

# IAASB CAG PAPER



**International Federation of Accountants**

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## Agenda Item C.2

**Committee:** IAASB Consultative Advisory Group

**Meeting Location:** Toronto

**Meeting Date:** September 4-5, 2008

### Report Back—Related Parties

#### Objective of Agenda Item

1. The objective of this Agenda Item is to provide a brief report back on proposals of Representatives on proposed ISA 550 (Revised and Redrafted), “Related Parties,” discussed at the March 3-4, 2008

The IAASB approved the proposed ISA as a final standard at its March 10-14, 2008 meeting.

#### March 3-4, 2008 CAG Proposals

2. Below is an extract from the draft minutes of the March 2008 CAG meeting<sup>1</sup> and an indication of how the IAASB Task Force or the IAASB responded to the Representatives’ comments.

Representatives’ Comments	Task Force/IAASB Response
GENERAL	
Mr. Damant thanked the Task Force and IAASB staff for a comprehensive report back, which clearly indicates how the Task Force and IAASB considered the comments of the Representatives at the September CAG meeting.	
Ms. Koski-Grafer commended the Task Force for its responses to the comments of public-interest-oriented respondents to the exposure draft. She hoped that the changes proposed by the Task Force will be accepted by the IAASB.	<p>The IAASB accepted all the changes proposed by the Task Force (with one or two minor refinements), except the proposal to include the following guidance on the circumstances that are indicators of potential risk, that is,:</p> <p>“Where the applicable financial reporting framework establishes related party requirements, risks of material misstatement associated with related party relationships and transactions may arise from one or</p>

<sup>1</sup> The minutes will be approved at the September 2008 IAASB CAG meeting.

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Representatives' Comments	Task Force/IAASB Response
	<p>more of the following circumstances</p> <ul style="list-style-type: none"> <li>(a) Management has not identified or disclosed to the auditor one or more of the entity's related parties;</li> <li>(b) Management has not identified or disclosed to the auditor relationships and transactions with identified related parties; or</li> <li>(c) Management has not appropriately accounted for or disclosed identified related party relationships or transactions in accordance with the applicable financial reporting framework."</li> </ul> <p>Some IAASB members felt that this guidance could be potentially confusing as items (a) and (b) seemed to be covered by item (c). The IAASB determined that the proposed guidance was unnecessary as the risk of material misstatement is simply that management has not appropriately accounted for or disclosed related party relationships or transactions in accordance with the applicable financial reporting framework <b>(Refer to paragraph 9(b) of the final ISA)</b>. Accordingly, this proposed guidance was deleted.</p>
<p>Mr. Cassel indicated that the IAASB CAG Working Group is satisfied with how the Task Force responded to the comments of the Representatives. He noted that the working group is of the view that the proposed ISA does not have to be re-exposed.</p>	<p>The IAASB agreed that re-exposure was not necessary.</p>
SPECIAL-PURPOSE ENTITIES	
<p>Ms. Koski-Grafer was of the view that the Requirements section of the final ISA should at least mention the existence of special purpose entities. Ms. Hillier indicated that special purpose entities are specifically referred to in the application material to the definition of related parties. As part of that definition, special purpose entities will be in the mind of the auditors when they comply with the requirements of the ISA. In addition, ISA 315</p>	<p>After further deliberation, the IAASB agreed that special-purpose entities should be emphasized as part of the requirements. The IAASB, however, determined that this would be best achieved through a conforming amendment to ISA 315 (Redrafted), in the context of the requirement for the auditor to obtain an understanding of the entity, i.e.:</p> <p>"The auditor shall obtain an understanding of the</p>

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Representatives' Comments	Task Force/IAASB Response
<p>(Redrafted)<sup>2</sup> deals with special purpose entities in the application material to the requirement for the auditor to obtain an understanding of the entity. Ms. Koski-Grafer pointed out, however, that special-purpose entities and structured finance vehicles have represented a special risk condition for more than 10 years and, for that reason, were worthy of being mentioned in the requirements directly. Messrs. Goebel and Roussey and Ms. Todd McEnally shared Ms. Koski-Grafer's view. Mr. Koktvedgaard, although not opposing this view, emphasized the fact that ISAs should remain principles based.</p>	<p>following:</p> <p>...</p> <p>(b) The nature of the entity, including:</p> <p>(iii) The types of investments that the entity is making and plans to make, <u>including investments in special-purpose entities</u>; and</p> <p>... .”</p> <p>New guidance on the nature of special-purpose entities has also been added to ISA 315 (Redrafted) through conforming amendments. (<i>Refer to paragraphs A23a and A23b of the conforming amendments to ISA 315 (Redrafted) approved by IAASB and attached to the final ISA 550 (Revised and Redrafted)</i>).</p>
PARTIES UNDER COMMON CONTROL	
<p>Mr. Scicluna asked how the proposed ISA deals with entities that are under the control of a single family; a question shared by Mr. Hegarty. Ms. Hillier responded that the IAASB was of the view that the Task Force's proposal to limit the definition of “common control” to fellow subsidiaries narrowed it unnecessarily. As a result, the revised definition includes family relationships. In the context of that definition, the auditor will focus on circumstances where there is evidence of influence as result of those relationships.</p>	<p>The IAASB agreed with the Task Force's proposal to broaden the definition of a related party to include close family relationships, i.e.</p> <p>“Related party – A party that is ...</p> <p>(ii)c. Another entity that is under common control with the reporting entity through having:</p> <p>i. Common controlling ownership;</p> <p>ii. Owners who are close family members;</p> <p>... .”</p> <p>As a result, entities that are related through close family relationships will fall within the scope of the ISA.</p>

<sup>2</sup> ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment.”

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### **Material Presented – IAASB CAG REFERENCE PAPERS ONLY**

Final version of ISA 550 (Revised and Redrafted) as issued by the IAASB in July 2008

[http://www.ifac.org/Members/DownLoads/ISA\\_550\\_Revised\\_and\\_Redrafted.pdf](http://www.ifac.org/Members/DownLoads/ISA_550_Revised_and_Redrafted.pdf)