

SA 550(REVISED) RELATED PARTIES

What do you mean by Related Parties?

According to SA 550 (R) Related party means a party that is either:

- (i) A related party as defined in the applicable financial reporting framework; or
- (ii) Where the applicable financial reporting framework establishes minimal or no related party requirements:
 - a. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
 - b. Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
 - c. Another entity that is under common control with the reporting entity through having:
 - i. Common controlling ownership;
 - ii. Owners who are close family members; or
 - iii. Common key management.

However, entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

What is Auditor's Duty in relation to Related Parties?

According to SA 550 (Revised) auditor has following duties in relation to related parties :-

1. **Duty to see that all Financial Statement Framework and Statutory compliance as far as related to related party, related party transactions accounting and disclosures Where the applicable have been appropriately Complied With:-** Some times financial reporting framework establishes Disclosure requirements of related party transactions or related parties the auditor has a responsibility to 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 requirements of the framework.
2. **Duty to understanding of the entity's related party relationships and transactions –Irrespective of the fact that financial reporting framework requires or not auditor shall obtain understanding of entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships and transactions:-**
 - (a) Achieve a true and fair presentation (for fair presentation frameworks); or
 - (b) Are not misleading
3. **Duty to evaluate Fraud Risk Factors in relation to related parties:-** relevant to the auditor's evaluation of whether one or more fraud risk factors are present as required by SA 240 because fraud may be more easily committed through related parties.
4. **Duty to have an attitude of Professional Skepticism:-** Planning and performing the audit with professional skepticism as required by SA 2008 is therefore particularly important in this context, given the potential for undisclosed related party relationships and transactions.

What are the requirements to be complied with by the auditor for this SA550 ?

Step-1 Enquiry with management The auditor shall inquire of management regarding following:

- (a) The identity of the entity's related parties, including changes from the prior period;
- (b) The nature of the relationships between the entity and these related parties; and
- (c) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

Step-2 Enquiry about Controls:- The auditor shall inquire about internal controls adopted by management for following

- (a) Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;
- (b) Authorise and approve significant transactions and arrangements with related parties; and
- (c) Authorise and approve significant transactions and arrangements outside the normal course of business.

Step-3 Maintaining Alertness :- During the audit, the auditor shall remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor.

Step-4 Sharing Related Party Information with the Engagement Team

The auditor shall share relevant information obtained about the entity's related parties with the other members of the engagement team.

Step-5 Designing Audit procedure on the basis of the above

After applying all the above procedure if the auditor identifies fraud risk factors (including circumstances relating to the existence of a related party with dominant influence) when performing the risk assessment procedures and related activities in connection with related parties, the auditor respond to assessed risks. The auditor shall designs and performs further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions.

Step -6 Response to results of the Audit Procedures

A) When auditor identified previously unidentified or undisclosed Related Parties or significant Related Party transactions:- the auditor shall:

- (a) Promptly communicate the relevant information to the other members of the engagement team;
- (b) Where the applicable financial reporting framework establishes related party requirements:
 - (i) Request management to identify all transactions with the newly identified related parties for the auditor's further evaluation; and
 - (ii) Inquire as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions;
- (c) Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions;
- (d) Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor, and perform additional audit procedures as necessary; and
- (e) If the non-disclosure by management appears intentional (and therefore indicative of a risk of material misstatement due to fraud), evaluate the implications for the audit.

B) Identified Significant Related Party Transactions outside the Entity's Normal Course of Business:- The auditor shall:

- (a) Inspect the underlying contracts or agreements, if any, and evaluate whether:
 - (i) The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets
 - (ii) The terms of the transactions are consistent with management's explanations; and
 - (iii) The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and
- (b) Obtain audit evidence that the transactions have been appropriately authorised and approved.

C) Conclusion about Prevailing Market Prices :- Auditor shall ascertain whether Related Party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction.

Step-7 Audit Conclusion and Reporting :- 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 (for fair presentation frameworks); or
 - (ii) Cause the financial statements to be misleading (for compliance frameworks).

Step – 8 Other considerations

1. Written Representations

Where the applicable financial reporting framework establishes related party requirements, the auditor shall 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) They have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.

2. Communication with Those Charged with Governance

Unless all of those charged with governance are involved in managing the entity, the auditor shall communicate with those charged with governance significant matters arising during the audit in connection with the entity's related parties.

3. 3. Documentation

In meeting the documentation requirements of SA 23016 and other SAs, the auditor shall include in the audit documentation the names of the identified related parties and the nature of the related party relationships.

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