

INTERNATIONAL STANDARD ON AUDITING 550

RELATED PARTIES

(Effective for audits of financial statements for periods beginning on or after December 15, 2004)*

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International Standard on Auditing (ISA) 550, “Related Parties” should be read in the context of the “Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services,” which sets out the application and authority of ISAs.



* ISA 315, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement,” ISA 330, “The Auditor’s Procedures in Response to Assessed Risks,” and ISA 500, “Audit Evidence” gave rise to conforming amendments to ISA 550. The conforming amendments are effective for audits of financial statements for periods beginning on or after December 15, 2004 and have been incorporated in the text of ISA 550.

Introduction

1. The purpose of this International Standard on Auditing (ISA) is to establish standards and provide guidance on the auditor's responsibilities and audit procedures regarding related parties and transactions with such parties regardless of whether International Accounting Standard (IAS) 24, "Related Party Disclosures," or similar requirement, is part of the applicable financial reporting framework.
2. **The auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence regarding the identification and disclosure by management of related parties and the effect of related party transactions that are material to the financial statements.** However, an audit cannot be expected to detect all related party transactions.
3. As indicated in ISA 200, "Objective and General Principles Governing an Audit of Financial Statements," in certain circumstances there are limitations that may affect the persuasiveness of audit evidence available to draw conclusions on particular assertions. Because of the degree of uncertainty associated with the assertions regarding the completeness of related parties, the audit procedures identified in this ISA will provide sufficient appropriate audit evidence regarding those assertions in the absence of any circumstance identified by the auditor that:
 - (a) Increases the risk of material misstatement beyond that which would ordinarily be expected; or
 - (b) Indicates that a material misstatement regarding related parties has occurred.

Where there is any indication that such circumstances exist, the auditor should perform modified, extended or additional audit procedures as are appropriate in the circumstances.

4. Definitions regarding related parties are given in IAS 24 and are adopted for the purposes of this ISA.¹

¹ Definitions of related party and related party transactions from IAS 24, "Related Party Disclosures" are as follows:

Related party—A party is related to an entity if:

- (a) Directly, or indirectly through one or more intermediaries, the party:
 - (i) Controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);
 - (ii) Has an interest in the entity that gives it significant influence over the entity; or
 - (iii) Has joint control over the entity;
- (b) The party is an associate (as defined in IAS 28, "Investments in Associates") of the entity;

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5. Management is responsible for the identification and disclosure of related parties and transactions with such parties. This responsibility requires management to implement adequate internal control to ensure that transactions with related parties are appropriately identified in the information system and disclosed in the financial statements.
6. The auditor needs to have a sufficient understanding of the entity and its environment to enable identification of the events, transactions and practices that may result in a risk of material misstatement regarding related parties and transactions with such parties. While the existence of related parties and transactions between such parties are considered ordinary features of business, the auditor needs to be aware of them because:
 - (a) The applicable financial reporting framework may require disclosure in the financial statements of certain related party relationships and transactions, such as those required by IAS 24;
 - (b) The existence of related parties or related party transactions may affect the financial statements. For example, the entity's tax liability and expense may be affected by the tax laws in various jurisdictions which require special consideration when related parties exist;
 - (c) The source of audit evidence affects the auditor's assessment of its reliability. Generally a greater degree of reliance may be placed on audit evidence that is obtained from or created by unrelated third parties; and
 - (d) A related party transaction may be motivated by other than ordinary business considerations, for example, profit sharing or even fraud.

Existence and Disclosure of Related Parties

7. **The auditor should review information provided by those charged with governance and management identifying the names of all known related parties and should perform the following audit procedures in respect of the completeness of this information:**

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- (c) The party is a joint venture in which the entity is a venturer (see IAS 31, "Interest in Joint Ventures");
 - (d) The party is a member of the key management personnel of the entity or its parent;
 - (e) The party is a close member of the family of any individual referred to in (a) or (d);
 - (f) The party is 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 (d) or (e); or
 - (g) The party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

Related party transactions—A transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

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- (a) **Review prior year working papers for names of known related parties;**
- (b) **Review the entity's procedures for identification of related parties;**
- (c) **Inquire as to the affiliation of those charged with governance and officers with other entities;**
- (d) **Review shareholder records to determine the names of principal shareholders or, if appropriate, obtain a listing of principal shareholders from the share register;**
- (e) **Review minutes of the meetings of shareholders and those charged with governance and other relevant statutory records such as the register of directors' interests;**
- (f) **Inquire of other auditors currently involved in the audit, or predecessor auditors, as to their knowledge of additional related parties; and**
- (g) **Review the entity's income tax returns and other information supplied to regulatory agencies.**

If, in the auditor's judgment, there is a lower risk of significant related parties remaining undetected, these procedures may be modified as appropriate.

- 8. **Where the applicable financial reporting framework requires disclosure of related party relationships, the auditor should be satisfied that the disclosure is adequate.**

Transactions with Related Parties

- 9. **The auditor should review information provided by those charged with governance and management identifying related party transactions and should be alert for other material related party transactions.**
- 10. **When obtaining an understanding of the entity's internal control, the auditor should consider the adequacy of control activities over the authorization and recording of related party transactions.**
- 11. During the course of the audit, the auditor needs to be alert for transactions which appear unusual in the circumstances and may indicate the existence of previously unidentified related parties. Examples include the following:
 - Transactions which have abnormal terms of trade, such as unusual prices, interest rates, guarantees, and repayment terms.
 - Transactions which lack an apparent logical business reason for their occurrence.
 - Transactions in which substance differs from form.

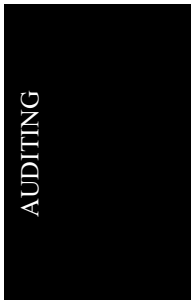
- Transactions processed in an unusual manner.
 - High volume or significant transactions with certain customers or suppliers as compared with others.
 - Unrecorded transactions such as the receipt or provision of management services at no charge.
12. During the course of the audit, the auditor carries out audit procedures which may identify the existence of transactions with related parties. Examples include the following:
- Performing detailed tests of transactions and balances.
 - Reviewing minutes of meetings of shareholders and those charged with governance.
 - Reviewing accounting records for large or unusual transactions or balances, paying particular attention to transactions recognized at or near the end of the reporting period.
 - Reviewing confirmations of loans receivable and payable and confirmations from banks. Such a review may indicate guarantor relationship and other related party transactions.
 - Reviewing investment transactions, for example, purchase or sale of an equity interest in a joint venture or other entity.

Examining Identified Related Party Transactions

13. **In examining the identified related party transactions, the auditor should obtain sufficient appropriate audit evidence as to whether these transactions have been properly recorded and disclosed.**
14. Given the nature of related party relationships, audit evidence of a related party transaction may be limited, for example, regarding the existence of inventory held by a related party on consignment or an instruction from a parent company to a subsidiary to record a royalty expense. Because of the limited availability of appropriate audit evidence about such transactions, the auditor considers performing audit procedures such as:
- Confirming the terms and amount of the transaction with the related party.
 - Inspecting information in possession of the related party.
 - Confirming or discussing information with persons associated with the transaction, such as banks, lawyers, guarantors and agents.

Management Representations

15. **The auditor should obtain a written representation from management concerning:**



- (a) **The completeness of information provided regarding the identification of related parties; and**
- (b) **The adequacy of related party disclosures in the financial statements.**

Audit Conclusions and Reporting

- 16. **If the auditor is unable to obtain sufficient appropriate audit evidence concerning related parties and transactions with such parties or concludes that their disclosure in the financial statements is not adequate, the auditor should modify the auditor's report appropriately.**

Public Sector Perspective

- 1. *In applying the audit principles in this ISA, auditors have to make reference to legislative requirements which are applicable to public sector entities and employees in respect of related party transactions. Such legislation may prohibit entities and employees from entering into transactions with related parties. There may also be a requirement for public sector employees to declare their interests in entities with which they transact on a professional or commercial basis. Where such legislative requirements exist, the audit procedures would need to be expanded to detect instances of noncompliance with these requirements.*
- 2. *While International Public Sector Guideline 1, "Financial Reporting by Government Business Enterprise" indicates that all International Accounting Standards (IASs) apply to business enterprises in the public sector, IAS 24, "Related Party Disclosures" does not require that transactions between state controlled enterprises be disclosed. Definitions of related parties included in IAS 24 and this ISA do not address all circumstances relevant to public sector entities. For example, the status, for purposes of application of this ISA, of the relationship between ministers and departments of state, and departments of state and statutory authorities or government agencies is not discussed.*