

June 29, 2007

Mr. Jim Sylph  
Executive Director, Professional Standards  
International Federation of Accountants  
545 Fifth Avenue, 14th Floor  
New York, NY 10017

Dear Mr. Sylph:

We appreciate this opportunity to comment on the proposed International Standard on Auditing (ISA) 550 (Revised and Redrafted), *Related Parties*, (the “proposed standard”) as developed by the International Auditing and Assurance Standards Board (IAASB). Overall, we are supportive of the changes made to the proposed standard since the 2005 exposure draft of ISA 550.

As requested in the explanatory memorandum accompanying the proposed standard, we have provided responses to specific questions posed. We have also included our comments by paragraph. Within our recommendations for editorial changes, additions are noted in “bold underline” and deletions in “double strike-through.”

#### **Questions Posed in the Explanatory Memorandum**

1. *Respondents are asked for their views on whether the proposed definition of a “related party” is appropriate.*

We believe that additional application material in paragraph A4 to support the definition of “related party” would be useful. Specifically, we suggest the addition of the following bullet to the list in paragraph A4:

- **An entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (b) or (c).**
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. 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 transactions.*

We believe that the auditor has a responsibility to audit arm's length assertions that management has made for related party transactions, regardless of whether those assertions are implicit or explicit. We therefore recommend clarifying paragraph 25 in that regard, as follows:

“When management has made an assertion in the financial statements, **either implicitly or explicitly, indicating** ~~stating~~ that a related party transaction was conducted on terms equivalent or similar to those prevailing in an arm's length transaction or transaction under normal market conditions, the auditor shall obtain sufficient appropriate audit evidence about the assertion **in relation to significant related party transactions**. If the auditor **believes the assertion is incorrect or concludes that there is insufficient** ~~unable to obtain sufficient~~ appropriate audit evidence about the assertion, the auditor shall request management to delete or correct the assertion as appropriate. If management disagrees, the auditor shall consider the implications on the audit, including on the auditor's report.”

3. *Respondents are asked to comment on whether, in their opinion, considerations in the audit of small entities have been dealt with appropriately in the proposed revised ISA.*

We believe that the considerations in the audit of small entities have been dealt with appropriately in the proposed standard.

4. *Respondents are asked to comment on whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed revised ISA.*

We believe that the considerations in the audit of public sector entities have been dealt with appropriately in the proposed standard.

#### **Comments by Paragraph**

- **Paragraph 4**

We recommend the following clarifying change:

“Because related parties are not entirely independent of each other, many financial reporting frameworks establish specific **accounting and** disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements.

- **Paragraphs 10(b)(i) and 10(b)(ii)**

As written, the objectives in paragraphs 10(a) and 10(b) may infer two levels of work effort. We recommend the following changes to paragraph 10(b)(i) to align more closely with the wording of paragraph 10(a):

“(i) To obtain ~~an understanding of~~ **sufficient appropriate audit evidence** about related party relationships and transactions ~~sufficient~~ to be able to conclude...”

In addition, as currently drafted, paragraph 10(b)(ii) infers that the auditor will not meet the objective of the ISA if no fraud risk factors are identified. We believe a more appropriate objective is to respond to fraud risk factors that are identified. We therefore recommend the following change:

“(ii) To **respond to any identified** fraud risk factors arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud.”

- **Paragraphs 11(b), 20, A20, A21, and A25**

We note that the concepts of “dominant influence” and “dominant party” have been carried forward from the 2005 exposure draft of ISA 550, and that a definition of “dominant influence” has been included in the proposed standard. However, we also note that the requirement for performing procedures relating to parties with dominant influence that was included in the 2005 exposure draft has been eliminated.

As currently written, we believe the proposed standard is not clear about the relationship between a party with “dominant influence” as defined in paragraph 11(b) and a “related party” as defined in paragraph 11(c). For example, a related party is defined as a party that “controls or significantly influences” rather than a party that has *the ability to* control or significantly influence. In contrast, the definition of “dominant influence” does not distinguish between an individual imposing his will from an individual who has the ability to impose his will. As a result of the differences in the construct of these two terms, we are unsure whether an individual with dominant influence is always considered a related party (e.g., if an individual has dominant influence, but does not control or significantly influence the entity, is he considered a related party for the purposes of applying the requirements and guidance of the proposed standard?)

Further, while we agree that the presence of a party with dominant influence may represent a fraud risk factor, as described in the application material paragraphs listed above, we believe that these paragraphs would be more appropriately placed with discussion of other potential fraud risk factors in ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*. While we recognize ISA 240 was recently finalized, we believe the application material paragraphs specified above would be more appropriately placed in ISA 240, and suggest a conforming amendment be made to that ISA. Further, we recommend the definition of “dominant influence” in paragraph 11(b) and the related reference to dominant parties in paragraph 20, be deleted from the proposed standard.

- **Paragraph 15(a)**

In order to avoid confusion, we recommend the wording of the sub-bullets in paragraph 15(a) be exactly the same as the wording in the sub-bullets of paragraph 11(c).

- **Paragraph 19**

We believe that the requirement for the auditor to be alert to the existence of previously unidentified or undisclosed related party relationships or transactions is appropriate. However, we believe that the bullets in paragraph 19, which describe documentation that the auditor must inspect as part of maintaining this “alertness” are overly-specific and should be included in application material (paragraph A19) rather than requirements.

While we agree that as part of an audit conducted in accordance with the ISAs the auditor should inspect minutes of meetings of shareholders and of those charged with governance (bullet (b)), we do not believe that the proposed standard is the appropriate ISA for this requirement.

Therefore, we recommend that the second sentence of paragraph 19 be deleted, and that bullets (a) and (b) be moved to paragraph A19. We also suggest that the IAASB consider making a conforming amendment to ISA 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*, requiring a review the minutes of meetings of shareholders and those charged with governance as part of the auditor’s risk assessment procedures.

- **Paragraph 27**

We believe that the requirement to obtain a written representation about whether management, and where appropriate, those charged with governance, have disclosed the identity of the entity’s related parties applies equally in cases where the applicable financial reporting framework establishes related party requirements and where it establishes minimal or no related party requirements. The auditor should use the definition of “related party” as defined in paragraph 11 (c) to frame the representation.

Therefore we recommend the following change to paragraph 27:

“In addition to any specific written representations the auditor believes are necessary in relation to related parties, the auditor shall, ~~where the applicable financial reporting framework establishes related party requirements,~~ obtain written representations from management and, where appropriate, those charged with governance that:

- ~~(a) They have disclosed to the auditor the identity of the entity’s related parties and all the related party relationships and transactions of which they are aware; and~~
- (b) In cases where the applicable financial reporting framework establishes related party requirements, that management has disclosed to the auditor all the related party relationships and transactions of which they are aware and they have appropriately accounted for and disclosed such these relationships and transactions in accordance with those requirements of the framework.”**

In addition, we recommend that the IAASB make conforming changes to paragraph 27 related to the terminology used in proposed ISA 580, *Written Representations*, (i.e., “relevant persons”).

- **Paragraph A19, bullet 11**

We suggested the following editorial change:

“Internal audit ~~working papers~~ **reports**.”

We would be pleased to discuss our letter with you or your staff at your convenience. If you have any questions, please contact Jens Simonsen, Director of Global Audit Services at + 1 212 492 3689 or John Fogarty, Chairman – DTT Assurance Technical Policies and Methodologies Group at + 1 203 761 3227.

Very truly yours,

A handwritten signature in black ink that reads "Jens Simonsen". The signature is written in a cursive style with a large, looped initial "J".