

### Proposed Disposition of the Present Tense in the Draft Revised ISA 550

§	Present Tense Statements	△Req?	Rationale/Comments
3.	<p>The auditor ordinarily <b>addresses</b> the risks of material misstatements resulting from related party relationships and transactions within the context of the applicable financial reporting framework. While an entity may enter into related party transactions as part of its normal business, such transactions may not be conducted at arm's length. Accordingly, financial reporting frameworks ordinarily require them to be disclosed so that users of the financial statements can understand the nature of the transactions and their financial effects. Financial reporting frameworks may also require disclosure of related party relationships to enable users to understand the nature of the relationships and their potential effects on the financial statements.</p> <p>When the applicable financial reporting framework does not establish such requirements, <b>it is nevertheless important for the auditor to obtain, through the performance of risk assessment procedures, an understanding</b> of the nature and extent of the entity's related party relationships and transactions to evaluate whether the financial statements are likely to be misleading.<sup>1</sup></p>	<p>No</p> <p>Yes</p>	<p>Explanatory in nature.</p> <p>Establishes a clear responsibility for the auditor to obtain an understanding of related party relationships and transactions and their effects when the FRF does not deal with related parties.</p>
5.	<p>For these reasons, there is an inherent level of uncertainty associated with the complete identification and appropriate accounting for and disclosure of related party relationships and transactions. Nevertheless, <b>the auditor plans and performs</b> the audit to obtain reasonable assurance of identifying material misstatements resulting from these relationships and transactions.</p>	No	<p>Explanatory in nature. The requirements are in ISAs 300 (the auditor should plan), and 315/330/500 (the auditor should assess risks, respond to them and obtain sufficient appropriate audit evidence to draw reasonable assurance).</p>
10.	<p>This discussion, which occurs as part of the discussion among the engagement team required by ISA 315, <b>ordinarily addresses matters that include:</b></p> <ul style="list-style-type: none"> <li>• The nature and extent of the entity's related party relationships and transactions.</li> <li>• The importance of remaining alert during the audit to the potential for material misstatement resulting from related parties, and the need to exercise appropriate professional skepticism; for example, when reviewing bank and legal confirmations, and other third party confirmations.</li> </ul>	No	Explanatory in nature.

<sup>1</sup> ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements," and Proposed ISA 701, "The Independent Auditor's Report on Other Historical Financial Information," provide further guidance on the circumstances when financial information could be considered misleading.

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	<ul style="list-style-type: none"> <li>The circumstances or conditions of the entity that may indicate the existence of unidentified related party relationships or transactions, for example, a complex organizational structure.</li> <li>The importance that management and those charged with governance attach to the identification and appropriate accounting for and disclosure of related party relationships and transactions, and the related risk of management override of relevant controls.</li> </ul>		
12.	In obtaining an understanding of the entity's relationships with its related parties as identified by management, <b>the auditor considers</b> the nature, extent and business rationale of these relationships.	Yes	Consideration appears essential to give effect to the broad requirement to understand the entity's related party relationships.
13.	Considering the nature and extent of the entity's related party relationships <b>involves the auditor obtaining an understanding</b> as to how the entity is controlled or significantly influenced, <sup>2</sup> and how it controls or significantly influences other parties. Control or significant influence can ordinarily be recognized by considering a party's ownership interests in, or extent of voting power over, an entity. Obtaining a full understanding of control relationships can, however, be difficult either because of the complexity of the issue (for example, the exercise of control or significant influence may occur indirectly through intermediate parties, or control may be exercised jointly with other parties), or because relationships with related parties may be concealed by management for fraudulent or other purposes. In some cases, the operation of effective control or significant influence may not be readily apparent for reasons such as: <ul style="list-style-type: none"> <li>A complex shareholding structure;</li> <li>The location of shareholder or other relevant records in a foreign or offshore jurisdiction; or</li> <li>Control or significant influence over management or those charged with governance by external parties.</li> </ul>	No	Explanatory in nature.
14.	<b>Understanding the business rationale of the entity's related party relationships is relevant</b> in evaluating the effects of the relationships on the financial statements. For example, if the entity has control over a transfer pricing arrangement with a related party, <b>an understanding of the business rationale of the relationship and of the transfer pricing</b>	No  No	Explanatory in nature.  Clearly an example.

<sup>2</sup> Appendix 1 provides examples of definitions of control and significant influence.

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	<p>financial or other interests, may affect the potential for management to override controls. As discussed in ISA 240, “The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements,” fraudulent financial reporting and misappropriation of assets often arise through management override of controls that otherwise appear to be operating effectively. The risk of management override of controls is greater if there are related party relationships involving management, 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 to commit fraud by (a) directing the entity, against its interests, to conclude transactions benefiting the related parties, or (b) colluding with those parties or controlling their actions. Examples of such fraud include:</p> <ul style="list-style-type: none"> <li>• Creating fictitious terms of transactions with related parties designed to misrepresent the business rationale of these transactions.</li> <li>• Fraudulently organizing the transfer of assets to management or others at amounts below market value.</li> <li>• 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.</li> </ul>		
19.	<p><b>The auditor also obtains</b> an understanding as to how those charged with governance exercise oversight of management’s processes for identifying, accounting for, and disclosing related party relationships and transactions. Obtaining this understanding will provide an insight into the general level of awareness of those charged with governance regarding the nature, extent and business rationale of the entity’s related party relationships and transactions, the adequacy of their oversight, and the susceptibility of the entity to management override of controls. Such understanding may be gained through inquiries of those charged with governance, observing meetings at which related party transactions are discussed and approved, or reading minutes of such meetings.</p>	No	Paraphrases the requirement that is in paragraph 43 of ISA 240.
22.	<p>Material misstatements resulting from related parties often arise from a failure by management to completely identify or disclose the entity’s related party relationships and transactions. Accordingly <b>the auditor performs</b> risk assessment procedures directed at identifying related party relationships and</p>	No	Introduces the requirement at paragraph 23.

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	transactions not identified or disclosed by management, notwithstanding the inherent uncertainty referred to in paragraph 5 regarding complete identification.		
24.	<p><b>The auditor inquires of</b> individuals other than management and those charged with governance regarding the possible existence of related party relationships or transactions not identified or disclosed by management.</p> <p><b>These individuals include</b>, for example:</p> <ul style="list-style-type: none"> <li>(a) Personnel in a position to initiate, process or record significant and unusual transactions, and those who supervise or monitor such personnel;</li> <li>(b) Internal audit;</li> <li>(c) In-house legal counsel; and</li> <li>(d) The chief ethics officer or equivalent person.</li> </ul>	<p>No</p> <p>No</p>	<p>Explanatory in nature.</p> <p>Intended to be illustrative.</p>
25.	<p>To assist in identifying related party relationships and transactions not identified or disclosed by management, <b>the auditor performs</b> procedures to identify significant and unusual transactions <b>and evaluates</b> whether related parties are involved. Such significant and unusual transactions include, for example:</p> <ul style="list-style-type: none"> <li>• Large equity transactions, such as corporate restructurings or acquisitions.</li> <li>• Transactions involving management from which they may be expected to benefit financially.</li> <li>• The leasing of premises or the rendering of management services by the entity to another party at no charge.</li> <li>• Significant sales transactions with unusually large discounts or returns.</li> </ul>	No	Explanatory in nature.
26.	<p>Special-purpose entities, sometimes referred to as structured finance entities, are usually established for limited purposes, such as providing financing, liquidity, hedging or credit support. They may be structured in various ways, such as in the form of corporations, partnerships, trusts, or other types of arrangements. In many cases, they lack physical operating characteristics, and this makes it relatively easier for them to be set up and dissolved. In addition, these entities tend not to be consolidated and often do not issue financial statements. For these reasons, <b>it is important that the auditor</b> (a) <b>identifies</b> special-purpose entities that have had some connection with the entity or its principal officers during the reporting period, <b>and</b> (b) <b>evaluates</b> the nature, extent and</p>	No	Explanatory in nature.

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	business rationale of these relationships to determine whether they involve unidentified or undisclosed related party relationships or transactions.		
27.	As part of the identification and assessment of risks of material misstatement required by ISA 315, <b>the auditor identifies and assesses</b> the risks of material misstatement resulting from related parties, <b>and determines</b> which of the identified risks are significant risks.	No	Paraphrases and explains the requirement in ISA 315 in the context of related parties.
33.	Where the auditor has identified significant risks, <b>the auditor:</b> (a) To the extent not already done, (i) <b>evaluates</b> the design of the entity's related party controls, and (ii) <b>determines</b> whether they have been implemented (paragraph 113 of ISA 315); (b) <b>Obtains</b> audit evidence about the operating effectiveness of these controls (on which the auditor plans to rely) from tests of control performed in the current period (paragraph 44 of ISA 330); and (c) <b>Performs</b> substantive procedures that specifically respond to the significant risks (paragraph 51 of ISA 330).	No	Paraphrases the requirements in ISAs 315 and 330.
34.	The nature, timing and extent of substantive procedures that the auditor may perform to respond to significant risks depend upon the nature of those risks and the circumstances of the entity. For example: • Where the auditor identifies significant risks in relation to significant and unusual related party transactions, <b>the auditor determines</b> whether the transactions were properly approved. In addition, where the identified risks are significant risks of fraud, <b>the auditor follows</b> the requirements and guidance in ISA 240 in responding to those risks, including obtaining an understanding of the business rationale of the transactions.	Yes  No	Appears to contain an essential procedure not included in other ISAs.  Explanatory in nature.
40.	<b>Written representations include</b> confirmation from management and, where appropriate, those charged with governance that they have disclosed to the auditor all relevant information relating to identified related parties, and that they are not aware of any other related party matters required to be disclosed in the financial statements in accordance with the applicable financial reporting framework. Such representations emphasize to management and, where appropriate, those charged with governance their responsibility to disclose the identities of related parties to the auditor even if there have been no transactions with such parties. The	No	Explains what the requirement to obtain written representations entails.

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	representations may also address, where appropriate, specific related party issues, such as the existence of undisclosed side agreements on significant related party transactions.		
43.	When evaluating a potential misstatement relating to a related party transaction, <b>the auditor considers</b> both the quantitative and qualitative aspects of the materiality of the transaction, as: (a) The monetary value of the transaction may not be relevant in evaluating the significance of the transaction; or (b) There may be no objective basis for measuring the transaction. For example, the applicable financial reporting framework may deem transactions between the entity and those charged with governance to be material regardless of the amounts involved.	Yes	Contains a principle.
44.	In evaluating the related party disclosures, <b>the auditor considers</b> whether they adequately and appropriately summarize the facts and circumstances of the related party relationships and transactions known to the auditor so that they are understandable and not misleading. Disclosures of related party transactions may be potentially misleading 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.	Yes	Appears essential in performing the evaluation.
46.	Management is responsible for substantiating any assertion that a related party transaction was conducted at arm's length. Such an assertion may explicitly state that the transaction was at arm's length or otherwise suggest that the transaction was consummated on terms equivalent or similar to those prevailing in transactions with unrelated parties. <b>The auditor evaluates</b> management's support for the assertion, which may include: • Comparing the terms of the related party transaction to those of an identical transaction with one or more unrelated parties; • Engaging an external expert to determine a market value for the transaction; or • Comparing the terms of the transaction to known market terms for broadly similar transactions on an open market.	No	Explains the requirement to obtain sufficient appropriate evidence regarding the arm's length assertion.

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