



EUROPEAN COMMISSION
Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE

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Mr J. Sylph
Technical Director
International Auditing and
Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York,
NY 10 017 - USA

Subject: Comment on the Exposure Draft of the revised ISA 550 "Related Parties" – December 2005

Dear Mr Sylph,

1. We appreciate the opportunity to comment on the proposed revision of the International Standard on Auditing 550 on Related Parties (Exposure Draft of the revised ISA 550), issued in December 2005. We generally support the revision, which includes modifications to the substance, but also implements the 'Clarity' project.
2. Our main comments on the Exposure Draft are as follows:

(a) **Definitions in ISAs should remain Framework or Jurisdiction neutral**

The Exposure Draft includes definitions of a related party transaction, of an arm's length transaction, and of a conflict of interest. In the search of the IAASB to establish standards that are "framework neutral", we appreciate the effort made to relate to definitions of a "Related party" given by locally applicable reporting frameworks, instead of only referring to IAS 24. Generally, potential overlaps with national company law should be avoided. Finally, the definition of a conflict of interest does not seem necessary.

The ISA should recognise in a clearer way the limitations arising from the applicable accounting framework for certain objectives of the standard. On the one hand, an auditor must assess whether related party transactions have been properly accounted for and/ or disclosed by a company in accordance with the applicable financial reporting framework. On the other hand, because of the unique relationship with related parties, an auditor considers whether the financial statements include material misstatements or are materially misstated (e.g. resulting from fraud/ going concern issues due to related party support and so forth).

These two aspects may mean that an auditor has to view related parties with a different scope. For instance, the definition of a related party given by an accounting framework other than IAS/IFRS may not be broad enough for the purpose of this ISA in certain circumstances, particularly for the work in connection with fraud or for going concern issues.

(b) **Framework override (paragraph 23(c))**

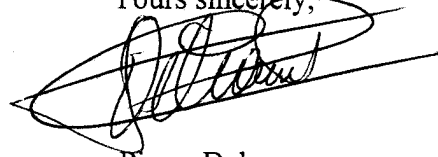
Paragraphs 23(c) and A29 of the Exposure draft require the auditor to "evaluate irrespective of the financial reporting framework whether the effects of the related party relationships and transactions could result in the financial statements being misleading in the circumstances of the engagement." ISA 200, in paragraphs 37-48, explains how to determine the acceptability of the financial reporting framework. ISA 700 in its revised version gives further explanations when an acceptable framework might result in misleading financial information. The value added of such a requirement in paragraph 23(c) is therefore unclear. We suggest the Board to let this important issue be addressed only within ISA 200 and 700, and to consider either deleting par. 23(c) or to refer to the relevant ISA paragraphs of ISA 200/700.

We understand though that a framework override for the purpose of assessing the risks of material misstatements arising from related party transactions may be necessary, for instance risks related to fraud or going concern. For this purpose, we agree that the definition of a related party set by ED ISA 550, as opposed to the definition set by the accounting framework applicable, should be used. Against this background, we accordingly suggest the Board exploring the notion of a framework override within section "Risk assessment procedures" clarifying that in considering certain risks such as fraud and going concern, the auditor should not necessarily be restricted by definitions of the financial reporting framework, but instead take account of parties relationships as appropriate to the circumstances of the engagement, based on the definitions given by the ISA.

3. The comments made in our letter of 13 March, 2006 are also applicable with respect to the revision and redrafting of the exposed ISA550, such as on drafting of the objective of ISA550, reviewing expression "shall consider", addressing properly the concept of inherent limitations, not interfering with EU or national corporate law.
4. This response cannot pre-empt our future official position on the possible adoption of ISA.
5. The comments in this letter have taken account of the views expressed within the European Group of Auditors' Oversight Bodies (EGAOB), and within subgroup 'ISA' of the EGAOB. The 'ISA' subgroup is comprised of participants from European organisations including audit regulators, standard setters on auditing, professional bodies, and companies. Those comments may not necessarily reflect in all circumstances the views of any of the members of the EGAOB and/or of any of the participants to the EGAOB 'ISA' Sub-group'.

6. Further detailed comments are offered in appendix, however trying to not repeating the above comments.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'P. Delsaux', is written over a large, loopy scribble that also overlaps the 'Yours sincerely,' text above it.

Pierre Delsaux
Acting Director

Enclosures: Appendix : Detailed comments

Appendix – Detailed comments

1. THE PROPOSED OBJECTIVE FOR ISA550

- 1.1. We support introducing Objectives in the body of the ISAs.
- 1.2. The European Commission has offered detailed comments on the drafting and consistency of Objectives in the past. We invite the IAASB to refer to our letter of 13 March 2006 on the Exposure draft "Improving the Clarity of IAASB standards".

2. ACCOUNTING FRAMEWORK / LEGAL ENVIRONMENT

Definitions

- 2.1. In the search of the IAASB to establish standards that are "framework neutral", we appreciate the effort made to relate to definitions of a "Related party" given by locally applicable reporting frameworks, instead of only referring to IAS 24.
- 2.2. We see no reason not to follow the same logic for the other definitions in this ISA, when they present the risk of conflicting with financial reporting frameworks or with the legal environment of a jurisdiction.
- 2.3. For instance Article 43 (1) (7b) of the recently revised EU 4th Company Law Directive (which will be formally adopted around July), applicable to individual accounts, will introduce the requirement to disclose transactions with related parties that are material and have not been concluded under normal market conditions, which may be slightly different from being not at arm's length.
- 2.4. In addition, the concept of "dominant influence" or "dominant party" would deserve further clarification, and possibly a definition. For instance a "dominant party" (e.g. a significant customer) might not always be a related party. Clarifying this concept would let appear the value added by this concept, and differences with the concept of "significant influence" which exists in most accounting frameworks.
- 2.5. Finally, we suggest deleting the definition of "conflicts of interests" as it is self-explanatory and appears only once in the requirements (paragraph 24).

Scope of audit work

- 2.6. It would be clearer to auditors how to implement ISA 550 if reference was made to relevant parts of ISA 240 and 315. For instance, section "Risks Assessment Procedures" could refer to paragraph 22 of redrafted ISA 315 which requires that, in determining which audit risks are significant, the auditor shall consider whether there is increased risk from significant transactions with related parties. This could be the starting point for clarifying the scope of work in this section.
- 2.7. In paragraphs 13-14 and 15-16, it is unclear whether the work applies to only significant and non-routine related party transactions, to those carrying a risk of material misstatement, or to any related party transaction. These paragraphs deserve at least a clearer connection with the work performed by the auditor in section "Risk Assessment Procedures" (§9-12). A clarification of the expected levels of risks of material misstatements that are meant to be addressed through paragraphs 9-12 would also be welcome. This is particularly critical on par. 11(b) where no limit is set on the extent of procedures to be performed as reason of the existence of a "dominant party".