

# Related Parties – SA 550

10 September 2023

# Why audit of related party and related party transactions is important?

*"Amount of ₹ 3,330 crore invested as equity by promoter companies was found to have been diverted out of the funds obtained as various loans by the Company in the shape of advances shown to various shell companies."*

*"The company on Tuesday informed stock exchanges that an investigation by an independent law firm had found that some employees had carried out unauthorised transactions, which led to a potential understatement of not only the liabilities of the Company but even advances to related and unrelated parties of the company and the group."*

*"The Audit Firm has failed to obtain sufficient appropriate audit evidence to conclude that the company has an adequate internal financial controls system in place and such controls are operating effectively regarding the related party transactions."*

*"The Audit Firm also failed to notice non-compliance with the provision of Section 177 of the Companies Act, 2013, which requires prior approval of the Audit Committee for the related party transactions, however, the transactions were approved post facto by the Audit Committee"*

*"The Audit Firm failed to evaluate the management assertion that related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction"*

*"The Audit Firm failed to communicate in writing the aforesaid significant deficiencies in internal control and violation of the Law in related party transactions to those charged with governance on a timely basis and thus failed to comply with the requirements of Para 9 of SA 265"*

# Related Party- Agenda for today'

Who is a related party?

Inquiry with management and others

Understanding related parties and controls

Ensuring completeness of related parties

Indicators of existence of connected related parties

Previously undisclosed / unidentified related parties

Fraud risk and its indicators

RPTs outside normal course of business and arms length assertion of RPT

Communicate with those charged with governance

Impact of RPT from CARO reporting

Example qualification in RPT



# SA 550 – Related Party

## Potential Risks relating to audit of related party transactions

- 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
- Transactions may not be on an arm's length basis - pricing policies, manner of settlement and other terms of such transactions may be different from those with independent third parties
  - e.g., if an entity intends to shift some of its profits from a high tax regime to a lower one, it may be inclined to set up a transfer pricing strategy to sell goods to a related party (e.g. a wholly-owned subsidiary) at a lower-than-market price
- Fraud may be more easily committed through related parties - related party relationships may present a greater opportunity for collusion, concealment or manipulation by management

# Related Party- Regulatory framework in India

- SA 550 – Auditing standard on ‘Related Parties’
- CARO reporting
- IND AS 24 / AS 18 – Accounting Standard on ‘Related Parties Disclosures’
- Provisions of Companies Act
- Provisions of Income Tax Act
- SEBI LODR – for listed securities

# SA 550 – Related Party

## Objective of an auditor :

- To **recognise 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;
- To conclude whether the financial statements, insofar as they are affected by those relationships and transactions: a. Achieve a true and fair presentation (for fair presentation frameworks); or b. Are not misleading (for compliance frameworks); and
- **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**

Refer SA 550 para 9

# Audit of related party and related party transactions – an overview of SA 550

Obtain an understanding of the entity's related parties, relationships and transactions for risk assessment purposes

1

Perform inquiries to identify and assess RMMs associated with related parties (including significant risk of error and /or risk of fraud)

2

Evaluate whether all related parties, relationships and transactions have been identified as required by SEBI regulation/ IND AS 24 / AS 18 / Companies Act 2013

3

Understand the process for identification, approval, accounting & disclosure of related party transactions, evaluate D&I and TOE of relevant controls

4

Perform relevant procedures on previously undisclosed related parties, relationships and transactions (if any)

5

Understand the business purpose (or the lack thereof) for each of the related party transactions

6

Evaluate management's arm's length assertion for related party transactions

7

Disclosure of identified related party relationships and transactions

8

Communicate related party matters with those charged with governance

9

# Assessment of RMM and Fraud risk

An engagement team rebutted the risk of fraud in revenue since all transactions are with related parties. Therefore, no significant RMM was identified in revenue. Is the engagement team's approach appropriate?

The engagement team should understand and evaluate the nature of the related party transactions and evaluate the fraud risk factors. Existence of related party transactions itself is one of the factors that indicate higher inherent risk.

Rebuttal of risk of fraud in revenue should be made after assessing all the fraud risk factors, merely rebutting the risk of fraud in revenue because transactions are with related parties is not appropriate

## Example – facts of the case

- Company A (holding company of Company B) announced expansion of distribution channels into key Asian markets but struggled to meet the analyst expectations during the year which caused a decline in the stock price.
- Directors of Company B have significant influence over Company C (retailer for Company A's products in Asian markets)
- Company A recorded substantially higher sales with Company C becoming the largest customer (representing 50% of total revenue).

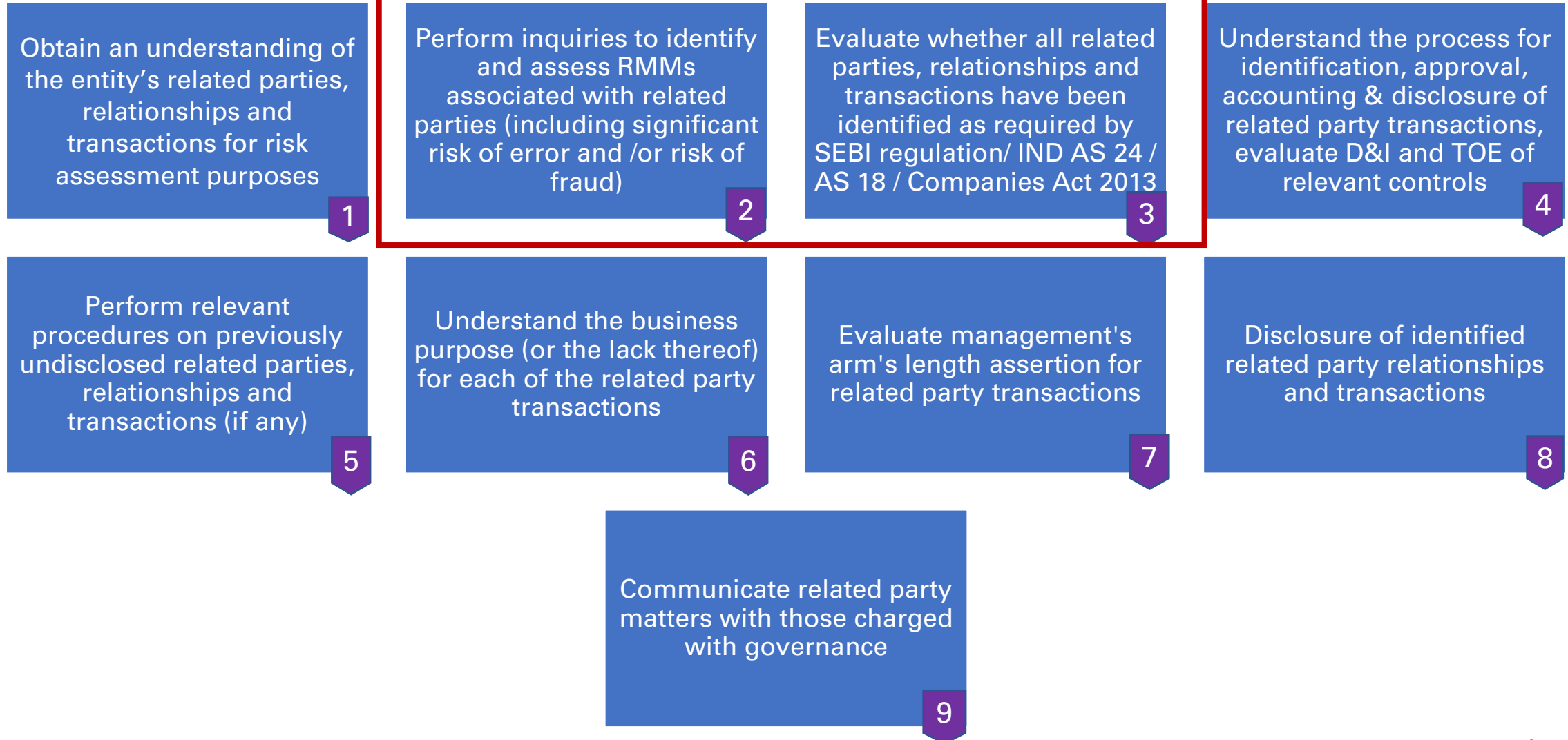
## Response

Considering there is pressure on the management and opportunity to manipulate the revenue, the engagement team evaluated the fraud risk factors and identified risk of fraud in revenue

We must use professional skepticism and exercise caution when auditing related party transactions



# Audit of related party and related party transactions – an overview of SA 550



# Who is a related party?

## Legal and accounting

Section 2(76)  
of the  
Companies  
Act, 2013

Regulation-  
SEBI LODR  
2015

IND AS 24

Accounting  
Standard 18

# Connected parties

The engagement teams should exercise professional skepticism when loans are given / purchases or sales are made / any other arrangement is entered into with unrelated parties (refer the examples given below) as they may be possible indicators of the parties being “connected parties”

## Loans



- Granting of loans despite insufficient cash flows
- Loans to parties lacking the capacity to repay
- Loans advanced for valid business purpose and later written off
- Loans with no scheduled terms of repayment
- Loans with accruing interest differing significantly from market rates

## Sales and Purchase



- Sales transaction with large discounts or returns
- Transactions with offshore entities in jurisdictions with weak corporate laws
- Change of suppliers without a tendering process, or to favorable terms
- Goods purchased or sent to another party at less than cost

## Other arrangements



- Consulting arrangements with directors, officers or members of management
- Land sales and other transactions with buyers of marginal credit risk
- Exchanging property for similar property in a non-monetary transactions

## Example

When a promoter of a company does not qualify to be a related party as per Ind AS24 /AS 18 may be a connected party

# Who is a related party -Inquiry with management and others

Refer SA 550 para 14 ( A15)

## With whom?

Management

Those charged with  
governance

Internal Audit

In-house legal counsel

Compliance officer

## What to inquire?

Entity's ownership and governance structure

Approval as per policy

Business rationale and justification

How is the entity structured and how is it  
financed

Understanding of related party process and  
controls

# Definition of 'Related Party' under SEBI Listing Regulations

Related party as defined under sub-section 2(76) of the Companies Act, 2013

Any person/ entity forming part of promoter or promoter group of the listed entity

Related party as defined under the applicable accounting standard – Ind AS 24/ AS 18

Any person/ entity holding equity shares in the listed entity either directly/ on beneficial interest as per section 89 of the Companies Act, 2013, at any time, during the immediate preceding financial year:

- $\geq 20\%$  of shareholding (from 1 April 22)
- $\geq 10\%$  of shareholding (from 1 April 23)

Indicates what is different from accounting standards

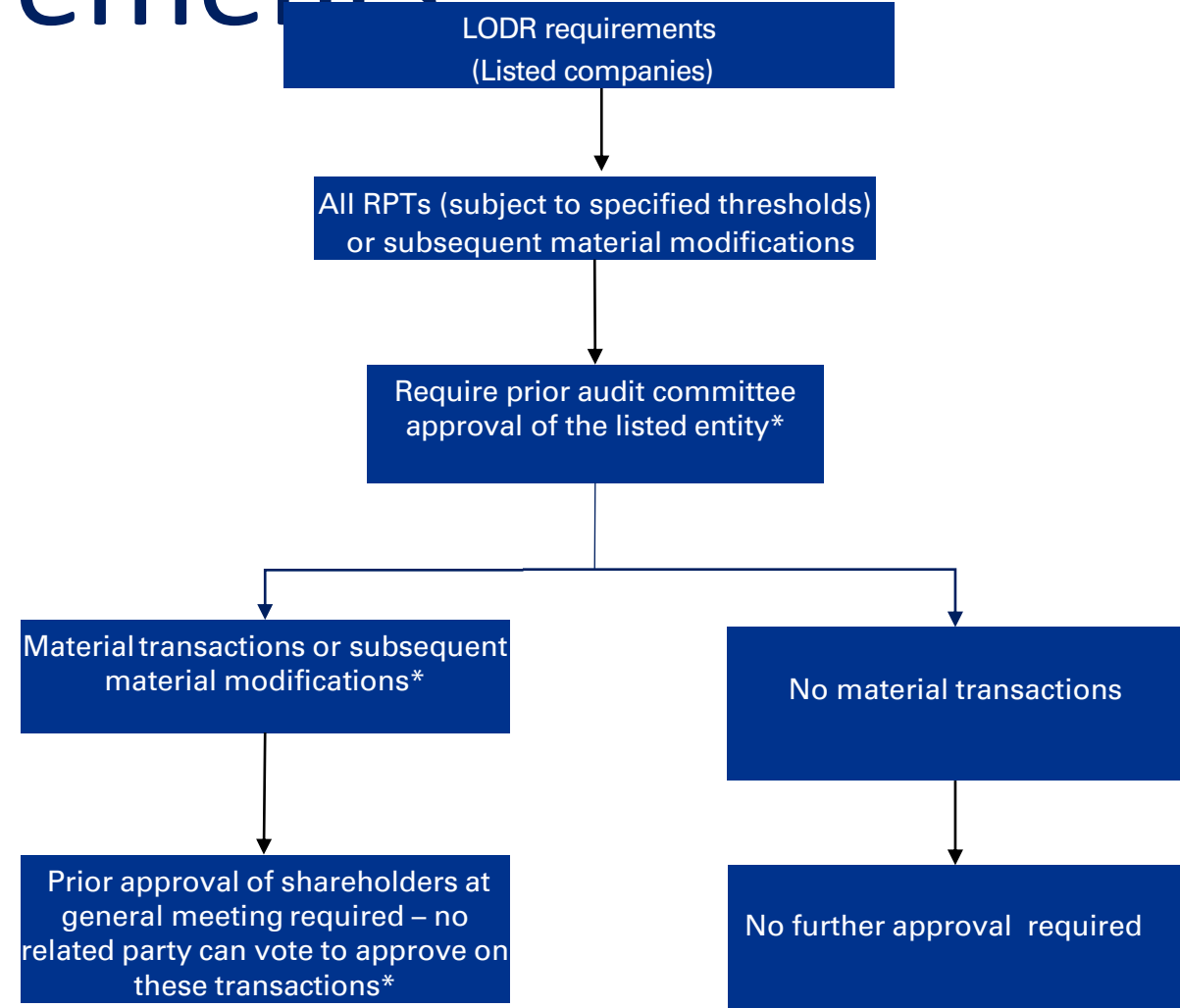
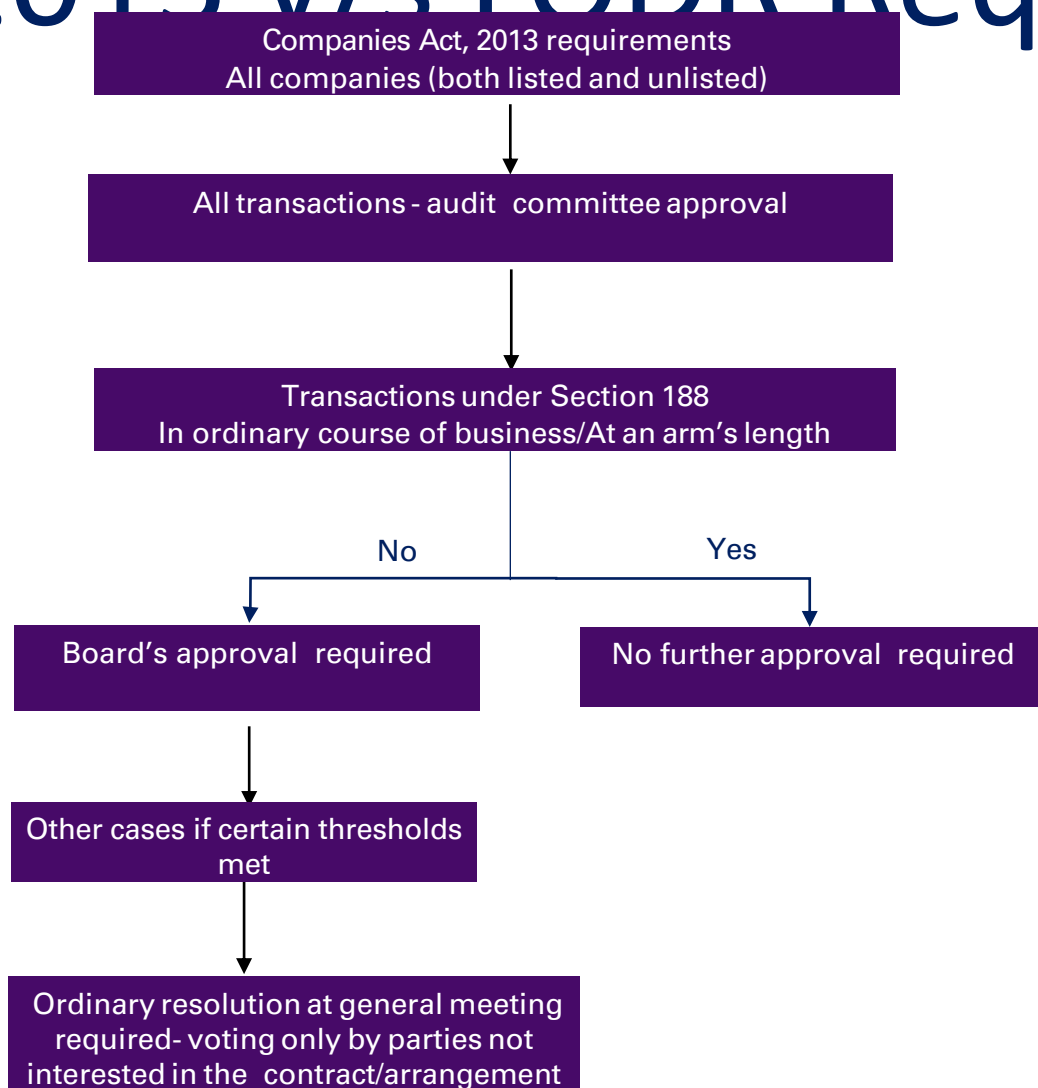
# Knowledge check: are these related parties? (1/2)

Case Study	Companies Act, 2013	Ind AS 24/ AS 18	SEBI
<p><b>Case 1:</b> Is the wife of a Director who is not KMP of the Company, a related party of the Company?</p>	<p>Yes, since relative of a Director</p>	<p>Depends, if wife has control/significant influence or is a KMP</p>	<p>Yes</p>
<p><b>Case 2:</b> Company X provides key managerial services to Company Y. Is Company Y a related party to Company X?</p>	<p>No</p>	<p><b>Ind AS 24:</b> Yes, specifically covered by the definition <b>AS 18:</b> No</p>	<p>Yes</p>
<p><b>Case 3:</b> Is stepbrother of a KMP a related party of the Company? This Company is a standalone entity and the stepbrother does not hold any voting power</p>	<p>Yes</p>	<p><b>Ind AS 24:</b> Yes, if qualifies to be a close member <b>AS 18:</b> No</p>	<p>Yes</p>

# Knowledge check: are these related parties? (2/2)

Case Study	Companies Act, 2013	Ind AS 24/ AS 18	SEBI
<b>Case 4:</b> Company A and C are private companies and have a common Director. Are they related parties based on this limited fact pattern?	Yes	No, merely common director does not mean the 2 companies are related parties	Yes
<b>Case 5:</b> Mr. X is a promoter of Company XYZ and holds 18% of share capital in the Company. Will X be related party for Company XYZ?	No	No	Yes
<b>Case 6:</b> Company H has significant influence on both Company S and Company T. Are companies S and T related parties?	No	No	No

# Approval mechanism – Companies Act 2013 v/s LODR Requirements



\*Additional conditions attached



# Identification of related parties

NFRA observation

Is the engagement team required to perform inquiries even if the listing of related party is obtained from the management?

Yes, While a list obtained from the management helps to identify the related parties, inquiry is one of the ways to exercise professional skepticism and helps in making an informed risk assessment

## With whom to inquire ?

- Identify individuals within the entity (**other than management**) who have relevant knowledge regarding related parties to make inquiries such as internal auditors, in-house legal counsel, the chief compliance/ethics office, company secretary and the human resources director or person in equivalent position
- inquire of management
- inquire of those charged with governance regarding related parties

Only performing inquiries to identify related party is not enough and the engagement team should perform other audit procedures

Refer SA 550 para 13 and 14

Para 17 of SA 240 and Para 14 of SA 315 R require the auditor to conduct inquiries with the management, TCWG and others within the entity as appropriate, to identify and assess risks of material misstatement

The written representations we receive regarding related parties are not a substitute for inquiries of management

# Key Management Personnel (KMP)

## - Key considerations



Authority & responsibility for planning, directing & controlling activities of the entity - directly/ indirectly

**Ind AS 24:**  
Includes both executive & non-executive directors  
**AS 18:** Does not consider non-executive director as KMP

Specifies role and is not limited to a person

May be a KMP even if not paid for the services given

Materiality considerations cannot override disclosure requirements  
Nature of KMP compensation always makes is qualitatively material

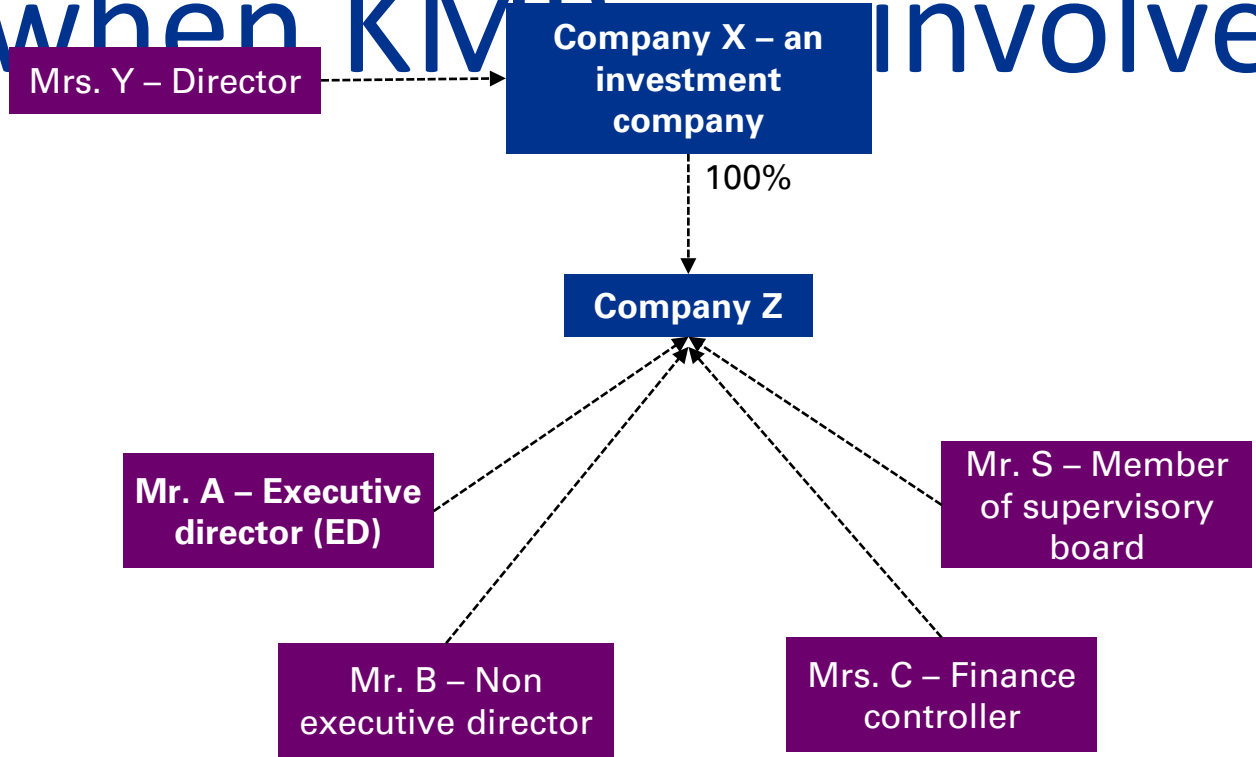
**Knowledge Check:** Is every company required to disclose Company Secretary ('CS') and its CFO as KMP of the Company in its financial statements?

**Response:**

Companies to disclose CS and CFO as KMP if they have the authority and responsibility for planning, directing & controlling activities of the company.

Merely because CFO and CS are KMP as per Companies Act, 2013, they will not be KMP in the financial statements prepared as per Accounting framework.

# Identification of a related party when KMP involved (2/1)

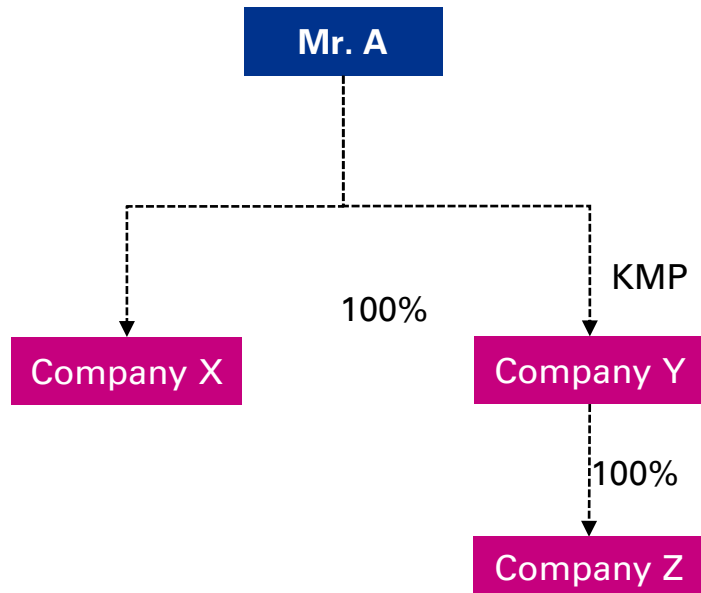


- Mr. A** KMP - since ED on the Board having authority & responsibility for planning, directing & controlling activities of the entity
- Mr. B** KMP – While Non ED, he is on the Board having authority & responsibility for planning, directing & controlling activities of the entity
- Mrs. C** **Depends** – If she has authority & responsibility on financial planning, directing & controlling activities of the entity, Yes.
- Mr. S** KMP – Since in the current instance, supervisory board sets the overall strategy & is involved in the implementation of these strategies
- Mrs. Y** KMP – Since in the current instance, she is responsible for the key activity of investing for the Company Z

1. Supervisory board assists the Board to set the overall strategy and is involved in the implementation of these strategies
2. Mrs. Y is not a Director of Company Z. However, she heads treasury for the company and is responsible for key planning, directing and controlling investment policies and activities of Company Z

**Who are the KMPs of Company Z for disclosure in the financial statements of Company Z?**

# Identification of a related party when KMP involved (2/4)



Who are the related parties of entities X, Y and Z in respective financial statements?

*Separate financial statements of X (reporting entity):*

- **Company Y** since Mr. A is a KMP in Company Y and controls the reporting entity
- **Company Z** since Mr. A is a KMP of Company Z's parent Company Y

*Separate financial statements of Company Y (reporting entity):*

- **Company X** as KMP of reporting entity exercises control over Company X
- **Company Z** as reporting entity exercises control over company Z
- **Mr. A** as he is a KMP of reporting entity

*Consolidated financial statements of Y:*

- Company X is a related party and Mr. A is a KMP.

*Financial statements of Z:*

- Company Y is a related party since Company Y exercises control over Company Z
- Company X is a related party as Mr. A controls Company X and is also a KMP of its parent Company Y

# Identification of related parties

NFRA observation

The Company has 8 executive directors out of which the management identified 4 directors as key managerial person ('KMP') and disclosed them as related party in the financial statements. The engagement team agreed with the management's identification and disclosure of KMP as related party.

Did the engagement team perform adequate audit procedures to ensure completeness of the related party listing?



What went wrong??

The engagement team did not document the details of other directors in the related party listing along with their evaluation as to why they are not related parties

No. As a part of risk assessment, the engagement team is required to perform audit procedures on identification of all related parties and disclose them appropriately in the financial statements.

- Obtain and reconcile a list of related parties to other information like form 3CD, transfer pricing report, annual director declarations, secretarial records, information provided to regulatory authorities, correspondence with legal consultants etc.
- Read minutes of meetings of shareholders and of those charged with governance

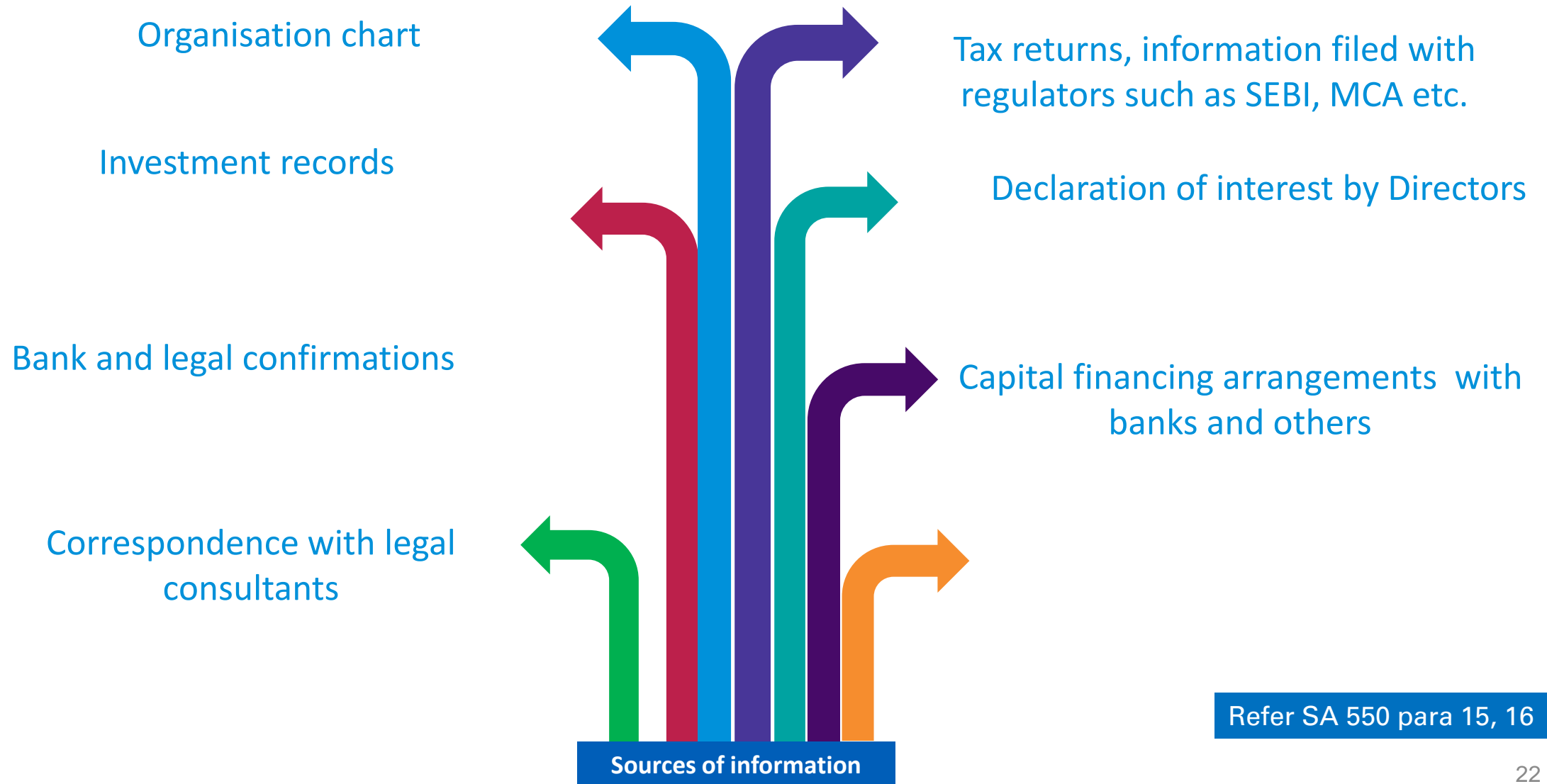
Not all directors would fall under the definition of KMP hence, the engagement team should test the appropriateness of the evaluation & identification of KMPs performed by the management.

Refer SA 550 para 15

Engagement team should assess the impact of the above on reporting

- Incomplete/ insufficient documentation by management of related party transaction may be indicative of a control deficiency impacting IFC opinion
- Critical for reporting on director disqualification in the audit report and CARO clauses on non-cash transactions

# Ensuring completeness of RPTs



Refer SA 550 para 15, 16

# Completeness of RPTs

- Request from management a list of related parties and transactions with them
- Review the minutes of meetings of shareholders, the board of directors and other meetings for material transactions authorised or disclosed
- Statutory registers for e.g., register required to be maintained under section 184 of the Companies Act 2013
- Understand and evaluate investment transactions, for example, purchase or sale of an equity interest in a joint venture or other entity
- Review confirmations of loan receivable and payable for indications of guarantees and determine the relationships, if any, with the guarantors
- Examine accounting records for material, unusual or nonrecurring transactions including loans to officers, directors, associated companies and individual parties, with special attention to transactions recognized at or near the period end

Refer SA 550 para 15, 16

# Completeness of RPTs

- Check background of parties which have material or unusual transactions with the enterprise by performing company search etc.
- Test entity's controls over completeness and accuracy of recording of related party relationships and transactions
- Review prior-year working papers for names of known related parties including changes from the prior period
- Obtain and review a listing of principal shareholders from the share register
- Examine correspondence and invoices from law firms
- Refer to entity income tax returns
- Refer to information supplied by entity to regulatory authorities



# Audit of related party and related party transactions – an overview of SA 550

Obtain an understanding of the entity's related parties, relationships and transactions for risk assessment purposes

1

Perform inquiries to identify and assess RMMs associated with related parties (including significant risk of error and /or risk of fraud)

2

Evaluate whether all related parties, relationships and transactions have been identified as required by SEBI regulation/ IND AS 24 / AS 18 / Companies Act 2013

3

Understand the process for identification, approval, accounting & disclosure of related party transactions, evaluate D&I and TOE of relevant controls

4

Perform relevant procedures on previously undisclosed related parties, relationships and transactions (if any)

5

Understand the business purpose (or the lack thereof) for each of the related party transactions

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Communicate related party matters with those charged with governance

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# Understanding of RP process and controls

Refer SA 550 para 14 ( A15)

## Entity Level Controls

- Approval mechanism
- Whistle blower policy
- Ethics Policy
- Policy on related party transactions

- Identification of related party and RPT
- Authorisation and approval including segregation of duties for RPTs
- Periodic review of RPT register by management
- Review of accounting and disclosures of RPT
- Internal audit review of RPTs

**Evaluation of D&I of RP controls is mandatory irrespective of whether RPT is identified as significant risk**  
**Documentation of understanding of RP process and testing of controls around RPT**

- Company ABC provided guarantee to loan taken by Company PQR from a bank
- Company ABC also provided a loan to Company PQR
- There were no other business transactions between both Companies
- PQR was not identified as a related party and hence the transactions did not go through the approval process

NFRA  
observation

What procedures are required to be performed by the engagement team?

The engagement team should:

- obtain an understanding of the management's controls around identification, approvals, authorisation and disclosures of related party transaction
- evaluate the design & implementation and test the operating effectiveness of the controls
- The approvals obtained as per SEBI/ Companies Act
- evaluate the nature of the relationship between the companies, the purpose of the transaction and whether this is an undisclosed related party

Refer SA 550 para 14

For related party and related party transactions, evaluate D&I and TOE of controls regardless of whether we have assessed the risk as an RM or a RMM or assessed an RMM as a significant risk or designed a controls approach for the RMM

Refer IFC guidance note para 80

Engagement team should assess the impact of the above on reporting

- Incomplete/ insufficient documentation by management of related party and related party transaction may be indicative of a control deficiency impacting IFC opinion
- The unapproved transactions will have to be reported in CARO clause 3(xiii) on compliance with sections 177 and 188 of Companies Act, 2013
- Numerous unapproved transactions / single unapproved material transaction may lead to a modification in the audit report

Exercise professional skepticism and understand the business rationale behind the Company advancing a loan or providing guarantee in absence of it being a related party or having any other business relationship as these are some of the indicators of the parties being "connected parties"

# Audit of related party and related party transactions – an overview of SA 550

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# Undisclosed related party (2/2)

On inspection of director declaration of all directors of Company ABC, the engagement team noticed that a Key Managerial Person of Company ABC held 60% shareholding in Company PQR, hence having control on Company PQR. Company PQR was not disclosed as related party in the financial statements by the management

What audit procedures should the engagement team perform on undisclosed related parties?

The engagement should perform procedures such as:

- communicate the newly identified related party to the engagement team (including component auditors if any) and TCWG
- inquire of management
- evaluate why the related party information was not disclosed
- consider whether to revise the risk assessment for this new information
- perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions

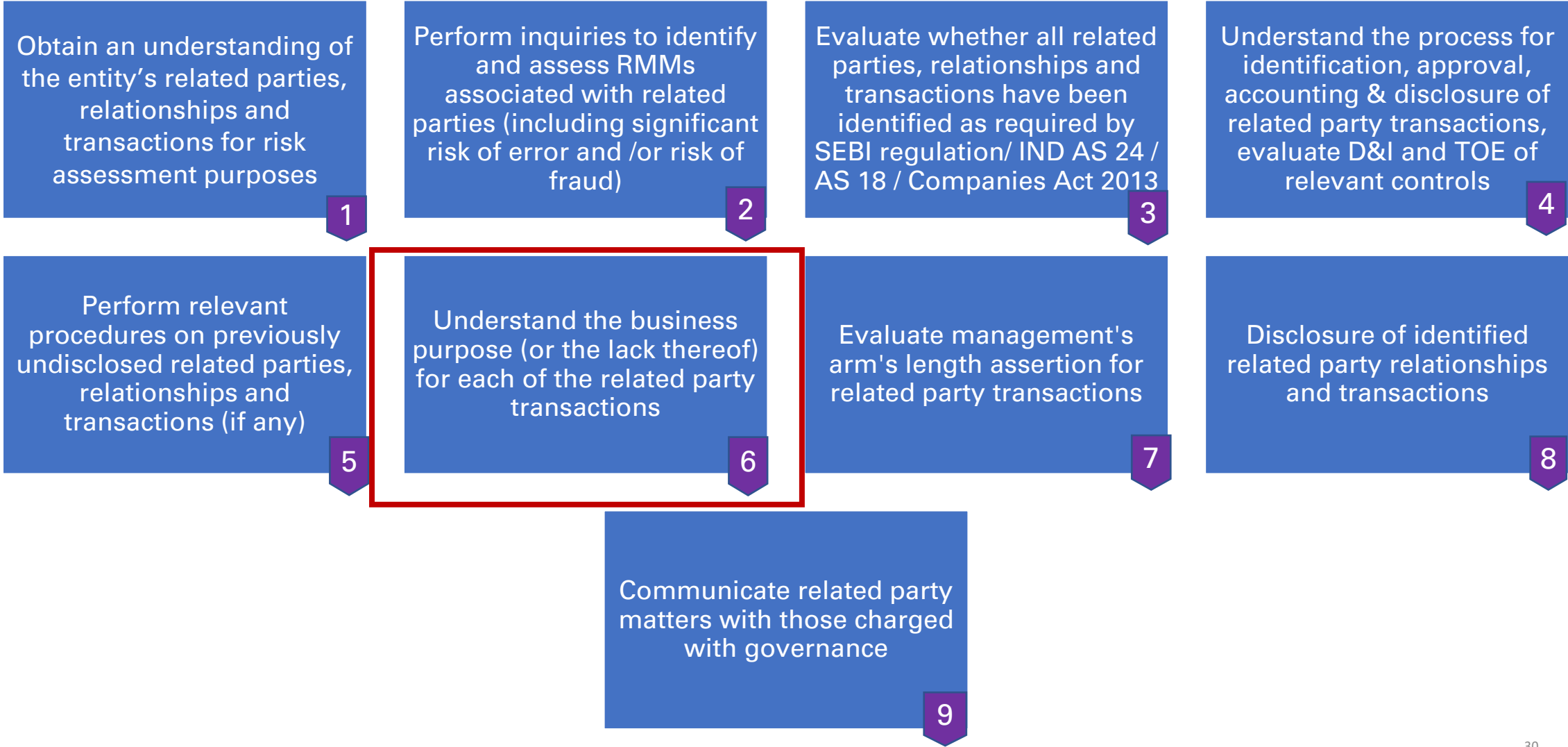
Refer SA 550 para 22

- Identification of undisclosed related parties, relationships or transactions may be indicative of
  - an increased risk assessment for RMMs, including fraud risks
  - new significant risks
  - control deficiencies impacting IFC reporting
  - non-reliability of other representations made by management
- qualified reporting under CARO clause 3(xiii) on compliance with section 177 and 188 of the Companies Act since undisclosed/unidentified transactions may be unapproved transactions

Combined evaluation of these factors may lead to a modification in the audit opinion

- Inquire and understand the business rationale and the end use of the funds given to its related parties as this may be used as a mechanism to divert the funds from one entity to other entities.
- Engagement teams should consider reporting implication under Rule 11(e) of the Companies (Audit and Auditor's) Rules, 2014 of diversion of funds in the main audit report.

# Audit of related party and related party transactions – an overview of SA 550



## business

While outside normal course of business has nowhere been specifically defined, SA 550 provides examples of transactions outside normal course of business as mentioned below

- Complex equity transactions, such as corporate restructurings or acquisitions.
- 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.
- Involves multiple related parties within the group or previously unidentified related party
- Lacks an apparent / logical business rationale
- Transactions have not been deliberated with TCWG

*Additionally, GN on CARO 2020 discusses that ordinary course of business will cover the usual transactions, customs and practices of a business and of a company*

The transactions outside the normal course of business may either be conducted with

- related parties
- unrelated parties which may be an indication of “connected parties”

Engagement teams should exercise professional skepticism and perform appropriate audit procedures as mentioned in

Company XYZ appointed Company LMN as its agent to exclusively sell the company products  
 Director of Company XYZ is also the promoter shareholder of Company LMN  
 Company XYZ has not appointed any other selling agents

What audit procedures should the engagement team perform?

The engagement team should

- Inquire from management about the nature of the transactions
- obtain an understanding of the business purpose (or lack thereof) of related party transaction
  - Read underlying documentation
  - evaluate consistency of terms and other information with explanations from inquiries and other audit evidence
  - Evaluate the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees, and other obligations, if any
- Obtain audit evidence that the transactions have been appropriately authorized, approved and disclosed

Refer SA 550 para 18 and 23

Engagement team should assess the impact of the above on reporting

- The transactions if not approved, will have to be reported in CARO clause 3(xiii) on compliance with sections 177 and 188 of Companies Act, 2013.
- Detailed disclosures under Ind AS/ AS should be provided being an unusual material transaction
- Numerous unapproved transactions / single material transaction may lead to a modification in the audit report

The engagement team should exercise professional skepticism as transactions with related parties may also be executed through third parties like vendors and customers

Treat identified significant related party transactions outside the entity's normal course of business as a significant risk



## business purpose

- Company ABC (parent company of XYZ) raises a monthly invoice to Company XYZ for management services and fees for maintenance of accounting software provided to Company XYZ .
- These expenses are significant to the total administrative expenses of Company XYZ.
- As part of process understanding, the engagement team was informed that the company uses a non-complex accounting software.
- At the year end, the engagement team verified the intercompany invoices and obtained an intercompany confirmation as part of audit procedures on the related party transactions.
- After the year end, a whistle blower complaint was raised indicating that the intercompany payments made for maintenance of accounting software were against fictitious services



What went wrong??

What audit procedures the engagement team should have performed ?

The engagement team did not obtain an understanding of the business purpose and the nature of services provided by the parent company and only verified the invoices raised by the parent Company

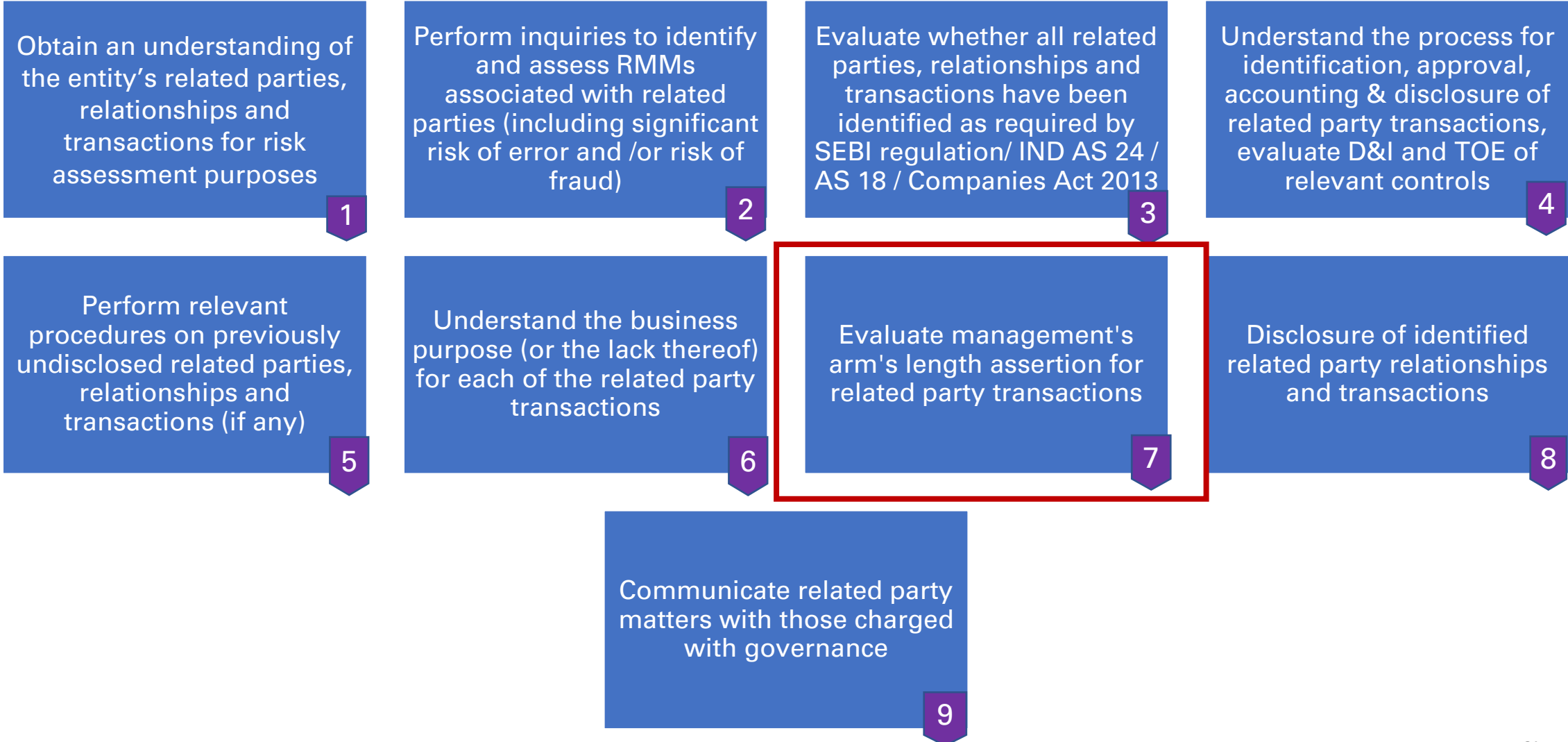
- inquire from management about the nature of the transactions
- obtain an understanding of the business purpose (or lack thereof) of related party transaction from underlying documentation as this may be used as a mechanism to divert funds
- evaluate consistency of terms and other information with explanations from inquiries and other audit evidence – in this case, the engagement team should have inquired the nature of services since they were as part of process informed that the accounting software used by the Company XYZ was not complex
- obtain audit evidence that the transactions have been appropriately authorized, approved and disclosed

Refer SA 550 para 18 and 23

Fraudulent transaction will lead to modification in audit report as well as may have an impact on the IFC opinion

- Engagement teams should exercise skepticism while reviewing significant related party transactions especially services
- When a transaction lacks a clear business purpose, it may be representative of an RMM.

# Audit of related party and related party transactions – an overview of SA 550



# Transactions at Arm's length

## Arm's length as per Companies Act, 2013

Section 188 (1)(b) states –  
the expression “arm's length transaction” means a transaction between 2 related parties conducted as if they were unrelated, so that there is no conflict of interest.

## Arm's length as per SA 550

Para 10(a) states –  
A transaction conducted on such terms & conditions as between unrelated, willing buyer & seller, acting independently of each other & pursuing their own best interests

The engagement teams should perform the required audit procedures as mentioned in to assess whether the transactions are at arms length

# Management's arm's length assessment

NFRA  
observation

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Company L purchases 80% its raw materials and spare parts from its group Companies Management has concluded that the transactions are at arms length based on the 3CEB report. The engagement team agreed to the management's assessment



Did the engagement team perform adequate procedures to assess the management's arms length assessment?

The engagement team relied solely on the transfer pricing report and concluded the transactions were on arms length

What went wrong??

No, solely relying on the transfer pricing report is not sufficient. The engagement team is required to perform other procedures such as -

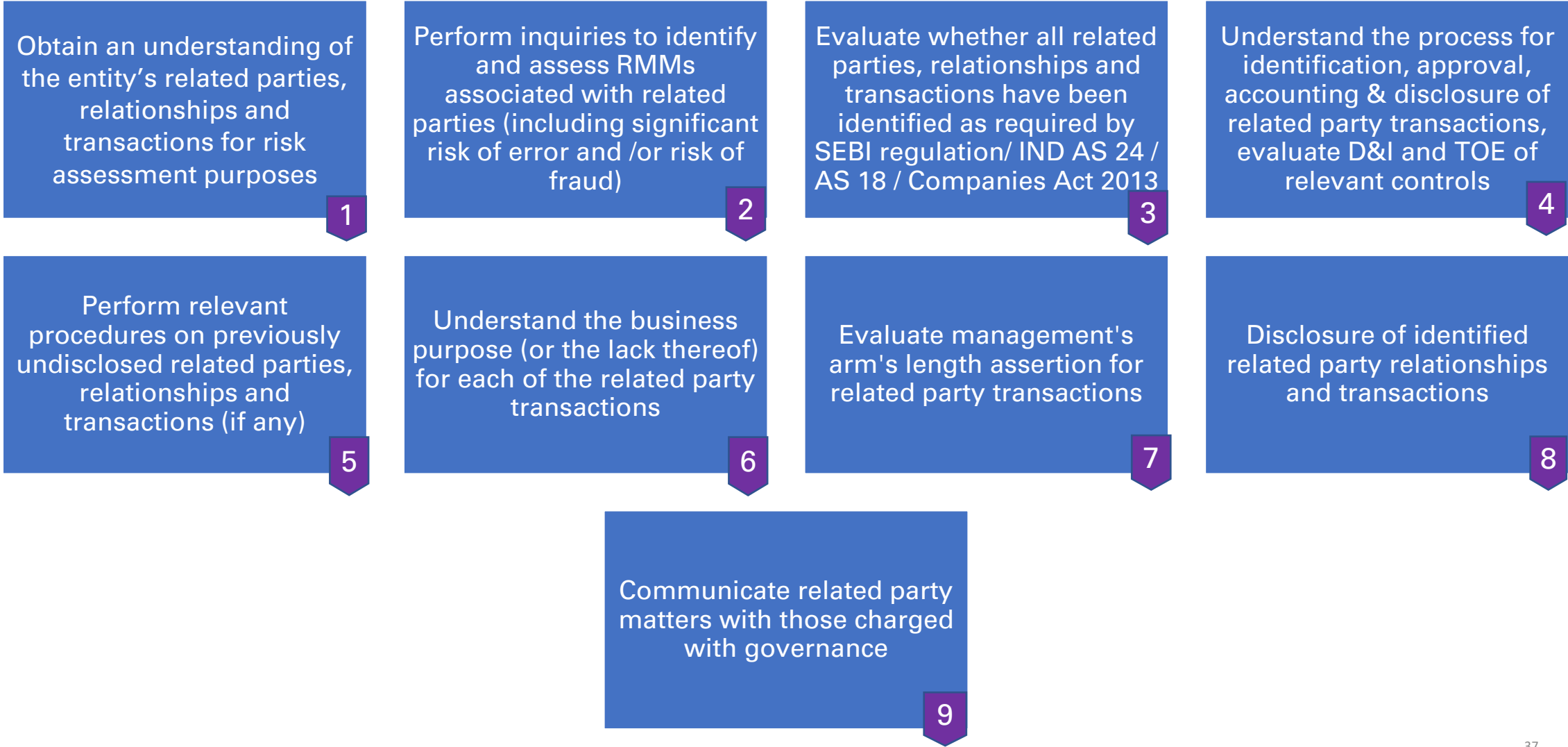
- obtain an understanding of management's process for supporting the assertion
- comparing the terms of the transaction to those of an identical or similar transaction with one or more unrelated parties.
- comparing the terms of the transaction to known market terms for broadly similar transactions on an open market
- engaging an external expert to determine the market value of the transaction and confirm market terms and conditions for the transaction
- consider involving a KPMG specialist
- verifying the source of the internal or external data supporting the assertion, and testing the data to determine their accuracy, completeness and relevance
- evaluate the reasonableness of significant assumptions on which the assertion is based (where applicable)
- where a management expert is involved, obtain an understanding of the work performed by expert including evaluating the competence, capabilities and objectivity of the expert and the appropriateness of the expert's work as audit evidence for the relevant assertion

Refer SA 550 Para 2

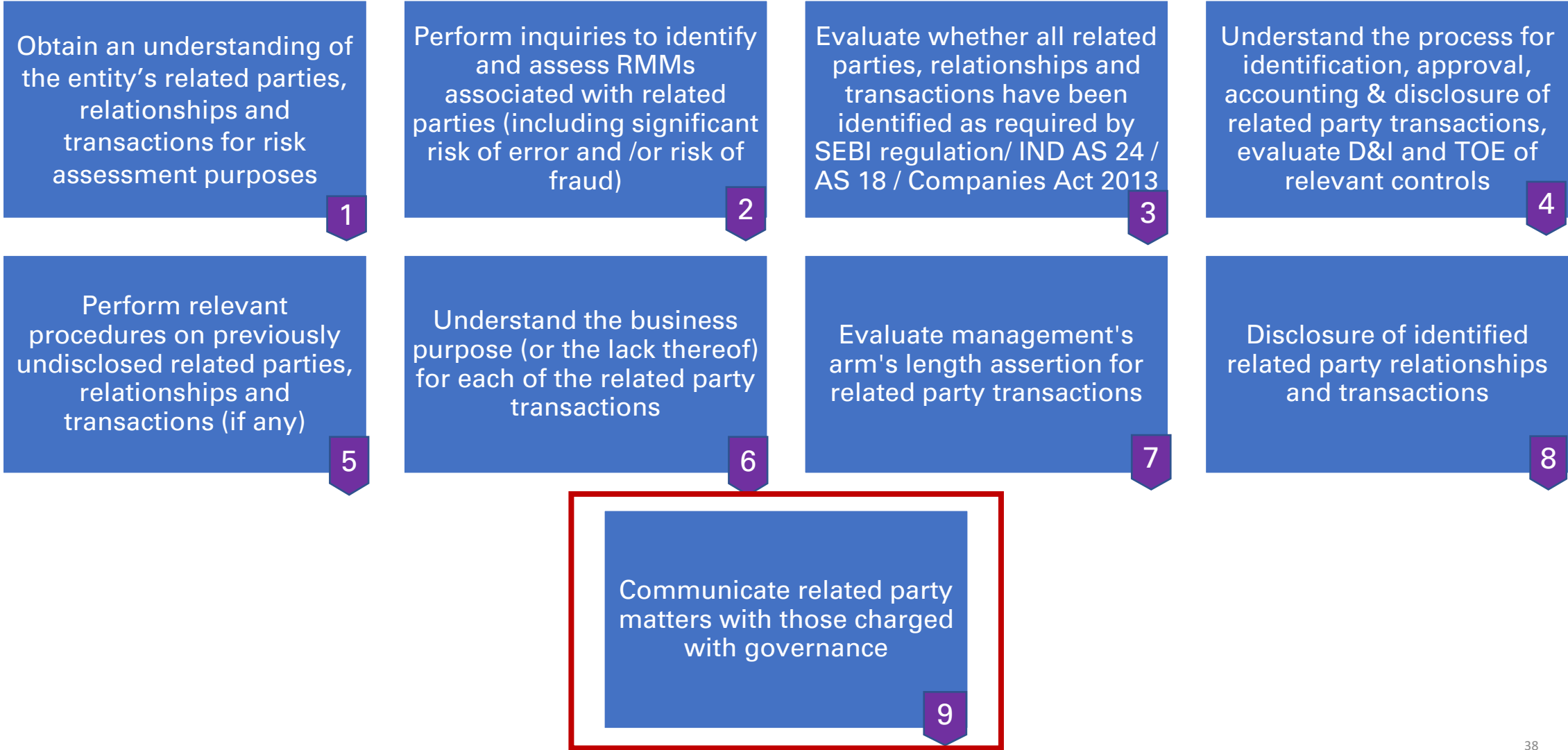
- Transaction not being at arms length are indicative of control deficiency and non-compliance with the regulatory requirements which may impact IFC reporting
- If transactions are not at arms length, the same will have to be reported in CARO clause 3(xiii) on compliance with sections 177 and 188 of Companies Act, 2013
- Considering the underlying nature of transaction being with a related party and not at arms length may be indicative of modification of the audit report

Management assessment of arm's length is for all of the terms of the transaction and not just for the price

# Audit of related party and related party transactions – an overview of SA 550



# Audit of related party and related party transactions – an overview of SA 550



## communicating with TCWG

**We communicate significant matters to TCWG regarding related parties [under the regulations and accounting standards] that we believe are relevant to their oversight of the financial reporting process. 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 lack a business purpose
- disagreements with management regarding the accounting for and disclosure of significant related party transactions;
- non-compliance with applicable law or regulations prohibiting or restricting specific types of related party transactions; and
- Any control deficiency identified around related party and related party transactions
- difficulties encountered in identifying the party that ultimately controls the entity.

Refer SA 550 para 27

In case of private companies where the meeting with board at times is not possible, engagement teams should conduct a meeting with one of the directors (such as MD) to communicate all the relevant matters as mentioned above. Further the engagement teams should request the director to take it on record in the board meeting

Engagement teams should use the standard template on written representation when obtaining written representations from the management / TCWG without tailoring them

Representation letter

# Does related party transactions impact reporting in CARO ??

- Clause 3(iii) on investments made, guarantee or security provided or loans/ advances in nature of loans granted
- Clause 3(iii)(f) on loans/ advances in nature of loans granted repayable on demand/without terms/period of repayment
- Clause 3(iv) compliance with section 185 and 186 of Companies Act 2013 w.r.t loans, investments, guarantees, and security
- Clause 3(ix)(e) on loans raised during the year on the pledge of securities held in its subsidiaries/ JV/associate companies and defaults in repayment, if any
- Clause 3(xiii) on compliance with section 177 and 188 of Companies Act 2013
- Clause 3(xv) on non-cash transactions with directors or persons connected with him and compliance with section 192 of Companies Act 2013.



# Examples of modification of auditors' report in relation to RPT

- CG Power ( March 2020) – Disclaimer of opinion
- Fortis Hospital ( March 2019) – qualification
- Coffee Day Entreprises ( March 2020) – disclaimer of opinion
- GVK Power and Infrastructure – Mar 2020 – Qualified opinion

*Sources : Respective annual report*

# Auditing related party transactions – what you need to be mindful of!

## The engagement team should exercise professional skepticism

- Perform appropriate audit procedures to ensure **completeness** of related parties
- Identifying ‘ **All** related parties’ and ‘connected parties’ appropriately after considering all the regulations and accounting standards
- Obtain an understanding and document the **business rationale** of related party transactions
- Ensure all approval requirements under Companies Act/ SEBI are complied with
- Ensure adequate work on arm’s length assertion is demonstrated in the audit file

Thank  
you

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