

CANADIAN AUDITING STANDARDS

CAS 550

related parties

SUPPLEMENT

This supplement sets out the previous wording of paragraphs that have been amended as a consequence of approving CAS 240, The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.

5. In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether one or more fraud risk factors are present as required by CAS 240, 4 because fraud may be more easily committed through related parties.
11. As part of the risk assessment procedures and related activities that CAS 315 and CAS 240 require the auditor to perform during the audit, 7 the auditor shall perform the audit procedures and related activities set out in paragraphs 12-17 to obtain information relevant to identifying the risks of material misstatement associated with related party relationships and transactions. (Ref: Para. A8)
12. The engagement team discussion that CAS 315 and CAS 240 require 8 shall include 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. (Ref: Para. A9-A10)
23. For 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; 11 (Ref: Para. A38-A39)
 - (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 authorized and approved. (Ref: Para. A40-A41)
- A17. In meeting the CAS 315 requirement to obtain an understanding of the control environment, 20 the auditor may consider features of the control environment relevant to mitigating the risks of material misstatement associated with related party relationships and transactions, such as:
 - Internal ethical codes, appropriately communicated to the entity's personnel and enforced, governing the circumstances in which the entity may enter into specific types of related party transactions.
 - Policies and procedures for open and timely disclosure of the interests that management and those charged with governance have in related party transactions.
 - The assignment of responsibilities within the entity for identifying, recording, summarizing, and disclosing related party transactions.
 - Timely disclosure and discussion between management and those charged with governance of significant related party transactions outside the entity's normal course of business, including whether those charged with governance have appropriately challenged the business rationale of such transactions (for example, by seeking advice from external professional advisors).
 - Clear guidelines for the approval of related party transactions involving actual or perceived conflicts of interest, such as approval by a subcommittee of those charged with governance comprising individuals independent of management.
 - Periodic reviews by the internal audit function, where applicable.
 - Proactive action taken by management to resolve related party disclosure issues, such as by seeking advice from the auditor or external legal counsel.
 - The existence of whistle-blowing policies and procedures, where applicable.
- A19. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. 22 The risk of management override of controls is higher if management has relationships that involve control or significant influence with parties with which the entity does business because these relationships may present management with greater incentives and opportunities to perpetrate fraud. For example, management's financial interests in certain related parties may provide incentives for management to override controls by (a) directing the

entity, against its interests, to conclude transactions for the benefit of these parties, or (b) colluding with such parties or controlling their actions. Examples of possible fraud include:

- Creating fictitious terms of transactions with related parties designed to misrepresent the business rationale of these transactions.
- Fraudulently organizing the transfer of assets from or to management or others at amounts significantly above or below market value.
- Engaging in complex transactions with related parties, such as special-purpose entities, that are structured to misrepresent the financial position or financial performance of the entity.

A33. If the auditor has assessed a significant risk of material misstatement due to fraud as a result of the presence of a related party with dominant influence, the auditor may, in addition to the general requirements of CAS 240, perform audit procedures such as the following to obtain an understanding of the business relationships that such a related party may have established directly or indirectly with the entity and to determine the need for further appropriate substantive audit procedures:

- Inquiries of, and discussion with, management and those charged with governance.
- Inquiries of the related party.
- Inspection of significant contracts with the related party.
- Appropriate background research, such as through the Internet or specific external business information databases.
- Review of employee whistle-blowing reports where these are retained.

A46. CAS 450 requires the auditor to consider both the size and the nature of a misstatement, and the particular circumstances of its occurrence, when evaluating whether the misstatement is material. ²⁷ The significance of the transaction to the financial statement users may not depend solely on the recorded amount of the transaction but also on other specific relevant factors, such as the nature of the related party relationship.

SUPPLEMENT

This supplement sets out the previous wording of paragraphs that have been amended as a consequence of approving CAS 600, Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors).

A13. In the context of a group audit, CAS 600 requires the group engagement team to provide each component auditor with a list of related parties prepared by group management and any other related parties of which the group engagement team is aware. ¹⁹ Where the entity is a component within a group, this information provides a useful basis for the auditor's inquiries of management regarding the identity of the entity's related parties.

A38. In evaluating the business rationale of a significant related party transaction outside the entity's normal course of business, the auditor may consider the following:

- Whether the transaction:
 - Is overly complex (for example, it may involve multiple related parties within a consolidated group).
 - Has unusual terms of trade, such as unusual prices, interest rates, guarantees and repayment terms.
 - Lacks an apparent logical business reason for its occurrence.
 - Involves previously unidentified related parties.
 - Is processed in an unusual manner.
- Whether management has discussed the nature of, and accounting for, such a transaction with those charged with governance.
- Whether management is placing more emphasis on a particular accounting treatment rather than giving due regard to the underlying economics of the transaction.

If management's explanations are materially inconsistent with the terms of the related party transaction, the auditor is required, in accordance with CAS 500, ²⁷ to consider the reliability of management's explanations and representations on other significant matters.

Footnotes

4. CAS 240, paragraph 25

7. CAS 315, paragraph 13; and CAS 240, paragraph 17

8. CAS 315, paragraph 17; and CAS 240, paragraph 16

11. CAS 240, paragraph 33(c)
 20. CAS 315, paragraph 21
 22. CAS 240, paragraphs 32 and A4
27. 27 CAS 450, *Evaluation of Misstatements Identified during the Audit*, paragraph 11(a). Paragraph A21 of CAS 450 provides guidance on the circumstances that may affect the evaluation of a misstatement.
19. CAS 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraph [40\(e\)](#)
27. CAS 500, *Audit Evidence*, paragraph [11](#)
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