INTRODUCTION

Scope of this SA
1. This Standard on Auditing (SA) deals with the auditor’s responsibilities regarding related party relationships and transactions when performing an audit of financial statements. Specifically, it expands on how SA 315, SA 330 and SA 240 are to be applied in relation to risks of material misstatement associated with related party relationships and transactions.

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 summarising 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

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1 SA 315, “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment”.
2 SA 330, “The Auditor’s Responses to Assessed Risks”.
3 SA 240 (Revised), “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”.

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Part I: Engagement and Quality Control Standards

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:

(a) Achieve a true and 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 SA 240 because fraud may be more easily committed through related parties.

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 SAs. 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.

7. Planning and performing the audit with professional skepticism as required by SA 200 is therefore particularly important in this context, given the potential for undisclosed related party relationships and transactions. The requirements in this SA 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.

Effective Date

8. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2010.

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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 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; and
   (ii) 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

(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 SAs, 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.

7 In Indian context, definitions of “Related Party” and “Related Party Transactions” as given in Accounting Standard (AS) 18, “Related Party Disclosures”, issued by the Institute of Chartered Accountants of India, will be applicable for the purposes of this SA, and the said definitions also meet the tests laid down in paragraph 10(b)(ii) of this SA.
However, entities that are under common control by a state (i.e., 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.

REQUIREMENTS

Risk Assessment Procedures and Related Activities

11. As part of the risk assessment procedures and related activities that SA 315 and SA 240 require the auditor to perform during the audit, 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)

Understanding the Entity’s Related Party Relationships and Transactions

12. The engagement team discussion that SA 315 and SA 240 require 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)

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:

   (a) Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;
   
   (b) Authorise and approve significant transactions and arrangements with related parties; and
   
   (c) Authorise 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)

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8 SA 315, paragraph 5; and SA 240 (Revised), paragraph 16.
9 SA 315, paragraph 10; and SA 240 (Revised), paragraph 15.
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, legal and third party 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)

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

18. In meeting the SA 315 requirement to identify and assess the risks of material misstatement, 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.

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 SA 240. (Ref: Para. A6 and A29-A30)

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

20. As part of the SA 330 requirement that the auditor respond to assessed risks, 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 SA 315, paragraph 24.
11 SA 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;¹² (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

¹² SA 240 (Revised), paragraph 32(c).
b) Obtain audit evidence that the transactions have been appropriately authorised and approved. (Ref: Para. A40-A41)

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

24. When 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)

**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 SA 700, 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 true and fair presentation (for fair presentation frameworks); or

(ii) Cause the financial statements to be misleading (for compliance frameworks).

**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.

**Communication with Those Charged with Governance**

27. Unless all of those charged with governance are involved in managing the entity, 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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Documentation

28. In meeting the documentation requirements of SA 230\(^{14}\) and other SAs, the auditor shall include in the audit documentation the names of the identified related parties and the nature of the related party relationships.

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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 SA, 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 true and fair presentation if, for example, the economic reality of such relationships and transactions is not appropriately reflected in the financial statements. For instance, true and 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.

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 SA 700 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

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\(^{14}\) SA 230 (Revised), “Audit Documentation”.

\(^{15}\) ISA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing” defines the meaning of fair presentation and compliance frameworks as follows:

“The term “fair presentation framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

(i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

(ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term “compliance framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain acknowledgements in (i) or (ii) above.”
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 SA 210 the auditor determined that the framework is acceptable.

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 (i.e., 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 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 SA 315, paragraphs A23a-A23b, provides guidance regarding the nature of a special-purpose entity.
Risk Assessment Procedures and Related Activities

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

A8. In case of certain entities, auditor’s responsibilities regarding related party relationships and transactions may be affected by the audit mandate, or by obligations on those entities arising from legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature. Consequently, in such cases the 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 laws and regulations governing such entities that lay down specific requirements in the conduct of business with related parties. Further, in such cases the auditor may need to have regard to any specific financial reporting requirements for related party relationships and transactions that may differ from other entities.

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 an attitude of 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 (e.g., a complex organisational 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 relevant 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 summarise 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 SA. 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 SA 315 to obtain information 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.

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

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

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19 Currently, SA 600 (AAS 10), “Using the Work of Another Auditor” is in force. The Standard is being revised in the light of the corresponding International Standard.
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;
- Internal auditors;
- 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. Accordingly, where the framework establishes related party requirements, management, with oversight from those charged with governance, is responsible for the design, implementation and maintenance of 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 are responsible for monitoring 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 order to fulfill their oversight responsibilities, obtain information from management to enable them to understand the nature and business rationale of the entity’s related party relationships and transactions.

A17. In meeting the SA 315 requirement to obtain an understanding of the control environment, 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, summarising, and disclosing related party transactions.

20 SA 200 [See footnote 2].
21 These changes have been made pursuant to the issuance of Standard on Auditing (SA) 210 (Revised), “Agreeing the Terms of Audit Engagements”, which is effective for all audits of financial statements for periods beginning on or after April 1, 2010.
22 SA 315, paragraph 14.
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- 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 internal auditors, 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.

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 SA 705, consider the implications for the audit, including the auditor’s report.

A19. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. The risk of management override of

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23 These changes had been made pursuant to the issuance of Standard on Auditing (SA) 265, “Communicating Deficiencies in Internal Control to Those Charged with Governance and Management”, which is effective for all audits of financial statements for periods beginning on or after April 1, 2010.


25 SA 240 (Revised), paragraphs 31 and 44.
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.

Considerations specific to smaller entities

A20. Control environment in smaller entities is likely to be different from larger entities. In particular those charged with governance may not include an outside member, and the role of governance may be undertaken directly by the owner-manager where no other owner exists. Control activities 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.

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

A21. Authorisation 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 predetermined 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 authorisation was granted. Examples of controls the entity may have established to authorise 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 authorisation 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:

- 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.
- Internal auditors’ reports.
- Documents associated with the entity’s filings with a securities regulator (e.g., prospectuses).

Arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions

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 require special audit consideration, in particular transactions in which management or those charged with governance are financially involved.

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.26 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.

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26 SA 240 (Revised), Appendix 1.
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.

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.

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.27

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.

27 SA 330 provides further guidance on considering the nature, timing and extent of further audit procedures. SA 240 (Revised) establishes requirements and provides guidance on appropriate responses to assessed risks of material misstatement due to fraud.
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 SA 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 SA 330 requirement to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls, 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.

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))

28 SA 330, paragraph 8(b).
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 SA 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 (e.g., it may involve multiple related parties within a consolidated group).
  - Has unusual terms of trade, such as unusual prices, interest rates, guarantees and repayment terms.
  - Lacks an apparent logical business reason for its occurrence.
  - Involves previously unidentified related parties.
  - Is processed in an unusual manner.
- Whether management has discussed the nature of, and accounting for, such a transaction with those charged with governance.
- Whether management is placing more emphasis on a particular accounting treatment rather than giving due regard to the underlying economics of the transaction.
If management’s explanations are materially inconsistent with the terms of the related party transaction, the auditor is required, in accordance with SA 500,29 to consider the reliability of management’s explanations and representations on other significant matters.

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. Authorisation 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 authorisation 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 error or fraud. In these circumstances, the auditor may need to be alert for other transactions of a similar nature. Authorisation and approval alone, however, may not be sufficient in concluding whether risks of material misstatement due to fraud are absent because authorisation 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

29 SA 500 (Revised), “Audit Evidence”.

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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. Management is responsible for the substantiation of 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.

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

**Materiality Considerations in Evaluating Misstatements** (Ref: Para. 25)

A46. SA 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.\(^\text{30}\) 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.

\(^{30}\) SA 450, “Evaluation of Misstatements Identified during the Audit,” paragraph 11(a). Paragraph A16 of SA 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.

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.
• Management’s assertion of responsibility that related party transactions were conducted on terms equivalent to those prevailing in an arm’s length transaction.

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.

Communication with Those Charged with Governance (Ref: Para. 27)

A50. Communicating significant matters arising during the audit 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 authorised and approved, which may give rise to suspected fraud.

31 SA 230 (Revised), “Audit Documentation”, paragraph A8 provides further guidance on the nature of significant matters arising during the audit.
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- 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.

**MATERIAL MODIFICATIONS VIS A VIS ISA 550, “RELATED PARTIES”**

**Additions**

1. In paragraph A20 of the Application Section, the lines, “Control environment in smaller entities is likely to be different from larger entities. In particular those charged with governance may not include an outside member, and the role of governance may be undertaken directly by the owner-manager where no other owner exists” have been added so to explain the difference between the control environment in the larger entities and smaller entities.
2. In paragraph A48 of the Application Section, it has been added that a written representation may be obtained by the auditor regarding management’s assertion of responsibility that related party transactions were conducted on terms equivalent to those prevailing in an arm’s length transaction.

**Deletions**

1. Paragraph A8 of the Application Section of ISA 550 deals with the application of the requirement of ISA 550 to the audits of public sector entities regarding the effect of laws and regulations governing the public sector bodies on the auditor’s responsibilities with regard to related party relationships and transactions. Since as mentioned in the “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services”, the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

Further, it is also possible that even in case of certain entities, the laws and regulations may also include a broader responsibility to address the risks of non-compliance with laws and regulations that lay down specific requirements in the conduct of business with related parties. Accordingly, the spirit of erstwhile A8, highlighting such additional responsibilities of the auditor, has been retained.

**Limited Revision Consequential to issuance of Revised Standard on Auditing (SA) 550, “Related Parties”**

The amendments to Standard on Auditing (SA) 315 have been shown in track change mode.

SA 315, “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment”
The Entity and Its Environment

11. The auditor shall obtain an understanding of the following:
   (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework. (Ref: Para. A15-A20)
   (b) The nature of the entity, including:
       (i) Its operations;
       (ii) Its ownership and governance structures;
       (iii) The types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
       (iv) The way that the entity is structured and how it is financed; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements. (Ref: Para. A21-A23)
   (c) The entity’s selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity’s accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry. (Ref: Para. A24)
   (d) The entity’s objectives and strategies, and those related business risks that may result in risks of material misstatement. (Ref: Para. A25-A31)
   (e) The measurement and review of the entity’s financial performance. (Ref: Para. A32-A37)

The following paragraphs are inserted after paragraph A23 in the Application and Other Explanatory Material section:

Nature of Special-Purpose Entities

A23a. A special-purpose entity (sometimes referred to as a special purpose vehicle) is an entity that is generally established for a narrow and well-defined purpose, such as to effect a lease or a securitisation of financial assets, or to carry out research and development activities. It may take the form of a corporation, trust, partnership or unincorporated entity. The entity on behalf of which the special-purpose entity has been created may often transfer assets to the latter (e.g., as part of a de-recognition transaction involving financial assets), obtain the right to use the latter’s assets, or perform services for the latter, while other parties may provide the funding to the latter. As SA 550 indicates, in some circumstances, a special-purpose entity may be a related party of the entity.32

A23b. Financial reporting frameworks often specify detailed conditions that are deemed to amount to control, or circumstances under which the special-purpose entity should be considered for consolidation. The interpretation of the requirements of such frameworks often demands a detailed knowledge of the relevant agreements involving the special-purpose entity.

INTRODUCTION

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor’s responsibilities relating to subsequent events in an audit of financial statements. *(Ref: Para. A1)*

2. Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:

   (a) Those that provide evidence of conditions that existed at the date of the financial statements; and
   
   (b) Those that provide evidence of conditions that arose after the date of the financial statements.

[Proposed] SA 700 (Revised) explains that the date of the auditor’s report informs the reader that the auditor has considered the effect of events and transactions of which the auditor becomes aware and that occurred up to that date.2

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1 ISA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in accordance with International Standards on Auditing”, Paragraph 13 (a) defines the applicable financial reporting framework as “The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

The term “fair presentation framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

   (i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
   
   (ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

The term “compliance framework” is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above”.

Effective Date
3. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2009.

Objectives
4. The objectives of the auditor are to:
   (a) Obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor’s report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements; and
   (b) Respond appropriately to facts that become known to the auditor after the date of the auditor’s report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor’s report.

Definitions
5. For purposes of the SAs, the following terms have the meanings attributed below:
   (a) Date of the financial statements – The date of the end of the latest period covered by the financial statements.
   (b) Date of approval of the financial statements – The date on which all the statements that comprise the financial statements have been prepared and those with the recognised authority have asserted that they have taken responsibility for those financial statements. (Ref: Para. A2)
   (c) Date of the auditor’s report – The date the auditor dates the report on the financial statements in accordance with SA 700 (Revised). (Ref: Para. A3)
   (d) Date the financial statements are issued – The date that the auditor’s report and audited financial statements are made available to third parties. (Ref: Para. A4-A5)
   (e) Subsequent events – Events occurring between the date of the financial statements and the date of the auditor’s report, and facts that become known to the auditor after the date of the auditor’s report.

REQUIREMENTS

Events Occurring Between the Date of the Financial Statements and the Date of the Auditor’s Report
6. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor’s report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. (Ref: Para. A6)
7. The auditor shall perform the procedures required by paragraph 6 so that they cover the period from the date of the financial statements to the date of the auditor’s report, or as near
as practicable thereto. The auditor shall take into account the auditor’s risk assessment in determining the nature and extent of such audit procedures, which shall include the following: (Ref: Para. A7-A8)

(a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
(b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements. (Ref: Para. A9)
(c) Reading minutes, if any, of the meetings, of the entity’s owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available. (Ref: Para. A10)
(d) Reading the entity’s latest subsequent interim financial statements, if any.

8. When, as a result of the procedures performed as required by paragraphs 6 and 7, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

Written Representations

9. The auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580 (Revised), “Written Representations” that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

Facts Which Become Known to the Auditor After the Date of the Auditor’s Report but Before the Date the Financial Statements are Issued

10. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor’s report. However, when, after the date of the auditor’s report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor’s report, may have caused the auditor to amend the auditor’s report, the auditor shall: (Ref: Para. A11)

(a) Discuss the matter with management and, where appropriate, those charged with governance.
(b) Determine whether the financial statements need amendment and, if so,
(c) Inquire how management intends to address the matter in the financial statements.

11. If management amends the financial statements, the auditor shall:

(a) Carry out the audit procedures necessary in the circumstances on the amendment.
(b) Unless the circumstances in paragraph 12 apply:

(i) Extend the audit procedures referred to in paragraphs 6 and 7 to the date of the new auditor’s report; and
(ii) Provide a new auditor’s report on the amended financial statements. The new auditor’s report shall not be dated earlier than the date of approval of the amended financial statements.

12. When law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent events or events causing that amendments and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, the auditor is permitted to restrict the audit procedures on subsequent events required in paragraph 11(b)(i) to that amendment. In such cases, the auditor shall either:

(a) Amend the auditor’s report to include an additional date restricted to that amendment that thereby indicates that the auditor’s procedures on subsequent events are restricted solely to the amendment of the financial statements described in the relevant note to the financial statements; or (Ref: Para. A12)

(b) Provide a new or amended auditor’s report that includes a statement in an Emphasis of Matter paragraph or Other Matter(s) paragraph that conveys that auditor’s procedures on subsequent events are restricted solely to the amendment of the financial statements as described in the relevant note to the financial statements.

13. In some entities, management may not be required by the applicable law, regulation or the financial reporting framework to issue amended financial statements and, accordingly, the auditor need not provide an amended or new auditor’s report. However, when management does not amend the financial statements in circumstances where the auditor believes they need to be amended, then: (Ref: Para. A13-A14)

(a) If the auditor’s report has not yet been provided to the entity, the auditor shall modify the opinion as required by [proposed] SA 705 and then provide the auditor’s report; or

(b) If the auditor’s report has already been provided to the entity, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity, those charged with governance, not to issue the financial statements to third parties before the necessary amendments have been made. If the financial statements are nevertheless subsequently issued without the necessary amendments, the auditor shall take appropriate action, to seek to prevent reliance on the auditor’s report. (Ref: Para. A15-A16)

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3 At present, there is no separate Standard on Auditing (SA) corresponding to International Standard on Auditing (ISA) 705. However, the concept of modified audit report has been discussed in SA 700, “The Auditor’s Report on Financial Statements”. The Auditing and Assurance Standards Board (AASB) has issued the Exposure Drafts of Revised SA 700, “Forming An Opinion and Reporting on Financial Statements”; SA 705, “Modifications to the Opinion in the Independent Auditor’s Report”; and SA 706, “Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report”, corresponding to the ISA 700, ISA 705 and ISA 706. These Exposure Drafts are published in the June 2009 issue of the Journal.
Facts Which Become Known to the Auditor After the Financial Statements have been Issued

14. After the financial statements have been issued, the auditor has no obligation to perform any audit procedures regarding such financial statements. However, when, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor’s report, may have caused the auditor to amend the auditor’s report, the auditor shall:

(a) Discuss the matter with management and, where appropriate, those charged with governance.

(b) Determine whether the financial statements need amendment and, if so,

(c) Inquire how management intends to address the matter in the financial statements.

15. If the management amends the financial statements, the auditor shall: (Ref: Para. A17)

(a) Carry out the audit procedures necessary in the circumstances on the amendment.

(b) Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor’s report thereon is informed of the situation.

(c) Unless the circumstances in paragraph 12 apply:

(i) Extend the audit procedures referred to in paragraphs 6 and 7 to the date of the new auditor’s report, and the date the new auditor’s report no earlier than the date of approval of the amended financial statements; and

(ii) Provide a new auditor’s report on the amended financial statements.

(d) When the circumstances in paragraph 12 apply, amend the auditor’s report, or provide a new auditor’s report as required by paragraph 12.

16. The auditor shall include in the new or amended auditor’s report an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor.

17. If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity, those charged with governance, that the auditor will seek to prevent future reliance on the auditor’s report. If, despite such notification, management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor’s report. (Ref: Para. A18)

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Application and Other Explanatory Material

Introduction (Ref: Para. 1)

A1. When the audited financial statements are included in other documents subsequent to the issuance of the financial statements, the auditor may have additional responsibilities relating to subsequent events that the auditor may need to consider, such as legal or regulatory requirements involving the offering of securities to the public in jurisdictions in which the securities are being offered. For example, the auditor may be required to perform additional audit procedures to the date of the final offering document. These procedures may include those referred to in paragraphs 6 and 7 performed up to a date at or near the effective date of the final offering document, and reading the offering document to assess whether the other information in the offering document is consistent with the financial information with which the auditor is associated.

Definitions

Date of Approval of the Financial Statements (Ref: Para. 5(b))

A2. In some entities, the applicable law or regulation identifies the individuals or bodies (for example, management or those charged with governance) that are responsible for concluding that all the statements comprising the financial statements have been prepared, and specifies the necessary approval process. In some other entities, the approval process is not prescribed in law or regulation and the entity follows its own procedures in preparing and finalising its financial statements in view of its management and governance structures. In some cases, final approval of the financial statements by shareholders is required. In such cases, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence on which to base the auditor’s opinion on the financial statements has been obtained. The date of approval of the financial statements for purposes of the SAs is the earlier date on which those with the recognised authority have asserted that all the statements comprising the financial statements have been prepared and that those with the recognised authority have taken responsibility for those financial statements.

Date of the Auditor’s Report (Ref: Para. 5(c))

A3. The auditor’s report cannot be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements.4 Sufficient appropriate audit evidence includes evidence that all the statements that comprise the financial statements have been prepared and that those with the recognised authority have asserted that they have taken responsibility for those financial statements. Consequently, the date of the auditor’s report cannot be earlier than the date of approval of the financial statements as defined in paragraph 5(b). A time period may elapse due to

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4 Standard on Auditing (SA) 700 (AAS 28), paragraph [24] states that in addition to an opinion on the true and fair view, the auditor’s report may need to include an opinion as to whether the financial statements comply with other requirements specified by relevant statutes or law.
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Administrative issues between the date of the auditor’s report as defined in paragraph 5(c) and the date the auditor’s report is provided to the entity.

**Date the Financial Statements are Issued** (Ref: Para. 5(d))

A4. The date the financial statements are issued generally depends on the regulatory environment of the entity. In some circumstances, the date the financial statements are issued may be the date they are filed with a regulatory authority. Since audited financial statements cannot be issued without an auditor’s report, the date that the audited financial statements are issued must not only be at or later than the date of the auditor’s report, but must also be at or later than the date the auditor’s report is provided to the entity.

A5. In the case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), the date the financial statements are issued may be the date the audited financial statements and the auditor’s report thereon are presented to the legislature or otherwise made public.

**Events Occurring Between the Date of the Financial Statements and the Date of the Auditor’s Report** (Ref: Para. 6-9)

A6. Depending on the auditor’s risk assessment, the audit procedures required by paragraph 6 may include procedures, necessary to obtain sufficient appropriate audit evidence, involving the review or testing of accounting records or transactions occurring between the date of the financial statements and the date of the auditor’s report. The audit procedures required by paragraphs 6 and 7 are in addition to procedures that the auditor may perform for other purposes that, nevertheless, may provide evidence about subsequent events (for example, to obtain audit evidence for account balances as at the date of the financial statements, such as cut-off procedures or procedures in relation to subsequent receipts of accounts receivable).

A7. Paragraph 7 stipulates certain audit procedures in this context that the auditor is required to perform pursuant to paragraph 6. The subsequent events procedures that the auditor performs may, however, depend on the information that is available and, in particular, the extent to which the accounting records have been prepared since the date of the financial statements. When the accounting records are not up-to-date, and accordingly no interim financial statements (whether for internal or external purposes) have been prepared, or minutes of meetings of management or those charged with governance have not been prepared, relevant audit procedures may take the form of inspection of available books and records, including bank statements. Paragraph A8 gives examples of some of the additional matters that the auditor may consider in the course of these inquiries.

A8. In addition to the audit procedures required by paragraph 7, the auditor may consider it necessary and appropriate to:

- Read the entity’s latest available budgets, cash flow forecasts and other related management reports for periods after the date of the financial statements;
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- Inquire, or extend previous oral or written inquiries, of the entity’s legal counsel concerning litigation and claims; or
- Consider whether written representations covering particular subsequent events may be necessary to support other audit evidence and thereby obtain sufficient appropriate audit evidence.

**Inquiry** (Ref: Para. 7(b))

A9. In inquiring of management and, where appropriate, those charged with governance, as to whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire as to the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matters:

- Whether new commitments, borrowings or guarantees have been entered into.
- Whether sales or acquisitions of assets have occurred or are planned.
- Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
- Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.
- Whether there have been any developments regarding contingencies.
- Whether any unusual accounting adjustments have been made or are contemplated.
- Whether any events have occurred or are likely to occur that will bring into question the appropriateness of accounting policies used in the financial statements, as would be the case, for example, if such events call into question the validity of the going concern assumption.
- Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.
- Whether any events have occurred that are relevant to the recoverability of assets.

**Reading Minutes** (Ref: Para. 7(c))

A10. In case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), the auditor may read the official records of relevant proceedings of the legislature and inquire about matters addressed in proceedings for which official records are not yet available.

**Facts Which Become Known to the Auditor After the Date of the Auditor’s Report but Before the Date the Financial Statements are Issued**

**Management Responsibility Towards Auditor** (Ref: Para. 10)

A11. As explained in SA 210 (Revised), the terms of the audit engagement include the agreement of management to inform the auditor of facts that may affect the financial
statements, of which management may becomes aware during the period from the date of the auditor’s report to the date the financial statements are issued.\(^5\)\(^6\)

**Dual Dating** (Ref: Para. 12(a))

A12. When, in the circumstances described in paragraph 12(a), the auditor amends the auditor’s report to include an additional date restricted to that amendment, the date of the auditor’s report on the financial statements prior to their subsequent amendment by management remains unchanged because this date informs the reader as to when the audit work on those financial statements was completed. However, an additional date is included in the auditor’s report to inform users that the auditor’s procedures subsequent to that date were restricted to the subsequent amendment of the financial statements. The following is an illustration of such an additional date:

"(Date of auditor’s report), except as to Note Y, which is as of (date of completion of audit procedures restricted to amendment described in Note Y)".

**No Amendment of Financial Statements by Management** (Ref: Para. 13)

A13. In some entities, management may not be required by the applicable law, regulation or the financial reporting framework to issue amended financial statements. This is often the case when issuance of the financial statements for the following period is imminent, provided appropriate disclosures are made in such statements.

A14. In case of certain entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions), the actions taken in accordance with paragraph 13 when management does not amend the financial statements may also include reporting separately to the legislature, or other relevant body in the reporting hierarchy, on the implications of the subsequent event for the financial statements and the auditor’s report.

**Auditor Action to Seek to Prevent Reliance on Auditor’s Report** (Ref: Para. 13(b))

A15. The auditor may need to fulfill additional legal obligations even when the auditor has notified management not to issue the financial statements and management has agreed to this request.

A16. When management has issued the financial statements despite the auditor’s notification not to issue the financial statements to third parties, the auditor’s course of action to prevent reliance on the auditor’s report on the financial statements depends upon the auditor’s legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

\(^5\) Revised Standard on Auditing (SA) 210, “Agreeing the Terms of Audit Engagements”, paragraph A23.

\(^6\) These changes have been made pursuant to the issuance of Standard on Auditing (SA) 210 (Revised), “Agreeing the Terms of Audit Engagements”, which is effective for all audits of financial statements for periods beginning on or after April 1, 2010.
Facts Which Become Known to the Auditor After the Financial Statements have been Issued

No Amendment of Financial Statements by Management (Ref: Para. 15)

A17. In some circumstances, the entities, such as, Central/State governments and related government entities (for example, agencies, boards, commissions) may be prevented from issuing amended financial statements by law or regulation. In such circumstances, the appropriate course of action for the auditor may be to report to the appropriate statutory body.

Auditor Action to Seek to Prevent Reliance on Auditor’s Report (Ref: Para. 17)

A18. When the auditor believes that management, or those charged with governance, have failed to take the necessary steps to prevent reliance on the auditor’s report on financial statements previously issued by the entity despite the auditor’s prior notification that the auditor will take action to seek to prevent such reliance, the auditor’s course of action depends upon the auditor’s legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

MATERIAL MODIFICATIONS TO ISA 560, “SUBSEQUENT EVENTS”

Deletion

1. Paragraph A5 of ISA 560 provides that in the case of public sector entities, the date the financial statements are issued may be the date the audited financial statements and the auditor’s report thereon are presented to the legislature or otherwise made public. Paragraph A10 of ISA 560 provides that in the case of public sector, the auditor may read the official records of relevant proceedings of the legislature and inquire about matters addressed in proceedings for which official records are not yet available. Paragraph A14 of ISA 560 provides that in the case of public sector, the actions taken in accordance with paragraph 13 of ISA when management does not amend the financial statements may also include reporting separately to the legislature, or other relevant body in the reporting hierarchy, on the implications of the subsequent event for the financial statements and the auditor’s report. Paragraph A17 of ISA 560 provides that in some circumstances, the entities in the public sector may be prevented from issuing amended financial statements by law or regulation. In such circumstances, the appropriate course of action for the auditor may be to report to the appropriate statutory body. Since as mentioned in the “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services”, the Standards issued by the Auditing and Assurance Standards Board, apply equally to all entities, irrespective of their form, nature and size, a specific reference to applicability of the Standard to public sector entities has been deleted.

Further, it is also possible that such situations may also exist in case of certain entities pursuant to a requirement under the statute or regulation under which they operate. Accordingly, the spirit of erstwhile A5, A10, A14 and A17, highlighting such fact, has been retained though a specific reference to public sector entities has been deleted.