Chairman

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IAASB exposure draft ISA 550 (revised and redrafted), Related parties

Dear Mr Sylph

The Basel Committee on Banking Supervision (the Committee) welcomes the opportunity to comment on your recent exposure draft. The Committee has a strong interest in high quality and independent audits of banks and has carefully analysed the revised proposal captioned above.

We appreciate the efforts of the International Auditing and Assurance Standards Board (IAASB) in revising and redrafting the auditing standard to enhance auditor performance in an audit of financial statements and improve the clarity of the language within the standard to more clearly describe the responsibilities of the professional accountant. Please find our detailed comments in the attached appendix. These comments have been prepared by the Committee’s Accounting Task Force, chaired by Ms Sylvie Mathérat, Director of the Commission Bancaire in France, and have been approved by the Committee. The Committee trusts that you will find its comments useful and constructive.

If you have any questions regarding our comments, please feel free to contact Sylvie Mathérat (+33 1 4292 6579), Marc Pickeur, who chairs the Audit Subgroup of the Accounting Task Force (+32 2 220 5253), or Linda Ditchkus at the Basel Committee Secretariat (+41 61 280 8007).

Yours sincerely,

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Appendix

Basel Committee comments on IAASB exposure draft ISA 550 (revised and redrafted), Related parties

1. Introduction

The Basel Committee on Banking Supervision (the Committee) has a strong interest in high quality and independent audits of banks and has carefully analysed the proposed redrafted International Standard on Auditing (ISA) pertaining to related parties. The remainder of this appendix highlights certain issues, questions and suggestions for the Board's consideration.

2. Responses to the IAASB’s questions

(1) What are our views on whether the proposed definition of a related party is appropriate

While we believe the proposed definition of the term ‘related party’ is appropriate, we believe the IAASB should consider modifying and clarifying the proposed definition for ‘dominant influence’ in paragraph 11(b). We propose the IAASB define the term ‘dominant party’ rather than the term ‘dominant influence,’ because the term ‘dominant party’ is used extensively in ISA 550 and is not defined within the ISA. By defining the term ‘dominant party’ the IAASB can also clarify the relationship between a ‘dominant party’ and a ‘related party,’ if the IAASB intends such a relationship. We also suggest that the definition of the term ‘dominant party’ include the concept of exerting ‘control’ rather than the concept of ‘impose their will,’ because we believe exerting ‘control’ is a more commonly used and understood concept, is consistent with the terminology within the definition of ‘related party,’ and appropriately distinguishes between a ‘dominant party’ and a ‘related party.’ Therefore, the proposed text for paragraph 11(b) would be:

‘Dominant party – a single individual or small group of individuals who are in a position to control the outcome of major decisions affecting the entity’s business. Such an individual or group of individuals may form a part of management or those charged with governance, or may have no official role within the entity; and’

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1 The Basel Committee on Banking Supervision is a committee of banking supervisory authorities, which was established by the central bank Governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. It usually meets at the Bank for International Settlements in Basel, where its permanent Secretariat is located.
The Committee presumes that all ‘dominant parties’ are also considered ‘related parties’ and that all of the requirements in ISA 550 with respect to ‘related parties’ are applicable to ‘dominant parties.’ If the IAASB agrees with this presumption, it should add language to clarify this relationship. However, if the IAASB does not agree, then it should consider the requirements for both the related parties and dominant parties and clearly specify the requirements in ISA 550 that apply with respect to each type of party.

(2) What are our 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. Additionally, what are our views on an appropriate approach, bearing in mind that there would be a need to distinguish between explicit and implicit arm’s length assertions.

No comment

(3) What are our views related to audits of small entities, audits of public sector entities, challenges for developing nations, and challenges for translation?

No comment

(4) Other technical comments for consideration

In order to complete the requirements within paragraphs 14 and 15, the auditor will need to conduct a review of the applicable financial reporting framework. The ISA should specifically mention this additional requirement. One way to modify the text to incorporate this requirement is as follows:

'14. The auditor shall determine whether the applicable financial reporting framework establishes related party requirements and if so, the auditor shall…'

'15. The auditor shall determine whether the applicable financial reporting framework establishes minimal or no related party requirements and, if so, the auditor shall inquire of management regarding…'

Instances where an auditor identifies related parties or significant related party transactions that management had not previously identified or disclosed to the auditor can be a significant matter (ie especially for regulated entities such as banks). In the proposed ISA 550, there is a requirement, in paragraph 28, for significant matters to be communicated to those charged with governance. However, no guidance on communications or audit implications is provided for those instances when non-identification or non-disclosure is a significant matter (ie irrespective of whether the event is intentional). The potential implications of unintentional but significant omissions are not further clarified within paragraphs 28 and A39. One way to provide guidance for this circumstance is to add the words “or is otherwise determined to be a significant matter” to the text. The revised text would be (change is indicated in bold):

‘23(e) If the non-identification or non-disclosure appears intentional or is otherwise determined to be a significant matter, (i) communicate this information to those charged with governance (unless all of them are part of management and are aware of the information already communicated by the auditor)³, and (ii) evaluate the implications on the audit. (Ref: Para. A28)’
Additionally, the IAASB should consider cross-referencing paragraph 23(e) with the ISA that describes the requirement for documenting this judgement (for example redrafted ISA 240.107-110).

In paragraph A20, we recommend modifying the text to include the term ‘dominant party’ and to include the concept of the ability of the dominant party to influence significant business activities. Proposed new text could be:

‘A20. The existence of a dominant party is a risk factor on its own because such a party has the ability to impose significant influence on the entity or on a major business activity of the entity. This type….’

Additionally, the proposed examples of evidence, which are included as bullets for paragraph A20, are setting too high of a threshold and should be modified as follows:

Modify the second bullet by deleting the word “all”

Modify the fourth bullet by changing the word “not” to “rarely”

Add a new bullet, for example:

‘• Directing management to adopt business decisions that serve the interests of the dominant party.’

As banking supervisors, we strongly believe there is a need to emphasise that transactions with close family members of a related party or dominant party deserve a high level of auditor scrutiny. The IAASB has included guidance in this regard within paragraph A4; however, additional emphasis is warranted. Therefore, we recommend that at least one of the examples evidencing the dominant party’s influence, which are included as bullets for paragraph A20, refer to a circumstance involving a close family member of a dominant party. One example of such a change would be to modify the fourth bullet as follows (note that a previously suggested change is also included with this proposed text):

‘• Transactions involving the dominant party or a close family member of the dominant party are rarely independently reviewed and approved.’

Paragraph A25 should be revised to remain consistent with the change from using the term ‘dominant influence’ to the term ‘dominant party’ (ie as explained above in the suggested changes to paragraph 11(b)).

In paragraph A39, a final bullet should be added to acknowledge that in many jurisdictions there are legal requirements, prohibitions and restrictions with respect to related party transactions, particularly for regulated entities such as banks. The following is an example of possible text that could be used for this final bullet, as an example of significant related party matters that should be communicated to those charged with governance:

‘• In accordance with ISA 250 (The Auditor’s Responsibilities Relating to Laws and Regulations in the Audit of Financial Statements), non-compliance issues for the entity that have come to the auditor’s attention as a result of the audit work conducted on related party transactions and disclosures.’