

OICV-IOSCO

Organización Internacional de Comisiones de Valores
International Organisation of Securities Commissions
Organisation internationale des commissions de valeurs
Organização Internacional das Comissões de Valores

November 1, 2007

Mr. James M. Sylph
Executive Director, Professional Standards
International Auditing and Assurance Standards Board
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017

Email Edcomments@ifac.org

Re: Proposed Redrafted International Standard on Auditing ISA 550 (Revised and Redrafted), *Related Parties*

Dear Mr. Sylph:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the opportunity to comment on the Exposure Draft of proposed redrafted international standard on auditing ISA 550, *Related Parties* (the ED). As an international organization of securities regulators representing the public interest, IOSCO SC 1 is committed to enhancing the integrity of international markets through promotion of high quality accounting, auditing, and professional standards.

Members of SC 1 seek to further IOSCO's mission through thoughtful consideration of accounting, auditing and disclosure concerns and pursuit of improved global financial reporting. As we review proposed auditing standards, our concerns focus on whether the standards are sufficient in scope and adequately cover all relevant aspects of the area of audit being addressed, whether the standards are clear and understandable, and whether the standards are written in such a way as to be enforceable. Our comments in this letter reflect those matters on which we have achieved a consensus among the members of SC 1; however, they are not intended to include all comments that might be provided by individual members on behalf of their respective jurisdictions.

Calle Oquendo 12
28006 Madrid
ESPAÑA
Tel.: (34.91)
417.55.49 • Fax: (34.91)
555.93.68
mail@oicv.iosco.org
• www.iosco.org

Overarching comment regarding changes since the earlier Exposure Draft

As we read this most recent Exposure Draft, our overall impression of the proposed ISA is that it has stepped back from the auditing requirements proposed in the previous December 2005 Exposure Draft and that it has now established a more modest standard for the identification and auditing of related party transactions. We are concerned that the latest version of the proposed standard seems to place too much emphasis on making inquiries of management, when inquiries are the weakest form of audit evidence. While of course the auditor must make inquiries of management regarding related parties and management's processes for identifying related parties, we believe there should be additional emphasis on the other actions auditors should carry out as part of identifying and auditing related party transactions.

The previous December 2005 Exposure Draft in paragraph 11 required the auditor to "review appropriate records or documents for transactions that are both significant and non-routine, and for other information that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions." It appears that the current ED that has modified or subtracted this requirement. We reproduce the text below and compare the two EDs.

Paragraph 11 in the December 2005 Exposure Draft stated:

"Material misstatements resulting from related parties often arise from management's failure (whether intentional or not) to completely identify or disclose the entity's related party relationships and transactions. Accordingly, the auditor shall in addition perform the following risk assessment procedures specifically directed towards identifying related party relationships and transactions that are not identified or disclosed by management:

(a) Inquire of management and others within the entity about the existence of transactions that are both significant and non-routine;

(b) Where a party appears to actively assert dominant influence over the entity, perform procedures intended to identify the parties to which the dominant party is related, and understand the nature of the business relationships that these parties may have established with the entity.

(c) Review appropriate records or documents for transactions that are both significant and non-routine, and for other information that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions. Appropriate records or documents shall include: (i) Bank and legal confirmations obtained by the auditor; and (ii) Minutes of meetings of shareholders and those charged with governance and other relevant statutory records."

In the current Exposure Draft, the comparable content is contained in paragraphs 18 and 19 as follows:

"If, during the audit, the auditor identifies significant transactions outside the normal course of business, the auditor shall inquire of management to understand the nature of these transactions and whether they involve related parties" and "During the audit, the auditor shall also be alert 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 addition, the auditor shall inspect the following documents for information that may indicate the existence of such relationships or transactions: (a) Bank and legal confirmations obtained as part of the auditor's procedures; and (b) Minutes of meetings of shareholders and of those charged with governance. The auditor shall obtain an understanding of the business rationale of the entity's related party relationships and transactions to assess whether they give rise to material misstatements in the financial statements. In addition, for those related party transactions that are both significant and non-routine, the auditor shall determine whether they have been properly authorized and approved."

While inquiries of management are required under both EDs, it appears that the records that were provided as two presumptively mandatory examples in the earlier ED's paragraph 11 (c) are now the only records the auditor is specifically required to review, and that the reference to "other relevant statutory records" has been removed from requirement in the latest ED. These and other changes from the first to the second ED can be viewed as shifting somewhat from an overall approach of requiring the auditor to "look for transactions outside the normal course of business" to an approach of "if you find transactions outside the normal course of business, do the following."

As we viewed the previous exposure draft as an improvement over the extant standard and had suggested additional improvements needed, we would like to have a greater understanding of the changes which appear to have curtailed required procedures somewhat. We understand that an auditor's search for related parties cannot be open-ended and limitless, and we agree that such a search should appropriately take risk of misstatement into account, but we believe the Board should find some language that conveys a greater or more specific obligation on the auditor's part than the requirement in paragraph 19 which begins "During the audit, the auditor shall also be alert..."

The identification of related parties is critical to assuring that the whole of the entity subject to audit is understood, as well as to assure that the relevant transactions are properly accounted for and disclosed. We are not sure the current ED will be as helpful to auditors seeking to identify and audit related party transactions as the former ED would have been.

There have been many successive revisions of the proposed text for ISA 550 during the Board's deliberations between the first and second Exposure Draft, and a mapping document was not provided with the latest ED. We have found it challenging to identify and understand all the changes made. While the Board has provided some explanation of its decision making in the Explanatory Memorandum, we did not find this explanation sufficient to understand the Board's decision making. We believe it would be helpful for the Board to develop and make available a full mapping document of changes from the

previous ED to the current ED, and that the Board should evaluate the cumulative effect of all changes made. This would help to ensure that the current ED is sufficiently robust in its requirements, before concluding this project.

Objectives - Paragraph 10

We think the objectives in the ED address in general most of the relevant areas but are missing sufficient coverage of the need to look for and identify related party relationships and transactions. We suggest the first objective in (a) would be improved to be more clear and direct if it stated the objectives of the auditor are "To determine whether related party relationships and transactions have been appropriately identified and are appropriately and completely accounted for and disclosed in accordance with the applicable financial reporting framework;"

Definitions Paragraph 11(b) - Dominant Influence

We believe the discussion regarding dominant parties in the earlier ED was very useful and suggest that a solution for any confusion which was noted by some parties commenting on the earlier ED could be addressed by including a definition for "dominant party" as well as "dominant influence". We suggest that an appropriate definition for "dominant party" consistent with the content in the ISA could be "Dominant Party - a individual or individuals who have the ability to impose their will on the entity through exercising dominant influence" We also think that both "dominant influence" and "significant influence" should be mentioned in paragraph 20.

Other comments - Special Purpose Entities should be mentioned in requirements section

In our comment letter on the previous Related Parties Exposure Draft, we stated that Special purpose entities should receive some mention in the requirements section of the standard. (The only mention in the previous ED was one passing reference to such entities in the Application Material section.) We continue to believe that the existence of such entities and their potential complexities and risks make it important to include a mention of such entities in the "Requirements" section of the standard, not just in Application Material. All auditors should have an awareness of the risks that can arise in special purpose entities even if SPEs do not exist in all entities and all audits.

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

Paragraph 23

In the previous Exposure Draft, there was a very specific and useful paragraph that noted three circumstances that were indicators of potential risk, as follows:

(a) Management has not identified or disclosed to the auditor one or more of the entity's related parties.

(b) Management has not identified or disclosed to the auditor relationships and transactions with identified related parties. (This paragraph and the circumstances listed have been deleted in the current Exposure Draft.)

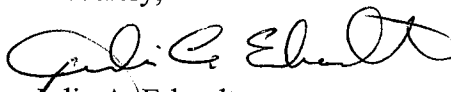
(c) Management has not appropriately accounted for or disclosed identified related party relationships or transactions in accordance with the applicable financial reporting framework.

This previous paragraph and its listed circumstances have been deleted in the current ED. Since risk identification and assessment, and reassessment, occurs throughout the audit, this listing of circumstances was a very helpful listing of indicators of heightened risk involving related party transactions. Even if the Board now thinks this is a mixture of procedures and actions that would occur in the course of an audit, we think the ISA is weaker without this content.

We also note that the list of required actions in paragraph 23 does not contain a requirement for the auditor to do further audit work to see if there are any other undisclosed related parties. The only action we see that perhaps comes close is (d) "Perform appropriate substantive procedures to respond to risks relating to such newly identified related parties or significant related party transactions." This text in item (d), however, is not the same as requiring the auditor to search for other undisclosed related parties once one undisclosed related party has been identified. (If that is what was intended, the sentence should be clarified.)

We appreciate the Board's thoughtful consideration of the points raised in this letter. If you have any questions or need additional information about the comments that we have provided, please do not hesitate to contact me at 202-551-5300 or contact members of the SC 1 Auditing Subcommittee.

Sincerely,



Julie A. Erhardt
Chair

IOSCO Standing Committee No. 1

Appendix - Answers to Request for Specific Comments Questions listed in Exposure Draft

Question 1: Respondents are asked for their views on whether the proposed definition of a related party is appropriate

We have suggested additional content for the Definitions section in our letter

Question 2: Respondents are asked for their views on whether the proposed ISA should address the auditing implications of implicit arm's length assertions that management has made for related party transactions.

We believe the auditor should first of all audit against the applicable financial reporting framework. If both the framework and the audited entity are silent on the matter of terms and conditions of related party transactions, then we think the auditor would need to evaluate whether either of the conditions in 26 (b) regarding misleading information exist and be guided accordingly.

If the framework in a given country provides that "silence on the issue of the terms of related party transactions is considered to be an assertion that the terms and conditions of related party transactions are the same as those applicable to unrelated parties", it would seem that an auditor auditing against that framework would have to determine if the assertion is correct.