



Standard on Auditing
SA 550- Related Parties



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Introduction, Nature of Related Party Relationships and Transactions

Introduction

- SA 550 deals with auditors responsibilities regarding related party relationships and transactions when performing an audit of financial statements.

Nature of Related Party Relationships and Transactions

- Two Types of Transactions- One carrying normal risk of material misstatement and one carrying significant risk of material misstatement.
- Examples of Significant Risk of Misstatement in transactions (SA 315, SA 330)
 - ✓ Complex structure and transactions
 - ✓ Ineffective Information Systems for identification of transactions and balances
 - ✓ Transactions not conducted at arms length pricing

Objectives and Auditors Responsibilities

Objective:

Understanding of Related Party Relationships and Transactions

Responsibilities relating to above objective

Conclude as to whether financial statements associated with those relationships and transactions are **true and fair** and not misleading.

Assess whether there are any fraud risk factors pertaining to related parties.

Objective:

Proper accounting and disclosure of Relationships and Transactions

Responsibilities relating to above objective

Perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the framework.

Objectives and Auditors Responsibilities

Other Responsibilities

Planning and performing the audit with **professional skepticism**.

There is higher detection risk of material misstatement for related party relationships and transactions due to greater opportunity for collusion, concealment and manipulation by Management since Management may be unaware of all related party relationships and transactions.

Framework and Definitions

- a) Arm's length transaction—A transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interests.
- b) Related parties – defined in AS 18
- c) Companies Act -Sections, 297, 299, 301

Proposed Changes in Companies Bill 2012

1. Additional transactions such as leasing of property, appointment of agent for purchase & sale of goods, services, materials & property
2. 'Cash at prevailing market price' has now been substituted with 'Arm's length transaction' which has been defined in the Clause
3. Transactions entered into with related parties now to be included in the Board's Report along with justification for entering into such contracts/ arrangements
4. Key Management Personnel to include Company Secretary and Chief Financial Officer

Risk Assessment Procedures

Understanding of Related Party Relationships and Transactions

- Specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.
- To inquire of management as to how they identify, nature of relationships and type/purpose of transactions
- Obtain understanding of controls from management and others within the entity to identify, account for , disclose, authorize and approve significant transactions and arrangements in normal and outside normal course of business.
- Consider other sources such as:
 - ✓ Bank, legal and third party confirmations
 - ✓ Minutes of Shareholders and Those charged with governance meetings.
 - ✓ Any other records considered necessary.

Risk Assessment Procedures (continued)

Significant transactions pertaining to related party shall be shared with engagement team

- Determining whether significant related party transactions give rise to **significant risk of material misstatement**
- Consider Fraud Risk



Responses to Risk of Material Misstatement

Non-Identified Related Parties

- If the auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor, the auditor shall:
 - ✓ Communicate to engagement team
 - ✓ Where the applicable financial reporting framework establishes related party requirements:
 - i. Request management to identify all transactions
 - ii. Inquire as to why the entity's controls failed to detect related party relationships and transactions
 - iii. Perform appropriate substantive audit procedures
 - iv. Reconsider risk of material misstatement
 - v. If non-disclosure by management appears intentional , consider audit implications

Responses to Risk of Material Misstatement

Identified Related Parties:

- For transactions outside normal course of business, the auditor shall inspect underlying contracts or agreements and evaluate whether:
 - i. Circumstances for fraudulent financial reporting or concealing misappropriation of assets exist.
 - ii. The terms of the transactions are consistent with management's explanations; and
- Accounting and disclosure is appropriate.
- Ensure that transactions have been appropriately authorised and approved.



Accounting, Disclosure of Related Party Relationships and transactions

Accounting and Disclosure

- In forming an opinion on the financial statements in accordance with SA 700, the auditor shall evaluate:
 - a) Whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and
 - b) Whether the effects of the related party relationships and transactions:
 - i. Prevent the financial statements from achieving **true and fair presentation**; or
 - ii. Cause the financial statements to be misleading.

Documentation

- Includes Names of Identified Related Parties and Nature of Related Party Relationships.

Communication with those Charged with Governance and Written Representations

Communication with those charged with governance

- Significant matters arising during the course of audit with respect to entity's related parties.

Written Representations by Management

- Include that Management has disclosed all related party relationships and transactions of which it is aware.
- Appropriate accounting and disclosure of relationships and transactions.



Questions



The views expressed are the personal view of the speaker