ASA 550
(October 2006)

Auditing Standard ASA 550
Related Parties

Issued by the **Auditing and Assurance Standards Board**

Australian Government
Auditing and Assurance Standards Board

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PREFACE

Reasons for Issuing Auditing Standard ASA 550 *Related Parties*

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 550 *Related Parties* due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (the CLERP 9 Act) established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Main Features

This Auditing Standard establishes mandatory requirements and provides explanatory guidance on the auditor's responsibilities and audit procedures regarding related parties and transactions with such parties. This Auditing Standard requires the auditor to:

(a) consider the risk of material misstatements in the financial report resulting from the existence of related parties and related party transactions, when performing audit procedures and when evaluating and reporting the results of such procedures;

(b) assess the risk that related parties and related party transactions will not be identified, or appropriately disclosed and/or measured;

(c) be alert for unusual transactions which may indicate the existence of previously unidentified related parties or related party transactions; and

(d) communicate with those charged with governance on significant related party relationships and related party transactions.

Operative Date

This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.

Main changes from AUS 518 (July 2002) *Related Parties*

The main differences between this Auditing Standard and the Auditing Standard issued by the Auditing & Assurance Standards Board of the Australian Accounting Research Foundation, AUS 518 (July 2002) *Related Parties*, are that in this Auditing Standard:

1. The word 'shall', in the **bold-type** paragraphs, is the terminology used to describe an auditor's mandatory requirements, whereas an auditor's degree of responsibility is described in AUS 518 by the word 'should'.

2. The explanatory paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas in AUS 518 some obligations are implied within certain explanatory paragraphs. Accordingly, such paragraphs have been redrafted to clarify that the matter forms part of the explanatory guidance.

3. The following implied obligations in AUS 518, have been elevated and re-stated as specific mandatory requirements:

   (a) based on the auditor's understanding of the entity and its environment including its internal control, the auditor shall make an assessment of the risk of material misstatement as it relates to the identification of related parties and the authorisation and recording of related party transactions (paragraph 13);

   (b) the auditor shall review information provided by those charged with governance and management identifying the names of all known related parties and shall perform the following audit procedures to reduce the risk of related parties remaining undetected to an acceptably low level:

      (i) review prior year working papers for names of known related parties;

      (ii) review the entity's procedures for identification of related parties;

      (iii) enquire as to the affiliation of those charged with governance and officers with other entities;

(iv) review shareholder records to determine the names of principal shareholders or, if appropriate, obtain a listing of principal shareholders from the share register;

(v) review minutes of the meetings of shareholders and those charged with governance and other relevant statutory records such as the register of directors' interests;

(vi) enquire of other auditors currently involved in the audit, or predecessor auditors, as to their knowledge of additional related parties; and

(vii) review the entity's income tax returns and other information supplied to regulatory agencies.

If, in the auditor's judgement, there is a lower risk of significant related parties remaining undetected, these procedures may be modified as appropriate (paragraph 18);

(c) the auditor shall endeavour to obtain a written representation from management concerning:

(i) the completeness of information provided regarding the identification of related parties; and

(ii) the adequacy of related party disclosures in the financial report (paragraph 33).

4. The following specific mandatory requirements, not in AUS 518, have been included:

(a) where there is any indication that there are limitations that may affect the persuasiveness of audit evidence, the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level (paragraph 7);

(b) where the applicable financial reporting framework requires disclosure of related party relationships, the auditor shall be satisfied that the disclosure is in accordance with that framework (paragraph 23); and

(c) the auditor shall discuss with those charged with governance the nature, extent and business rationale of significant related party relationships and transactions, including those involving actual conflicts of interest (paragraph 31).

5. Additional explanatory guidance paragraphs have been included on:

   (a) the application of this Auditing Standard to public sector entities (paragraph 4);

   (b) communication with those charged with governance (paragraph 32); and

   (c) circumstances when management is unable to or refuses to provide the auditor a written representation (paragraph 34).

6. The following mandatory requirement in paragraph .13 of AUS 518 and associated explanatory guidance at paragraphs .14 to .16 have been replaced with explanatory guidance at paragraph 17:

   (a) the auditor should consider the assessed levels of inherent and control risks in determining the nature, timing and extent of substantive audit procedures.

AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) makes Auditing Standard ASA 550 *Related Parties* as set out in paragraphs 1 to 39, pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

The mandatory requirements of this Auditing Standard are set out in **bold-type** paragraphs.

Dated 9 October 2006

M H Kelsall
Chairman - AUASB

AUDITING STANDARD ASA 550

Related Parties

Application

1 This Auditing Standard applies to:

> **(a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with Part 2M.3 of the *Corporations Act 2001*; and**
>
> **(b) an audit of a financial report for any other purpose.**

Operative Date

2 This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.

Introduction

3 The purpose of this Auditing Standard is to establish mandatory requirements and to provide explanatory guidance on the auditor's responsibilities and audit procedures regarding related parties and transactions with such parties when:

> (a) Accounting Standard AASB 124 *Related Party Disclosures*, or similar requirement, is part of the applicable financial reporting framework; or
>
> (b) in other circumstances, the auditor considers it appropriate to identify related parties and related party transactions.

4 In applying the mandatory requirements of this Auditing Standard to the audit of related party transactions and related party disclosures of public sector entities, the auditor ordinarily considers any relevant legislative requirements and the implications for audit procedures of such transactions and disclosures.

5 The auditor shall perform audit procedures designed to:

> **(a) obtain sufficient appropriate audit evidence regarding the:**
>
> > **(i) identification and**

(ii) **disclosure in accordance with the applicable financial reporting framework,**

by those charged with governance and management of related parties and the effect of related party transactions that are material to the financial report; and

(b) **reduce to an acceptably low level the risks of material misstatement in the financial report resulting from the existence of related parties and related party transactions.**

6 As indicated in ASA 200 *Objective and General Principles Governing an Audit of a Financial Report*, in certain circumstances limitations exist 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 Auditing Standard 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.

7 Where there is any indication that there are limitations that may affect the persuasiveness of audit evidence, the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level.

8 The following definitions regarding related party and related party transaction are contained in AASB 124 and are adopted for the purposes of this Auditing Standard:

(a) Related party means a party is related to an entity if:

(i) directly, or indirectly through one or more intermediaries, the party:

○ controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);

- ○ has an interest in the entity that gives it significant influence over the entity; or
- ○ has joint control over the entity;

(ii) the party is an associate (as defined in Accounting Standard AASB 128 *Investments in Associates*) of the entity;

(iii) the party is a joint venture in which the entity is a venturer (see Accounting Standard AASB 131 *Interests in Joint Ventures*);

(iv) the party is a member of the key management personnel of the entity or its parent;

(v) the party is a close member of the family of any individual referred to in (i) or (iv);

(vi) 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 (iv) or (v); or

(vii) 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.

(b) Related party transaction means a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

9 Those charged with governance and management are responsible for the identification and disclosure of related parties and transactions with such parties. This responsibility requires those charged with governance and 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 report.

10 Under ASA 315 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, 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 ordinarily maintains an awareness of them because:

- The applicable financial reporting framework may require disclosure in the financial report of certain related party relationships and transactions, such as those required by Accounting Standard AASB 124 and Accounting Standard AASB 101 *Presentation of Financial Statements*.
- The existence of related parties or related party transactions may affect the financial report. For example, provisions relating to financial benefits to related parties under the *Corporations Act 2001*, or where 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.
- 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.
- A related party transaction may be motivated by other than ordinary business considerations, for example, profit sharing or even fraud.
- The potential for error may increase because documentation regarding related party transactions may receive less scrutiny than documentation regarding other transactions.

Risk Assessment Procedures

11 Based on the auditor's knowledge of the business and enquiries of those charged with governance and management, the auditor shall assess the risk that related parties and related party transactions will not be identified, or that related party transactions will not be disclosed or measured in accordance with the applicable financial reporting framework.

12 To assess the risk of material misstatement at the assertion level, the auditor uses professional judgement to evaluate the impact of the following relevant factors:

- A complex organisational or ownership structure may make the identification of related parties more difficult, a situation which may be further complicated when the auditor does not audit all entities within an economic entity.
- The number of related parties and the volume of related party transactions.
- The extent to which the entity operates in foreign jurisdictions.
- Goods or services are provided at no charge.
- Indications of changes in the terms of transactions with related parties, particularly if they no longer reflect normal commercial terms.
- The entity is experiencing difficulty meeting the terms of debt agreements or has going concern problems.
- The entity has aggressive incentive programmes or is experiencing rapid growth in profitability when compared with other entities in the same industry.
- The nature of transactions with related parties, such as those involving intangibles.

13 Based on the auditor's understanding of the entity and its environment including its internal control, the auditor shall make an assessment of the risk of material misstatement as it relates to the identification of related parties and the authorisation and recording of related party transactions.

14 Ordinarily, this assessment involves consideration of policies and procedures relating to matters such as:

(a) ensuring that declarations of interests in other entities are current and communicated by and to those charged with governance and management within the entity;

(b) identifying related party transactions within information systems, including those policies and procedures which ensure the recording of transactions for which no consideration has been received or paid; and

(c) authorising and approving prices for transactions with related parties, including those not in the normal course of operations.

15 In some circumstances, the entity's control procedures may not be effective in providing relevant and reliable information about related parties and related party transactions, particularly those that are not in the normal course of operations. In this case the risk of material misstatement is ordinarily assessed as high.

16 In other circumstances, however, the auditor may assess the risk of material misstatement at less than high and perform tests of controls to support that assessment. However, an audit cannot be expected to detect all related party transactions.

Responses to Assessed Risks

17 ASA 330 *The Auditor's Procedures in Response to Assessed Risks* provides explanatory guidance on the nature, timing and extent of substantive procedures that the auditor may design to respond to the assessed risks of material misstatement resulting from related parties. Appendix 3 of ASA 240 *The Auditor's Responsibility to Consider Fraud in an Audit of a Financial Report* lists possible procedures to respond to assessed risks of material misstatement due to fraud, some of which may also be relevant in addressing the assessed risks of material misstatement resulting from related parties.

Existence and Disclosure of Related Parties

18 The auditor shall review information provided by those charged with governance and management identifying the names of all known related parties and shall perform the following audit procedures to reduce the risk of related parties remaining undetected to an acceptably low level:

(a) Review prior year working papers for names of known related parties.

(b) Review the entity's procedures for identification of related parties.

(c) Enquire 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) Enquire of other auditors currently involved in the audit, or predecessor auditors, as to their knowledge of additional related parties.

(g) Review the entity's income tax returns and other information supplied to regulatory agencies.

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

19 In addition the auditor may consider:

- Enquiring as to the names of all superannuation and other trusts established for the benefit of employees, and the names of their management, those charged with governance and trustees.
- Reviewing invoices and correspondence from lawyers for indications of the existence of related parties.
- Reviewing contracts and agreements, for example management agreements and trust agreements.

20 Related parties and related party transactions can be difficult to identify and measure because:

- Related parties may operate through an extensive and complex range of relationships and structures.
- Related party transactions may not always involve an exchange of consideration.
- Transactions with related parties may not be at arm's length and may be controlled, manipulated and/or concealed by those charged with governance and management.

21 When performing audit procedures which may identify related parties and related party transactions, the auditor shall consider the substance of the relationship and/or transaction being tested and not merely the legal form.

22 In considering substance over legal form, the auditor may consider the guidance in Accounting Standard AASB 101.

23 Where the applicable financial reporting framework requires disclosure of related party relationships, the auditor shall be satisfied that the disclosure is in accordance with that framework.

Transactions with Related Parties

24 The auditor shall review information provided by those charged with governance and management identifying related party transactions and shall be alert for other material related party transactions.

25 During the course of the audit, under paragraph 24 of this Auditing Standard, 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 of transactions which may indicate the existence of unidentified related parties 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.

26 During the course of the audit, the auditor ordinarily carries out other 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 recognised 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 a 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.

27 If, the auditor has reason to suspect the existence of previously unidentified related party transactions, under paragraph 7 of this Auditing Standard, the auditor needs to perform further audit procedures which are designed specifically to determine whether related party transactions have occurred.

28 Where during the audit, the auditor identifies related parties or related party transactions not previously identified, the auditor ordinarily considers:

(a) the reason for this, and the need to reassess risk of material misstatement concerning the identification of related parties and related party transactions; and

(b) the impact on other aspects of the audit when there is a reassessment of these risks.

Examining Identified Related Party Transactions

29 In examining the identified related party transactions, the auditor shall obtain sufficient appropriate audit evidence as to whether these transactions have been properly recorded and disclosed.

30 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 ordinarily considers performing audit procedures such as:

- Discussing the purpose of the transaction with those charged with governance and management.
- 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.

Communication with Those Charged With Governance

31 The auditor shall discuss with those charged with governance the nature, extent and business rationale of significant related party relationships and transactions, including those involving actual conflicts of interest.

32 Ordinarily, the discussion enables the auditor to:

(a) confirm that those charged with governance are fully aware of the nature and extent of significant related party relationships and transactions and their effects on the financial report;

(b) establish a common understanding with those charged with governance of the business rationale and propriety of the related party relationships and transactions, especially those involving actual or perceived conflicts of interest, and corroborate responses from management to enquiries the auditor has made into related party matters;

(c) alert those charged with governance to specific related party relationships and transactions of which they may not have been aware, to enable them to take appropriate action where necessary;

(d) review with those charged with governance the completeness, accuracy and transparency of management's related party disclosures, and the appropriateness of the accounting for related party relationships and transactions; and

(e) resolve identified related party issues, such as disagreements regarding the nature and extent of disclosure, on a timely basis.

Management Representations

33 The auditor shall endeavour to obtain a written representation from management concerning:

(a) the completeness of information provided regarding the identification of related party relationships and transactions; and

(b) the adequacy of related party disclosures in the financial report.

34 In the event management is unable to or refuses to provide a written representation, under ASA 580 *Management Representations* the auditor needs to consider the implications of the refusal for the auditor's report.

Materiality

35 When determining materiality regarding related parties, the auditor ordinarily considers the nature and circumstances of related party transactions, as it may often be difficult to extend materiality levels used in other aspects of the audit to those involving related parties because, for example:

(a) there is no objective value or basis of measurement for some related party transactions;

(b) the requirement to measure qualitative aspects such as the extent and impact of control or significant influence, or the impact of transactions on the users of the financial report; and

(c) director related disclosures are deemed material regardless of the quantum of the amounts involved.

36 The auditor may consider it appropriate to request those charged with governance and management to estimate or place an imputed value on transactions in order to determine the impact on the financial report, for example transactions that have occurred but which have no recorded value.

Audit Conclusions and Reporting

37 If the auditor is unable to:

(a) obtain sufficient appropriate audit evidence regarding related parties and related party transactions; or

(b) form a conclusion as to the completeness of the disclosure of related party relationships and transactions in accordance with the applicable financial reporting framework;

the auditor shall, modify the auditor's report in accordance with ASA 701 *Modifications to the Auditor's Report.*

38 If the auditor concludes that the related party disclosures in the financial report do not satisfy the requirements of the applicable financial reporting framework the auditor shall modify the auditor's report in accordance with ASA 701.

Conformity with International Standards on Auditing

39 Except as noted below, this Auditing Standard conforms with International Standard on Auditing ISA 550 *Related Parties* issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants. The main differences between this Auditing Standard and ISA 550 are:

- This Auditing Standard includes the following additional mandatory requirements:
  - ♦ The auditor shall perform audit procedures designed to reduce to an acceptably low level the risks of material misstatement in the financial report resulting from the existence of related parties and related party transactions (paragraph 5(b)).
  - ♦ When performing audit procedures which may identify related parties and related party transactions, the auditor shall consider the substance of the relationship and/or transaction being tested and not merely the legal form (paragraph 21).

  - ♦ The auditor shall discuss with those charged with governance the nature, extent and business rationale of significant related party relationships and transactions, including those involving actual conflicts of interest (paragraph 31).

  - ♦ If the auditor concludes that the related party disclosures in the financial report do not satisfy the requirements of the applicable financial reporting framework the auditor shall modify the auditor's report in accordance with ASA 701(paragraph 38).

- This Auditing Standard includes the following mandatory requirement which is included as explanatory guidance in ISA 550:

  - ♦ Based on the auditor's knowledge of the business and enquiries of those charged with governance and management, the auditor shall assess the risk that related parties and related party transactions will not be identified, or that related party transactions will not be disclosed or measured in accordance with the applicable financial reporting framework (paragraph 11).

- This Auditing Standard provides explanatory guidance on the additional specific mandatory requirements that are not included in ISA 550, as follows:

  - ♦ risk assessment procedures (paragraphs 12, 14, 15 and 16);

  - ♦ responses to assessed risks(paragraphs 17);

  - ♦ substance over legal form (paragraph 22); and

  - ♦ materiality in terms of related parties (paragraphs 35 and 36).

- ISA 550 includes a Public Sector Perspective section whereas this Auditing Standard provides explanatory guidance on the application of this Auditing Standard to public sector entities (paragraph 4).

Compliance with this Auditing Standard enables compliance with ISA 550.