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Dear Mr. Sylph

Proposed International Standard on Auditing 550 (Revised) Related Parties

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

Through their opinions on annual accounts and annual reports, external auditors constitute an integral part of the public oversight model and contribute to enhancing the capital adequacy of credit institutions and 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.

In general we support the changes to auditing related parties set out in the ED. In particular we welcome the mandated procedures for searching for undisclosed related parties and the introduction of the idea of reviewing the role of people who exert a dominant influence over the firm that is being audited. However, based on our review of the ED, we do have some concerns about how robust the ED will be as a basis for audit work in this area. In particular we have concerns about the following:

- The objective;
- The situation that may arise where the financial reporting framework does not provide sufficient disclosure requirements on related parties; and
- The context for the risk assessment procedures laid out in the ED.

Our comments on these concerns and some other aspects are presented in the attached appendix.

The enclosed comments have been prepared by one of CEBS' expert groups, the Expert Group on Financial Information (EGFI), chaired by Mr. Arnoud Vossen, in charge of monitoring any developments in that area and of preparing positions to be taken by CEBS. The development of our comments on this ED was coordinated by a Subgroup of EGFI under the direction of Miss. Patricia Sucher.

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

Yours sincerely

A handwritten signature in black ink, consisting of several fluid, overlapping strokes that form a stylized representation of the name Danièle Nouy.

Danièle Nouy
Chair

Appendix

Comments on Proposed International Standard on Auditing 550 (Revised) Related Parties (ED)

The objective

The objective laid out in paragraph 6 is more a summary of later requirements than an overarching objective. We believe it should reflect the overall objective for this part of the audit and be outcome focused. We would therefore encourage the IAASB to revisit the objective.

Limitations of the audit

Paragraph 4 of the ISA conveys a rather negative message by reiterating the limitations implicit in an audit. This is already covered in ISA 200. Related parties are a complex area where there is more scope for misstatement in the financial statements, and this is covered in paragraph 3. Therefore it should be emphasised that the auditor has to be even more alert in this area. Paragraph 4 suggests that it is almost too big a problem for the auditor. This does not seem appropriate in an auditing standard on the subject.

Related parties and financial reporting frameworks

Paragraph 7 of the ED sets out what related party definitions the auditor must follow when the applicable financial reporting framework does not establish related party requirements. If a financial reporting framework establishes related party requirements, then those apply for the purpose of the audit.

It is possible there may be situations under some financial reporting frameworks where the related party requirements and/or definitions are not sufficient, for example concerning the disclosures of related parties and their transactions. Financial statements produced under such frameworks may therefore be misleading, though they may be in accordance with the relevant financial reporting framework. We are not clear what should be the response of the auditor in such circumstances. We would therefore encourage the IAASB to consider this aspect in more detail and to provide some more guidance on how the auditor should approach this situation.

Dominant influence

In paragraph 11(b), the ED introduces the concept of dominant influence. However, we would welcome greater explanation about what it is, how it arises and how it would be demonstrated. This could be provided in the application material. Some of our members presumed that it was another way of expressing significant influence, but we believe use of the phrase 'dominant influence' is an attempt by the IAASB to capture the sort of situation that has arisen with some recent corporate financial reporting frauds where there has been an over-riding dictatorial influence behind the fraud. It would therefore be helpful to have more explanation.

Importance of specific regulations

Related Parties is an area that may be subject to specific legal and other regulatory requirements in particular jurisdictions. We consider that the auditor should also have a sufficient understanding of such requirements to enable identification of transactions and practices that may result in a risk of material misstatement. Regulated entities like banks may have to comply with qualitative and quantitative restrictions regarding related party transactions. Non-

compliance with such requirements may call into question the entity's continuance as a going concern. This sort of situation is referred to by implication in A 29. However, we believe it may need some greater emphasis in the requirements section.

Context, timing and order of requirements

The risk of non-identification of related parties, other than those notified by management, is covered in paragraph 11. The emphasis in sub-paragraphs (a) and (c) is on identifying significant and non-routine transactions that may indicate the presence of previously unidentified related parties.

We believe it would be helpful to provide more context regarding factors which might indicate that there is more risk of unidentified related parties. Examples of what could be included would be complex group structures and special purpose entities (SPEs). In particular we believe there should be more emphasis on the importance of SPEs as such entities may present exposures which are not immediately clear, where related parties may be substantially involved. This might provide an indication of the risk of unidentified related parties which would help focus, to a greater extent, the audit work in paragraph 11 on the risk of unidentified related parties and transactions.

The audit of related parties is a continuous process and we are concerned that some requirements seem to be presented in the ED at either too early or too late a stage in the audit. For example, paragraph 14 covers the communication of the identity of the entity's related parties to the engagement team during audit planning. This communication would surely happen throughout the audit process depending on the results of other requirements e.g. paragraph 12, not just at the audit planning stage. We would encourage the IAASB to consider the timing of the requirements laid out in the ED to ensure they are in an appropriate order.

Internal controls

The work of the auditor in relation to internal control is covered under Paragraph 16. It seems a little "too weak" to consider that "the auditor shall only obtain an understanding about how they work" It seems advisable to revert to the wording included in the previous standard where the task of the auditor was "to consider the adequacy of".

Additional paragraphs in the Requirements section

In line with our points in our comment letter on clarity, we would suggest that paragraph 18 should be part of the application material

Application material – suggested additions

To make the application material more comprehensive, we would suggest the following additional points could be added

- A7 Transactions, which have unusual terms of trade such as unusual prices, interest rates, guarantees or repayment terms
 - Transactions, which seem to lack a logical or business reason for occurrence
 - Special purpose entities
- A 8 Prior year working papers
- A13 Corporate governance ratings attributed by some credit rating agencies.
- A27 Add that the relationships and transactions have been fairly stated