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Dear Mr Sylph

Proposed Revised and Redrafted International Standard on Auditing ISA 550, Related Parties

The Committee of European Banking Supervisors welcomes the opportunity to comment on the Proposed Revised and Redrafted International Standard on Auditing ISA 550, Related Parties (ISA).

Through their opinions on annual accounts and annual reports, external auditors constitute an integral part of the public oversight model and contribute to the financial stability of the market. As banking supervisors we therefore have an interest in ensuring that auditing standards, which are the basis for audit work, are of a high quality and are clear and capable of consistent application.

Overall we are supportive of the proposed ISA but, in our response to the specific questions, have raised some minor concerns about some aspects of the ISA where clarification would be helpful. In the attached appendix we provide responses to the specific questions raised in the guide for respondents.

Our comments were coordinated by our Expert Group on Financial Information (EGFI), and especially by its Subgroup on Auditing, which is under the direction of Pat Sucher from the FSA, UK.

If you have any questions regarding our comments, please feel free to contact the chairman of EGFI, Arnoud Vossen (+31.20.524.3903) or Miss Pat Sucher (+44.20.7066.5644).

Yours sincerely



Danièle Nouy
Chair

Questions on the proposed redrafted ISA

Q1 – Respondents are asked for their views on whether the proposed definition of a related party is appropriate.

Our understanding of the proposed definition included in paragraph 11 (c) is that section (iii), through its reference to A 4, includes parties who are members of key management personnel of the entity or a close family member. On this basis we believe the definition is appropriate.

However, we do query whether paragraph 15's coverage of when to apply the ISA 550 definition of related parties is sufficiently unambiguous. It might be helpful to include in the application material some criteria or examples to improve consistency of application.

We note that the proposed definition of 'dominant influence' in paragraph 11(b) describes it as allowing an individual or small group 'to impose their will on the significant decisions affecting the entity's business.' We believe this might set a very high threshold for what is considered a 'dominant influence' and is likely to be interpreted inconsistently. We would therefore suggest that 'dominant influence' would be better described as 'exerting significant influence'. This should have the advantage of being a definition which would be more commonly understood and of setting a more appropriate threshold for what might be included in the definition.

Given the term 'dominant party' is used extensively in the ISA, but the definition in paragraph 11(b) relates to 'dominant influence', the Board may also want to consider including some linkage between the two in the definition in paragraph 11(b).

We also note that the ISA does not sufficiently carry through its emphasis in A 4, that transactions involving close family members of management or those charged with governance may indicate the existence of control or significant influence, to the section of the ISA dealing with the identification and risks of material misstatement. This could be rectified by including an example of these situations as a separate bullet point in A20.

Q2 - 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. If respondents support the provision of specific guidance, respondents are asked for their views on an appropriate approach, bearing in mind that there would be a need to distinguish between explicit and implicit arm's length assertions.

An implicit arm's length transaction assertion for related parties could be one where management only has to disclose if there are any related party transactions that are not at arm's length e.g. Under Directive 2006/46/EC, 'related party transactions which are material and have not been concluded under normal market conditions have to be disclosed.' Therefore a non-disclosure implies implicitly that the related party transactions have been on an arm's length basis. This applies to those companies not applying IFRS. Therefore in the EU context, we would support the ISA including reference to implicit arm's length assertions for related party transactions.

The onus is on management to provide the evidence to support the assertion. The auditor's responsibility would be to evaluate management's evidence for the assertion. The guidance provided in A 33 & A 34 would probably provide a sufficient basis for the audit work, but we would encourage the IAASB to reflect on the need for any further guidance given both the significant risks in this area and the difficulty of identifying 'market prices'.