- [A] Yes. They're prepared by whoever is performing the test, yeah.
- [Q] And sometimes the work papers include discussions with clients?
- [A] Yes.
- [Q] And they reflect confirmation from outside sources when that's done?
- [A] Yeah. When that's done, yeah.
- [Q] But the work papers don't necessarily record all of the work or considerations that go into the audit, right?
- [A] I mean, generally, we try to document all of the items that we think are significant and perform a foundation for us expressing our opinion.
- [Q] You do your best, but not everything makes it into the work papers, right?
- [A] That's — that could be a fair comment, yeah.
- [Q] But, like you said, it records many important considerations and what you're focusing on as material, right?
- [A] That's correct.
- \* \* \*
- [Q] And when you initial a work paper, it means that, basically, you've reviewed it and you signed off on it subject to any comments you might have written onto the document, right?
- [A] Practice is somewhat mixed. I mean, sometimes you may review a document and have a question and you've prepared what we refer to as review notes. And you would sort of separately track your outstanding items with respect to review of a document.
- [Q] But it's — the typical practice is when you initial it, you're signing — is it called "signing off on the document"?
- [A] Generally, that is the practice. You shouldn't sign off on it until you have cleared your review notes.
- [Q] And, then, after the audit's completed, the work papers are all filed in a central place that KPMG keeps, right?
- [A] That is correct.

**REQUIRED**

[1] The following requirements relate to Ms. Stitt's testimony about the concept of reasonable assurance:

- [a] Research the auditing standards for "reasonable assurance" and provide your assessment as to the accuracy of Ms. Stitt's description of that concept in her testimony.
- [b] Ms. Stitt testified that audit evidence is often not conclusive. Describe professional standards requirements related to the need to collect audit evidence and provide a summary of what is meant by "sufficient appropriate audit evidence."
- [c] As part of Ms. Stitt's testimony, she describes auditor responsibility for detecting material misstatements due to fraud. Review auditing standards requirements related to auditor responsibilities for detecting material misstatements due to fraud and assess whether her testimony is consistent with auditing standards.

[2] The following requirements relate to Ms. Stitt's testimony about the CanWest non-compete payments:

- [a] The concept of a "related party" is defined by generally accepted accounting principles (GAAP). Review the FASB's Accounting Standards Codification (ASC) and determine where guidance for related parties is contained in accounting standards.
- [b] Provide a brief overview of the accounting standards' definition of "related party transactions."
- [c] What are the primary accounting requirements for related parties described in the ASC? What types of information should be included in financial statements?
- [d] Based on your understanding of the concept of "related party transactions," why would the non-compete payments described in this case be considered a "related party transaction?"

In June 2014, the PCAOB issued Auditing Standard No. 18, *Related Parties*. Visit the PCAOB's website ([www.pcaob.org](http://www.pcaob.org)) and locate PCAOB Release No. 2014-002 issued on June 10, 2014 to answer the following questions:

- [e] What three critical areas are the subject of this new standard and why did the PCAOB decide those areas should be addressed in this new standard?
- [f] Summarize the primary auditor responsibilities in the PCAOB's AS 18 regarding the auditor's responsibilities with respect to identifying related party relationships and transactions.

[3] The following requirements relate to Ms. Stitt's testimony about the audit committee presentation:

- [a] Visit the PCAOB's website to identify where guidance related to auditor communications with audit committees resides.
- [b] Provide a brief overview of the requirements in PCAOB auditing standards about the auditor's communications with those charged with governance. Be sure to describe the overall purpose of this required communication.
- [c] What does PCAOB AS No. 18, *Related Parties*, say about communications with audit committees?
- [d] Based on your overview of the auditor's communication responsibilities, why was it appropriate for KPMG to discuss the related party transactions with Hollinger International's Audit Committee?
- [e] Based on your review of the transcript about the audit committee meeting, describe whether you believe KPMG exercised due professional care in pursuing this issue with Hollinger International's Audit Committee. Did KPMG accomplish the intent of auditing standards? What could KPMG have done differently with respect to this issue during this meeting?

- [4] The following requirements relate to Ms. Stitt's testimony about the audit working papers:
- [a] Based on your review of requirements in auditing standards related to auditor documentation, why must auditors prepare audit documentation?
  - [b] Discuss the concept of "experienced auditors" as described in auditing standards and highlight how that concept relates to the form, content, and extent of audit documentation.
  - [c] Summarize the requirements for identifying the preparer and reviewer of audit documentation. Is Ms. Stitt's testimony consistent with those requirements? Briefly explain.
  - [d] Summarize the responsibilities for reviewing audit documentation as described in auditing standards.

### PROFESSIONAL JUDGMENT QUESTION

It is recommended that you read the Professional Judgment Introduction found at the beginning of the book prior to responding to the following question.

- [5] In December 2012, the PCAOB issued Staff Audit Practice Alert No. 10, *Maintaining and Applying Professional Skepticism in Audits*. Review that Alert to answer the following:
- [a] How does the PCAOB define professional skepticism?
  - [b] How do responsibilities for applying professional skepticism differ among the engagement team?
  - [c] What are common impediments to the application of professional skepticism?
  - [d] What types of audit procedures represent examples where professional skepticism is needed?
  - [e] What is the role of systems of quality control in regards to the application of professional skepticism?