ISA Application and Other Explanatory Material: ISA 550.A29-A30

How do we comply with the standards?

Response to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions

International Standards on Auditing: ISA 550.20-24

ISA Application and Other Explanatory Material: ISA 550.A31-A45

How do we comply with the standards?

Evaluation of the Accounting for and Disclosure of Identified Related Party Relationships and Transactions

International Standards on Auditing: ISA 550.25

ISA Application and Other Explanatory Material: ISA 550.A46-A47

How do we comply with the standards?

Written Representations

International Standards on Auditing: ISA 550.26

ISA Application and Other Explanatory Material: ISA 550.A48-A49

How do we comply with the standards?

Communication with Those Charged with Governance

International Standards on Auditing: ISA 550.27

ISA Application and Other Explanatory Material: ISA 550.A50

How do we comply with the standards?

1 Communicate related party matters with those charged with governance

Documentation

International Standards on Auditing: ISA 550.28

How do we comply with the standards?

1.C Inquire of management regarding related parties

1.E Inquire of management and other individuals regarding related parties

ISA 550 Related Parties

View the Full Chapter for this Standard

ISA 550 *Related Parties*

(Effective for audits of financial statements for periods beginning on or after December 15, 2009)

Introduction, Objectives, Definitions

International Standards on Auditing: ISA 550.01-10

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibilities relating to related party relationships and transactions in an audit of financial statements. Specifically, it expands on how ISA 315 (Revised),[1] ISA 330,[2] and ISA 240[3] are to be applied in relation to risks of material misstatement associated with related party relationships and transactions.

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1 ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

2 ISA 330, *The Auditor's Responses to Assessed Risks*

3 ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

Nature of Related Party Relationships and Transactions

2. Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. For example:

- Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
- Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

Responsibilities of the Auditor

3. Because related parties are not independent of each other, many financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. Where the applicable financial reporting framework establishes such requirements, 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.

4. Even if the applicable financial reporting framework establishes minimal or no related party requirements, the auditor nevertheless needs to obtain an understanding of the 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: (Ref: Para. A1)

(a) Achieve fair presentation (for fair presentation frameworks); or (Ref: Para. A2)

(b) Are not misleading (for compliance frameworks). (Ref: Para. A3)

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 ISA 240,[4] because fraud may be more easily committed through related parties.

4 ISA 240, paragraph 25

6. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs.[5] In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- Management may be unaware of the existence of all related party relationships and transactions, particularly if the applicable financial reporting framework does not establish related party requirements.
- Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.

5 ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraphs A53 - A54

7. Planning and performing the audit with professional skepticism as required by ISA 200[6] is therefore particularly important in this context, given the potential for undisclosed related party relationships and

transactions. The requirements in this ISA are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions, and in designing audit procedures to respond to the assessed risks.

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6 ISA 200, paragraph 15

Effective Date

8. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.*

Objectives

9. The objectives of the auditor are:

(a) Irrespective of whether the applicable financial reporting framework establishes related party requirements, to obtain an understanding of related party relationships and transactions sufficient to be able:

> (i) To recognize fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud; and
>
> (ii) To conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions:
>
> > a. Achieve fair presentation (for fair presentation frameworks); or
> >
> > b. Are not misleading (for compliance frameworks); and

(b) In addition, where the applicable financial reporting framework establishes related party requirements, to obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in the financial statements in accordance with the framework.

Definitions

10. For purposes of the ISAs, the following terms have the meanings attributed below:

(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 party - A party that is either: (Ref: Para. A4 - A7)

> (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 (that is, 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.

ISA Application and Other Explanatory Material: ISA 550.A1-A7

Application and Other Explanatory Material

Responsibilities of the Auditor

Financial Reporting Frameworks That Establish Minimal Related Party Requirements (Ref: Para. 4)

A1. An applicable financial reporting framework that establishes minimal related party requirements is one that defines the meaning of a related party but that definition has a substantially narrower scope than the definition set out in paragraph 10(b)(ii) of this ISA, so that a requirement in the framework to disclose related party relationships and transactions would apply to substantially fewer related party relationships and transactions.

Fair Presentation Frameworks (Ref: Para. 4(a))

A2. In the context of a fair presentation framework,[15] related party relationships and transactions may cause the financial statements to fail to achieve fair presentation if, for example, the economic reality of such relationships and transactions is not appropriately reflected in the financial statements. For instance, fair presentation may not be achieved if the sale of a property by the entity to a controlling shareholder at a price above or below fair market value has been accounted for as a transaction involving a profit or loss for the entity when it may constitute a contribution or return of capital or the payment of a dividend.

15 ISA 200, paragraph 13(a), defines the meaning of fair presentation and compliance frameworks.

Compliance Frameworks (Ref: Para. 4(b))

A3. In the context of a compliance framework, whether related party relationships and transactions cause the financial statements to be misleading as discussed in ISA 700 (Revised) depends upon the particular circumstances of the engagement. For example, even if non-disclosure of related party transactions in the financial statements is in compliance with the framework and applicable law or regulation, the financial statements could be misleading if the entity derives a very substantial portion of its revenue from transactions with related parties, and that fact is not disclosed. However, it will be extremely rare for the auditor to consider financial statements that are prepared and presented in accordance with a compliance framework to be misleading if in accordance with ISA 210[16] the auditor determined that the framework is acceptable.[17]

16 ISA 210, *Agreeing the Terms of Audit Engagements*, paragraph 6(a)

17 ISA 700 (Revised), paragraph A17

Definition of a Related Party (Ref: Para. 10(b))

A4. Many financial reporting frameworks discuss the concepts of control and significant influence. Although they may discuss these concepts using different terms, they generally explain that:

(a) Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities; and

(b) Significant influence (which may be gained by share ownership, statute or agreement) is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies.

A5. The existence of the following relationships may indicate the presence of control or significant influence:

(a) Direct or indirect equity holdings or other financial interests in the entity.

(b) The entity's holdings of direct or indirect equity or other financial interests in other entities.

(c) Being part of those charged with governance or key management (that is, those members of management who have the authority and responsibility for planning, directing and controlling the activities of the entity).

(d) Being a close family member of any person referred to in subparagraph (c).

(e) Having a significant business relationship with any person referred to in subparagraph (c).

Related Parties with Dominant Influence

A6. Related parties, by virtue of their ability to exert control or significant influence, may be in a position to exert dominant influence over the entity or its management. Consideration of such behavior is relevant when identifying and assessing the risks of material misstatement due to fraud, as further explained in paragraphs A29 - A30.

Special-Purpose Entities as Related Parties

A7. In some circumstances, a special-purpose entity[18] may be a related party of the entity because the entity may in substance control it, even if the entity owns little or none of the special-purpose entity's equity.

18 ISA 315 (Revised), paragraphs A34 - A35, provides guidance regarding the nature of a special-purpose entity.

Risk Assessment Procedures and Related Activities

International Standards on Auditing: ISA 550.11-17 Requirements

Risk Assessment Procedures and Related Activities

11. As part of the risk assessment procedures and related activities that ISA 315 (Revised) and ISA 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)

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7 ISA 315 (Revised), paragraph 5; ISA 240, paragraph 17

Understanding the Entity's Related Party Relationships and Transactions

12. The engagement team discussion that ISA 315 (Revised) and ISA 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)

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8 ISA 315 (Revised), paragraph 10; ISA 240, paragraph 16

13. The auditor shall inquire of management regarding:

    (a) The identity of the entity's related parties, including changes from the prior period; (Ref: Para. A11 - A14)

    (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.

14. The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to: (Ref: Para. A15 - A20)

    (a) Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;

    (b) Authorize and approve significant transactions and arrangements with related parties; and (Ref: Para. A21)

    (c) Authorize and approve significant transactions and arrangements outside the normal course of business.

Maintaining Alertness for Related Party Information When Reviewing Records or Documents

15. 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. (Ref: Para. A22 - A23)

In particular,, the auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor:

(a) Bank and legal confirmations obtained as part of the auditor's procedures;

(b) Minutes of meetings of shareholders and of those charged with governance; and

(c) Such other records or documents as the auditor considers necessary in the circumstances of the entity.

16. If the auditor identifies significant transactions outside the entity's normal course of business when performing the audit procedures required by paragraph 15 or through other audit procedures, the auditor shall inquire of management about: (Ref: Para. A24 - A25)

(a) The nature of these transactions; and (Ref: Para. A26)

(b) Whether related parties could be involved. (Ref: Para. A27)

Sharing Related Party Information with the Engagement Team

17. The auditor shall share relevant information obtained about the entity's related parties with the other members of the engagement team. (Ref: Para. A28)

ISA Application and Other Explanatory Material: ISA 550.A8-A28

Risk Assessment Procedures and Related Activities

Risks of Material Misstatement Associated with Related Party Relationships and Transactions (Ref: Para. 11)

Considerations Specific to Public Sector Entities

A8. The public sector auditor's responsibilities regarding related party relationships and transactions may be affected by the audit mandate, or by obligations on public sector entities arising from law, regulation or other authority. Consequently, the public sector auditor's responsibilities may not be limited to addressing the risks of material misstatement associated with related party relationships and transactions, but may also include a broader responsibility to address the risks of non-compliance with law, regulation and other authority governing public sector bodies that lay down specific requirements in the conduct of business with related parties. Further, the public sector auditor may need to have regard to public sector financial reporting requirements for related party relationships and transactions that may differ from those in the private sector.

Understanding the Entity's Related Party Relationships and Transactions

Discussion among the Engagement Team (Ref: Para. 12)

A9. Matters that may be addressed in the discussion among the engagement team include:

- The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit).

- An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions.
- The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (for example, a complex organizational structure, use of special-purpose entities for off-balance sheet transactions, or an inadequate information system).
- The records or documents that may indicate the existence of related party relationships or transactions.
- The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions (if the applicable financial reporting framework establishes related party requirements), and the related risk of management override of controls.

A10. In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:

- How special-purpose entities controlled by management might be used to facilitate earnings management.
- How transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.

The Identity of the Entity's Related Parties (Ref: Para. 13(a))

A11. Where the applicable financial reporting framework establishes related party requirements, information regarding the identity of the entity's related parties is likely to be readily available to management because the entity's information systems will need to record, process and summarize related party relationships and transactions to enable the entity to meet the accounting and disclosure requirements of the framework. Management is therefore likely to have a comprehensive list of related parties and changes from the prior period. For recurring engagements, making the inquiries provides a basis for comparing the information supplied by management with the auditor's record of related parties noted in previous audits.

A12. However, where the framework does not establish related party requirements, the entity may not have such information systems in place. Under such circumstances, it is possible that management may not be aware of the existence of all related parties. Nevertheless, the requirement to make the inquiries specified by paragraph 13 still applies because management may be aware of parties that meet the related party definition set out in this ISA. In such a case, however, the auditor's inquiries regarding the identity of the entity's related parties are likely to form part of the auditor's risk assessment procedures and related activities performed in accordance with ISA 315 (Revised 2019) to obtain information regarding the entity's organizational structure, ownership, governance and business model.

In the particular case of common control relationships, as management is more likely to be aware of such relationships if they have economic significance to the entity, the auditor's inquiries are likely to be more effective if they are focused on whether parties with which the entity engages in significant transactions, or shares resources to a significant degree, are related parties.

A13. In the context of a group audit, ISA 600 (Revised) requires the group auditor to request component auditors to communicate on a timely basis related party relationships not previously identified by group management or the group auditor.[19] Such information provides a useful basis for the group auditor's inquiries of management regarding the identity of related parties.

19 ISA 600 (Revised), *Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors),* paragraph 32(b)

A14. The auditor may also obtain some information regarding the identity of the entity's related parties through inquiries of management during the engagement acceptance or continuance process.

The Entity's Controls over Related Party Relationships and Transactions (Ref: Para. 14)

A15. Others within the entity are those considered likely to have knowledge of the entity's related party relationships and transactions, and the entity's controls over such relationships and transactions. These may include, to the extent that they do not form part of management:

- Those charged with governance;
- Personnel in a position to initiate, process, or record transactions that are both significant and outside the entity's normal course of business, and those who supervise or monitor such personnel;
- The internal audit function;
- In-house legal counsel; and
- The chief ethics officer or equivalent person.

A16. The audit is conducted on the premise that management and, where appropriate, those charged with governance have acknowledged and understand that they have responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, and for such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.[20] Accordingly, where the framework establishes related party requirements, the preparation of the financial statements requires management, with oversight from those charged with governance, to design, implement and maintain adequate controls over related party relationships and transactions so that these are identified and appropriately accounted for and disclosed in accordance with the framework. In their oversight role, those charged with governance monitor how management is discharging its responsibility for such controls. Regardless of any related party requirements the framework may establish, those charged with governance may, in their oversight role, obtain information from management to enable them to understand the nature and business rationale of the entity's related party relationships and transactions.

20 ISA 200, paragraph A4

A17. In meeting the ISA 315 (Revised) requirement to obtain an understanding of the control environment,[21] 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.

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21 ISA 315 (Revised), paragraph 14

A18. Controls over related party relationships and transactions within some entities may be deficient or non-existent for a number of reasons, such as:

- The low importance attached by management to identifying and disclosing related party relationships and transactions.
- The lack of appropriate oversight by those charged with governance.
- An intentional disregard for such controls because related party disclosures may reveal information that management considers sensitive, for example, the existence of transactions involving family members of management.
- An insufficient understanding by management of the related party requirements of the applicable financial reporting framework.
- The absence of disclosure requirements under the applicable financial reporting framework.

Where such controls are ineffective or non-existent, the auditor may be unable to obtain sufficient appropriate audit evidence about related party relationships and transactions. If this were the case, the auditor would, in accordance with ISA 705 (Revised),[22] consider the implications for the audit, including the opinion in the auditor's report.

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22 ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

A19. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively.[23] 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.

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23 ISA 240, paragraphs 32 and A4

Considerations specific to smaller entities

A20. Controls in smaller entities are likely to be less formal and smaller entities may have no documented processes for dealing with related party relationships and transactions. An owner-manager may mitigate some of the risks arising from related party transactions, or potentially increase those risks, through active involvement in all the main aspects of the transactions. For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through inquiry of management combined with other procedures, such as observation of management's oversight and review activities, and inspection of available relevant documentation.

Authorization and approval of significant transactions and arrangements (Ref: Para. 14(b))

A21. Authorization involves the granting of permission by a party or parties with the appropriate authority (whether management, those charged with governance or the entity's shareholders) for the entity to enter into specific transactions in accordance with pre-determined criteria, whether judgmental or not. Approval involves those parties' acceptance of the transactions the entity has entered into as having satisfied the criteria on which authorization was granted. Examples of controls the entity may have established to authorize and approve significant transactions and arrangements with related parties or significant transactions and arrangements outside the normal course of business include:

- Monitoring controls to identify such transactions and arrangements for authorization and approval.
- Approval of the terms and conditions of the transactions and arrangements by management, those charged with governance or, where applicable, shareholders.

Maintaining Alertness for Related Party Information When Reviewing Records or Documents

Records or Documents That the Auditor May Inspect (Ref: Para. 15)

A22. During the audit, the auditor may inspect records or documents that may provide information about related party relationships and transactions, for example:

- Third-party confirmations obtained by the auditor (in addition to bank and legal confirmations).
- Entity income tax returns.
- Information supplied by the entity to regulatory authorities.
- Shareholder registers to identify the entity's principal shareholders.
- Statements of conflicts of interest from management and those charged with governance.
- Records of the entity's investments and those of its pension plans.
- Contracts and agreements with key management or those charged with governance.
- Significant contracts and agreements not in the entity's ordinary course of business.
- Specific invoices and correspondence from the entity's professional advisors.

- Life insurance policies acquired by the entity.
- Significant contracts re-negotiated by the entity during the period.
- Reports of the internal audit function.
- Documents associated with the entity's filings with a securities regulator (for example, prospectuses).

Arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions (Ref: Para. 15)

A23. An arrangement involves a formal or informal agreement between the entity and one or more other parties for such purposes as:

- The establishment of a business relationship through appropriate vehicles or structures.
- The conduct of certain types of transactions under specific terms and conditions.
- The provision of designated services or financial support.

Examples of arrangements that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor include:

- Participation in unincorporated partnerships with other parties.
- Agreements for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business.
- Guarantees and guarantor relationships.

Identification of Significant Transactions outside the Normal Course of Business (Ref: Para. 16)

A24. Obtaining further information on significant transactions outside the entity's normal course of business enables the auditor to evaluate whether fraud risk factors, if any, are present and, where the applicable financial reporting framework establishes related party requirements, to identify the risks of material misstatement.

A25. Examples of transactions outside the entity's normal course of business may include:

- Complex equity transactions, such as corporate restructurings or acquisitions.
- Transactions with offshore entities in jurisdictions with weak corporate laws.
- The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged.
- Sales transactions with unusually large discounts or returns.
- Transactions with circular arrangements, for example, sales with a commitment to repurchase.
- Transactions under contracts whose terms are changed before expiry.

Understanding the nature of significant transactions outside the normal course of business (Ref: Para. 16(a))

A26. Inquiring into the nature of the significant transactions outside the entity's normal course of business involves obtaining an understanding of the business rationale of the transactions, and the terms and conditions under which these have been entered into.

Inquiring into whether related parties could be involved (Ref: Para. 16(b))

A27. A related party could be involved in a significant transaction outside the entity's normal course of business not only by directly influencing the transaction through being a party to the transaction, but also by indirectly influencing it through an intermediary. Such influence may indicate the presence of a fraud risk factor.

Sharing Related Party Information with the Engagement Team (Ref: Para. 17)

A28. Relevant related party information that may be shared among the engagement team members includes, for example:

- The identity of the entity's related parties.
- The nature of the related party relationships and transactions.
- Significant or complex related party relationships or transactions that may be determined to be significant risks, in particular transactions in which management or those charged with governance are financially involved.

How do we comply with the Standards?

[ISA | KAEGHDWC]

1 Obtain an understanding of related party relationships and transactions [ISA | 4309]

What do we do?

Obtain an understanding of the entity's relationships and transactions with its related parties

Why do we do this?

As we perform risk identification and assessment procedures, we obtain an understanding of the entity's relationships and transactions with its related parties in order to be able to identify, assess and respond to risks that may be present with respect to related parties.

Execute the Audit

How do we know what or who is a 'related party'? [ISA | 4309.14479]

'Related party' is normally defined by the applicable financial reporting framework, including other associated regulatory rules and interpretations (e.g. SEC Rules and Regulations). The term may be defined by the applicable auditing standard.

How does the auditing framework define related party? [ISA | 4309.1300]

Below are examples of how certain auditing frameworks define related parties.

Auditing framework	How is related party defined?
AS 2410 *Related parties*	The release notes of AS 2410 (A4-6) tell us that the intent of AS 2410 is to be financial reporting framework neutral

	with respect to the definition of a related party. This means that when the applicable financial reporting framework is US GAAP, the definition of related parties is from ASC 850, *Related Party Disclosures*. Whereas when the applicable financial reporting framework is IFRS, then the definition of related parties is from IAS 24 *Related Party Disclosures.* If the entity intends to leverage its existing proxy disclosure process for the purposes of preparing financial statement disclosures on related parties, we keep in mind that there may be differences in the definition of related persons used in the proxy process (as defined in Item 404 of Regulation S-K https://www.sec.gov/divisions/corpfin/ecfrlinks.shtml) as compared to the applicable financial reporting framework.
AU-C 550 *Related parties*	AU-C 550 refers to the definition of related parties from the applicable financial reporting framework issued by bodies recognized by the AICPA, which includes US GAAP and IFRS.
ISA 550 *Related parties*	ISA 550 *Related Parties* includes references to the definition within the entity's applicable financial reporting framework. However, it also sets a base-line definition of related party that is applied when the applicable financial reporting framework does not define a related party or defines it substantially more narrowly than the base-line definition (refer to the base-line definition included in ISA 550.10(b)(ii) https://alex.kpmg.com/AROWeb/document/lfc/find/UN_XLNUK_IFAC18_ISA_550_BODY_para10_HDG and ISA 550.A1). The related party definitions of US GAAP and IFRS are broader than the base-line definition in ISA 550.

How does the applicable financial reporting framework define related party? [ISA | 4309.14480]

Below is an example of how certain more widely used financial reporting frameworks define related parties.

Applicable financial reporting framework	Where is related party defined?
U.S. GAAP	*ASC Topic 850 Related Party Disclosures*
IFRS	IAS 24 *Related party disclosures*

What are situations and structures that may be indicative of a related party under ISA 550? [ISA | 4309.14469]

Many financial reporting frameworks discuss the concepts of control and significant influence. Although they may discuss these concepts using different terms, they explain that:

- control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities; and
- significant influence (which may be gained by share ownership, statute or agreement) is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies.

The existence of the following relationships may indicate the presence of control or significant influence:

- direct or indirect equity holdings or other financial interests in the entity.
- the entity's holdings of direct or indirect equity or other financial interests in other entities.
- being part of those charged with governance or key management (that is, those members of management who have the authority and responsibility for planning, directing and controlling the activities of the entity).
- being a close family member of those charged with governance or key management.
- having a significant business relationship with those charged with governance or key management.

What information do we obtain about related parties? [ISA | 4309.1500]

We obtain information to understand:

- the nature of the entity's relationships with its related parties;
- terms and business purposes (or the lack thereof) of the transactions involving related parties; and
- any other relevant information.

This understanding enables us to then identify and assess whether RMs are RMMs.

How do we obtain and distribute relevant information about related parties? [ISA | 4309.1600]

We perform the following procedures:

- discussing the susceptibility of the financial statements to material misstatement, including the potential for material misstatement due to fraud;
- inquiring regarding related parties;
- obtaining an understanding of related party processes and controls, including evaluating the design and implementation of controls;
- communicating to the engagement team relevant information regarding related parties;
- evaluating whether all related parties, relationships and transactions have been identified;
- understanding relevant controls that address SUTs; and
- inquiring about fraud and fraud risks, including significant unusual transactions.

Additionally, in a group audit we also perform the following procedures:

- communicating to component auditors relevant information regarding related parties; and

- requesting component auditors to communicate related party information not previously identified.

What might a lack of business purpose in a related party transaction mean? [ISA | 4309.1800]

When a transaction lacks a clear business purpose, it may be representative of an RMM.

Lacking a business purpose relates to an entity engaging in transactions where it is unclear what the commercial rationale for the transaction is - i.e., we ask the question "Why did they enter into this transaction?".

The question "why" may arise when:

- the terms of the transaction have no real commercial basis, or
- there is no clear reason why the entity entered into the transaction (e.g., an entity buying an asset at market value that is completely unrelated to their operations, business model or business strategy).

Lack of business purpose may be indicative that the accounting outcome does not reflect the substance of the transaction or that related parties are being used to perpetrate fraudulent financial reporting or misappropriation of assets.

What are some examples of how related parties may be used to materially misstate the financial statements? [ISA | 4309.1900]

Due to the nature of related party relationships, the existence of related parties may increase the risks of material misstatement and make them more susceptible to fraud. For example:

Objective	Using related parties
Improve the entity's balance sheet	Pay down related party debt prior to the balance sheet date, while having an informal agreement to subsequently borrow the same or a comparable amount shortly after period-end.
Recognize additional revenue	A related party of the entity buys significantly more units than usual at higher than normal prices in the last month of the financial year from the entity, which allows the entity to comply with financial covenants in its loan agreements.
Personal financial gain	Certain suppliers and service providers are used that management/ those charged with governance have a financial interest in, on different terms than those conducted with unrelated parties.

Examples

How can the presence of related parties affect financial statement disclosure? [ISA | 4309.2100]

Fact Pattern

Management of ABC entity has identified XYZ entity as a related party. ABC and XYZ are both controlled by the same parent entity. In the prior year, there were no transactions between ABC and XYZ. In the current year, ABC purchased equipment from XYZ.

Analysis

Management determined (and the engagement team concurred) that in addition to disclosing ABC's relationship with XYZ, disclosure of the transaction between the two parties is necessary to comply with the applicable financial reporting framework.

1.1 Discuss accounting policies or principles and susceptibility of financial statements to material misstatement [ISA | 553]

What do we do?

Discuss (1) the entity's selection and application of accounting policies or principles, including related disclosure requirements and (2) the susceptibility of financial statements to material misstatement due to error or fraud

Why do we do this?

Engaging in a meaningful discussion about the entity's accounting policies or principles, how they've been applied, and whether they're appropriate — while considering where the entity's financial statements may be more susceptible to material misstatement — is likely to confirm, or may point us to new, risks of material misstatement (RMMs).

Execute the Audit

What do we focus on when discussing the application of the financial reporting framework including accounting policies or principles, and related disclosure requirements? [ISA | 553.1300]

The Risk Assessment and Planning Discussion (RAPD) includes a meaningful, thought-provoking analysis of:

- the financial reporting framework, including the entity's accounting policies or principles;
- how they have been applied;
- whether they are appropriate to the entity and its circumstances, and
- related disclosure requirements.

Prior-period knowledge and understanding is valuable, and we incorporate it in our discussion. However, all participants in the discussion take a fresh look at these matters.

What questions might we ask during this discussion? [ISA | 553.11518]

Throughout the discussion, we may find it helpful to ask ourselves the following questions.

- Are the accounting policies or principles appropriate for the entity?
- Are they common practice in the industry?
- How have they been implemented — especially in emerging areas, or areas in which the accounting requirements are less prescriptive?
- Will changes in financial reporting requirements result in significant new or revised disclosures?
- Will changes in the entity's environment, financial condition or activities result in significant new or revised disclosures — e.g. a significant business combination in the period under audit?
- Has it been difficult in the past to obtain sufficient appropriate audit evidence for certain disclosures?
- Are there any disclosures about complex matters, including those involving significant management judgment as to what information to disclose?

How might we begin this discussion? [ISA | 553.11519]

We might begin the discussion by inspecting the results of our risk assessment procedures or the entity's accounting policies note from the prior period financial statements, and by considering any changes we are aware of in the current period.

Changes can occur for many reasons, including:

- changes in the entity's business during the period - e.g. a new line of business;
- new accounting policies or principles that were adopted during the period;
- recent significant changes in the economic, regulatory, industry, or other aspects of the environment in which the entity operates; and
- changes in the way the entity applies its current accounting policies or principles.

What do we focus on when discussing the susceptibility of the entity's financial statements to material misstatement? [ISA | 553.1400]

In discussing the susceptibility of the entity's financial statements to material misstatement, we:

- consider all the information gathered throughout risk assessment; and
- share our thoughts about where there may be indications of RMMs, due to both error and fraud.

Our discussion also includes specific consideration of the susceptibility of the financial statements to material misstatement due to error that could result from the entity's related party relationships and transactions.

This may include the matters raised during our RAPD discussion about selecting and applying accounting policies or principles, including related disclosure requirements.

However, we are not limited to items coming from the RAPD discussion. We might also use the prior-period financial statements and related notes as a springboard for discussion, combined with the results of our current-period risk assessment procedures to date.

Our primary goal is to have a robust discussion about the areas of the entity's financial statements that may be susceptible to material misstatements, and therefore evaluate whether RMMs may exist.

Example

What matters might we discuss regarding the entity's selection and application of accounting policies or principles? [ISA | 553.1500]

The table below sets out examples of matters we might identify during risk assessment, and discuss in the RAPD, about the selection and application of accounting policies or principles, including related disclosure requirements.

As we discuss these matters, we consider their effects on risk assessment — specifically on identifying and assessing RMMs.

Matter we identify	**Example discussion points**	Possible effect
The entity is in the early stages of its lifecycle and has just begun to generate sales. It is now implementing revenue recognition policies.	This is the first time the entity is implementing a revenue accounting policy, so there are increased risks associated with selecting and applying the policy. These are affected by the industry and nature of the sales process.	We identify an RMM related to how the entity records and reports revenue in the financial statements and related disclosures.
The entity has completed a significant business combination and is therefore applying business combination accounting policies or principles for the first time.	This is the first time the entity is applying these accounting policies or principles, and the principles are complex. Significant judgments are involved in accounting for business combinations.	We identify an RMM related to the accounting for business combinations, including related disclosures.
The entity has changed its method for accounting for inventory (from FIFO to average cost).	We explore a series of questions, including: • What is the reason for change? • What is accepted within the industry? • Are the entity's systems equipped to manage the change — e.g. can its IT systems properly calculate the average cost? • Was the change adopted at the beginning of the period or mid-period? • How will this be disclosed?	We identify an RMM related to the cost of inventory recorded and consider whether a fraud risk exists.
Due to rising interest rates, the entity	Given the economic environment, the entity needed to update significant	We identify an RMM related to the

updates significant assumptions in its cash flow model for goodwill valuation.	assumptions in its cash flow model for goodwill to account for the current economic environment, including the discount rate, inflation, and other projected financial information such as revenue and expenses.	valuation of goodwill, including related disclosures.

1.2 Discuss the potential for material misstatement due to fraud [ISA | 554]

What do we do?

Discuss the potential for material misstatement due to fraud.

Why do we do this?

A material misstatement due to fraud could be present, regardless of our past experience with the entity and regardless of our belief about management's honesty and integrity.

Questioning what we think we know, particularly in an open discussion, may highlight risks of fraud that we would not otherwise have considered. In addition, brainstorming encourages us to share views and may generate new ideas about fraud risk.

Execute the Audit

When do we discuss the potential for material misstatement due to fraud? [ISA | 554.1300]

Our discussion about fraud doesn't have to take place as part of the risk assessment and planning discussion (RAPD). We may discuss RMMs due to error separately from fraud risks. However, it's usually more convenient to hold the two discussions together — especially as all of the relevant members are already participating.

Also, a fraud risk may relate to the same account or disclosure as a risk due to error. So, given how the risks may interrelate, discussing the risks at the same time may be more effective.

If we decide to discuss fraud separately from the RAPD, we conduct our discussion in a very similar manner - i.e., with similar attendees and documentation. Regardless of how or when this happens, we hold a robust discussion about the potential for material misstatement due to fraud.

How do we prepare for and participate in the fraud discussion? [ISA | 554.1400]

To make the discussion more effective, it may be useful to inspect items that help us to brainstorm — including:

- our past audit experience with the entity
- current-period information obtained during planning
- experience on other audits
- KPMG guidance and training
- the entity's internal fraud risk assessment

- the entity's board minutes
- the entity's earnings calls and press releases.

These can help identify matters and events that are relevant to considering risks of fraud.

What ideas do we exchange about the possible occurrence of fraud? [ISA | 554.1500]

When we discuss the potential for material misstatement due to fraud, it's helpful to start with understanding the three categories of fraud risk factors (i.e., 1. Incentive / Pressure, 2. Attitude or Rationalization, 3. Opportunity), which forms the fraud triangle (refer to activity on identifying fraud risk factors for further discussion on the fraud risk factors and illustration of the fraud triangle). Then brainstorming how and where we believe the entity's financial statements (including individual statements and disclosures) may be susceptible to fraud. We specifically exchange ideas about:

- how and where management could perpetrate and conceal fraudulent financial reporting;
- how the entity's assets could be misappropriated;
- the susceptibility of the financial statements to material misstatement through related party transactions;
- how fraud might be perpetrated or concealed by omitting or presenting incomplete or inaccurate disclosures;
- how the financial statements could be manipulated through management bias in accounting estimates in significant accounts and disclosures;
- what incentives, pressures or opportunities are present to enable fraud;
- whether management could rationalize committing fraud;
- circumstances that might indicate earnings management or manipulation of other financial measures; and
- practices that management might follow to manage earnings or manipulate other financial measures.

How do we exchange ideas about the possible occurrence of fraud? [ISA | 554.1600]

The exchange of ideas works in combination with thinking about fraud risk factors and fraud risks. Our discussions are intended to be an iterative process among team members in which we exchange ideas and information.

These discussions go beyond simply inspecting a list of fraud risks from the prior period and confirming which of them still apply to the current period. We do include considerations from prior periods, but we use a fresh lens to identify and assess:

- new circumstances that might indicate the potential for fraud; and
- when fraud risks may have changed.

All participants bring their thoughts to the table and discuss the fraud risks that may exist for the current period audit.

> Suppose that an audit manager on the engagement team knows that the entity is implementing a new payroll system during the fourth quarter of its fiscal year.
>
> They also know, from past audits, that the entity has previously given inappropriate access to users during system implementations, and didn't promptly revoke that access after implementation.

> Therefore, the engagement team may discuss the potential for a fraud risk in the current period over inappropriate access to the new payroll system implemented. This information may help the team discuss fraud risks in the current period that weren't fraud risks in the prior period.

What do we emphasize to all engagement team members during our fraud discussions? [ISA | 554.1700]

During our discussion of fraud risk, we stress to all engagement team members that throughout the audit we:

- maintain a questioning mind and exercise professional skepticism in gathering and evaluating evidence;
- remain alert for information or other conditions that might affect our assessment of fraud risks — e.g. contradictory or inconsistent evidence; and
- consider any contradictory or inconsistent information we identify by:
  - probing the issues;
  - obtaining additional evidence, as necessary; and
  - consulting with other team members and others in the firm — including specialists and/or specific team members, if appropriate.

Why do we consider contradictory or inconsistent information? [ISA | 554.11533]

Contradictory or inconsistent information identified during the audit may suggest other fraud risks that we haven't yet identified or, possibly, actual instances of fraud.

If we gather evidence that is inconsistent or seems to contradict our initial conclusions, we do not want to — nor is it appropriate for us to — brush it off or stop there.

To reach a conclusion about the matter, we probe, obtain additional evidence and involve others.

It is helpful to remind engagement team members of the matters that might affect our assessment of fraud risks.

Why do we set aside prior beliefs about management's honesty and integrity and maintain a questioning mind? [ISA | 554.1800]

Sometimes, we can develop a high degree of trust or confidence in management, which can have negative consequences. For example, we do not just accept management representations at face value but corroborate them and seek both confirming and disconfirming evidence.

Our goal is to approach our fraud discussion with the mindset that a material misstatement due to fraud could be present, regardless of our past experience with the entity and our belief about management's honesty and integrity.

In practice, this means that:

- we assume that management are neither honest nor dishonest; and
- we don't trust management blindly, or without gathering and objectively evaluating evidence, where appropriate.

We act with professional skepticism.

This questioning frame of mind allows us to carefully and objectively consider areas where there is potential for material misstatement due to fraud.

What do we focus on when discussing the risk of material misstatement from related party relationships and transactions? [ISA | 554.1900]

Our RAPD may include the following matters in relation to related party relationships and transactions.

- The nature and extent of the entity's relationships and transactions with related parties — using, for example, our record of identified related parties, which we update after each audit.
- An emphasis on maintaining professional skepticism throughout the audit about the potential for material misstatement from related party relationships and transactions.
- Entity-specific circumstances that may indicate related party relationships or transactions that management has not identified or disclosed to us — for example:
  - a complex organizational structure;
  - use of special-purpose entities for off-balance sheet transactions; or
  - an inadequate information system.
- Records or documents that may indicate related party relationships or transactions.
- The importance that management and those charged with governance attach to:
  - identifying, appropriately accounting for, and disclosing related party relationships and transactions (if the entity is subject to related party accounting and disclosure requirements); and
  - the related risk of management override of relevant controls.

Why do we discuss related party relationships and related party transactions? [ISA | 554.2000]

Transactions with related parties are common, but they may give rise to fraud risks. This is because related parties are not independent of each other. For example:

- special-purpose entities controlled by management might be used for earnings management; or
- transactions could be arranged between the entity and the business partner of a key member of management, to misappropriate the entity's assets.

Why do we discuss the risk of management override, and what do we discuss? [ISA | 554.2100]

We discuss risk of management override because:

- fraud can be perpetrated through override of management's controls; and
- this risk is present in all entities.

We put aside beliefs we have had in prior periods and discuss thoroughly where we believe the risk of management override may occur in the current period.

Entities operate in a dynamic environment, so significant changes may have occurred from prior periods, especially significant changes in the entity — e.g. new revenue streams, new management, or new pressures or incentives — that may change or elevate the risks of management override that existed in prior periods.

Why do we discuss our potential audit responses to fraud? [ISA | 554.2200]

Discussing our potential audit responses to fraud — including the nature, timing and extent of procedures — can help us better identify and assess fraud risks.

This discussion will also help us begin to formulate our audit plan, including detailed audit procedures to address these fraud risks.

1.3 Inquire regarding related parties [ISA | 4311]

What do we do?

Inquire of management, others and those charged with governance regarding related parties, relationships and transactions

Why do we do this?

To inform our identification and assessment of RMMs, we inquire of management, others, and those charged with governance regarding their knowledge of related parties, relationships and transactions.

Execute the Audit

Enhanced | How do we conduct related party inquiries? [ISA | 4311.1300]

We:

- identify individuals within the entity (other than management) who have relevant knowledge regarding related parties to make inquiries ;
- inquire of management and other individuals regarding related parties ; and
- inquire of those charged with governance regarding related parties .

When do we perform related party inquiries? [ISA | 4311.1400]

We perform our related party inquiries early in the audit and, when possible, in conjunction with other inquiries that inform our overall assessment of RMMs (see activity 'Inquire of those charged with governance, management and others about RMMs '). The information we receive from our general risk assessment inquiries can be leveraged for related party purposes.

> For example the following general risk assessment inquiries may also inform our related party inquiries regarding :
>
> - the entity's ownership and governance structures;
> - the types of investments that the entity is making and plans to make; and
> - the way the entity is structured and how it is financed.

We also update our inquiries to reflect any changes to related parties, relationships or transactions (see activity 'Make specific inquiries about subsequent events ') at the end of the audit during our subsequent event procedures.

Who makes the inquiries? [ISA | 4311.1600]

Inquiries are made by an engagement team member with the appropriate level of knowledge, experience and stature for both:

- the matter(s) we are inquiring about; and
- the person of whom we are inquiring.

> For example, we wouldn't ask a first-year associate to inquire of the audit committee chair or owner-manager. Similarly, if there is a going concern risk, then a more senior team member — e.g. the engagement partner — is likely the best person to inquire.

To the extent possible, we make inquiries in person - observing nonverbal communication can help us evaluate the inquiree's response.

If the applicable financial reporting framework does not establish related party disclosure requirements, do we still inquire? [ISA | 4311.14498]

Yes, we conduct inquiries even when the applicable financial reporting framework does not establish related party disclosure requirements.

If the applicable financial reporting framework does not require related party disclosures, there may be other RMMs our inquiries may identify.

> For example, our inquiries may identify RMMs regarding:
>
> - whether related party transactions have been appropriately accounted for (e.g. accounting reflects the substance of the transaction); or
> - whether additional disclosure of related party transactions is necessary for the financial statements to be presented fairly.

Are written representations a substitute for inquiries of management? [ISA | 4311.1700]

No, the written representations we receive regarding related parties are not a substitute for inquiries of management.

What are the implications if inquiry responses are unsatisfactory or contradictory? [ISA | 4311.1800]

When inquiries are unsatisfactory or contradictory, we may increase our assessment of the related RMMs and CAR. For example, if management cannot respond knowledgably to our inquiries and identify accurately or completely their related parties, relationships and transactions, it may be an indication that management does not have effectively designed and operating internal controls over related parties and/or there is a greater chance of a material misstatement occurring.

What do we do if management inquiry responses are unsatisfactory or contradictory? [ISA | 4311.14356]

When inquiries are contradictory or inconsistent with other information we've obtained, we perform additional procedures to resolve the matter and determine the effect on the audit (see activity 'If there are inconsistencies or doubts, modify or perform additional audit procedures and evaluate the effect on our audit '). In addition, as a part of evaluating the results of our audit, we conclude on whether we've obtained sufficient appropriate audit evidence (see activity 'Conclude on whether sufficient appropriate audit evidence has been obtained ').

1.3.1.E Enhanced | Identify individuals other than management to make related party inquiries [ISA | 4312]

What do we do?

Identify individuals other than management who are likely to have related party knowledge to inquire of regarding related parties

Why do we do this?

Inquiries inform our risk assessment procedures. Identifying others outside of management to inquire of regarding related party transactions may provide us with a more complete understanding of who is a related party and how they interact with the entity. These inquiries can also corroborate our management inquiries and may identify additional related parties that management is unaware of or did not disclose to us.

Execute the Audit

Enhanced | Who do we inquire of regarding related parties other than management and those charged with governance? [ISA | 4312.1300]

In addition to management and those charged with governance, we identify other individuals with relevant related party knowledge within the entity to inquire of regarding related parties.

Enhanced | How do we identify others with relevant related party knowledge (other than management and those charged with governance) to inquire of regarding related parties? [ISA | 4312.1400]

We consider whether there are individuals (other than management and those charged with governance) that are likely to have knowledge regarding:

- The entity's related parties, relationships or transactions;
- The entity's controls over related party relationships or transactions; and
- The existence of related parties, relationships or transactions previously undisclosed to the auditor.

These individuals may be in a position to initiate, process, or record transactions with related parties or supervise such personnel.

> For example, the following individuals may have relevant related party knowledge:
>
> - internal auditors;
> - in-house legal counsel;
> - the chief compliance/ethics officer or person in equivalent position; and
> - the human resources director or person in equivalent position.

Enhanced | When do we identify other individuals with relevant related party knowledge (other than management and those charged with governance) to inquire of regarding related parties? [ISA | 4312.1500]

We identify other individuals with relevant related party knowledge before or as we conduct our inquiries of management and those charged with governance. Our inquiries inform our risk assessment and are best completed early in the audit.

1.3.2.C Core and Less Complex | Inquire of management regarding related parties [ISA | 4584]

What do we do?

Inquire of management regarding related parties, related party relationships and transactions

Why do we do this?

Management is responsible for the preparation of the financial statements, including related party transactions and relevant disclosures. Our inquiries of them regarding related parties, relationships and transactions inform our risk assessment and provides a basis for determining if there are related parties, relationships or transactions that management is not aware of or did not disclose to us.

Execute the Audit

Core and Less Complex | What related party inquiries do we make of management? [ISA | 4584.1300]

We inquire of management about related parties and the entity's relationship with those related parties, including:

- The names of the entity's related parties during the period under audit, including changes from the prior period;
- The nature of the relationships between the entity and these related parties; and
- Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

How do we leverage the information we obtained from prior year inquiries and audit procedures? [ISA | 4584.1400]

Our current year inquiries focus on understanding the related parties, relationships and transactions in the current period. Our prior year understanding of related parties, relationships and transactions can provide a preliminary understanding of related parties; however, not all relevant information can be derived from the prior year.

If we receive a list of related parties, relationships and transactions from management, do we still inquire? [ISA | 4584.1500]

Yes. While a list from management is helpful to summarize related party information, inquiry is one of the ways we exercise professional skepticism and helps us make an informed risk assessment. Inquiry allows us to ask probing questions that clarify and inform our risk assessment, such as, when we seek to understand the business purpose of related party arrangements or why transactions changed from the prior year. Additionally, management may disclose other relevant or sensitive information when we speak to them that may not be disclosed in their written correspondence.

What might a lack of business purpose in a related party transaction mean? [ISA | 4584.1800]

When a transaction lacks a clear business purpose, it may be representative of an RMM.

Lacking a business purpose relates to an entity engaging in transactions where it is unclear what the commercial rationale for the transaction is - i.e., we ask the question "Why did they enter into this transaction?".

The question "why" may arise when:

- the terms of the transaction have no real commercial basis, or
- there is no clear reason why the entity entered into the transaction (e.g., an entity buying an asset at market value that is completely unrelated to their operations, business model or business strategy).

Lack of business purpose may be indicative that the accounting outcome does not reflect the substance of the transaction or that related parties are being used to perpetrate fraudulent financial reporting or misappropriation of assets.

What can we learn from inquiries about modified or terminated related party transactions? [ISA | 4584.1600]

The nature and circumstances of modified or cancelled transactions inform our understanding of the business purpose of completed transactions and ultimately our risk assessment. We think about:

- who requested the modification/termination;
- the business purpose of the modified terms and the termination; and
- whether terminated transaction were re-initiated under different terms and the business purpose of those terms.

What might be the impact of related party transactions that are unauthorized/unapproved within the established policies/procedures? [ISA | 4584.1700]

Related party transactions that are unauthorized/unapproved within the established policies/procedures may be representative of:

- an internal control deficiency;
- override of internal controls;
- dominant influence of a related party;
- fraud; or
- non-compliance (for example, if the policy was in response to legal or regulatory restrictions).

With our inquiries, we seek to understand the rationale for the entity's policy/procedures and reason for the exception identified. We then use that information to determine whether it effects our assessment of RMMs and planned procedures. Identifying an unauthorized/unapproved related party transaction will impact the nature, timing and/or extent of our planned procedures.

Examples

Core and Less Complex | What inquiries of management might we make regarding related parties? [ISA | 4584.1900]

The table below sets out examples of questions we may ask management, responses we may receive and how we might evaluate those responses during risk assessment. We may ask these questions while we are obtaining our understanding of management's process.

Question asked	Response received	Evaluation of response
How does management identify related parties and have there been any changes to related parties from the previous year?	When the entity enters into new contracts, the legal department, does a background check of the party to the contract and its ownership, etc. If the party is identified as a related party, the legal department adds the name to the related party register.	We may plan to make related party inquiries with the legal department as they have an instrumental role in the identification of related parties. We may make further inquiries of the processes in place that prompt others to notify the legal department of new related parties or relationships.
What transactions do you enter into with related parties? And what's the business purpose of those transactions?	The entity is a fashion retailer and the majority of products sold are sourced from the parent company which is based in another country. The board has authorized these transactions because the entity sells the product on cost-plus basis.	We ask to inspect the board minutes which authorize transactions with the related parties. We may also ask follow up questions, such as: • have any transactions with related parties been modified or canceled? • have any transactions that have occurred not been on standard pricing and terms? • And if so, have they been appropriately authorized? • And if there were any exceptions, why? Lastly, we may follow up by asking management if they are aware of any other transaction with related parties as they may have focused first on the most common types of transactions.

1.3.2.E Enhanced | Inquire of management and other individuals regarding related parties [ISA | 4313]

What do we do?

Inquire of management and other individuals identified regarding related parties, relationships and transactions

Why do we do this?

Management is responsible for the preparation of the financial statements, including related party transactions and relevant disclosures. Our inquiries of management and other individuals that may have relevant knowledge regarding related parties, relationships and transactions inform our risk assessment and provides a basis for determining if there are related parties, relationships or transactions that management is not aware of or did not disclose to us.

Execute the Audit

Enhanced | What inquiries do we make of management and others with relevant related party knowledge? [ISA | 4313.1300]

We pursue two lines of inquiry with management. First, we inquire regarding related parties and the entity's relationship with those related parties, including:

- The names of the entity's related parties during the period under audit, including changes from the prior period;
- Background information concerning the related parties (for example, physical location, industry, size, and extent of operations);
- The nature of any relationships, including ownership structure, between the entity and its related parties.

Secondly, we inquire regarding the nature of transactions between the entity and related parties, including:

- The transactions entered into, modified, or terminated, with related parties during the period under audit and the terms and business purposes (or the lack thereof) of such transactions;
- The business purpose for entering into a transaction with a related party versus an unrelated party;
- Whether any related party transactions have not been authorized and approved in accordance with the entity's established policies or procedures regarding the authorization and approval of transactions with related parties; and
- Whether any related party transactions for which exceptions to the entity's established policies or procedures were granted and the reasons for granting those exceptions.

For individuals (other than management and those charged with governance) with relevant related party knowledge, we determine which inquiries are relevant to make based on the role and relevant knowledge of the individual.

> For example, if under the auditing and accounting framework, management and their immediate family members are considered related parties, the engagement team may inquire of the human resources director (or equivalent position) regarding the names of management and for additional background information regarding immediate family members. However, the engagement team may determine that knowledge of transactions with management that were exceptions to

policies and procedures are not relevant knowledge to the human resource director's role and, accordingly, may choose not to inquire regarding that information.

It may be helpful to make inquiries regarding related parties in conjunction with our walkthrough of relevant business processes for identifying, authorizing/approving, accounting for and disclosing related parties, relationships, transactions and arrangements, as applicable.

How do we leverage the information we obtained from prior year inquiries and audit procedures? [ISA | 4313.1400]

Our current year inquiries focus on understanding the related parties, relationships and transactions in the current period. Our prior year understanding of related parties, relationships and transactions can provide a preliminary understanding of related parties; however, not all relevant information can be derived from the prior year.

If we receive a list of related parties, relationships and transactions from management, do we still inquire? [ISA | 4313.1500]

Yes. While a list from management is helpful to summarize related party information, inquiry is one of the ways we exercise professional skepticism and helps us make an informed risk assessment. Inquiry allows us to ask probing questions that clarify and inform our risk assessment, such as, when we seek to understand the business purpose of related party arrangements or why transactions changed from the prior year. Additionally, management may disclose other relevant or sensitive information when we speak to them that may not be disclosed in their written correspondence.

What might a lack of business purpose in a related party transaction mean? [ISA | 4313.1800]

When a transaction lacks a clear business purpose, it may be representative of an RMM.

Lacking a business purpose relates to an entity engaging in transactions where it is unclear what the commercial rationale for the transaction is - i.e., we ask the question "Why did they enter into this transaction?".

The question "why" may arise when:

- the terms of the transaction have no real commercial basis, or
- there is no clear reason why the entity entered into the transaction (e.g., an entity buying an asset at market value that is completely unrelated to their operations, business model or business strategy).

Lack of business purpose may be indicative that the accounting outcome does not reflect the substance of the transaction or that related parties are being used to perpetrate fraudulent financial reporting or misappropriation of assets.

What can we learn from inquiries about modified or terminated related party transactions? [ISA | 4313.1600]

The nature and circumstances of modified or cancelled transactions inform our understanding of the business purpose of completed transactions and ultimately our risk assessment. We think about:

- who requested the modification/termination;
- the business purpose of the modified terms and the termination; and

- whether terminated transaction were re-initiated under different terms and the business purpose of those terms.

What might be the impact of related party transactions that are unauthorized/unapproved within the established policies/procedures? [ISA | 4313.1700]

Related party transactions that are unauthorized/unapproved within the established policies/procedures may be representative of:

- an internal control deficiency;
- override of internal controls;
- dominant influence of a related party;
- fraud; or
- non-compliance (for example, if the policy was in response to legal or regulatory restrictions).

With our inquiries, we seek to understand the rationale for the entity's policy/procedures and reason for the exception identified. We then use that information to determine whether it effects our assessment of RMMs and planned procedures. Identifying an unauthorized/unapproved related party transaction will impact the nature, timing and/or extent of our planned procedures.

Examples

Enhanced | What inquiries of management and other individuals might we make regarding related parties? [ISA | 4313.2000]

The table below sets out examples of questions we may ask (typically in conjunction with our walkthrough of management's process), responses we may receive and how we might evaluate those responses.

Inquiry of	Question asked	Response received	Evaluation of response
Management	How does management identify related parties and have there been any changes to related parties from the previous year?	When the entity enters into new contracts, the legal department does a background check of the party to the contract and its ownership, etc. If the party is identified as a related party, the legal department adds the name to the related party register.	We plan to make related party inquiries with the legal department as they have an instrumental role in the identification of related parties. We make further inquiries of the processes in place that prompt others to notify the legal department of new related parties or relationships.

Head of Legal	How do you identify new related parties and have there been any changes to related parties from the previous year?	The entity reviews and compares changes to the shareholder register quarterly and all new contracts to determine if there are new related parties. There have been two new related parties added to the related party register since the previous year.	We ask to inspect the related party register. We make further inquiries regarding: • understanding background information and the nature of the entity's relationship with the two new related parties; and • confirming that there are no other changes regarding background information and the nature of relationships with known related parties from the previous year.
Management	What transactions do you enter into with related parties? And what's the business purpose of those transactions?	The entity is a fashion retailer and the majority of products sold are sourced from the parent company which is based in another country. The board has authorized these transactions because the entity sells the product on cost-plus basis.	We ask to inspect the board minutes which authorize transactions with the related party. We may also ask follow up questions, such as: • have any transactions with related parties been modified or canceled? • have any transactions not been conducted at standard pricing and terms? • if so, have they been appropriately authorized? • if there were any exceptions, why? Lastly, we may follow up by asking management

			if they are aware of any other transaction with related parties as they may have focused first on the most common or significant types of transactions.

1.3.3 Enhanced | Inquire of those charged with governance regarding related parties [ISA | 4314]

What do we do?

Inquire of those charged with governance regarding related parties.

Why do we do this?

Making inquiries with those charged with governance helps us to identify factors that are relevant to our assessment of RMMs and corroborate our management inquiries. It also provides an opportunity to discuss related party information that might be too sensitive to inquire of management.

Execute the Audit

Enhanced | What related party inquiries do we make of those charged with governance? [ISA | 4314.1300]

We inquire of those charged with governance regarding:

- their understanding of the entity's relationships and transactions with related parties that are significant to the entity; and
- whether any member of those charged with governance has concerns regarding relationships or transactions with related parties and, if so, the substance of those concerns.

Enhanced | Who within those charged with governance do we inquire of? [ISA | 4314.1400]

We direct these inquiries to those that we have determined it appropriate to direct our audit communications (see activity 'Determine who those charged with governance are ').

Enhanced | What if a significant related party transaction involves a member of those charged with governance? [ISA | 4314.1600]

We may consider speaking to other members of those charged with governance privately regarding a significant related party transaction that another member is involved with so that we create an environment where individuals can speak freely and express their concerns.

Examples

Enhanced | What inquiries of those charged with governance might we make regarding related parties? [ISA | 4314.1700]

The table below sets out examples of questions we may ask, responses we may receive and how we might evaluate those responses during risk assessment.

Inquiry of	Question asked	Response received	Evaluation of response
Those Charged with Governance	What relationships or transactions with related parties do you consider significant to entity and to financial reporting?	We are primarily concerned with management's compensation arrangements, including variable compensation based on achieving performance benchmarks. (Management is a related party under the applicable financial reporting framework)	We make further inquiries to understand: • the structure of managements variable compensation; • how achievement of benchmarks will be measured; • how achievement might be fraudulently accomplished. Lastly, we may follow up by asking those charged with governance if there are other transactions or relationships they consider significant as they may have focused first on the most significant.
Those Charged with Governance	Are there any relationships or transactions with related parties that you have concerns with?	We keep a close eye on transactions with the former President and founder of the entity. Because of her close relationships with management, transactions with this individual are approved by the Board.	It appears those charged with governance see a heightened risk in transactions and arrangement with the founder of the entity. Although retired, this related party may have the opportunity to exercise dominant influence and override internal controls as founder of the entity. We will use this information in identifying

			and assessing RMMs regarding related parties.

1.4 Obtain an understanding of related party processes and process control activities [ISA | 4310]

What do we do?

Obtain an understanding of processes and controls for related party relationships, transactions, and arrangements

Why do we do this?

Obtaining an understanding of related party processes and controls is an extension of our responsibilities to obtain an understanding of internal controls relevant to financial reporting. Additionally, it may be difficult for us to obtain sufficient appropriate evidence that all related parties, relationships, and transactions have been identified, accounted for and disclosed without appropriately designed controls.

Execute the Audit

Which related party processes and process control activities do we obtain an understanding of? [ISA | 4310.1300]

We obtain an understanding of related party processes and process control activities that:

- identify all related parties, relationships and transactions,
- authorize and approve significant related party transactions and arrangements; and
- account for and disclose all related party relationships and transactions in the financial statements.

What are authorization controls? [ISA | 4310.14410]

Authorization involves the granting of permission by a party or parties with the appropriate authority (whether management, those charged with governance or the entity's shareholders) for the entity to enter into specific transactions in accordance with pre-determined criteria, whether judgmental or not.

What are approval controls? [ISA | 4310.14411]

Approval involves those parties' acceptance of the transactions the entity has entered into as having satisfied the criteria on which authorization was granted.

What if the entity does not transact with related parties during the audit period? [ISA | 4310.1900]

Regardless of whether the entity transacts with its related parties, we obtain an understanding of processes and process control activities to identify all related parties, relationships and transactions, and evaluate the design and implementation of relevant controls.

However, if the entity did not transact with its related parties during the period, we do not obtain an understanding of process and process control activities or evaluate the design and implementation of process control activities to authorize/approve, account for or disclose arrangements and transactions.

Our understanding of these attributes may consist of our knowledge of how the entity previously transacted with its related parties and an overview of any known transactional processes and controls in place.

When an entity does not have defined processes or process control activities for related party arrangements/transactions and no related party transactions have occurred in the audit period, we do not consider it a control deficiency. Similarly, if an entity does not have defined processes or process control activities for substantiating an arm's length assertion in the financial statements (see activity 'Evaluate management's arm's length assertion for related party transactions'), we do not consider it a control deficiency if the entity has not made such an assertion in the financial statements. However, we expect that an entity will have appropriate processes and process control activities at the time that these arrangements and transactions do occur or when they make an arm's length assertion.

Enhanced | How do we obtain an understanding of related party processes and process control activities? [ISA | 4310.2000]

We obtain an understanding of related party processes and process control activities in a very similar manner to how we obtain an understanding of process control activities in other financial reporting processes.

However, obtaining an understanding of related party processes and process control activities differs from our approach in other financial reporting processes, in that, we perform appropriate procedures, which includes conducting a walkthrough (see activity 'Perform a walkthrough to understand the business processes' for further information about walkthroughs), and evaluate the design and implementation of process control activities regardless of whether we have:

- assessed the risk as an RM or an RMM;
- assessed an RMM as a significant risk; or
- designed a controls-based approach for the RMM.

We do this to assess the risks of material misstatement and design further audit procedures (see activity 'Understand control activities') for related parties. Our understanding of CERAMIC may also help us assess the risks of material misstatement associated with related parties.

How may our understanding of CERAMIC help us assess risks of material misstatement associated with related parties? [ISA | 4310.14496]

Depending upon the nature and complexity of the entity, there may be features of the control environment that address the entity's 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.

When these features are absent, there may be an increased risk associated with related parties.

Enhanced | How do we perform a walkthrough of related party processes and process control activities? [ISA | 4310.14389]

Obtaining an understanding of related party processes and process control activities involves performing a walkthrough of the entity's processes and process control activities for identifying related parties, relationships and transactions. Then, if arrangements or transactions have occurred in the period, we perform walkthrough(s) of processes and process control activities for related party transactions and arrangements regarding how they are identified, accounted for and disclosed in the financial statements.

Understanding how related party arrangements and transactions are 'accounted for' does not involve understanding the business processes for how those transactions are initiated, processed and recorded. 'Accounted for' is similar to how we understand the financial reporting process which addresses, among other elements, how transactions are entered into the general ledger, accounting principles and policies are applied, and preparation of financial statements. When obtaining this understanding for related party transactions, we are focused on whether the presence of a related party impacts the substance of that transaction and how it is accounted for or disclosed. Additionally, if the entity discloses that a transaction was conducted at arms-length, we are also interested in the determination of whether transactions were conducted on terms equivalent to those prevailing in arm's-length transactions.

For example, if a board member of the entity is also the owner of a supplier, then the supplier is a related party. In this context 'accounted for' would not mean that we test the design and implementation of controls over the purchasing process (e.g. how raw material purchases are initiated, processed and recorded). Instead, it means we would test design and implementation of controls for:

- how the complete population of related party purchases are identified for preparation of the financial statements;
- whether the accounting policies applied to purchases continue to be appropriate with the presence of a related party in the transaction (e.g. when a purchase is recognized);
- whether the entity had made an assertion that the transactions were conducted at terms equivalent to those made at arm's length; and
- the appropriateness of any other relevant disclosures in the financial statements.

Our walkthrough of the entity's process for identifying related parties, relationships and transactions may be more like our walkthrough of the financial reporting process (see activity 'Understand the period-end financial reporting process') where we do not necessarily follow a single transaction from initiation to the recording of the transaction. Instead of following one single related party transaction, we focus on the process and process control activities management has in place for identifying related parties, relationships and transactions broadly.

Once we have an understanding of:

- how the entity identifies related parties, relationships and transactions and
- what related parties, relationships and transactions that management has identified;

we can identify relevant business processes in which related party transactions and arrangements are authorized/approved, as well as the financial reporting process in which they are accounted for and disclosed and perform walkthroughs of those elements of the processes.

Related party processes and process control activities may overlap with CERAMIC or other financial statement processes (for example, procurement processes). If we will refer to or combine our documentation of related party processes with other processes, it is best to use specific referencing to identify the related party considerations.

Core and Less Complex | How do we obtain an understanding of related party processes and process control activities? [ISA | 4310.2001]

We obtain an understanding of related party processes and process control activities in a very similar manner to how we obtain an understanding of process control activities in other financial reporting processes (see question 'How do we obtain an understanding of business processes and the financial reporting process?' for further information about understanding of processes).

However, obtaining an understanding of related party processes and process control activities differs from our approach in other financial reporting processes, in that, we perform appropriate procedures, which may include conducting a walkthrough, and evaluate the design and implementation of process control activities regardless of whether we have:

- assessed the risk as an RM or an RMM;
- assessed an RMM as a significant risk; or
- designed a controls-based approach for the RMM.

We do this to assess the risks of material misstatement and design further audit procedures (see activity 'Understand control activities'). Our understanding of CERAMIC may also help us assess the risks of material misstatement associated with related parties.

How may our understanding of CERAMIC help us assess risks of material misstatement associated with related parties? [ISA | 4310.8632]

Depending upon the nature and complexity of the entity, there may be features of the control environment that address the entity's 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.

When these features are absent, there may be an increased risk associated with related parties.

Core and Less Complex | How do we perform our understanding of related party processes and process control activities? [ISA | 4310.8694]

Obtaining an understanding of related party processes and process control activities involves either performing (i) a walkthrough or (ii) inquiry and observation or inspection of the entity's processes and process control activities for identifying related parties, relationships and transactions. Then, if arrangements or transactions have occurred in the period, we understand the processes and process control activities for related party transactions and arrangements regarding how they are identified, accounted for and disclosed in the financial statements by either performing (i) a walkthrough or (ii) through inquiry and observation or inspection.

Understanding how related party arrangements and transactions are 'accounted for' does not involve understanding the business processes for how those transactions are initiated, processed and recorded. 'Accounted for' is similar to how we understand the financial reporting process which addresses, among other elements, how transactions are entered into the general ledger, accounting principles and policies are applied, and preparation of financial statements. When obtaining this understanding for related party transactions, we are focused on whether the presence of a related party impacts the substance of that transaction and how it is accounted for or disclosed. Additionally, if the entity discloses that a transaction was conducted at arms-length, we are also interested in the determination of whether transactions were conducted on terms equivalent to those prevailing in arm's-length transactions.

For example, if a board member of the entity is also the owner of a supplier, then the supplier is a related party. In this context 'accounted for' does not mean that we test the design and implementation of process control activities over the purchasing process (e.g. how raw material purchases are initiated, processed and recorded). Instead, it means we test design and implementation of process control activities for:

- how the complete population of related party purchases are identified for preparation of the financial statements;
- whether the accounting policies applied to purchases continue to be appropriate with the presence of a related party in the transaction (e.g. when a purchase is recognized);

- whether the entity had made an assertion that the transactions were conducted at terms equivalent to those made at arm's length; and
- the appropriateness of any other relevant disclosures in the financial statements.

Our walkthrough of the entity's process for identifying related parties, relationships and transactions may be more like our walkthrough of the financial reporting process (see activity 'Understand the period-end financial reporting process') where we do not necessarily follow a single transaction from initiation to the recording of the transaction. Instead of following one single related party transaction, we focus on the process and process control activities management has in place for identifying related parties, relationships and transactions broadly.

Once we have an understanding of:

- how the entity identifies related parties, relationships and transactions and
- what related parties, relationships and transactions that management has identified;

we can identify relevant business processes in which related party transactions and arrangements are authorized/approved, as well as the financial reporting process in which they are accounted for and disclosed and perform walkthroughs of those elements of the processes.

Related party processes and process control activities may overlap with CERAMIC or other financial statement processes (for example, procurement processes). If we will refer to or combine our documentation of related party processes with other processes, it is best to use specific referencing to identify the related party considerations.

Do we identify process risk points and evaluate the design and implementation of related party process control activities? [ISA | 4310.8633]

Yes. We evaluate the design and implementation of process control activities (see activity 'Evaluate the design and implementation of relevant process control activities') that address those process risk points that relate to the risk that the entity may not identify all related parties, relationships and transactions.

When related party arrangements and transactions have occurred in the period, we also evaluate the design and implementation of process control activities that address process risk points that relate to risks that the entity may not authorize and approve significant related party transactions and arrangements and may not account for and disclose related party relationships and transactions appropriately.

For related party risks and process risk points, we evaluate design and implementation of process control activities regardless of whether we have:

- assessed the risk as an RM or a RMM;
- assessed an RMM as a significant risk; or
- designed a controls approach for the RMM.

In assessing the design of process control activities, we consider events and conditions identified when obtaining our understanding of the entity and its environment.

For example, if we are aware that financing arrangements restrict the entity from making loans/advances to related parties under certain conditions, we consider these conditions in evaluating whether process control activities are designed appropriately for authorizing and approving arrangements and transactions with related parties.

When do we obtain an understanding of related party processes and process control activities? [ISA | 4310.14391]

We obtain an initial understanding of related party processes and process control activities early in the audit (i.e. during our risk assessment procedures) when we are understanding the entity's other processes and process control activities (see activities 'Understand control activities' and 'Understand the period-end financial reporting process' for further information on when we obtain an understanding of other processes and controls). Related party processes and process control activities may overlap with other business and accounting processes and we may be able to leverage the information obtained for both purposes. Knowing whether process control activities are designed appropriately also helps us plan other audit procedures, such as, determining whether we will test the operating effectiveness of those controls to reduce the extent of substantive audit procedures we perform.

What is the difference between an arrangement and a transaction with a related party? [ISA | 4310.14393]

A related party arrangement may be captured by a contractual agreement or legal structure, but does not necessarily mean that a financial transaction has occurred (and is accounted for in the financial statements).

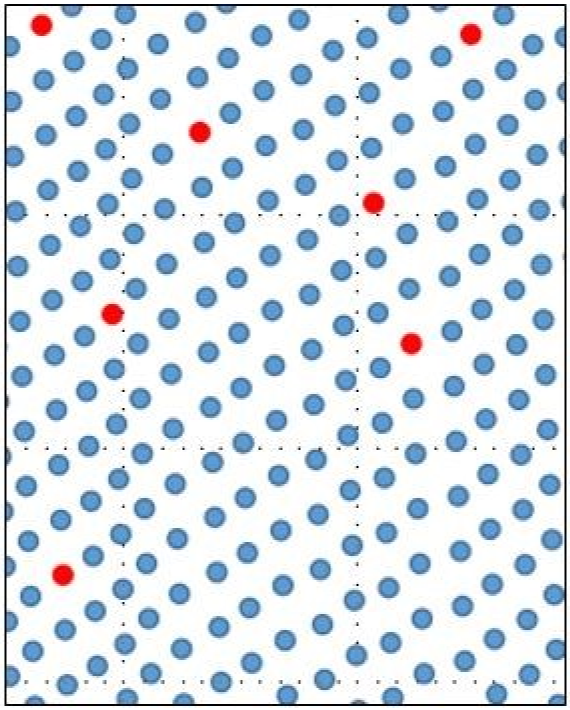
> For example, when a related party guarantees a loan of the entity, there is an arrangement with the related party, but there may not be a financial transaction that has occurred.

What is the impact on our audit if the entity does not have effective or appropriately designed related party processes and process control activities? [ISA | 4310.14394]

When an entity does not have effective or appropriately designed related party processes and process control activities, we may not be able to determine that:

- all related parties and transactions with these parties have been identified by management; and
- that related party transactions and relationships have been appropriately accounted for and disclosed.

For example, in the graphic below, imagine the dots represent all the entity's transactions and the red dots represent transactions with related parties. We ask ourselves whether management can identify the red dots from the blue dots completely and accurately without appropriately designed and effectively operating process control activities. And if they can't identify them, how does management know that they have been appropriately accounted for and disclosed?



When the related party controls are ineffective or non-existent, it can impact our ability to obtain sufficient appropriate audit evidence about related party relationships and transactions.

How does the size and complexity of the entity effect on related party processes and controls? [ISA | 4310.14464]

Large and complex entities may interact with thousands of parties and conduct millions of different types of transactions. Without effective processes and controls it may be difficult for management to identify all related parties, relationships and transactions accurately and completely. Likewise, it may also be difficult for us to obtain sufficient and appropriate audit evidence regarding the completeness of related party relationships and transactions through substantive procedures alone.

For entities with simple structures, transactions and/or a small number of employees, we may be able to obtain sufficient appropriate evidence, including completeness, through substantive procedures alone.

How does the applicable financial reporting framework impact related party processes and controls? [ISA | 4310.14465]

Where the applicable financial reporting framework specifies related party requirements, it is likely that management has designed and implemented processes and controls to enable the preparation of the financial statements. This stems from their responsibility to have internal controls to enable the preparation of the financial statements free from material misstatement.

However, if the applicable financial reporting framework does not have specific related party requirements, processes and controls may not exist and/or be ineffective in preventing material misstatement in the financial statements.

What do we think about in determining whether we group related party transactions together? [ISA | 4310.14399]

When we think about whether to group related party transactions together when performing our risk assessment, control testing, and substantive testing, we think about the following factors:

Factor	What we think about
Processes and controls	When related party transactions have different processes and controls it may be more appropriate to consider these transactions separately, despite the fact that they are transacted with the same related party. Otherwise, we may miss key aspects that impact our audit approach.
Aggregation in the financial statement presentation	When related party transactions are aggregated in the financial statement presentation, it may be appropriate to group them together. However, when amounts are disclosed separately, we think about whether they have a different risk assessment and whether our audit procedures are appropriate. For example, if we were to sample the grouped transactions, it might not be an appropriate audit procedure if the transactions are not aggregated together in the financial statements.
Different transaction terms or parties	If we group transactions together that have different terms or related parties associated with them, we think about whether our designed audit response is appropriate. For example, if contractual terms are not standardized with related parties, it may not be appropriate to read only one contract. We may read several contracts to understand the varying terms in order to determine if they impact how the transactions are accounted for and disclosed. There are similar considerations when the transactions are conducted with different related parties.
Other risk assessment factors	When related party transactions have different risk assessments (including CAR) associated with them, it may not be appropriate to group them together. Doing so may compromise designing an appropriate audit response. If, in rare instances, we do group related party transactions together with different risk assessments, we use the highest risk assessment for all transactions in designing our audit response.

Examples

In obtaining an understanding of related party processes and process control activities, what are some examples of related party RMMs, PRPs, and process control activities? [ISA | 4310.2100]

The table below illustrates examples of related party RMMs, PRPs and process control activities:

RMM(s)	PRP(s)	Example process control activities

(1) The identification of related parties and relationships and transactions with related parties is incomplete. (2) The disclosures of relationships and transactions with related parties are omitted.	New related parties and new or changed relationships and transactions with related parties are not identified	Internal audit review of transactions for unknown related parties, relationships, and transactions
		Periodic review of related party register maintained by management for completeness
		Annual related party disclosure survey completed by those charged with governance and addressed by management
(1) The accounting for transactions with related parties is inaccurate or incomplete. (2) The disclosures of relationships and transactions with related parties are omitted.	Related party transactions and arrangements are not authorized and approved in accordance with internal policies	Policies and procedures for related party arrangement and transaction approval, including consideration of actual or perceived conflicts of interest
		Internal audit review of authorization and approval of related party transactions with relevant policies, including substantiating the business purpose of the transactions
		Segregation of duties between initiating and approving related party transactions and arrangements

		Dual signature authorization of related party transactions
		Those charged with governance/ shareholder approval and other due diligence procedures for significant transactions with related parties outside the normal course of business
(1) The accounting for transactions with related parties is inaccurate or incomplete. (2) The disclosure of relationships and transactions with related parties are inaccurate, incomplete or not fairly presented. (3) The disclosures of relationships and transactions with related parties are omitted.	Related party relationships and processes are not accounted for and disclosed in the financial statements appropriately	Internal audit review of accounting for and disclosure of related party transactions
		Annual related party disclosure survey completed by those charged with governance and addressed by management
		Reconciliation of related party disclosures to supporting documentation, including evidence of arm's length transactions
(1) Related party transactions were not conducted on terms equivalent to those prevailing in arm's-length transactions	There is no sufficient evidence to substantiate that a transaction was arm's length as disclosed in the financial statements	Reconciliation of related party disclosures to supporting documentation, including evidence of arm's length transactions

despite disclosures stating they were.		

1.5 Communicate to the engagement team relevant information regarding related parties [ISA | 4315]

What do we do?

Communicate to the engagement team information regarding related parties, relationships and transactions

Why do we do this?

We communicate information about related parties amongst the engagement team so that the engagement team can participate in identifying and understanding associated RMMs and can be alert to and identify related party information that management has not disclosed to us.

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What information do we communicate to the engagement team about related parties? [ISA | 4315.1300]

We communicate to the engagement team:

- the names of the related parties; and
- the nature of the entity's relationships and transactions with those related parties

that we are aware of and management has disclosed to us.

In addition to the information we always communicate, we determine if there is any other relevant information to communicate to the engagement team.

For example, we may determine to communicate more detailed information if the transactions:

- are quantitatively significant (for example, they are a large amount);
- are qualitatively significant (for example, management or those charged with governance are financially involved with the transaction); or
- they involve a complex arrangement with multiple parties, including multiple related parties.

What is an example of our communications to the engagement team regarding related parties?

			Optional information:
Name	Relationship	Transactions	Other relevant information
Related Party 1 (RP1)	Supplier to group entity	Group entity purchases all raw material from RP1	Transactions are disclosed in the financial statements

	CEO has significant influence		occurring on terms equivalent to those prevailing in an arm's-length transaction
Related Party 2 (RP2)	Financier (senior debt)/ Entity also hold 45% equity holder in the group entity (significant influence)	Financing/ No interest payments	New transaction executed in current period is accounted for as debt. Significant risk identified in connection with whether the substance of the transaction has been accounted for in accordance with the applicable financial reporting framework (e.g. whether the entity is financially capable of repaying the debt or whether the transaction is in substance a capital contribution).

What related parties do we communicate? [ISA | 4315.14461]

We communicate all related parties as defined under the applicable financial reporting framework (and, at times, as defined by the applicable auditing standard).

US GAAP and IFRS are common applicable financial reporting frameworks that define who or what is a related parties. When we use these definitions, we consider all aspects of the definition in our risk assessment procedures and identification of related parties.

> For example, under US GAAP, we identify immediate family members of principal owners and management (which includes the board of directors) as these are related parties per ASC 850-10-20.

See question 'How do we know what or who is a 'related party'? ' for further information how we identify the definition of a related party.

Enhanced | When is relevant information regarding related parties communicated amongst the engagement team? [ISA | 4315.1500]

We communicate relevant information during or before the Risk Assessment and Planning Discussion (RAPD). This is because related party information is relevant to the engagement team's discussion of the susceptibility of the financial statements to material misstatement due to fraud and error (see activity 'Discuss matters affecting the identification and assessment of RMMs among the engagement team ').

Communications regarding related parties continue to be updated throughout the audit to the engagement team on a real time basis when new parties, relationships or transactions are identified. We may identify one person on the engagement team as being responsible for making these updated communications. Further, it may be helpful to have a list of relevant related party information that engagement team members can reference throughout the audit as they perform audit procedures and remain alert for additional related parties that management has not disclosed to us.

The Risk and Audit Quality Assessment (RAQA) meeting conducted at the end of the audit is also a time for the engagement team to reflect on changes to relevant information about related parties. We think about what we know about the entity and its related parties, the results of our procedures, and what this tells us about the sufficiency and appropriateness of evidence we have accumulated (see activity 'Hold a RAQA meeting and document the details ' for further information).

Enhanced | How do we communicate related party information to the engagement team at the RAPD?

Communication of related party information during the RAPD is most effective when the engagement team can refer to a list of related parties and other relevant information that facilitates their discussion of RMMs. So simply adding an agenda item to the RAPD meeting agenda may not be sufficient to effectively communicate related party information amongst the engagement team.

Core and Less Complex | When is relevant information regarding related parties communicated amongst the engagement team? [ISA | 4315.1501]

We communicate relevant information during or before the Risk Assessment and Planning Discussion (RAPD). This is because related party information is relevant to the engagement team's discussion of the susceptibility of the financial statements to material misstatement due to fraud and error (see activity 'Discuss matters affecting the identification and assessment of RMMs among the engagement team ').

Communications regarding related parties continue to be updated throughout the audit to the engagement team on a real time basis when new parties, relationships or transactions are identified. We may identify one person on the engagement team as being responsible for making these updated communications. Further, it may be helpful to have a list of relevant related party information that engagement team members can reference throughout the audit as they perform audit procedures and remain alert for additional related parties that management has not disclosed to us.

How do we communicate related party information to the engagement team at the RAPD? [ISA | 4315.1601]

Communication of related party information during the RAPD is most effective when the engagement team can refer to a list of related parties and other relevant information that facilitates their discussion of RMMs. So simply adding an agenda item to the RAPD meeting agenda may not be sufficient to effectively communicate related party information amongst the engagement team.

What do we do if we identify an undisclosed related party or significant related party relationship or significant transaction? [ISA | 4315.1700]

We:

- inquire of management (step 1);
- evaluate why the related party information was undisclosed to us (step 2);
- perform additional procedures to identify other undisclosed related party information, when relevant (step 3);
- communicate the undisclosed related party information to the engagement team and, if relevant, component auditors (step 4);
- perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions (step 5);
- determine whether there are any other implications on our audit (step 6).

1.6 Evaluate whether all related parties, relationships and transactions have been identified

[ISA | 4325]

What do we do?

Inspect documents and evaluate whether the entity has properly identified related parties, relationships and transactions AND IF we identify indicators of undisclosed related parties, relationships and transactions, THEN perform procedures to determine whether they exist and are undisclosed.

Why do we do this?

Management may not be able to prepare the financial statements free from material misstatement if they do not have a complete and accurate understanding of related parties, relationships and transactions. We evaluate whether our and management's identification is complete and accurate and perform procedures to address any indicators which might suggest the existence of a related party, relationship or transaction that management has not disclosed to us.

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What are our responsibilities regarding identifying undisclosed related party relationships and transactions? [ISA | 4325.1300]

Our responsibilities are to

- remain alert during the audit when inspecting records or documents for information that may indicate the existence of related parties, relationships or transactions not disclosed to us; and
- evaluate whether the entity has identified its related parties and relationships and transactions with related parties.

> For example, when inspecting contracts and other documents regarding a significant transaction, we remain alert as to whether any information may indicate that a related party is involved with the transaction.

What is an undisclosed related party, relationship or transaction? [ISA | 4325.1400]

Related parties, relationships and transactions are undisclosed when management has not disclosed them to us. An undisclosed related party, relationship or transaction includes undisclosed:

- related parties; or
- relationships or transactions with disclosed or undisclosed related parties.

How do we evaluate whether the entity has identified its related parties, relationships and transactions? [ISA | 4325.1500]

We perform procedures to evaluate the completeness and accuracy of related party transactions. We cannot rely solely on our understanding of the entity's related party processes/controls or our evaluation of the design and operating effectiveness of controls alone. At a minimum, we:

- establish a base population of related parties, relationships and transactions that management has disclosed to us from our risk assessment procedures (step 1);
- consider whether other audit procedures or component auditors have identified additional or different related party information (step 2);
- inspect relevant documents to determine if it provides additional or different related party information (step 3);
- consider steps 1-3, and determine if we have obtained sufficient appropriate evidence or whether we will perform additional procedures (step 4)

Our testing of the completeness of management's identification of related parties, relationships and transactions, may be different than other tests we perform for other accounts, such as accounts payable. Unlike accounts payable, there may not be a suitable reciprocal population from which to select items to identify additional related parties, relationships and transactions. As such, we perform risk assessment procedures, including:

- understand the entity's processes and controls,
- obtain a list from management of all related parties, and related party relationships and transactions that they have identified through their processes, and
- communicate that list to the engagement team and component auditors.

Then through the course of our testwork in all areas of the audit, we remain alert for the existence of undisclosed related parties or related party relationships and transactions.

How do we establish the base population of related parties, relationships and transactions (step 1)? [ISA | 4325.1600]

First, we complete risk assessment procedures to establish what related parties, relationships, and transactions management has identified to us (see activity 'Obtain an understanding of related party relationships and transactions '). This is primarily accomplished through our related party inquiries with management. Management may also provide us with a written list, which we may request from them in our prepared by client (PBC) requests.

What other audit procedures may identify additional or different related party information (step 2)? [ISA | 4325.1700]

In determining whether management has appropriately identified related parties, relationships, or transactions, we consider whether other audit procedures may have identified additional or different related party information, such as:

- Procedures to understand and evaluate the design and implementation of relevant related party processes and controls (see activity '[Obtain an understanding of related party processes and controls](#) ');
- Procedures over management identified related party transactions that have been disclosed to us by management (see activity '[Perform procedures to address RMMs associated with related parties](#) ');
- Procedures over significant unusual transactions (see activity '[Understand the business purpose (or the lack thereof) for each SUT](#) ';
- Procedures over financial relationships and transactions with executives (see activity '[Understand financial relationships and transactions with executive officers](#) ' for further information on these procedures); or
- Any other audit procedures where we become aware of a related party not previously disclosed to us by management.

We also consider whether component auditors have communicated to us any related parties, relationships or transactions that are not included on the list that we provided to them (see activity '[Request component auditors to communicate related party information not previously identified](#) ').

> Examples of audit procedures that we perform in connection with our audit that may lead us to identify undisclosed related parties or related party relationships and transactions are may include:
>
> - determining that other procedures over known related party transactions, significant unusual transactions and management compensation have not identified undisclosed related parties;
> - inspecting board minutes;
> - obtaining and inspecting third party confirmations;
> - payables or revenue testwork;
> - understanding the business purpose of significant unusual transactions (SUTs);
> - reading annual disclosures completed by the board and management regarding their investments, participation on boards of other entities, and previous employment history;
> - reading other publicly available information.

What arrangements or information from other audit procedures might indicate that related party relationships or transactions exist (step 2)? [ISA | 4325.1900]

The following circumstances may indicate that related party relationships or transactions exist:

- borrowing or lending on an interest-free basis or at a rate of interest significantly above or below market rates prevailing at the time of the transaction;
- buying or selling services or assets, including real estate, at a price that differs significantly from its appraised or fair value;

- transactions between two or more entities in which each party provides and receives the same or similar amounts of consideration (e.g. round-trip transactions). For example, exchanging property for similar property in a non-monetary transaction;
- making or receiving loans with no scheduled terms for when or how the funds will be repaid;
- transactions that have abnormal terms of trade (such as unusual prices, interest rates, guarantees, rights of return and repayment terms);
- transactions that lack an apparent logical business reason for their occurrence;
- transactions processed in an unusual manner;
- "bill and hold" type transactions;
- occupying premises or receiving other assets or rendering or receiving management services when no consideration is exchanged;
- engaging in a nonmonetary transaction that lacks commercial substance;
- sales without economic substance (e.g. funding the other party to the transaction to facilitate collection of the sales price, or entering into a transaction shortly prior to period end and unwinding that transaction shortly after period end);
- loans to parties that, at the time of the loan transaction, do not have the ability to repay and possess insufficient or no collateral;
- loans made without prior consideration of the ability of the party to repay;
- a subsequent repurchase of goods that indicates that at the time of sale an implicit obligation to repurchase may have existed that would have precluded revenue recognition or sales treatment;
- advancing entity funds that are used directly or indirectly to pay what would otherwise be an uncollectible loan or receivable;
- sales at below market rates to an intermediary whose involvement serves no apparent business purpose and who, in turn, sells to the ultimate customer at a higher price, with the intermediary (and ultimately its principals) retaining the difference;
- participation in unincorporated partnerships with other parties;
- agreements for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business;
- guarantees and guarantor relationships outside the normal course of business.

What documents do we inspect to determine whether there are related parties, relationships or transactions that management has not disclosed to us (step 3)? [ISA | 4325.2000]

We inspect:

- minutes of the meetings of shareholders and of those charged with governance, or summaries of actions of recent meetings for which minutes have not yet been prepared;
- bank and legal confirmations; and
- any other documents considered relevant.

What other documents might be relevant to inspect (step 3)?

We think about what other documents might assist us in testing the completeness and accuracy of related parties, relationships, including publically available information.

Common documents we may inspect, include:

- organizational charts;
- conflicts of interest questionnaires of those charged with governance and management;

- shareholder registers;
- investment records, including pension/post-employment plan investments;
- third-party confirmations, in addition to bank and legal confirmations;
- entity tax returns and related correspondence;
- information supplied by the entity to regulatory authorities;
- contracts and agreements with key members of management or those charged with governance;
- significant contracts and agreements outside the entity's ordinary course of business;
- invoices and correspondence between the entity and its professional advisors, including legal counsel;
- life insurance policies acquired by the entity;
- significant contracts re-negotiated by the entity during the period;
- reports of the internal audit function;
- capital financing arrangements with entities other than financial institutions;
- economic development arrangements for capital additions;
- documents associated with the entity's filings with a securities regulator (e.g. prospectuses);
- disclosures contained on the entity's website;
- records from a management or those charged with governance's whistleblower program;
- expense reimbursement documentation for senior management and executives.

How do we determine whether we have obtained sufficient appropriate evidence (step 4)? [ISA | 4325.2200]

To determine whether or not we have obtained sufficient appropriate evidence, we think about:

- our assessed RMMs (revised accordingly for new information);
- if applicable, the evidence we have gathered through control testing over related party processes and controls;
- the evidence we have gathered through substantive testing; and
- results of procedures to follow up contradictory information that may indicate that management has not identified all related party relationships and transactions.

What other procedures may we perform to evaluate whether identified related parties, relationships and transactions are complete (step 4)? [ISA | 4325.2300]

In many cases, performing our related party risk assessment procedures, performing steps 1-3 in this activity and being alert for undisclosed related parties, relationships and transactions when performing other procedures in our audit will be sufficient. Our evaluation of the completeness of management's identification of related parties, relationships and transactions may be different than other procedures we perform over completeness for other accounts and disclosures, such as accounts payable. Unlike accounts payable, there may not be a suitable reciprocal population from which to select items to identify additional related parties, relationships and transactions.

What do we do if there are indicators that related parties, relationships or transactions may not be identified or disclosed to us? [ISA | 4325.2400]

When there are indicators that related parties, relationships or transactions may not be identified or disclosed to us, we perform procedures beyond inquiry to evaluate whether there is, in fact, an undisclosed related party, relationship or transaction. These procedures are consistent with our general responsibilities to perform additional audit procedures if audit evidence is inconsistent or we have doubts about the reliability of information (see activity 'If there are inconsistencies or doubts, modify or perform additional audit procedures and evaluate the effect on our audit ').

Why is inquiry not enough?

In a situation where management failed to disclose a related party, relationship or transaction, there may be serious implications for our audit. Undisclosed related parties, relationships and transactions may be indicative of:

- An increased risk assessment for RMMs, including fraud risks;
- A new significant risk;
- A control deficiency; or
- Other representations made by management may not be reliable.

We corroborate our inquiries with other procedure to determine the effect on the audit.

What do we do if we discover related parties, relationships or transactions that management did not identify or disclose to us? [ISA | 4325.2600]

When we discover related parties, relationships or transactions that management did not identify or disclose to us, we:

- perform procedures over those unidentified or undisclosed relationships and significant transactions (see activity 'Perform relevant procedures on previously undisclosed related parties, relationships and transactions ');
- we consider whether to revise our risk assessment for this new information;
- we communicate the matter to those charged with governance, if we determine it to be a significant audit finding (see activity 'Communicate related party matters with those charged with governance ').

Examples

What circumstances might indicate that an undisclosed related party transaction has occurred? [ISA | 4325.2700]

Fact pattern

While reading the board minutes, an engagement team member notes that the entity has acted as guarantor for a new loan of another entity (guarantee beneficiary). The entity typically acts as guarantor for its subsidiaries and other joint ventures (typically also related parties under the applicable financial reporting framework); however, this entity has not been identified by management as a related party and has not disclosed the relationship in the financial statements.

Analysis

Using professional skepticism, the engagement team member searches for publicly available information regarding the entity's relationship with the guarantee beneficiary. The engagement team member determines that the entity owns a controlling interest in the guarantee beneficiary and that the party is, in fact, a related party as defined under the applicable financial reporting framework.

1.7.C Core and Less Complex | Understand relevant controls that address SUTs [ISA | 4582]

What do we do?

Obtain an understanding of the relevant controls that management has established related to significant unusual transactions

Why do we do this?

Given the unique nature, size and complexity of significant unusual transactions (SUTs), they often present a risk of material misstatement (RMM) that is higher on the inherent risk continuum. This is because there may be:

- greater management intervention to specify the accounting treatment;
- greater manual intervention for data collection and processing;
- complex calculations or accounting principles;
- difficulty in implementing effective processes to account for the transactions (due to their non-routine nature); and/or
- related party transactions.

We therefore perform procedures to identify these transactions and the possible risks. One of those procedures is to obtain an understanding of the relevant internal controls established by management related to SUTs.

Execute the Audit

What is a significant unusual transaction (SUT)? [ISA | 4582.14472]

A SUT is a significant transaction that is outside the normal course of business for the entity or that otherwise appears to be unusual due to its timing, size, or nature.

Core and Less Complex | Do we evaluate the design and implementation of controls that management has established over SUTs? [ISA | 4582.14478]

Yes. We obtain an understanding of the controls that management has established to authorize and approve SUTs. This includes evaluating the design and implementation of the relevant controls.

What types of SUTs might the entity enter into? [ISA | 4582.1500]

Examples of SUTs include:

- business combinations executed by an entity that doesn't regularly make acquisitions;
- the issuance of debt, or refinancing of existing debt under a new vehicle or agreement with terms not typical to the entity;
- a long-lived asset impairment trigger within an entity that does not regularly have triggers;
- restructuring charges by an entity that doesn't regularly recognize restructuring costs; and
- unusual sales transactions.

Core and Less Complex | What if the entity does not have any SUTs during the period? [ISA | 4582.1600]

If the entity does not have any SUTs during a period, the controls in place to authorize and approve SUTs will remain dormant and there will be no instances of the control to evaluate in the current period.

Core and Less Complex | How do we obtain an understanding of controls that address SUTs? [ISA | 4582.6281]

We perform the following procedures to understand management's internal controls over the authorization and approval of SUTs.

- We understand how the SUTs are authorized and approved
- We determine the process risk points related to the authorization and approval of SUTs.
- We identify controls throughout the organization that address the identified process risk points related to the SUTs.
- We may consider our understanding of CERAMIC, and how the entity's CERAMIC may influence relevant controls related to the SUTs.
- We identify and evaluate the design and implementation of relevant control activities.

In addition, we may perform the following additional procedures to understand management's additional relevant internal controls over SUTs:

- understand whether management has control activities to identify SUTs. These may include controls that are part of the Risk Assessment component of ICFR that not only identify the transactions, but also evaluate the potential RMMs associated with the transaction;
- understand how the SUTs are initiated, processed and recorded, as well as the accounts and disclosures they affect.

Because SUTs are non-routine, they are often less likely to be subject to the entity's routine, established controls. Therefore, an entity's process and control documentation may not be complete or properly capture the process risk points or controls related to those types of transactions.

This means it may not be practical to develop a flowchart for a process that includes an SUT. However, we still understand the process-level risks at a granular level so that we understand the process risk points and all aspects of the control(s) that need to be present and functioning.

Understanding relevant controls for SUTs is part of how we identify and assess risks of misstatement related to them. Our understanding of CERAMIC may also help us assess the risks of material misstatement associated with SUTs.

How may our understanding of CERAMIC help us assess risks of material misstatement associated with SUTs? [ISA | 4582.6280]

Depending upon the nature and complexity of the entity, there may be features of the control environment that influence relevant controls that address SUTs, 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 SUTs.
- the assignment of responsibilities within the entity for identifying, recording, summarizing, and disclosing SUTs.
- timely disclosure and discussion between management and those charged with governance of SUTs, 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 SUTs.
- periodic reviews by the internal audit function, where applicable.
- proactive action taken by management to resolve SUTs disclosure issues, such as by seeking advice from the auditor or external legal counsel.

When these features are absent, there may be an increased risk associated with SUTs.

What controls may the entity have in place to authorize and approve SUTs? [ISA | 4582.1900]

Controls over SUTs typically include specific controls over authorization and approval.

Authorization involves a party or parties with the appropriate authority granting permission to another party to perform a function or enter into a transaction. Often, certain individuals are allowed to enter into specific transactions in accordance with a pre-determined criteria. Depending on the type of transaction, the criteria may be judgmental. An entity's controls may include authorization from many levels, including:

- management;
- those charged with governance; or
- shareholders or owners (where applicable).

The level of authorization may be determined by the significance of the transaction, or by the level of judgment required to evaluate the transaction in accordance with the pre-determined criteria.

Examples of controls the entity may have established to authorize and approve SUTs include:

- controls in the Risk Assessment and Monitoring ICFR components to identify transactions and arrangements for authorization and approval; and
- approval of the terms and conditions of the transactions and arrangements by management, those charged with governance, or shareholders or owners (where applicable).

What if controls are not implemented for SUTs? [ISA | 4582.2100]

Failure by management to implement SUT controls is a deficiency in internal control, and may indicate a more severe deficiency - for example, a significant deficiency. We evaluate deficiencies in this way and communicate them, as necessary — even if we're performing a financial statement audit in which we do not intend to test controls.

1.7.E Enhanced | Understand relevant controls that address SUTs [ISA | 577]

What do we do?

Obtain an understanding of the relevant controls that management has established related significant unusual transactions

Why do we do this?

Given the unique nature, size and complexity of significant unusual transactions (SUTs), they often present a risk of material misstatement (RMM) that is higher on the inherent risk continuum. This is because there may be:

- greater management intervention to specify the accounting treatment;
- greater manual intervention for data collection and processing;
- complex calculations or accounting principles;
- difficulty in implementing effective processes to account for the transactions (due to their non-routine nature); and/or
- related party transactions.

We therefore perform procedures to identify these transactions and the possible risks. One of those procedures is to obtain an understanding of the relevant internal controls established by management related to SUTs.

Execute the Audit

What is a significant unusual transaction (SUT)? [ISA | 577.14472]

A SUT is a significant transaction that is outside the normal course of business for the entity or that otherwise appears to be unusual due to its timing, size, or nature.

Enhanced | Do we evaluate the design and implementation of controls that management has established over SUTs? [ISA | 577.1330]

Yes. We obtain an understanding of the controls that management has established to identify, authorize and approve SUTs. This includes evaluating the design and implementation of the relevant controls.

What types of SUTs might the entity enter into? [ISA | 577.1500]

Examples of SUTs include:

- business combinations executed by an entity that doesn't regularly make acquisitions;
- the issuance of debt, or refinancing of existing debt under a new vehicle or agreement with terms not typical to the entity;
- a long-lived asset impairment trigger within an entity that does not regularly have triggers;
- restructuring charges by an entity that doesn't regularly recognize restructuring costs; and
- unusual sales transactions.

Enhanced | What if the entity does not have any SUTs during the period? [ISA | 577.1530]

If the entity does not have any SUTs during a period, we still understand the entity's process and controls to identify, authorize and approve SUTs. However, only those controls in place to *identify* SUTs will occur during the period. The remaining controls will remain dormant and there will be no instances to evaluate in the current period.

Enhanced | How do we obtain an understanding of controls that address SUTs? [ISA | 577.6281]

We perform the following procedures to understand management's internal controls over the authorization and approval of SUTs.

- We understand how the SUTs are authorized and approved

- We determine the process risk points related to the authorization and approval of SUTs.
- We identify controls throughout the organization that address the identified process risk points related to the SUTs.
- We may consider our understanding of CERAMIC, and how the entity's CERAMIC may influence relevant controls related to the SUTs.
- We identify and evaluate the design and implementation of relevant control activities.

In addition, we understand whether management has control activities to identify SUTs. These may include controls that are part of the Risk Assessment component of ICFR that not only identify the transactions, but also evaluate the potential RMMs associated with the transaction.

Because SUTs are non-routine, they are often less likely to be subject to the entity's routine, established controls. Therefore, an entity's process and control documentation may not be complete or properly capture the process risk points or controls related to those types of transactions.

This means it may not be practical to develop a flowchart for a process that includes an SUT. However, we still understand the process-level risks at a granular level so that we understand the process risk points and all aspects of the control(s) that need to be present and functioning.

Understanding relevant control activities for SUTs is part of how we identify and assess risks of misstatement related to them. Our understanding of CERAMIC may also help us assess the risks of material misstatement associated with SUTs.

How may our understanding of CERAMIC help us assess risks of material misstatement associated with SUTs? [ISA | 577.6280]

Depending upon the nature and complexity of the entity, there may be features of the control environment that influence relevant controls that address SUTs, 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 SUTs.
- the assignment of responsibilities within the entity for identifying, recording, summarizing, and disclosing SUTs.
- timely disclosure and discussion between management and those charged with governance of SUTs, 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 SUTs.
- periodic reviews by the internal audit function, where applicable.
- proactive action taken by management to resolve SUTs disclosure issues, such as by seeking advice from the auditor or external legal counsel.

When these features are absent, there may be an increased risk associated with SUTs.

Enhanced | What controls may the entity have in place to identify SUTs? [ISA | 577.1800]

Controls to identify SUTs vary from entity to entity, and depend on the entity's business process. They may, for example, include steps where management reviews and approves:

- arrangements/transactions with third parties above a certain amount defined in the entity policies
- arrangements/transactions with related parties above a certain amount defined in the entity policies

- arrangements/transactions for which key terms and conditions are not consistent with entity policies (e.g. modified credit terms, liability terms)
- arrangements/transactions with regulators or counterparties to settle claims/litigation
- arrangements/transactions that include options, embedded derivatives or other similar features
- cross border intercompany arrangements/transactions subject to transfer pricing rules

What controls may the entity have in place to authorize and approve SUTs? [ISA | 577.1900]

Controls over SUTs typically include specific controls over authorization and approval.

Authorization involves a party or parties with the appropriate authority granting permission to another party to perform a function or enter into a transaction. Often, certain individuals are allowed to enter into specific transactions in accordance with a pre-determined criteria. Depending on the type of transaction, the criteria may be judgmental. An entity's controls may include authorization from many levels, including:

- management;
- those charged with governance; or
- shareholders or owners (where applicable).

The level of authorization may be determined by the significance of the transaction, or by the level of judgment required to evaluate the transaction in accordance with the pre-determined criteria.

Examples of controls the entity may have established to authorize and approve SUTs include:

- controls in the Risk Assessment and Monitoring ICFR components to identify transactions and arrangements for authorization and approval; and
- approval of the terms and conditions of the transactions and arrangements by management, those charged with governance, or shareholders or owners (where applicable).

What if controls are not implemented for SUTs? [ISA | 577.2100]

Failure by management to implement SUT controls is a deficiency in internal control, and may indicate a more severe deficiency - for example, a significant deficiency. We evaluate deficiencies in this way and communicate them, as necessary — even if we're performing a financial statement audit in which we do not intend to test controls.

1.8 Inquire about fraud and fraud risks [ISA | 559]

What do we do?

Inquire of those charged with governance, management, internal audit personnel and others about fraud and fraud risks

Why do we do this?

Management are responsible for designing and implementing programs and controls to prevent, deter and detect fraud. This means they often have their own views and an in-depth knowledge about instances of fraud and the fraud risks affecting the entity.

Similarly, those charged with governance often have a more comprehensive or top-down view of the risks affecting the entity as a whole. They may therefore have different views about the fraud risks that affect the entity.

As a result, management, along with others, are likely to have information and perspectives that are relevant to our fraud risk assessment.

Execute the Audit

What information do we seek in our inquiries about fraud and fraud risks? [ISA | 559.1300]

When we inquire about fraud, we are seeking to:

- identify and assess additional fraud risks we may have yet to consider;
- confirm our understanding of fraud risks that we have already identified; and
- identify actual, alleged or suspected fraudulent acts.

These inquiries may lead us to identify fraud risk factors that we take into account when identifying and assessing fraud risks. So we focus on specific matters that will increase our knowledge about fraud risks and fraud risk factors.

When do we make our specific fraud inquiries? [ISA | 559.1400]

We sometimes talk about making specific inquiries for fraud risks — but in practice, we plan to inquire about risks of material misstatement (RMMs) due to error and fraud risks at the same time.

We inquire about these with the same entity personnel, so it can be more effective to address both types of inquiry during the same meeting.

Inquiries are part of risk assessment, so they're most effective when we perform them before we develop our audit plan.

Who do we inquire of when we make our specific fraud inquiries? [ISA | 559.1500]

The standards tell us to make specific fraud risk inquiries of:

- management;
- those charged with governance; and
- internal audit (where one exists).

We also inquire of individuals who we believe may have relevant information about fraud risks. To identify them, we consider who might:

- have additional knowledge about fraud, alleged fraud or suspected fraud; or
- be able to corroborate fraud risks identified in our other discussions.

It may be useful to inquire of individuals in other departments and at different levels throughout the entity — including positions such as:

- accounting managers;
- segment/location managers;
- the chief compliance officer;
- key members of the human resources department;
- in-house counsel;
- employees involved in initiating, processing or recording complex or unusual transactions;

- the Chief Ethics Officer;
- persons charged with dealing with allegations of fraud; and
- key position holders throughout the operations group.

What fraud inquiries do we make of management? [ISA | 559.1600]

At a minimum, our inquiries of management about fraud risks include the following topics.

1	Whether they know about fraud, alleged fraud or suspected fraud affecting the entity.
2	Their assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessment.
3	Their process for identifying and responding to fraud risks, including: • any specific fraud risks management has identified or that has been brought to its attention; or • account balances or disclosures for which a fraud risk is likely to exist, and the nature, extent and frequency of their fraud risk assessment process.
4	Controls established to address identified fraud risks, or that otherwise help to prevent and detect fraud — including how management monitor those controls.
5	For an entity with multiple locations: • the nature and extent of monitoring of operating locations or business segments; and • whether there are particular operating locations or business segments for which a fraud risk might be more likely to exist.
6	Whether and how they communicate to employees their views on business practices and ethical behavior.
7	Whether they have received tips or complaints about the entity's financial reporting — including through an internal whistleblower program if such a program exists — and, if so, their responses.
8	Whether they have reported to those charged with governance on how the entity's internal control prevents and detects material misstatements due to fraud (unless all of those charged with governance are in charge of managing the entity).
9	Whether the entity has entered into any significant unusual transactions and, if so: • the nature, terms and business purpose (or lack thereof) of those transactions; and • whether those transactions involved related parties.

These are the minimum inquiries we make. They don't preclude us making any additional inquiries we deem necessary, based on our knowledge of the entity or considering the answers we receive to our initial inquiries.

For example, we may ask management if they are aware of fraud, alleged fraud, or suspected fraud. If they reply that there is 'nothing material', we might then probe further, and inquire about specific instances of which they may be aware.

What fraud inquiries do we make of those charged with governance? [ISA | 559.1700]

At a minimum, our inquiries of those charged with governance about fraud risks include the following topics.

1	Their views about fraud risks, including risk of management override of controls, in the entity and whether they have taken any actions to respond to these risks.
2	Whether they know about fraud, alleged fraud, or suspected fraud affecting the entity.
3	Whether they have received tips or complaints about the entity's financial reporting — including through an internal whistleblower program, if such a program exists — and, if so, their responses.
4	How they oversee fraud risk assessments and the establishment of controls to address fraud risks.
5	Whether the entity has entered into any significant unusual transactions.

These are the minimum inquiries we make. They don't preclude us making any additional inquiries we deem necessary based on our knowledge of the entity or considering the answers we receive to our initial inquiries.

What fraud inquiries do we make of the internal audit function (when one exists)? [ISA | 559.1800]

At a minimum, our inquiries of the internal audit function (when one exists) about fraud risks include the following topics. We make these inquiries even when we don't plan to use the work of internal audit in our audit:

1	Their views about fraud risks in the entity.
2	Whether they know about fraud, alleged fraud or suspected fraud affecting the entity.
3	Whether they have performed procedures to identify or detect fraud during the period and whether management have satisfactorily responded to their findings.

4	Whether they are aware of instances of management override of controls, and the nature and circumstances of such overrides.
5	Whether the entity has entered into any significant unusual transactions.

These are the minimum inquiries we make. They don't preclude us making any additional inquiries we deem necessary based on our knowledge of the entity or considering the answers we receive to our initial inquiries.

What fraud inquiries do we make of others who may have relevant information? [ISA | 559.1900]

At a minimum, our inquiries of others who may have relevant information about fraud risks include the following topics.

1	Their views regarding fraud risks in the entity
2	Whether they know about fraud, alleged fraud, or suspected fraud affecting the entity.

These are the minimum inquiries we make. They don't preclude us making any additional inquiries we deem necessary based on our knowledge of the entity or considering the answers we receive to our initial inquiries.

What if we identify actual or suspected instances of fraud? [ISA | 559.2000]

We perform further procedures as outlined in the chapter on fraud. We also perform the relevant procedures outlined in the chapter on laws and regulations.

Example

What inquiries might we make related to fraud risks? [ISA | 559.11563]

The table below sets out examples of questions we may ask, responses we may receive and how we might evaluate those responses during risk assessment.

Inquiry of	Question asked	Response received	Evaluation of response
Management	Do you know of any fraud, alleged fraud or suspected fraud affecting the entity?	I am not aware of anything material.	There may have been a fraud, which management are trying to pass off as 'not material'. This could have a material effect on the financial statements, or

			provide insight into RMMs we may consider in our audit. We may ask follow-on questions to probe the matter and identify instances of fraud management are aware of — regardless of whether management determine that the fraud is material.
Audit committee	Are you aware of any tip-offs or complaints about the entity's financial reporting? And if so, how did you respond?	We received a complaint last month. We investigated it and dismissed the individual charged with the fraud based on the evidence we discovered.	We may want to obtain more information about this complaint and understand whether improprieties were detected/ corrected and the thoroughness of management's investigation. We may also seek to understand more about any RMMs we want to consider in our audit.
Internal audit	Has the entity entered into significant unusual transactions?	We recently made a significant investment in an entity operating in an industry unrelated to our own.	We may want to obtain more information about the transaction and the business purpose — including who authorized and approved the transaction — to determine whether

			RMMs exist or whether this may create a fraud risk.

Identification and Assessment of the Risks of Material Misstatement Associated with Related Parties

International Standards on Auditing: ISA 550.18-19

Identification and Assessment of the Risks of Material Misstatement Associated with Related Party Relationships and Transactions

18. In meeting the ISA 315 (Revised) requirement to identify and assess the risks of material misstatement,[9] the auditor shall identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks. In making this determination, the auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks.

9 ISA 315 (Revised), paragraph 25

19. 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 shall consider such information when identifying and assessing the risks of material misstatement due to fraud in accordance with ISA 240. (Ref: Para. A6, A29 - A30)

ISA Application and Other Explanatory Material: ISA 550.A29-A30

Identification and Assessment of the Risks of Material Misstatement Associated with Related Party Relationships and Transactions

Fraud Risk Factors Associated with a Related Party with Dominant Influence (Ref: Para. 19)

A29. Domination of management by a single person or small group of persons without compensating controls is a fraud risk factor.[24] Indicators of dominant influence exerted by a related party include:

- The related party has vetoed significant business decisions taken by management or those charged with governance.
- Significant transactions are referred to the related party for final approval.
- There is little or no debate among management and those charged with governance regarding business proposals initiated by the related party.
- Transactions involving the related party (or a close family member of the related party) are rarely independently reviewed and approved.

Dominant influence may also exist in some cases if the related party has played a leading role in founding the entity and continues to play a leading role in managing the entity.

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24 ISA 240, Appendix 1

A30. In the presence of other risk factors, the existence of a related party with dominant influence may indicate significant risks of material misstatement due to fraud. For example:

- An unusually high turnover of senior management or professional advisors may suggest unethical or fraudulent business practices that serve the related party's purposes.
- The use of business intermediaries for significant transactions for which there appears to be no clear business justification may suggest that the related party could have an interest in such transactions through control of such intermediaries for fraudulent purposes.
- Evidence of the related party's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates may suggest the possibility of fraudulent financial reporting.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Identify and assess RMMs associated with related parties [ISA | 4318]

What do we do?

Identify and assess the risk of material misstatement associated with related parties

Why do we do this?

Once we have obtained information regarding related parties, relationships and transactions, we use that information to identify and assess whether RM are RMMs. The RMMs that we identify regarding related parties, including significant risks, drive our planned audit procedures.

Execute the Audit

How do we identify and assess RMMs associated with related parties? [ISA | 4318.1300]

We use the information we gathered during the risk assessment phase and through our audit to identify and assess RMMs, including:

- significant risks associated with related parties ; and

- if there are related party fraud risk factors, RMMs due to fraud associated with related parties .

1.1 Identify and assess RMMs, including significant risks, associated with related parties [ISA | 4319]

What do we do?

Identify and assess RMMs associated with related parties, relationships and transactions at the financial statement and assertion level, including significant risks.

Why do we do this?

Identified RMMs will drive our audit response to related parties. We design procedures that respond specifically to the identified significant risks.

Execute the Audit

What information do we consider in assessing RMMs associated with related parties? [ISA | 4319.1301]

We use the understanding that we have gained from our related party risk assessment procedures to assess RMMs, which includes:

- discuss the susceptibility of the financial statements to material misstatement, including discussing the potential for material misstatement due to fraud;
- obtaining an understanding of related party processes and controls, including evaluating the design and implementation of controls;
- inquiries regarding related parties;
- communicating to the engagement team relevant information regarding related parties;
- Group Audit or Component Audit | communicating to component auditors relevant information regarding related parties;
- Group Audit or Component Audit | requesting component auditors to communicate related party information not previously identified.
- Understanding the relevant controls that address SUTs; and
- Inquiring about fraud and fraud risks, including inquiries regarding SUTs.

We also consider other relevant information that we gather from other risk assessment procedures that might inform how we assess the risks of material misstatement associated with related parties.

For example, our understanding of the entity and its environment, specifically the entity's organizational structure, may identify relevant related party information.

How do we identify and assess RMMs associated with related parties? [ISA | 4319.1500]

We use the same six-step process to identify and assess RMMs for related parties at the assertion level and financial statement level as we do for other risks to the financial statements (see activity 'Identify and assess RMMs').

How do we identify and assess significant risks associated with related parties? [ISA | 4319.14451]

Significant risks are RMMs where inherent risk has been assessed as Significant considering relevant factors (see activity 'Identify significant risks').

We evaluate quantitative and qualitative factors to determine whether the inherent risk of the RMM is Significant - i.e., it is a significant risk. The fact that a transaction involves a related party is one factor that increases inherent risk. With respect to related party RMMs, it is our assessment of qualitative factors (e.g. fraud, complexity, etc.) that may make an RMM significant. Related party transactions do not necessarily have to be large amounts (quantitative factor) in order to be representative of a significant risk.

When we identify a risk as Significant there are other impacts on our audit, for example, in addition to evaluating the design and implementation of controls we also design specific audit procedures to respond to the significant risk.

Are there circumstances that give rise to related party significant risks? [ISA | 4319.14403]

Yes. We identify at least one significant RMM related to the:

- identification
- authorization and approval
- accounting

of significant related party transactions that are outside the entity's normal course of business.

Depending on the circumstances, we may identify a significant RMM related to one or more of these categories. The risk associated with 'identification' and 'authorization and approval' may not necessarily be significant because management has already identified the transaction and in most cases will have also authorized and approved them. However, the risk associated with 'accounting' could be significant in many circumstances because the transaction is unusual in nature and the accounting may be more complex or subjective.

What are other examples of circumstances that may give rise to related party significant risks? [ISA | 4319.14450]

The following are examples of circumstances that may give rise to significant risks associated with related parties:

- related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- related party transactions may not be conducted under normal market terms and conditions; some related party transactions may be conducted with no exchange of consideration.
- related party transactions could be motivated solely or in large measure to engage in fraudulent financial reporting or conceal misappropriation of assets.

When thinking about the business purposes of the related party arrangements and transactions, what circumstances may give rise to a significant risk? [ISA | 4319.14449]

Related party arrangements and transactions may be representative of a significant risk when their business purpose is motivated solely or largely by circumstances such as:

- maintaining sufficient working capital or credit to continue the business;
- an urgent desire for a continued favorable earnings record in the hope of supporting the price of the entity's stock;
- an overly optimistic earnings forecast;
- dependence on a single or relatively few products, customers or transactions for the continuing success of the venture;
- a declining industry characterized by a large number of business failures;
- excess capacity;
- significant litigation, especially litigation between stockholders and management; and
- significant obsolescence dangers because the entity is in a high-technology industry.

How do we assess combined assessed risk associated with related parties? [ISA | 4319.14448]

The information we have gathered through related party risk assessment procedures (and controls testing, if applicable) is used to inform our inherent risk and control risk assessment of the RMM at the assertion level. The resulting assessment of inherent and control risk is known as combined assessed risk (CAR), which drives the nature, timing and extent of further audit procedures (see question 'How do we assess risk for assertion-level RMMs?').

What may influence our related party inherent risk assessment? [ISA | 4319.14447]

Our inherent risk assessment is influenced by our understanding of different related party transaction attributes, such as,

- understood business purpose or lack thereof;
- whether the structure of the transactions are simple or complex;
- whether the transaction occurs in the normal course of business or is a conducted outside normal course of business.

What may influence our related party control risk assessment? [ISA | 4319.14446]

We also assess control risk by considering:

- our assessment of the design and implementation of relevant related party controls and whether or not the controls are operating effectively; and
- whether there is a risk that controls may be overridden by management or related parties (e.g. dominant influence).

What are examples of related party RMMs at the financial statement level? [ISA | 4319.14445]

Related party RMMs may not always be associated with one account or disclosure. We may determine that the information gathered during our related party risk assessment procedures is representative of an RMM at the financial statement level.

> For example, there may be a related party RMM and/or significant risk at the financial statement level, such as:
>
> - related parties may be used to perpetrate fraud broadly throughout the entity; or
> - management or other related parties that exert dominant influence may override controls.

When do we assess related party RMMs? [ISA | 4319.14444]

We identify and assess related party RMMs early in the audit, after we have obtained relevant information on which to base our assessment.

What does it mean to continue our risk assessment throughout the audit? [ISA | 4319.1300]

Risk assessment is an iterative process, rather than something we perform only at the beginning of the audit. During the course of the audit, we constantly obtain new information and evidence. This may support or contradict our original risk assessment and can affect our overall audit plan.

For example, information that supports our original risk assessment might support the fact that a specific risk exists, that we assessed it appropriately, and that we linked the risks of material misstatement (RMMs) to the appropriate assertions, accounts and disclosures.

As we obtain information or evidence throughout the audit, we consider whether it supports or contradicts our original risk assessment. 'Throughout the audit' means through performing our risk assessment, control and substantive procedures, all the way to when we form our audit opinion. This enables us to:

- identify evidence that contradicts our original risk assessment; and
- respond appropriately by revising our, or performing additional, risk assessment and planned audit procedures.

If the applicable financial reporting framework does not have related party disclosure requirements, do we still identify and assess RMMs associated with related parties? [ISA | 4319.14443]

Yes, risk assessment procedures are still relevant to assessing:

- RMMs associated with accounting for related party transactions in accordance with the applicable financial reporting framework; and

> For example, we think about whether there are risks that related party transactions:
>
> - do not reflect the substance of the transaction (in accordance with the applicable financial reporting framework); or
> - may be used to perpetrate fraudulent financial reporting.

- whether the financial statements are fairly presented.

> For example, we may determine that the financial statements are not presented fairly without additional related party disclosures (even though they are not specifically required by the applicable financial reporting framework).

What circumstances might give rise to an RMM associated with related parties? [ISA | 4319.14409]

The following circumstances may give rise to an RMM associated with related parties:

- Related parties operating through an extensive and complex range of relationships and structures, with a corresponding complexity of transactions.
- Information systems that are ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
- Related party transactions not conducted under normal market terms and conditions (for example, some related party transactions may be conducted with no exchange of consideration).
- Related party transactions motivated solely or primarily to engage in fraudulent financial reporting or conceal misappropriation of assets.
- Related party transactions motivated solely or primarily by conditions similar to the following:
    - Lack of sufficient working capital or credit to continue the business
    - An overly optimistic earnings forecast
    - Dependence on a single or relatively few products, customers, or transactions for the continued success of the business
    - A declining industry characterized by a large number of business failures
    - Excess capacity
    - Significant litigation, especially litigation between stockholders and management
    - Significant obsolescence dangers because the entity is in a high technology industry

Examples

How do we assess likelihood and magnitude of related party RMs and RMMs? [ISA | 4319.2400]

The table below sets out examples of how we might assess likelihood and magnitude when we assess related party RMMs.

Description of RM	Related accounts / disclosures	Considerations related to likelihood and magnitude of potential misstatement	Assessment of RMM

	and assertions		
Related party transactions are not completely and accurately recorded.	Equity	• Transaction is complex with a debt issuance with features convertible to equity shares. • Management has asserted that the purpose of the transaction was to achieve equity financing as debt classification would cause debt covenant ratios to be breached • The funding is just above materiality.	We conclude that there is a likely chance that a material misstatement may occur, given the complexity of the transaction and serious implications if management's accounting was not in compliance with the applicable financial reporting framework As such, we conclude that the risk is an RMM for this transaction.
Related party transactions are not completely and accurately recorded.	Loans	• The CEO, a related party, has borrowed a de minimis amount from the entity. • The loan is not a complex arrangement and not considered material qualitatively.	We conclude that there is only a remote possibility that the amount may not be accounted for appropriately or is representative of fraudulent activity. As such, we conclude that the risk is an RM for this transaction.
The disclosure of relationships and transactions with related parties are incomplete, inaccurate or not fairly presented.	Related party disclosures	• Related parties, relationships and transactions are to be disclosed in accordance with the applicable financial reporting framework.	We conclude that there is a likely chance that a material misstatement may occur, given the number of

		• The entity has multiple related parties and business arrangements and transactions with those parties.	related parties and transactions. As such, we conclude that the risk is an RMM.
Related party transactions were not conducted on terms equivalent to those prevailing in arm's-length transactions despite disclosures stating they were.	Related party disclosures	• Management does not make any arm's length assertions regarding related party transactions in the financial statements • There is no assertion from non-disclosure implied by the requirements of the financial reporting framework	We conclude that the RM is not applicable to the entity.

1.2 Identify and assess RMMs due to fraud associated with related parties [ISA | 4320]

What do we do?

If we identify fraud risk factors, then consider this information when assessing RMMs due to fraud.

Why do we do this?

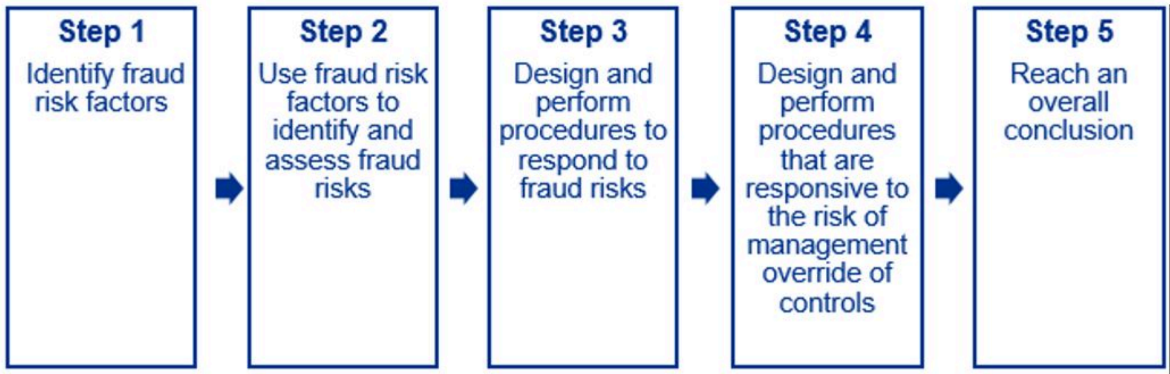
Due to the fact that related parties may not always act independently or with their own self-interest in mind, consideration of fraud risks are relevant to our risk assessment. We consider whether the information we gather through risk assessment procedures and other audit evidence indicates that one of more fraud risk factors are present, and whether that information results in a fraud risk.

Execute the Audit

What do we do if we identify fraud risk factors associated with related parties? [ISA | 4320.1300]

If we identify fraud risk factors (including circumstances relating to the existence of a related party with dominant influence), we consider that information when identifying and assessing fraud risks.

We use the same five-step process to identify, assess and respond to fraud risks in the audit as we do for other risks to the financial statements (see activity 'Identify fraud risks').



What is dominant influence? [ISA | 4320.1400]

Dominant influence is a behavior where related parties may dictate activities of the entity or its management. This behavior may be exhibited by a single person or a group of persons as a result of their ability to control or exercise significant influence but may also be a result of the person's role in founding the entity and/or playing a lead role in the management of the entity (formally or informally).

Examples of dominant influence include:

- The related party has vetoed significant business decisions taken by management or those charged with governance;
- Significant transactions are referred to the related party for final approval;
- There is little or no debate among management and those charged with governance regarding business proposals initiated by the related party; and
- Transactions involving the related party (or a close family member of the related party) are rarely independently reviewed and approved.

What are fraud risk factors? [ISA | 4320.11964]

Fraud risk factors can cover a broad range of events and conditions. They are specific events and conditions we observe or identify that promote or foster an environment where fraud could occur.

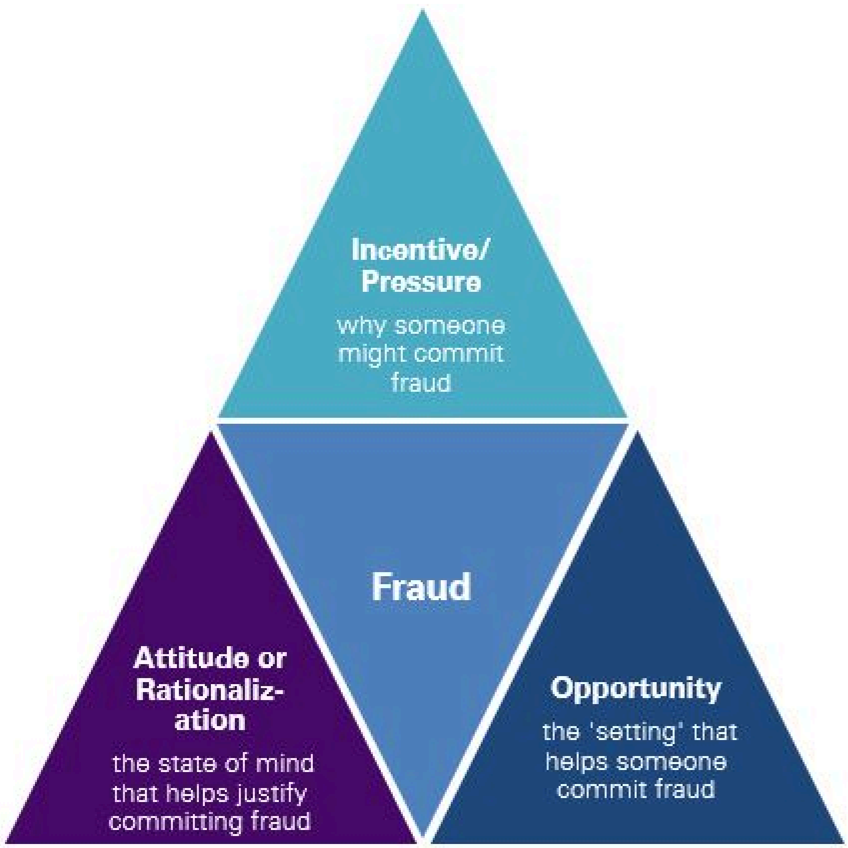
Understanding these factors helps us consider where fraud risks may exist that call for a specific audit response.

Identifying fraud risk factors does not necessarily mean that fraud exists or will eventually occur. But these factors are often present in circumstances in which fraud exists.

Category of fraud risk factor	Description	Example
Incentive or pressure	Why someone might commit fraud	An employee may be in financial distress (internal incentive), or management may be under extreme pressure to meet financial targets (external incentive). These situations can be a catalyst for committing the

		fraud, and could be internal or external to the entity or the person committing the fraud.
Opportunity	The 'setting' that helps someone commit fraud	Deficiencies in CERAMIC or poorly designed control activities can make it easier for an individual to carry out fraud.
Attitude or rationalization	The state of mind that helps justify committing fraud	Management's attitude that the entity will meet its targets at all costs, or a justification claiming that the fraud doesn't really harm anybody.

These three categories of fraud risk factors form the fraud triangle.



Why is dominant influence a fraud risk factor? [ISA | 4320.1600]

Domination of a single person or a small group of people, without compensating controls, could provide an opportunity for fraudulent financial reporting or misappropriation of assets. These individual(s) may also rationalize their actions, for example, if they founded the entity.

We consider this information, along with other factors, in our assessment of fraud risks.

Other than dominant influence, what other fraud risk factors might be identified through our related party risk assessment procedures? [ISA | 4320.1700]

In addition to dominant influence, we may identify the following fraud risk factors:

- An ineffective controls over the authorization and approval of related party transactions may provide an opportunity for fraudulent activity using related parties;
- Management being incentivized to conduct transactions with related parties (e.g. buy goods and services or finance);
- An unusually high turnover of senior management or professional advisors that may suggest unethical or fraudulent business practices that serve the related party's purposes;
- The use of business intermediaries for significant transactions that related parties may have an interest in for which there appears to be no clear business justification; or
- Evidence of a related party's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.

Is the risk of management override of controls relevant to related party controls? [ISA | 4320.1800]

Yes, where management has control or significant influence over parties that the entity does business with, then there may be greater incentive or opportunity to use those relationships to perpetrate fraud. Management may direct an entity or collude with others to enter into transactions that benefit management's financial interests.

For example, management may:

- Create 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; or
- Engage 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.

Examples

How might related party fraud risk factors contribute to fraud risk? [ISA | 4320.1900]

Fact pattern:

An entity made a loan to a related party during the period. During the period, the terms of the transaction were modified so that interest payments would be due upon maturity of the loan instead of six-monthly. Around the same time, the controller and two mid-level managers resigned. If the loan was materially impaired, management would not achieve earnings targets for the year to which their variable compensation is dependent. Management asserts that there is no impairment of the loan.

Analysis:

When the engagement team analyze this set of facts and circumstances, they may identify these risk factors:

Category	Identified risk factor

Incentive or pressure	Management is under pressure to achieve earnings targets.
Opportunity	Management approved modification of the terms of the transaction during the period. High turn-over in the accounting department during the period.
Attitude or rationalization	Management may have modified the terms of the transaction to prevent default on the loan.

The team may conclude that a fraud risk exists related to the valuation of loans to related parties.

Response to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions

International Standards on Auditing: ISA 550.20-24

Responses to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions

20. As part of the ISA 330 requirement that the auditor respond to assessed risks,[10] the auditor 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. These audit procedures shall include those required by paragraphs 21 - 24. (Ref: Para. A31 - A34)

10 ISA 330, paragraphs 5 - 6

Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions

21. If the auditor identifies arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, the auditor shall determine whether the underlying circumstances confirm the existence of those relationships or transactions.

22. 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:

(a) Promptly communicate the relevant information to the other members of the engagement team; (Ref: Para. A35)

(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; (Ref: Para. A36)

(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. (Ref: Para. A37)

Identified Significant Related Party Transactions outside the Entity's Normal Course of Business

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)

11 ISA 240, paragraph 33(c)

Assertions That Related Party Transactions Were Conducted on Terms Equivalent to Those Prevailing in an Arm's Length Transaction

24. If management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor shall obtain sufficient appropriate audit evidence about the assertion. (Ref: Para. A42 - A45)

ISA Application and Other Explanatory Material: ISA 550.A31-A45

Responses to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions (Ref: Para. 20)

A31. The nature, timing and extent of the further audit procedures that the auditor may select to respond to the assessed risks of material misstatement associated with related party relationships and transactions depend upon the nature of those risks and the circumstances of the entity.[25]

25 ISA 330 provides further guidance on considering the nature, timing and extent of further audit procedures. ISA 240 establishes requirements and provides guidance on appropriate responses to assessed risks of material misstatement due to fraud.

A32. Examples of substantive audit procedures that the auditor may perform when the auditor has assessed a significant risk that management has not appropriately accounted for or disclosed specific related party transactions in accordance with the applicable financial reporting framework (whether due to fraud or error) include:

- Confirming or discussing specific aspects of the transactions with intermediaries such as banks, law firms, guarantors, or agents, where practicable and not prohibited by law, regulation or ethical rules.
- Confirming the purposes, specific terms or amounts of the transactions with the related parties (this audit procedure may be less effective where the auditor judges that the entity is likely to influence the related parties in their responses to the auditor).
- Where applicable, reading the financial statements or other relevant financial information, if available, of the related parties for evidence of the accounting of the transactions in the related parties' accounting records.

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 ISA 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.

A34. Depending upon the results of the auditor's risk assessment procedures, the auditor may consider it appropriate to obtain audit evidence without testing the entity's controls over related party relationships and transactions. In some circumstances, however, it may not be possible to obtain sufficient appropriate audit evidence from substantive audit procedures alone in relation to the risks of material misstatement associated with related party relationships and transactions. For example, where intra-group transactions between the entity and its components are numerous and a significant amount of information regarding these transactions is initiated, recorded, processed or reported electronically in an integrated system, the auditor may determine that it is not possible to design effective substantive audit procedures that by themselves would reduce the risks of material misstatement associated with these transactions to an acceptably low level. In such a case, in meeting the ISA 330 requirement to obtain sufficient appropriate audit evidence as to the operating effectiveness of controls,[26] the auditor is required to test the entity's controls over the completeness and accuracy of the recording of the related party relationships and transactions.

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26 ISA 330, paragraph 8(b)

Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions

Communicating Newly Identified Related Party Information to the Engagement Team (Ref: Para. 22(a))

A35. Communicating promptly any newly identified related parties to the other members of the engagement team assists them in determining whether this information affects the results of, and conclusions drawn from, risk assessment procedures already performed, including whether the risks of material misstatement need to be reassessed.

Substantive Procedures Relating to Newly Identified Related Parties or Significant Related Party Transactions (Ref: Para. 22(c))

A36. Examples of substantive audit procedures that the auditor may perform relating to newly identified related parties or significant related party transactions include:

- Making inquiries regarding the nature of the entity's relationships with the newly identified related parties, including (where appropriate and not prohibited by law, regulation or ethical rules) inquiring of parties outside the entity who are presumed to have significant knowledge of the entity and its business, such as legal counsel, principal agents, major representatives, consultants, guarantors, or other close business partners.
- Conducting an analysis of accounting records for transactions with the newly identified related parties. Such an analysis may be facilitated using computer-assisted audit techniques.
- Verifying the terms and conditions of the newly identified related party transactions, and evaluating whether the transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

Intentional Non-Disclosure by Management (Ref: Para. 22(e))

A37. The requirements and guidance in ISA 240 regarding the auditor's responsibilities relating to fraud in an audit of financial statements are relevant where management appears to have intentionally failed to disclose related parties or significant related party transactions to the auditor. The auditor may also consider whether it is necessary to re-evaluate the reliability of management's responses to the auditor's inquiries and management's representations to the auditor.

Identified Significant Related Party Transactions outside the Entity's Normal Course of Business

Evaluating the Business Rationale of Significant Related Party Transactions (Ref: Para. 23)

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 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 ISA 500,[27] to consider the reliability of management's explanations and representations on other significant matters.

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27 ISA 500, *Audit Evidence*, paragraph 11

A39. The auditor may also seek to understand the business rationale of such a transaction from the related party's perspective, as this may help the auditor to better understand the economic reality of the transaction and why it was carried out. A business rationale from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor.

Authorization and Approval of Significant Related Party Transactions (Ref: Para. 23(b))

A40. Authorization and approval by management, those charged with governance, or, where applicable, the shareholders of significant related party transactions outside the entity's normal course of business may provide audit evidence that these have been duly considered at the appropriate levels within the entity and that their terms and conditions have been appropriately reflected in the financial statements. The existence of transactions of this nature that were not subject to such authorization and approval, in the absence of rational explanations based on discussion with management or those charged with governance, may indicate risks of material misstatement due to fraud or error. In these circumstances, the auditor may need to be alert for other transactions of a similar nature. Authorization and approval alone, however, may not be sufficient in concluding whether risks of material misstatement due to fraud are absent because authorization and approval may be ineffective if there has been collusion between the related parties or if the entity is subject to the dominant influence of a related party.

Considerations specific to smaller entities

A41. A smaller entity may not have the same controls provided by different levels of authority and approval that may exist in a larger entity. Accordingly, when auditing a smaller entity, the auditor may rely to a lesser degree on authorization and approval for audit evidence regarding the validity of significant related party transactions outside the entity's normal course of business. Instead, the auditor may consider performing other audit procedures such as inspecting relevant documents, confirming specific aspects of the transactions with relevant parties, or observing the owner-manager's involvement with the transactions.

Assertions That Related Party Transactions Were Conducted on Terms Equivalent to Those Prevailing in an Arm's Length Transaction (Ref: Para. 24)

A42. Although audit evidence may be readily available regarding how the price of a related party transaction compares to that of a similar arm's length transaction, there are ordinarily practical difficulties that limit the auditor's ability to obtain audit evidence that all other aspects of the transaction are equivalent to those of the arm's length transaction. For example, although the auditor may be able to confirm that a related party transaction has been conducted at a market price, it may be impracticable to confirm whether other terms and conditions of the transaction (such as credit terms, contingencies and specific charges) are equivalent to those that would ordinarily be agreed between independent parties. Accordingly, there may be a risk that management's assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction may be materially misstated.

A43. The preparation of the financial statements requires management to substantiate an assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction. Management's support for the assertion may include:

- Comparing the terms of the related party transaction to those of an identical or similar transaction with one or more unrelated parties.
- Engaging an external expert to determine a market value and to confirm market terms and conditions for the transaction.
- Comparing the terms of the transaction to known market terms for broadly similar transactions on an open market.

A44. Evaluating management's support for this assertion may involve one or more of the following:

- Considering the appropriateness of management's process for supporting the assertion.
- Verifying the source of the internal or external data supporting the assertion, and testing the data to determine their accuracy, completeness and relevance.
- Evaluating the reasonableness of any significant assumptions on which the assertion is based.

A45. Some financial reporting frameworks require the disclosure of related party transactions not conducted on terms equivalent to those prevailing in arm's length transactions. In these circumstances, if management has not disclosed a related party transaction in the financial statements, there may be an implicit assertion that the transaction was conducted on terms equivalent to those prevailing in an arm's length transaction.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Perform procedures to address RMMs associated with related parties [ISA | 4321]

What do we do?

Design and perform audit procedures to address CAR of RMMs associated with related party relationships and transactions

Why do we do this?

Like with other RMMs we identify, we respond to those related party risks we identify and assess as RMMs. We design and perform audit procedures commensurate with our assessed CAR for each of these RMMs to obtain sufficient appropriate audit evidence.

Execute the Audit

How do we design a response to related party RMMs? [ISA | 4321.1300]

We respond in the same manner as we do for other RMMs and consider their assessed level of CAR, which is addressed in the chapter on responding to risks of material misstatement (ISA 330). However, our response also includes specific procedures that include:

- Designing and performing audit procedures to address related party RMMs, including specific procedures over significant unusual related party transactions ;
- Evaluating whether all related parties, relationships and transactions have been identified ;
- Performing relevant procedures on previously undisclosed related parties, relationships and transactions ;
- If the related party transaction is also a Significant Unusual Transaction (SUT), understanding the business purpose (or the lack thereof) for each SUT and evaluating whether SUTs have been properly accounted for and disclosed ; and
- Evaluating management's arm's length assertion for related party transactions .

Additionally, in a group audit we also perform the following procedure:

- Group Audit or Component Audit | Perform procedures over intercompany account balances .

1.1 Design and perform audit procedures to address related party RMMs, including specific procedures over significant unusual related party transactions [ISA | 4322]

What do we do?

Design and perform audit procedures to address RMMs associated with related party relationships and transactions. If there are related party transactions that are also considered significant unusual transactions, then perform additional procedures.

Why do we do this?

Like with other RMMs we identify, we respond to those related party risks we identify and assess as RMMs. We design and perform audit procedures commensurate with our assessed CAR for each of these RMMs to obtain sufficient appropriate audit evidence. Sometimes related party transactions are also identified as significant and unusual transactions (SUTs). When this is the case, we perform additional procedures relevant to assessing whether the transactions have been initiated to perpetrate fraudulent reporting or concealment of the misappropriation.

Execute the Audit

How do we design a response to related party financial statement-level RMMs? [ISA | 4322.1300]

Our response is the same as designing a response for other financial statement-level RMMs. See activity 'Design and implement overall responses ' for further information.

How do we design a response to related party significant risks? [ISA | 4322.1400]

If the RMM at the financial statement level or assertion level is also a significant risk, our response is the same as designing a response for other significant risks. We:

- evaluate the design and implementation of relevant controls that address the financial statement level or assertion level significant risk (see activity 'Understand relevant controls that address significant risks ' for further information)
- design our overall response to the financial statement level risk (see activity 'Design and implement overall responses ' for further information); and
- design audit procedures that are specifically responsive to the RMM at the assertion level (see activity 'Perform substantive procedures that respond to significant risks ' for further information).

What might we do differently in designing a response to a fraud risk associated with related party dominant influence? [ISA | 4322.1500]

Our response is the same as designing a response for significant risks (see activity 'Perform substantive procedures that respond to significant risks ') or other RMMs due to fraud (see activity 'Design and perform procedures to address each assertion-level RMM due to fraud '). In addition to the general risk assessment procedures, we may find it helpful to perform other risk assessment procedures that support our understanding of the business relationship with the related party that exercises dominant influence by:

- 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; and
- Review of employee whistle-blowing reports where these are retained.
- We may also consider implementing an overall response to the RMM (see activity 'Design and implement overall responses ' for further information).
- Our understanding of the business relationship shapes the 'special' specific response to addressing the RMM due to fraud through our substantive procedures.

What do we think about in determining whether we group related party transactions together? [ISA | 4322.14399]

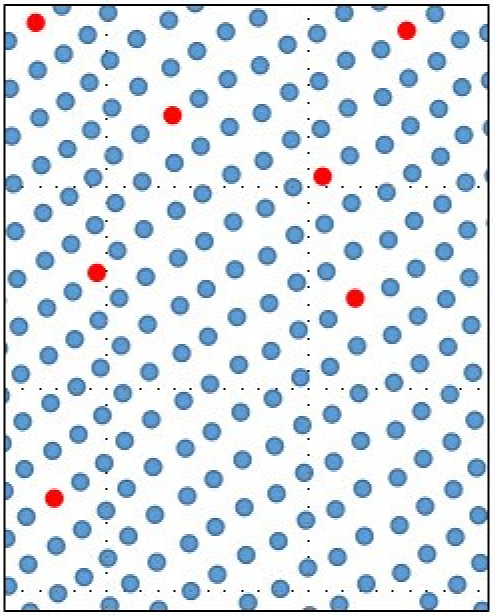
When we think about whether to group related party transactions together when performing our risk assessment, control testing, and substantive testing, we think about the following factors:

Factor	What we think about
Processes and controls	When related party transactions have different processes and controls it may be more appropriate to consider these transactions separately, despite the fact that they are transacted with the same related party. Otherwise, we may miss key aspects that impact our audit approach.
Aggregation in the financial statement presentation	When related party transactions are aggregated in the financial statement presentation, it may be appropriate to group them together. However, when amounts are disclosed separately, we think about whether they have a different risk assessment and whether our audit procedures are appropriate. For example, if we were to sample the grouped transactions, it might not be an appropriate audit procedure if the transactions are not aggregated together in the financial statements.
Different transaction terms or parties	If we group transactions together that have different terms or related parties associated with them, we think about whether our designed audit response is appropriate. For example, if contractual terms are not standardized with related parties, it may not be appropriate to read only one contract. We may read several contracts to understand the varying terms in order to determine if they impact how the transactions are accounted for and disclosed. There are similar considerations when the transactions are conducted with different related parties.
Other risk assessment factors	When related party transactions have different risk assessments (including CAR) associated with them, it may not be appropriate to group them together. Doing so may compromise designing an appropriate audit response. If, in rare instances, we do group related party transactions together with different risk assessments, we use the highest risk assessment for all transactions in designing our audit response.

What do we think about when determining whether to test the operating effectiveness of controls that address related party RMMs? [ISA | 4322.14483]

We think about whether we can obtain sufficient appropriate evidence without testing the operating effectiveness of controls.

For example, in the graphic below, imagine the dots represent the entity's transactions and red dots are transactions with related parties. We ask ourselves whether we can obtain sufficient appropriate audit evidence that management has completely and accurately identified the red dots from the blue dots through substantive procedures alone without testing controls.



How does the size and complexity of the entity effect on related party processes and controls? [ISA | 4322.14464]

Large and complex entities may interact with thousands of parties and conduct millions of different types of transactions. Without effective processes and controls it may be difficult for management to identify all related parties, relationships and transactions accurately and completely. Likewise, it may also be difficult for us to obtain sufficient and appropriate audit evidence regarding the completeness of related party relationships and transactions through substantive procedures alone.

For entities with simple structures, transactions and/or a small number of employees, we may be able to obtain sufficient appropriate evidence, including completeness, through substantive procedures alone.

How does the applicable financial reporting framework impact related party processes and controls? [ISA | 4322.14465]

Where the applicable financial reporting framework specifies related party requirements, it is likely that management has designed and implemented processes and controls to enable the preparation of the financial statements. This stems from their responsibility to have internal controls to enable the preparation of the financial statements free from material misstatement.

However, if the applicable financial reporting framework does not have specific related party requirements, processes and controls may not exist and/or be ineffective in preventing material misstatement in the financial statements.

What do we do if a related party transaction is also a SUT? [ISA | 4322.14470]

In addition to procedures we perform for related parties, we also perform procedures relevant to SUTs. See the question '[What procedures do we perform over significant unusual transactions?]' for those procedures.

What is a significant unusual transaction (SUT)? [ISA | 4322.14472]

A SUT is a significant transaction that is outside the normal course of business for the entity or that otherwise appears to be unusual due to its timing, size, or nature.

Examples

How do we determine whether to test the operating effectiveness of controls to address related party risks at the assertion level? [ISA | 4322.14477]

Fact pattern 1

An entity enters into numerous intra-group transactions with its subsidiaries and a significant amount of information regarding these transactions is initiated, recorded, processed or reported electronically in an integrated system.

Analysis 1

Given the volume of transactions and information, the engagement team determines that it is not possible to design effective substantive audit procedures that by themselves reduce audit risk associated with these transactions to an acceptably low level.

Fact pattern 2

An entity's primary business is managing investment property for a small number of clients that own multiple buildings. It receives management fees for its services and its primary expenses are salary and wages to its property managers and administrative expenses. The entity is privately owned by its founder and CEO. The entity has no debt.

Analysis 2

The engagement team determined that they could obtain sufficient appropriate audit evidence regarding related parties without testing controls to obtain sufficient appropriate evidence. The engagement team determined that substantive procedures alone were appropriate due to the following factors:

- The ownership structure is simple
- There are a small number of customers
- The drivers of income and expense transactions are simple and predictable.

1.2 Evaluate whether all related parties, relationships and transactions have been identified

[ISA | 4325]

What do we do?

Inspect documents and evaluate whether the entity has properly identified related parties, relationships and transactions AND IF we identify indicators of undisclosed related parties, relationships and transactions, THEN perform procedures to determine whether they exist and are undisclosed.

Why do we do this?

Management may not be able to prepare the financial statements free from material misstatement if they do not have a complete and accurate understanding of related parties, relationships and transactions. We evaluate whether our and management's identification is complete and accurate and perform procedures to address any indicators which might suggest the existence of a related party, relationship or transaction that management has not disclosed to us.

Execute the Audit

What are our responsibilities regarding identifying undisclosed related party relationships and transactions? [ISA | 4325.1300]

Our responsibilities are to

- remain alert during the audit when inspecting records or documents for information that may indicate the existence of related parties, relationships or transactions not disclosed to us; and
- evaluate whether the entity has identified its related parties and relationships and transactions with related parties.

> For example, when inspecting contracts and other documents regarding a significant transaction, we remain alert as to whether any information may indicate that a related party is involved with the transaction.

What is an undisclosed related party, relationship or transaction? [ISA | 4325.1400]

Related parties, relationships and transactions are undisclosed when management has not disclosed them to us. An undisclosed related party, relationship or transaction includes undisclosed:

- related parties; or
- relationships or transactions with disclosed or undisclosed related parties.

How do we evaluate whether the entity has identified its related parties, relationships and transactions? [ISA | 4325.1500]

We perform procedures to evaluate the completeness and accuracy of related party transactions. We cannot rely solely on our understanding of the entity's related party processes/controls or our evaluation of the design and operating effectiveness of controls alone. At a minimum, we:

- establish a base population of related parties, relationships and transactions that management has disclosed to us from our risk assessment procedures (step 1);
- consider whether other audit procedures or component auditors have identified additional or different related party information (step 2);
- inspect relevant documents to determine if it provides additional or different related party information (step 3);
- consider steps 1-3, and determine if we have obtained sufficient appropriate evidence or whether we will perform additional procedures (step 4)

Our testing of the completeness of management's identification of related parties, relationships and transactions, may be different than other tests we perform for other accounts, such as accounts payable. Unlike accounts payable, there may not be a suitable reciprocal population from which to select items to identify additional related parties, relationships and transactions. As such, we perform risk assessment procedures, including:

- understand the entity's processes and controls,
- obtain a list from management of all related parties, and related party relationships and transactions that they have identified through their processes, and
- communicate that list to the engagement team and component auditors.

Then through the course of our testwork in all areas of the audit, we remain alert for the existence of undisclosed related parties or related party relationships and transactions.

How do we establish the base population of related parties, relationships and transactions (step 1)? [ISA | 4325.1600]

First, we complete risk assessment procedures to establish what related parties, relationships, and transactions management has identified to us (see activity 'Obtain an understanding of related party relationships and transactions '). This is primarily accomplished through our related party inquiries with management. Management may also provide us with a written list, which we may request from them in our prepared by client (PBC) requests.

What other audit procedures may identify additional or different related party information (step 2)? [ISA | 4325.1700]

In determining whether management has appropriately identified related parties, relationships, or transactions, we consider whether other audit procedures may have identified additional or different related party information, such as:

- Procedures to understand and evaluate the design and implementation of relevant related party processes and controls (see activity 'Obtain an understanding of related party processes and controls ');
- Procedures over management identified related party transactions that have been disclosed to us by management (see activity 'Perform procedures to address RMMs associated with related parties ');
- Procedures over significant unusual transactions (see activity 'Understand the business purpose (or the lack thereof) for each SUT ';
- Procedures over financial relationships and transactions with executives (see activity 'Understand financial relationships and transactions with executive officers ' for further information on these procedures); or
- Any other audit procedures where we become aware of a related party not previously disclosed to us by management.

We also consider whether component auditors have communicated to us any related parties, relationships or transactions that are not included on the list that we provided to them (see activity 'Request component auditors to communicate related party information not previously identified ').

> Examples of audit procedures that we perform in connection with our audit that may lead us to identify undisclosed related parties or related party relationships and transactions are may include:

- determining that other procedures over known related party transactions, significant unusual transactions and management compensation have not identified undisclosed related parties;
- inspecting board minutes;
- obtaining and inspecting third party confirmations;
- payables or revenue testwork;
- understanding the business purpose of significant unusual transactions (SUTs);
- reading annual disclosures completed by the board and management regarding their investments, participation on boards of other entities, and previous employment history;
- reading other publicly available information.

What arrangements or information from other audit procedures might indicate that related party relationships or transactions exist (step 2)? [ISA | 4325.1900]

The following circumstances may indicate that related party relationships or transactions exist:

- borrowing or lending on an interest-free basis or at a rate of interest significantly above or below market rates prevailing at the time of the transaction;
- buying or selling services or assets, including real estate, at a price that differs significantly from its appraised or fair value;
- transactions between two or more entities in which each party provides and receives the same or similar amounts of consideration (e.g. round-trip transactions). For example, exchanging property for similar property in a non-monetary transaction;
- making or receiving loans with no scheduled terms for when or how the funds will be repaid;
- transactions that have abnormal terms of trade (such as unusual prices, interest rates, guarantees, rights of return and repayment terms);
- transactions that lack an apparent logical business reason for their occurrence;
- transactions processed in an unusual manner;
- "bill and hold" type transactions;
- occupying premises or receiving other assets or rendering or receiving management services when no consideration is exchanged;
- engaging in a nonmonetary transaction that lacks commercial substance;
- sales without economic substance (e.g. funding the other party to the transaction to facilitate collection of the sales price, or entering into a transaction shortly prior to period end and unwinding that transaction shortly after period end);
- loans to parties that, at the time of the loan transaction, do not have the ability to repay and possess insufficient or no collateral;
- loans made without prior consideration of the ability of the party to repay;
- a subsequent repurchase of goods that indicates that at the time of sale an implicit obligation to repurchase may have existed that would have precluded revenue recognition or sales treatment;
- advancing entity funds that are used directly or indirectly to pay what would otherwise be an uncollectible loan or receivable;
- sales at below market rates to an intermediary whose involvement serves no apparent business purpose and who, in turn, sells to the ultimate customer at a higher price, with the intermediary (and ultimately its principals) retaining the difference;
- participation in unincorporated partnerships with other parties;

- agreements for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business;
- guarantees and guarantor relationships outside the normal course of business.

What documents do we inspect to determine whether there are related parties, relationships or transactions that management has not disclosed to us (step 3)? [ISA | 4325.2000]

We inspect:

- minutes of the meetings of shareholders and of those charged with governance, or summaries of actions of recent meetings for which minutes have not yet been prepared;
- bank and legal confirmations; and
- any other documents considered relevant.

What other documents might be relevant to inspect (step 3)?

We think about what other documents might assist us in testing the completeness and accuracy of related parties, relationships, including publically available information.

Common documents we may inspect, include:

- organizational charts;
- conflicts of interest questionnaires of those charged with governance and management;
- shareholder registers;
- investment records, including pension/post-employment plan investments;
- third-party confirmations, in addition to bank and legal confirmations;
- entity tax returns and related correspondence;
- information supplied by the entity to regulatory authorities;
- contracts and agreements with key members of management or those charged with governance;
- significant contracts and agreements outside the entity's ordinary course of business;
- invoices and correspondence between the entity and its professional advisors, including legal counsel;
- life insurance policies acquired by the entity;
- significant contracts re-negotiated by the entity during the period;
- reports of the internal audit function;
- capital financing arrangements with entities other than financial institutions;
- economic development arrangements for capital additions;
- documents associated with the entity's filings with a securities regulator (e.g. prospectuses);
- disclosures contained on the entity's website;
- records from a management or those charged with governance's whistleblower program;
- expense reimbursement documentation for senior management and executives.

How do we determine whether we have obtained sufficient appropriate evidence (step 4)? [ISA | 4325.2200]

To determine whether or not we have obtained sufficient appropriate evidence, we think about:

- our assessed RMMs (revised accordingly for new information);
- if applicable, the evidence we have gathered through control testing over related party processes and controls;
- the evidence we have gathered through substantive testing; and

- results of procedures to follow up contradictory information that may indicate that management has not identified all related party relationships and transactions.

What other procedures may we perform to evaluate whether identified related parties, relationships and transactions are complete (step 4)? [ISA | 4325.2300]

In many cases, performing our related party risk assessment procedures, performing steps 1-3 in this activity and being alert for undisclosed related parties, relationships and transactions when performing other procedures in our audit will be sufficient. Our evaluation of the completeness of management's identification of related parties, relationships and transactions may be different than other procedures we perform over completeness for other accounts and disclosures, such as accounts payable. Unlike accounts payable, there may not be a suitable reciprocal population from which to select items to identify additional related parties, relationships and transactions.

What do we do if there are indicators that related parties, relationships or transactions may not be identified or disclosed to us? [ISA | 4325.2400]

When there are indicators that related parties, relationships or transactions may not be identified or disclosed to us, we perform procedures beyond inquiry to evaluate whether there is, in fact, an undisclosed related party, relationship or transaction. These procedures are consistent with our general responsibilities to perform additional audit procedures if audit evidence is inconsistent or we have doubts about the reliability of information (see activity 'If there are inconsistencies or doubts, modify or perform additional audit procedures and evaluate the effect on our audit ').

Why is inquiry not enough?

In a situation where management failed to disclose a related party, relationship or transaction, there may be serious implications for our audit. Undisclosed related parties, relationships and transactions may be indicative of:

- An increased risk assessment for RMMs, including fraud risks;
- A new significant risk;
- A control deficiency; or
- Other representations made by management may not be reliable.

We corroborate our inquiries with other procedure to determine the effect on the audit.

What do we do if we discover related parties, relationships or transactions that management did not identify or disclose to us? [ISA | 4325.2600]

When we discover related parties, relationships or transactions that management did not identify or disclose to us, we:

- perform procedures over those unidentified or undisclosed relationships and significant transactions (see activity 'Perform relevant procedures on previously undisclosed related parties, relationships and transactions ');
- we consider whether to revise our risk assessment for this new information;
- we communicate the matter to those charged with governance, if we determine it to be a significant audit finding (see activity 'Communicate related party matters with those charged with governance ').

Examples

What circumstances might indicate that an undisclosed related party transaction has occurred? [ISA | 4325.2700]

Fact pattern

While reading the board minutes, an engagement team member notes that the entity has acted as guarantor for a new loan of another entity (guarantee beneficiary). The entity typically acts as guarantor for its subsidiaries and other joint ventures (typically also related parties under the applicable financial reporting framework); however, this entity has not been identified by management as a related party and has not disclosed the relationship in the financial statements.

Analysis

Using professional skepticism, the engagement team member searches for publicly available information regarding the entity's relationship with the guarantee beneficiary. The engagement team member determines that the entity owns a controlling interest in the guarantee beneficiary and that the party is, in fact, a related party as defined under the applicable financial reporting framework.

1.3 Perform relevant procedures on previously undisclosed related parties, relationships and transactions [ISA | 4326]

What do we do?

If we determine that a previously undisclosed related party, relationship or transaction exists, then perform relevant procedures

Why do we do this?

There can be serious implications for our audit when we identify that management did not disclose to us certain related parties, relationships or transactions. We perform procedures that respond to this new information and evaluate the implications for our audit.

Execute the Audit

What is an undisclosed related party, relationship or transaction? [ISA | 4326.1300]

Related parties, relationships and transactions are undisclosed when management has not disclosed them to us. An undisclosed related party, relationship or transaction includes undisclosed:

- related parties; or
- relationships or transactions with disclosed or undisclosed related parties.

When do we perform procedures over undisclosed related parties, relationships or transactions? [ISA | 4326.1500]

We perform the procedures in this activity when we identify an undisclosed:

- related party; or
- significant related party transactions.

What do we do if we identify an undisclosed related party, relationship or transaction? [ISA | 4326.1600]

We:

- inquire of management (step 1);
- evaluate why the related party information was undisclosed to us (step 2);
- perform additional procedures to identify other undisclosed related party information, when relevant (step 3);
- communicate the undisclosed related party information to the engagement team including, in a group audit, component auditors (step 4);
- perform procedures on transactions that are significant risk or disclosed in the financial statements (step 5); and
- determine whether there are any other implications on our audit (step 6).

What inquiries do we make of management (step 1)? [ISA | 4326.1800]

We ask management:

- why the related party, relationship or significant transaction was not disclosed to us;
- whether there is a possibility of other transactions that are not disclosed to us.

If the applicable financial reporting framework establishes related party requirements, we also ask management:

- why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or significant transaction, if applicable; and
- to identify all transactions with the newly identified related party or relationship for our further evaluation.

How do we evaluate why the related party information was previously undisclosed to us (step 2)? [ISA | 4326.2000]

We think about management's response to our inquiries to evaluate why the related party information is undisclosed. The cause of the omission is relevant to evaluating whether our risk assessment remains appropriate and if we will perform additional procedures in step 6.

Undisclosed related parties, relationships and transactions may have a significant impact on our audit.

> For example, undisclosed related parties, relationships or transactions may be indicative of:
>
> - An increased risk assessment for RMMs, including fraud risks;
> - A new significant risks;
> - A control deficiency; or
> - Other representations made by management are not reliable.

We think about whether management was aware, or should have been aware, of the related party, relationship or transaction.

- Was it an oversight by management - a new related party, relationships or transaction that had not yet been formally identified?
- Did internal controls fail to identify the related party, relationships or transaction?
- Was the non-disclosure intentional? Is management trying to conceal this information from investors or from us in order to support the accounting positions they've made? Further, is the concealment to engage in fraudulent activity?
- Is there a possibility that other related parties, relationships and transaction may not have been disclosed to us?
- What additional procedures do we perform to address these new information and our revised risk assessment?

How do we assess if we will perform additional procedures to identify other undisclosed related parties, relationships or transactions (step 3)? [ISA | 4326.2100]

Once we understand why the related party information was undisclosed to us, we determine that there is a risk that other related party information may be undisclosed to us. We perform additional or modify our planned procedures to respond to this risk as necessary.

Fact pattern 1

We determine that management was unaware of a new relationship and transactions with a related party because of a deficiency in controls.

Analysis 1

We determine that there is a risk that controls may have also failed to identify other new relationships and transactions with other related parties. We design additional substantive procedures or increase the extent of testing to address the completeness of identified related party relationships and transactions.

Fact pattern 2

We determine that management was aware of a new relationship and transactions with a related party but did not disclose this information to us or in the financial statements.

Analysis 2

We determine that there is a fraud risk that management intended not to disclose this information in the financial statements because the arrangement may have been viewed unfavorably by users of the financial statements. In response to the fraud risk, we may choose to include a forensics specialist to perform procedures targeted at identifying other ways related parties may have been used to misstate the financial statements or conceal the misappropriation of assets.

What related party information do we communicate to the engagement team, including component auditors (step 4)? [ISA | 4326.2200]

We communicate to the engagement team including, in a group audit, component auditors (see activity 'Communicate to component auditors relevant information regarding related parties' for more information when it is a group audit):

- the names of any newly identified related parties; and

- any changes or new information regarding the nature of the entity's relationships and transactions with those related parties.

In addition to the information we always communicate, we determine if there is any other relevant information to communicate to the engagement team including, in a group audit, component auditors.

Communicating any newly identified related parties promptly to the other members of the engagement team including, in a group audit, component auditors assists them in determining whether this information affects their risk assessment or the results of, and conclusions drawn from, audit procedures already performed.

What substantive audit procedures do we perform on the undisclosed related party or significant transactions (step 5)? [ISA | 4326.2400]

We design our substantive audit procedures to address the assessed CAR of each RMM associated with either the undisclosed related party or significant related party transaction. Examples of procedures we may perform include:

- inquiring regarding the nature of the entity's relationships with the newly identified related parties, including (where appropriate and not prohibited by law, regulation or ethical rules) inquiring of parties outside the entity who are presumed to have significant knowledge of the entity and its business, such as legal counsel, principal agents, major representatives, consultants, guarantors or other close business partners;
- conducting an analysis of accounting records for transactions with the newly identified related parties. Such an analysis may be facilitated using computer assisted audit techniques; or
- inspecting documents regarding the terms and conditions of the newly identified related party transactions, and evaluating whether the transactions have been appropriately accounted for and disclosed.

What other procedures do we perform when we identify undisclosed related parties, relationships or significant transactions (step 6)? [ISA | 4326.2600]

We:

- Reassess the RMMs;
- Evaluate the implications for the audit; and
- Evaluate the implications on our assessment of internal control over financial reporting, if applicable.

In conjunction with step 3, we consider whether our initial risk assessment remains appropriate given our new knowledge that management did not disclose to us all related parties, relationships or transactions. In addition to adjusting our inherent or control risk assessment on previously identified RMMs, we may also identify additional RMMs, including fraud risks, such as the risk that management has not identified or disclosed to us related parties, relationships or transactions.

We also evaluate whether there are other implications for the audit. Management's non-disclosure may be indicative of fraud or non-compliance. If we become aware of information indicating that fraud or another illegal act has occurred or might have occurred, we perform other relevant fraud (see the chapter on fraud (ISA 240) and non-compliance/ illegal acts (see chapter on laws and regulation (ISA 250) procedures, and determine if we have any additional responsibilities under relevant professional standards, laws or regulations.

1.4 Understand the business purpose (or the lack thereof) for each SUT [ISA | 825]

What do we do?

Design and perform procedures to obtain an understanding of the business purpose (or lack thereof) of each significant unusual transaction that we have identified.

Why do we do this?

We obtain an understanding of the business purpose of a SUT to determine whether the transaction could have been entered into to engage in fraud. Because fraud is an intentional act that may result in a material misstatement in the financial statements, we evaluate indicators of inconsistency in the business purpose between what management asserts and our understanding.

Execute the Audit

What procedures do we perform to obtain an understanding of the business purpose of the SUT? [ISA | 825.1300]

To obtain an understanding of the business purpose of SUTs we:

- Read underlying documentation and evaluate whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or lack thereof) of the transaction ;
- Determine whether the transaction has been authorized and approved in accordance with the entity's established policies and procedures ;
- Evaluate the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees, and other obligations, if any; and
- Perform other procedures as necessary depending on the identified and assessed risks of material misstatement .

When do we obtain an understanding of the business purpose of the SUT? [ISA | 825.1400]

We obtain an understanding of the business purpose of any identified SUTs during planning and risk assessment. If we identify SUTs later in the audit, we obtain an understanding of the business purpose of the SUT as soon as such transactions are identified. Our understanding of the business purpose of the SUT can affect our assessment of the risks of material misstatement related to the SUT and the nature and extent of the procedures we plan to perform.

1.4.1 Read underlying documentation [ISA | 826]

What do we do?

Read the underlying documentation and evaluate whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction.

Why do we do this?

Reading the underlying documentation related to a significant unusual transaction (SUT) helps us to identify possible inconsistencies between the terms and other information about the transaction with the explanations from inquiries and other audit evidence regarding the business purpose (or lack thereof) of the transaction.

Execute the Audit

What types of underlying documentation related to a SUT may exist? [ISA | 826.1300]

Underlying documentation may include a variety of items, such as:

- contracts and agreements (and any amendments to the original contracts and agreements),
- presentations or documents prepared by management for the board of directors related to the transaction, and
- presentations or documents summarizing the steps to complete a particular transaction.

Can we read draft documents related to a SUT? [ISA | 826.1400]

We may first read draft contracts and agreements related to a significant unusual transaction prior to receiving final executed copies. However, we also obtain and read the final executed copies of the contracts and agreements to determine whether there have been any changes to the terms of the contracts and agreements made subsequent to the draft provided.

Who should read the underlying documentation related to a SUT? [ISA | 826.1500]

As SUTs are often complex in nature and may have been entered into to engage in fraud, we assign personnel with an appropriate level of knowledge, skill, ability, and experience to perform procedures in response to significant unusual transactions and increase the level of supervision and review.

Given the complexity and importance of these times, it may be necessary for more experienced team members - e.g., engagement manager and/or partner - to read the underlying documentation related to a SUT.

1.4.2 Determine whether the transaction has been authorized and approved [ISA | 827]

What do we do?

Determine whether the transaction has been authorized and approved in accordance with the entity's established policies and procedures.

Why do we do this?

When a significant unusual transaction (SUT) has not been authorized and approved in accordance with the entity's established policies and procedures, it can be an indicator that it may lack a legitimate business purpose and/or may have been entered into to engage in fraud.

Execute the Audit

Enhanced | How do we determine the entity's established policies and procedures for authorizing and approving SUTs? [ISA | 827.1300]

We obtain an understanding of and evaluate the design and implementation of controls that management has established to identify, authorize and approve, and account for and disclose SUTs as part of our procedures performed to identify and assess risks of material misstatement.

We use our knowledge obtained from these procedures when determining whether a SUT has been authorized and approved in accordance with the entity's established policies and procedures and what evidence of this authorization/approval exists.

What are authorization controls? [ISA | 827.14410]

Authorization involves the granting of permission by a party or parties with the appropriate authority (whether management, those charged with governance or the entity's shareholders) for the entity to enter into specific transactions in accordance with pre-determined criteria, whether judgmental or not.

What are approval controls? [ISA | 827.14411]

Approval involves those parties' acceptance of the transactions the entity has entered into as having satisfied the criteria on which authorization was granted.

What are examples of process control activities the entity may have to authorize and approve SUTs? [ISA | 827.14412]

Examples of process control activities the entity may have to authorize and approve significant unusual transactions include:

- approval of the terms and conditions of the transactions and arrangements by management, those charged with governance or, where applicable, shareholders; and
- monitoring controls to ensure such transactions and arrangements have been appropriately authorized and approved in accordance with the entity's established policies and procedures for authorization and approval.

Core and Less Complex | How do we determine the entity's established policies and procedures for authorizing and approving SUTs? [ISA | 827.14413]

We obtain an understanding of and evaluate the design and implementation of controls that management has established to authorize and approve SUTs as part of our procedures performed to identify and assess risks of material misstatement.

We use our knowledge obtained from these procedures when determining whether a SUT has been authorized and approved in accordance with the entity's established policies and procedures and what evidence of this authorization/approval exists.

What are authorization controls? [ISA | 827.1401]

Authorization involves the granting of permission by a party or parties with the appropriate authority (whether management, those charged with governance or the entity's shareholders) for the entity to enter into specific transactions in accordance with pre-determined criteria, whether judgmental or not.

What are approval controls? [ISA | 827.1402]

Approval involves those parties' acceptance of the transactions the entity has entered into as having satisfied the criteria on which authorization was granted.

What are some examples of process control activities an entity may have to authorize and approve SUTs? [ISA | 827.1403]

Examples of process control activities the entity may use to authorize and approve significant unusual transactions include:

- approval of the terms and conditions of the transactions and arrangements by management, those charged with governance or, where applicable, shareholders; and
- monitoring controls to ensure such transactions and arrangements have been appropriately authorized and approved in accordance with the entity's established policies and procedures for authorization and approval.

Do we evaluate the design and implementation of process control activities over the authorization and approval of SUTs? [ISA | 827.14414]

Not necessarily. When the entity has not entered into any SUTs during the year, we don't evaluate the design and implementation of process control activities over the authorization and approval of SUTs. This is because there are no current year operations of the process control activity to evaluate.

How do we determine whether a SUT has been authorized and approved in accordance with the entity's established policies and procedures? [ISA | 827.1500]

We inspect documentation supporting the authorization and approval of the SUT. Such documentation may include final executed contracts and agreements, evidence of approval by board of directors and other required approvals, included in related meeting minutes.

1.4.3 Evaluate the financial capability of the other parties [ISA | 828]

What do we do?

Evaluate the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees, and other obligations, if any

Why do we do this?

When a significant unusual transaction (SUT) has been entered into with other parties who are not capable of meeting or fulfilling their respective obligations, this can be an indicator that the SUT lacks a legitimate business purpose and may have been entered into in order to engage in fraud.

Execute the Audit

How do we evaluate the financial capability of other parties involved in a SUT? [ISA | 828.1300]

We obtain and inspect evidence regarding the financial capability of the other parties.

> Examples of evidence we may obtain and inspect include, among other things, the audited financial statements of the other party, reports issued by regulatory agencies, financial publications (e.g., credit agency ratings) and income tax returns of the other party, to the extent available.

How does the financial capability of other parties affect the recognition and measurement of a transaction? [ISA | 828.1400]

The initial recognition and subsequent measurement of an accounting transaction is often dependent upon the financial capability of other parties involved in a transaction.

> Examples of the initial recognition and subsequent measurement of an accounting transaction dependent upon financial capability of other parties include:
>
> - Revenue recognition. Assessing whether an entity will collect substantially all of the consideration to which it will be entitled in exchange for goods and services that are transferred to customers.
> - Lease classification. A lease that would otherwise meet the tests to be classified either as a sales-type lease, direct finance lease or a leveraged lease but that does not meet the "collectability of the minimum lease payments is reasonably predictable" criterion is classified as an operating lease by the lessor.

1.4.4 Perform other procedures as necessary, depending on identified and assessed RMMs [ISA | 829]

What do we do?

Perform other procedures as necessary, depending on the identified and assessed risks of material misstatement.

Why do we do this?

When we identify significant unusual transactions (SUTs) entered into by the entity, we identify and assess risks of material misstatement (RMM) related to the SUT. Our assessment is based on our understanding of the transaction entered into, including the business rationale (or lack thereof), as well as the accounting standards applicable to the transaction. We then design and perform procedures whose nature, timing, and extent are responsive to each RMM so that there is a clear link between our procedures and our risk assessment.

Execute the Audit

What other procedures might we perform over a SUT to obtain an understanding of the business purpose? [ISA | 829.1600]

Our other procedures may consist of substantive procedures or a combination of tests of operating effectiveness of controls and substantive procedures. In some cases, it may be helpful to involve specific team members or specialists to obtain an understanding of the business purpose of complex SUTs.

1.5 Evaluate whether SUTs have been properly accounted for and disclosed [ISA | 832]

What do we do?

Evaluate whether significant unusual transactions have been properly accounted for and disclosed in the financial statements.

Why do we do this?

Significant unusual transactions (SUT) may relate to transactions that are particularly challenging to account for or lead to specific disclosures that are essential for fair presentation. As a result, we specifically evaluate whether a SUT has been properly accounted for and disclosed in the financial statements in accordance with the applicable financial reporting framework.

Execute the Audit

How do we evaluate whether a significant unusual transaction has been properly accounted for? [ISA | 832.1300]

If the SUT is assessed as a significant risk, we first evaluate the design and implementation of the entity's process control activities over the accounting for SUTs.

We then consider whether:

- the accounting principles selected and applied to the significant unusual transaction have general acceptance;
- the accounting principles selected and applied to the significant unusual transaction are appropriate in the circumstances;
- the information presented in the financial statements is classified and summarized in a reasonable manner, that is, neither too detailed nor too condensed; and
- the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits (i.e., materiality).

For SUTs that are complex, we may engage specific team members or specialists to assist us in the performance of any or all of the above procedures.

What if a SUT has not been properly accounted for? [ISA | 832.14379]

When a SUT is not properly accounted for, we identify a misstatement. Refer to activity 'Evaluate whether uncorrected misstatements are material and the implications' for further guidance.

How do we evaluate whether a SUT has been properly disclosed in the financial statements? [ISA | 832.1600]

If the SUT is assessed as a significant risk, we first evaluate the design and implementation of the entity's process control activities over the disclosure of SUTs.

We then evaluate whether a SUT is disclosed in the financial statements in conformity with the applicable financial reporting framework. Refer to activity 'Evaluate whether the financial statements are presented fairly' for further guidance.

What if a SUT is not properly disclosed in the financial statements? [ISA | 832.1800]

SUT is not properly disclosed when there is omission of disclosures or presentation of inaccurate or incomplete disclosures. Refer to activity 'Evaluate whether uncorrected misstatements are material and the implications' for further guidance.

1.6 Evaluate management's arm's length assertion for related party transactions [ISA | 4328]

What do we do?

If the financial statements include a statement that transactions with related parties were conducted on an arm's length basis, then evaluate management's assertion

Why do we do this?

Whether related party transactions are conducted on terms equivalent to those offered to unrelated parties is information that users of the financial statements want to know. If management makes such an assertion, we obtain evidence that supports the assertion.

Execute the Audit

What terms of the transaction is management's arm's length assertion referring to? [ISA | 4328.1300]

When management makes an assertion that the transaction was conducted at terms equivalent to those prevailing in an arm's-length transaction, they are asserting that all of the terms of the transaction are at arm's length, not just the price.

What are examples of terms of the transaction other than price? [ISA | 4328.1400]

Other terms may include credit terms, contingencies, warranties, etc.

What does 'arm's length' mean? [ISA | 4328.1500]

Arm's length means that the terms and conditions of the transaction reflect those conducted between a willing buyer and willing seller who are unrelated and acting independently and in their own best interest.

In other words, if the same transaction occurred with an unrelated party, that party would have received the same or similar terms and conditions.

Who is responsible for supporting an arm's length assertion? [ISA | 4328.1600]

Substantiating an arm's length assertion in the financial statements is management's responsibility. If management cannot provide evidence to substantiate all of the terms of the transaction, it may indicate that there is not sufficient appropriate evidence to support their assertion.

We are not responsible for obtaining evidence beyond that available from management to support the assertion.

What audit evidence might support management's arm's length assertion? [ISA | 4328.1700]

The following are examples of audit evidence management may provide to substantiate the assertion:

- Other identical or similar transactions between the entity and unrelated parties
- Report of a management's specialist that has evaluated or determined a market value and terms of the transaction
- Other similar transactions conducted outside the entity by other parties in an open market

Evidence may be readily available regarding the price of the transaction. However, it may be more difficult to substantiate management's arm's length assertion of other terms unless the entity routinely engages in similar transactions with unrelated entities.

What audit evidence does not support management's arm's length assertion? [ISA | 4328.1800]

The following are examples of evidence that does not substantiate an arm's length assertion:

- Management inquiries or written representation by themselves; or
- Other transactions that are not similar to the related party transaction.

It may be difficult for management to substantiate management's arm's length assertion of the transaction's terms unless the entity routinely engages in similar transactions with unrelated entities.

How may we test management's assertion that the transaction was conducted on term's equivalent to those prevailing in an arm's-length transaction? [ISA | 4328.1900]

To obtain audit evidence regarding management's assertion, we may:

- Obtain an understanding of management's process for supporting the assertion;
- Obtain evidence regarding the source of the internal or external data supporting the assertion, and testing the data to determine their accuracy, completeness and relevance; and/or
- Evaluate, where applicable, the reasonableness significant assumptions on which the assertion is based.

What if management qualifies its assertion that the transaction was conducted on term's equivalent to those prevailing in an arm's-length transaction? [ISA | 4328.2000]

Even if management uses qualifiers, such as "it is management's belief" or "it is the entity's belief", it does not change our responsibilities regarding obtaining appropriate evidence regarding management's arm's length assertion in the financial statements.

Is there an audit implication if management does not make an arm's length assertion regarding related party transactions? [ISA | 4328.2100]

Most of the time there is no implication on our audit when management has not made an arm's length assertion regarding a related party transaction in the financial statements. However, if the applicable financial reporting framework requires disclosure of related party transactions not conducted at arm's length, then the absence of a disclosure may imply an assertion. Where an arm's length assertion is implied, we then have a responsibility to obtain sufficient appropriate evidence regarding the implied assertion.

What do we do if the arm's length assertion is not supportable? [ISA | 4328.2200]

Substantiating the arm's length assertion is management's responsibility.

If management cannot substantiate the assertion, we ask management to remove the assertion from the financial statements.

What do we do if management refuses to remove the assertion? [ISA | 4328.2300]

If management refused to remove the assertion, then we consider the implications for our audit and audit opinion

Refer to International Standards Reports Manual (ISRM) Chapter 4 for reporting requirements when we believe the financial statements are materially misstated or we are unable to obtain sufficient appropriate evidence.

Examples

Has management substantiated an arm's length assertion for a related party transactions in the financial statement? [ISA | 4328.2600]

Fact pattern 1

An entity's primary business is manufacturing and selling widgets. The entity has standardized pricing, credit, and warranty terms depending on whether the customer is:

- international or domestic; and
- wholesale, retail, or online (direct) sales.

During the year, the entity begins selling large volumes of widgets to a related party (a domestic wholesaler) and discloses in the financial statements that the transactions occurred at term's equivalent to those prevailing in an arm's length transaction.

Analysis 1

In combination with revenue testing, the engagement team inspects the customer sales agreement and a sample of individual invoices to obtain audit evidence that the related party transactions are commensurate with those offered to other unrelated customers.

Fact pattern 2

An entity's primary business is manufacturing and selling widgets. During the year, the entity sells a customize piece of manufacturing equipment to a related party and discloses in the financial statements that the transaction occurred at term's equivalent to those prevailing in an arm's length transaction. Management provides information regarding the sale of similar second-hand equipment; however, these sales are not customized equipment and not all sales are of assets of similar age and characteristics.

Analysis 2

The engagement team determines, based on the evidence provided to them by management, that there is not sufficient appropriate audit evidence to support the arm's length assertion. They request that management remove the assertion from the financial statements.

Evaluation of the Accounting for and Disclosure of Identified Related Party Relationships and Transactions

International Standards on Auditing: ISA 550.25

Evaluation of the Accounting for and Disclosure of Identified Related Party Relationships and Transactions

25. In forming an opinion on the financial statements in accordance with ISA 700 (Revised),[12] the auditor shall evaluate: (Ref: Para. A46)

(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 (Ref: Para. A47)

(b) Whether the effects of the related party relationships and transactions:

(i) Prevent the financial statements from achieving fair presentation (for fair presentation frameworks); or

(ii) Cause the financial statements to be misleading (for compliance frameworks).

12 ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* , paragraphs 10 - 15

ISA Application and Other Explanatory Material: ISA 550.A46-A47

Evaluation of the Accounting for and Disclosure of Identified Related Party Relationships and Transactions

Materiality Considerations in Evaluating Misstatements (Ref: Para. 25)

A46. ISA 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.[28] 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.

28 ISA 450, *Evaluation of Misstatements Identified during the Audit*, paragraph 11(a). Paragraph A21 of ISA 450 provides guidance on the circumstances that may affect the evaluation of a misstatement.

Evaluation of Related Party Disclosures (Ref: Para. 25(a))

A47. Evaluating the related party disclosures in the context of the disclosure requirements of the applicable financial reporting framework means considering whether the facts and circumstances of the entity's related party relationships and transactions have been appropriately summarized and presented so that the disclosures are understandable. Disclosures of related party transactions may not be understandable if:

(a) The business rationale and the effects of the transactions on the financial statements are unclear or misstated; or

(b) Key terms, conditions, or other important elements of the transactions necessary for understanding them are not appropriately disclosed.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Evaluate whether related party information is appropriately accounted for, disclosed and fairly presented [ISA | 4327]

What do we do?

Evaluate whether related party information has been properly accounted for and disclosed in the financial statements, including achieving fair presentation

Why do we do this?

Our ultimate goal is to express an opinion on whether the financial statements are free from material misstatement. Determining whether related party relationships and transactions are appropriately accounted for and disclosed as well as evaluating that the financial statements as a whole achieve fair presentation is a part of achieving that goal.

Execute the Audit

How do we evaluate whether related party information is appropriately accounted for and disclosed? [ISA | 4327.1300]

Related party relationships and transactions are appropriately accounted for and disclosed when they are in accordance with the requirements of the applicable financial reporting framework.

Our audit procedures address the assessed RMM and may include:

- testing the design, implementation, and operating effectiveness of relevant controls;
- performing substantive analytical procedures;
- confirming amounts, balances, and transaction key terms;
- agreeing key terms and amounts to underlying documents that support the transaction; or
- recalculating amounts and balances.

At the end of our audit, we evaluate whether the financial statements as a whole are presented fairly (see activity 'Evaluate whether the financial statements are presented fairly ').

What are examples of substantive procedures to respond to a significant risk that management has not appropriately accounted for or disclosed related party transactions in accordance with the applicable financial reporting framework? [ISA | 4327.1400]

We may perform substantive procedures to respond to a significant risk that management has not appropriately accounted for or disclosed related party transactions in accordance with the applicable financial reporting framework, such as:

- confirm or inquire directly of the related party regarding the business purpose of the transaction;
- inspect available information in the possession of the related party or other parties to the transaction;
- read any public information regarding the related party and the transaction;
- read the financial statements or other relevant financial information obtained from the related party, if available, to understand how the related party accounted for the transaction;
- confirm the terms of the transaction with other parties with knowledge of the transaction (e.g. banks, guarantors, agents, or attorneys), if any;
- determine whether there are any side agreements or other arrangements (either written or oral) with the related party, including confirming that none exist, if appropriate;
- evaluate the transferability and value of collateral provided by the related party, if any; or
- perform other appropriate procedures to determine if the substance of the transaction differs materially from its form.

What do we think about when evaluating whether related party information is 'appropriately accounted for'? [ISA | 4327.1500]

In our assessment of whether related party transactions have been appropriately accounted for in accordance with the applicable financial reporting framework, we think about whether the accounting treatment reflects the substance of the transaction versus the legal form or management's desired accounting outcome.

It cannot be assumed that related parties always act in their own self-interest and execute transactions at arm's length when interacting with an entity. We think about the possibility that the structure of the transaction may not be representative of its substance, especially when it involves difficult measurement and recognition issues or when the structure of the transaction is complex involving multiple parties.

What does 'appropriately disclosed' mean? [ISA | 4327.1600]

Appropriate disclosure refers to complete and accurate disclosure of information in accordance with the applicable financial reporting framework. It also refers to presentation of financial information that as a whole achieves fair presentation. Fair presentation of the financial information is still a relevant consideration even when the applicable financial reporting framework does not specify related party disclosure requirements. We may determine that additional disclosures beyond those specifically required by the framework are necessary for the financial statements to be fairly presented.

What types of related party information may be disclosed? [ISA | 4327.1700]

The applicable financial reporting framework may require disclosure of quantitative and qualitative related party information, for example:

- amounts and balances of transactions with related parties;
- numerical information regarding relationships and transactions (e.g. interest rates, ownership percentage); or
- narrative information identifying the related party and describing its relationships and transactions with the entity.

Planning procedures to obtain evidence over quantitative information may be straight forward. Obtaining audit evidence regarding qualitative and narrative information requires more professional judgment to determine, for example, that the disclosures are materially understandable, free from bias, and complete.

What do we think about when evaluating whether related party information prevents the financial statements from achieving fair presentation? [ISA | 4327.1800]

In our evaluation of whether the financial statements are presented fairly (see activity 'Evaluate whether the financial statements are presented fairly '), we think about whether the financial statement reflects the economic reality of related party transactions and whether the form, arrangement/ structure and content of the information is understandable. This includes use of terminology, detail, classification and bases of amounts set forth.

> For example, related party disclosures may not be understandable and contribute towards fair presentation if:
>
> - the business purpose, substance of the transaction, or effects of the transaction on the financial statements is unclear or misstated; or
> - key terms, conditions and other important elements of the relationship or transaction are not appropriately disclosed.

What do we do if we determine related party information is not appropriately accounted for or disclosed? [ISA | 4327.14373]

If related party information is not appropriately accounted for or disclosed in accordance with the applicable financial reporting framework, it constitutes a misstatement. We perform procedures to accumulate, communicate and evaluate identified misstatements (see activity 'Accumulate, communicate and evaluate misstatements ').

What do we think about when evaluating related party misstatements?

Whether any misstatement is material depends on an assessment of quantitative and qualitative factors. Qualitative factors are particularly relevant to the evaluation of related party misstatements due to the fact that the entity may use them to conceal fraud.

> For example, the following qualitative factors may be indicative of a material misstatement and/or fraud:
>
> - we may determine that a misstatement of a small amount may have been motivated by a desire to conceal misappropriation of assets; or

- that omissions of facts in a narrative disclosure regarding related party relationships or transactions may have been motivated to conceal certain arrangements from users of the financial statements.

Written Representations

International Standards on Auditing: ISA 550.26

Written Representations

26. 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: (Ref: Para. A48 - A49)

(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.

ISA Application and Other Explanatory Material: ISA 550.A48-A49

Written Representations (Ref: Para. 26)

A48. Circumstances in which it may be appropriate to obtain written representations from those charged with governance include:

- When they have approved specific related party transactions that (a) materially affect the financial statements, or (b) involve management.
- When they have made specific oral representations to the auditor on details of certain related party transactions.
- When they have financial or other interests in the related parties or the related party transactions.

A49. The auditor may also decide to obtain written representations regarding specific assertions that management may have made, such as a representation that specific related party transactions do not involve undisclosed side agreements.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Obtain written representations for all financial statement periods [ISA | 3851]

What do we do?

Obtain written representations from management for all financial statement periods covered by the auditor's report

Why do we do this?

While management representations do not provide sufficient appropriate audit evidence on their own, they complement the evidence we obtain from other auditing procedures. Specifically, they serve as a written record of management's acknowledgement that they have fulfilled their responsibilities, their understanding and evaluation of audit differences and their honesty and cooperation with us during the audit. Accordingly, failure of management to provide written representations requested by the auditor can have serious implications on the audit and on our report.

Execute the Audit

Which financial statement period(s) do management's written representations relate to? [ISA | 3851.1300]

The written representations relate to all financial statement periods covered in the audit report, including prior periods that are presented in the financial statements.

Why do we obtain management's written representations about prior periods that have already been reported?

Management reaffirms to us that the written representations from previous period(s) remain appropriate before we sign our audit opinion in the current year, as our audit opinion relates to all periods presented in the financial statements. If a restatement has been made to correct a material misstatement in the prior period that affects the comparative financial statements, then we draft a specific representation for management to review and also reaffirm.

What written representations do we obtain from management if we are issuing more than one audit report?

We obtain representations from management for all audit reports issued, either in one representation letter, listing the applicable set of financial statements, or in separate representation letters for each set of financial statements.

Who prepares the management representation letter? [ISA | 3851.1600]

We prepare the MRL template and provide it to management for their review and signature.

How do we prepare the management representation letter? [ISA | 3851.15774]

We first select the appropriate KPMG example MLR template https://alex.kpmg.com/AROWeb/document/lfc/GSC_INTL_AUDDOC_DOCSEAUDIT_TOC/toc/GSC_INTL_AUDDOC_DOCSEAUDIT_TOC?tocref=GSC_INTL_AUDDOC_DOCSEAUDIT_TOC, depending on the applicable auditing standards, financial reporting framework used by the entity and legal and regulatory framework in which the entity operates.

We then determine any additional representations to include in the MLR template. Attachment 1 provides additional representations that we may include, depending on the other circumstances that are applicable to the entity. At a minimum, we include all required representations from the auditing standards, which are included in the KPMG example MLR template.

In some circumstances, we use nationally-tailored versions of the base representation letter and/or listing of additional representations.

Once we have compiled all applicable representations into the MRL template, we provide it to management.

How do we determine which additional representations, beyond those which are required, are appropriate in the circumstances of our audit? [ISA | 3851.1800]

We select additional representations based on the specific facts and circumstances of the audit and the entity we audit. This can include additional representations to address a variety of topics, such as:

- specific circumstances related to the engagement and basis of presentation of the financial statements (e.g. US GAAP, IFRS);
- specific types of transactions, balances and disclosures present at the entity;
- the nonexistence of transactions/balances/disclosures or circumstances that commonly exist for entities or entities within a particular industry;
- management's intent (e.g., intention to reinvest undistributed earnings of a foreign subsidiary) or plans (e.g., going concern);
- oral representations made to us by management, explicitly or implicitly, during the course of our audit (e.g., disclosure of unique sales terms);
- information presented with the audited financial statements that is not contemplated by the base letter (e.g., supplemental information, adjustments to a prior period that are audited by us as the successor auditor);
- specialized circumstances or disclosures (e.g., restatement, restructuring); and
- management's selection and application of accounting policies, for example non-GAAP policies.

When might it be appropriate for management to modify the representations we have requested from them? [ISA | 3851.2100]

We expect that management will not make any major revisions to the letter template we provide. We review the signed letter that is provided back to us to allow us to make sure we agree with final version, including any revisions management may have made or proposed.

In some cases, management may modify a representation to further describe and represent relevant facts and circumstances, but not to change or limit its meaning or contradict the auditing standards.

Base representations (i.e. required representations), are not to be removed or modified by management unless it adds an "except for" clause to highlight a matter already disclosed in the financial statements and/or disclosed to the auditor. If management modifies the base representations, refer to activity 'Consider the effect if management refuses to provide representations ' to determine what to do.

Examples of representations modified by management:

	Default Language:	Example Modified Language:
Scenario 1 : *An event subsequent to the balance sheet has been disclosed in financial statements*	To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or	To the best of our knowledge and belief, except as discussed in Note X to the financial statements, no events have occurred subsequent to the balance-sheet date and

	disclosure in the aforementioned financial statements.	through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.
Scenario 2: *Management plans to dispose of a specific business segment*	The company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.	The company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except for its plans to dispose of segment A, as disclosed in Note X to the financial statements, which are discussed in the minutes of the December 7, 20X1 meeting of the board of directors.
Scenario 3: *Management has received a communication of an allegation of fraud or suspected fraud*	We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, analysts, regulators, short sellers, or others.	Except for the allegation discussed in the minutes of the December 7, 20X1 meeting of the board of directors (or disclosed to you at our meeting on October 15, 20X1), we have no knowledge of any allegations of fraud or suspected fraud affecting the company received in communications from employees, former employees, analysts, regulators, short sellers, or others.

If we think management may have questions as to the meaning of certain terminology used in the MRL template, we may consider providing those definitions to management or requesting that they include the definitions in the MRL response to confirm their understanding.

How does the management representation letter address materiality? [ISA | 3851.2200]

Management representations may be limited to matters that are considered individually or in the aggregate to be material to the financial statements. In order for management to exclude "immaterial" items from its representations, we first come to a common understanding with management as to what is material. Materiality may be different for different representations, similar to the concept of having different materiality considerations for specific areas of the audit.

A discussion of materiality may be included explicitly in the representation letter, in either qualitative or quantitative terms.

Does the concept of materiality apply to all management representations?

No. Materiality does not apply to:

- representations not directly related to financial statement amounts;
- any representations regarding the possible effects of fraud on other aspects of the audit; or
- items that involve an omission or misstatement of accounting information that, based on the circumstance, would change or influence the judgment of a reasonable person relying on the financial statements if the omission or misstatement were adjusted.

The following table sets out some examples of representations in which materiality would not be applicable.

	Representation
Example 1	We confirm that we are responsible for the fair presentation in the [consolidated] financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles [or other applicable accounting framework].
Example 2	We have made available to you all - (a) Financial records and related data, including the names of all related parties and all relationships and transactions with related parties. (b) Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.
Example 3	There have been no communications from regulatory agencies concerning non-compliance with or deficiencies in financial reporting practices.
Example 4	We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.

Do we attach any information to the management representation letter? [ISA | 3851.15776]

Yes. We attach a summary of uncorrected misstatements, which includes the nature, amount, and effect of the uncorrected misstatements, excluding those misstatements that are clearly trivial. We also include a listing of omissions of amounts or disclosures in the financial statements.

We use the KPMG template, Summary of Audit Misstatements (SAM) - uncorrected misstatements section for the summary of uncorrected misstatements unless law, regulation or custom specifies a different format.

While not required, we also may choose to attach a summary of corrected misstatements.

How is the management representation letter adjusted when management disagrees with an uncorrected misstatement? [ISA | 3851.15778]

If management does not agree with a misstatement we have included on the SAM - uncorrected misstatements section attached to the MRL, they may modify the representation about uncorrected audit misstatements as follows:

We do not agree that items ... and ... constitute misstatements because [description of reasons].

Communication with Those Charged with Governance

International Standards on Auditing: ISA 550.27

Communication with Those Charged with Governance

27. Unless all of those charged with governance are involved in managing the entity,[13] the auditor shall communicate with those charged with governance significant matters arising during the audit in connection with the entity's related parties. (Ref: Para. A50)

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13 ISA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 13

ISA Application and Other Explanatory Material: ISA 550.A50

Communication with Those Charged with Governance (Ref: Para. 27)

A50. Communicating significant matters arising during the audit[29] in connection with the entity's related parties helps the auditor to establish a common understanding with those charged with governance of the nature and resolution of these matters. Examples of significant related party matters include:

- Non-disclosure (whether intentional or not) by management to the auditor of related parties or significant related party transactions, which may alert those charged with governance to significant related party relationships and transactions of which they may not have been previously aware.
- The identification of significant related party transactions that have not been appropriately authorized and approved, which may give rise to suspected fraud.
- Disagreement with management regarding the accounting for and disclosure of significant related party transactions in accordance with the applicable financial reporting framework.
- Non-compliance with applicable law or regulations prohibiting or restricting specific types of related party transactions.
- Difficulties in identifying the party that ultimately controls the entity.

29 ISA 230, paragraph A8, provides further guidance on the nature of significant matters arising during the audit.

How do we comply with the Standards? [ISA | KAEGHDWC]

1 Communicate related party matters with those charged with governance [ISA | 4330]

What do we do?

Communicate significant findings and issues arising from related party matters with those charged with governance

Why do we do this?

We endeavor to have transparent, relevant, two-way communication with those responsible for oversight of management and the preparation of the financial statements. Communicating related party matters with those charged with governance contributes to this objective and establishing a common understanding of the nature and resolution of relevant matters.

Execute the Audit

Who are those charged with governance? [ISA | 4330.1300]

Those charged with governance are the person(s) or organization(s) - for example, a corporate trustee or the board of directors - with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process.

Those charged with governance may include management personnel - e.g. executive members of a governance board or an owner-manager.

What matters might we communicate to those charged with governance regarding related parties? [ISA | 4330.1500]

We communicate significant matters to those charged with governance (unless all of those charged with governance are involved in managing the entity) regarding related parties that we believe are relevant to their oversight of the financial reporting process (see activity 'Communicate significant findings from the audit').

Significant matters may include:

- the identification of related parties, related party relationships or significant related party transactions that were previously undisclosed to us;
- the identification of significant related party transactions that have not been authorized or approved in accordance with the company's established policies or procedures;
- the identification of significant related party transactions that appear to the auditor to lack a business purpose;

- disagreements with management regarding the accounting for and disclosure of significant related party transactions in accordance with the applicable financial reporting framework;
- non-compliance with applicable law or regulations prohibiting or restricting specific types of related party transactions; and
- difficulties encountered in identifying the party that ultimately controls the entity.

What if all of those charged with governance are involved in managing the entity? [ISA | 4330.1600]

When:

- all of those charged with governance are involved in managing the entity and
- matters to be communicated with those charged with governance are also communicated to management,

the matters do not need to be communicated twice.

How do we communicate to those charged with governance? [ISA | 4330.11466]

Our communications regarding related parties may be made orally or in writing. We document our oral communications and include a copy of our written communications in our audit documentation, as applicable. See activity 'Set-up the communication process' for more information on communicating with those charged with governance.

When do we communicate related party matters to those charged with governance? [ISA | 4330.1800]

The appropriate timing for communications may vary with the circumstance of the engagements. Usually, our communication of related party matters occurs at the end of the audit when we report the results of our audit. However, sometimes, we may consider it appropriate to communicate certain matters as soon as practicable after we identify them as it may enable those charged with governance to take corrective action as soon as possible. At the end of the engagement, it may be too late. See activity 'Determine the timing of the communications' for further information.

Documentation

International Standards on Auditing: ISA 550.28

Documentation

28. The auditor shall include in the audit documentation the names of the identified related parties and the nature of the related party relationships.[14]

14 ISA 230, *Audit Documentation* , paragraphs 8 - 11, and paragraph A6

How do we comply with the Standards? [ISA | KAEGHDWC]

1.C Core and Less Complex | Inquire of management regarding related parties [ISA | 4584]

What do we do?

Inquire of management regarding related parties, related party relationships and transactions

Why do we do this?

Management is responsible for the preparation of the financial statements, including related party transactions and relevant disclosures. Our inquiries of them regarding related parties, relationships and transactions inform our risk assessment and provides a basis for determining if there are related parties, relationships or transactions that management is not aware of or did not disclose to us.

Execute the Audit

Core and Less Complex | What related party inquiries do we make of management? [ISA | 4584.1300]

We inquire of management about related parties and the entity's relationship with those related parties, including:

- The names of the entity's related parties during the period under audit, including changes from the prior period;
- The nature of the relationships between the entity and these related parties; and
- Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

How do we leverage the information we obtained from prior year inquiries and audit procedures? [ISA | 4584.1400]

Our current year inquiries focus on understanding the related parties, relationships and transactions in the current period. Our prior year understanding of related parties, relationships and transactions can provide a preliminary understanding of related parties; however, not all relevant information can be derived from the prior year.

If we receive a list of related parties, relationships and transactions from management, do we still inquire? [ISA | 4584.1500]

Yes. While a list from management is helpful to summarize related party information, inquiry is one of the ways we exercise professional skepticism and helps us make an informed risk assessment. Inquiry allows us to ask probing questions that clarify and inform our risk assessment, such as, when we seek to understand the business purpose of related party arrangements or why transactions changed from the prior year. Additionally, management may disclose other relevant or sensitive information when we speak to them that may not be disclosed in their written correspondence.

What might a lack of business purpose in a related party transaction mean? [ISA | 4584.1800]

When a transaction lacks a clear business purpose, it may be representative of an RMM.

Lacking a business purpose relates to an entity engaging in transactions where it is unclear what the commercial rationale for the transaction is - i.e., we ask the question "Why did they enter into this transaction?".

The question "why" may arise when:

- the terms of the transaction have no real commercial basis, or

- there is no clear reason why the entity entered into the transaction (e.g., an entity buying an asset at market value that is completely unrelated to their operations, business model or business strategy).

Lack of business purpose may be indicative that the accounting outcome does not reflect the substance of the transaction or that related parties are being used to perpetrate fraudulent financial reporting or misappropriation of assets.

What can we learn from inquiries about modified or terminated related party transactions? [ISA | 4584.1600]

The nature and circumstances of modified or cancelled transactions inform our understanding of the business purpose of completed transactions and ultimately our risk assessment. We think about:

- who requested the modification/termination;
- the business purpose of the modified terms and the termination; and
- whether terminated transaction were re-initiated under different terms and the business purpose of those terms.

What might be the impact of related party transactions that are unauthorized/unapproved within the established policies/procedures? [ISA | 4584.1700]

Related party transactions that are unauthorized/unapproved within the established policies/procedures may be representative of:

- an internal control deficiency;
- override of internal controls;
- dominant influence of a related party;
- fraud; or
- non-compliance (for example, if the policy was in response to legal or regulatory restrictions).

With our inquiries, we seek to understand the rationale for the entity's policy/procedures and reason for the exception identified. We then use that information to determine whether it effects our assessment of RMMs and planned procedures. Identifying an unauthorized/unapproved related party transaction will impact the nature, timing and/or extent of our planned procedures.

Examples

Core and Less Complex | What inquiries of management might we make regarding related parties? [ISA | 4584.1900]

The table below sets out examples of questions we may ask management, responses we may receive and how we might evaluate those responses during risk assessment. We may ask these questions while we are obtaining our understanding of management's process.

Question asked	Response received	Evaluation of response
How does management identify related parties and have there been any	When the entity enters into new contracts, the legal department, does a background check of the	We may plan to make related party inquiries with the legal department as they have an instrumental

changes to related parties from the previous year?	party to the contract and its ownership, etc. If the party is identified as a related party, the legal department adds the name to the related party register.	role in the identification of related parties. We may make further inquiries of the processes in place that prompt others to notify the legal department of new related parties or relationships.
What transactions do you enter into with related parties? And what's the business purpose of those transactions?	The entity is a fashion retailer and the majority of products sold are sourced from the parent company which is based in another country. The board has authorized these transactions because the entity sells the product on cost-plus basis.	We ask to inspect the board minutes which authorize transactions with the related parties. We may also ask follow up questions, such as: • have any transactions with related parties been modified or canceled? • have any transactions that have occurred not been on standard pricing and terms? • And if so, have they been appropriately authorized? • And if there were any exceptions, why? Lastly, we may follow up by asking management if they are aware of any other transaction with related parties as they may have focused first on the most common types of transactions.

1.E Enhanced | Inquire of management and other individuals regarding related parties [ISA | 4313]

What do we do?

Inquire of management and other individuals identified regarding related parties, relationships and transactions

Why do we do this?

Management is responsible for the preparation of the financial statements, including related party transactions and relevant disclosures. Our inquiries of management and other individuals that may have relevant knowledge regarding related parties, relationships and transactions inform our risk assessment and provides a basis for determining if there are related parties, relationships or transactions that management is not aware of or did not disclose to us.

Execute the Audit

Enhanced | What inquiries do we make of management and others with relevant related party knowledge? [ISA | 4313.1300]

We pursue two lines of inquiry with management. First, we inquire regarding related parties and the entity's relationship with those related parties, including:

- The names of the entity's related parties during the period under audit, including changes from the prior period;
- Background information concerning the related parties (for example, physical location, industry, size, and extent of operations);
- The nature of any relationships, including ownership structure, between the entity and its related parties.

Secondly, we inquire regarding the nature of transactions between the entity and related parties, including:

- The transactions entered into, modified, or terminated, with related parties during the period under audit and the terms and business purposes (or the lack thereof) of such transactions;
- The business purpose for entering into a transaction with a related party versus an unrelated party;
- Whether any related party transactions have not been authorized and approved in accordance with the entity's established policies or procedures regarding the authorization and approval of transactions with related parties; and
- Whether any related party transactions for which exceptions to the entity's established policies or procedures were granted and the reasons for granting those exceptions.

For individuals (other than management and those charged with governance) with relevant related party knowledge, we determine which inquiries are relevant to make based on the role and relevant knowledge of the individual.

> For example, if under the auditing and accounting framework, management and their immediate family members are considered related parties, the engagement team may inquire of the human resources director (or equivalent position) regarding the names of management and for additional background information regarding immediate family members. However, the engagement team may determine that knowledge of transactions with management that were exceptions to policies and procedures are not relevant knowledge to the human resource director's role and, accordingly, may choose not to inquire regarding that information.

It may be helpful to make inquiries regarding related parties in conjunction with our walkthrough of relevant business processes for identifying, authorizing/approving, accounting for and disclosing related parties, relationships, transactions and arrangements, as applicable.

How do we leverage the information we obtained from prior year inquiries and audit procedures? [ISA | 4313.1400]

Our current year inquiries focus on understanding the related parties, relationships and transactions in the current period. Our prior year understanding of related parties, relationships and transactions can provide a preliminary understanding of related parties; however, not all relevant information can be derived from the prior year.

If we receive a list of related parties, relationships and transactions from management, do we still inquire? [ISA | 4313.1500]

Yes. While a list from management is helpful to summarize related party information, inquiry is one of the ways we exercise professional skepticism and helps us make an informed risk assessment. Inquiry allows us to ask probing questions that clarify and inform our risk assessment, such as, when we seek to understand the business purpose of related party arrangements or why transactions changed from the prior year. Additionally, management may disclose other relevant or sensitive information when we speak to them that may not be disclosed in their written correspondence.

What might a lack of business purpose in a related party transaction mean? [ISA | 4313.1800]

When a transaction lacks a clear business purpose, it may be representative of an RMM.

Lacking a business purpose relates to an entity engaging in transactions where it is unclear what the commercial rationale for the transaction is - i.e., we ask the question "Why did they enter into this transaction?".

The question "why" may arise when:

- the terms of the transaction have no real commercial basis, or
- there is no clear reason why the entity entered into the transaction (e.g., an entity buying an asset at market value that is completely unrelated to their operations, business model or business strategy).

Lack of business purpose may be indicative that the accounting outcome does not reflect the substance of the transaction or that related parties are being used to perpetrate fraudulent financial reporting or misappropriation of assets.

What can we learn from inquiries about modified or terminated related party transactions? [ISA | 4313.1600]

The nature and circumstances of modified or cancelled transactions inform our understanding of the business purpose of completed transactions and ultimately our risk assessment. We think about:

- who requested the modification/termination;
- the business purpose of the modified terms and the termination; and
- whether terminated transaction were re-initiated under different terms and the business purpose of those terms.

What might be the impact of related party transactions that are unauthorized/unapproved within the established policies/procedures? [ISA | 4313.1700]

Related party transactions that are unauthorized/unapproved within the established policies/procedures may be representative of:

- an internal control deficiency;

- override of internal controls;
- dominant influence of a related party;
- fraud; or
- non-compliance (for example, if the policy was in response to legal or regulatory restrictions).

With our inquiries, we seek to understand the rationale for the entity's policy/procedures and reason for the exception identified. We then use that information to determine whether it effects our assessment of RMMs and planned procedures. Identifying an unauthorized/unapproved related party transaction will impact the nature, timing and/or extent of our planned procedures.

Examples

Enhanced | What inquiries of management and other individuals might we make regarding related parties? [ISA | 4313.2000]

The table below sets out examples of questions we may ask (typically in conjunction with our walkthrough of management's process), responses we may receive and how we might evaluate those responses.

Inquiry of	Question asked	Response received	Evaluation of response
Management	How does management identify related parties and have there been any changes to related parties from the previous year?	When the entity enters into new contracts, the legal department does a background check of the party to the contract and its ownership, etc. If the party is identified as a related party, the legal department adds the name to the related party register.	We plan to make related party inquiries with the legal department as they have an instrumental role in the identification of related parties. We make further inquiries of the processes in place that prompt others to notify the legal department of new related parties or relationships.
Head of Legal	How do you identify new related parties and have there been any changes to related parties from the previous year?	The entity reviews and compares changes to the shareholder register quarterly and all new contracts to determine if there are new related parties.	We ask to inspect the related party register. We make further inquiries regarding: • understanding background information and the nature of the entity's

		There have been two new related parties added to the related party register since the previous year.	relationship with the two new related parties; and • confirming that there are no other changes regarding background information and the nature of relationships with known related parties from the previous year.
Management	What transactions do you enter into with related parties? And what's the business purpose of those transactions?	The entity is a fashion retailer and the majority of products sold are sourced from the parent company which is based in another country. The board has authorized these transactions because the entity sells the product on cost-plus basis.	We ask to inspect the board minutes which authorize transactions with the related party. We may also ask follow up questions, such as: • have any transactions with related parties been modified or canceled? • have any transactions not been conducted at standard pricing and terms? • if so, have they been appropriately authorized? • if there were any exceptions, why? Lastly, we may follow up by asking management if they are aware of any other transaction with related parties as they may have focused first on the most common or significant types of transactions.

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