

(October 2006)

Explanatory Statement

ASA 550 Related Parties

Issued by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

Explanatory Statement

Reasons for Issuing ASA 550 *Related Parties*

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 550 *Related Parties* due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 336 of the *Corporations Act 2001*, the AUASB may make Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Process of making Auditing Standards

Section 1455 of the *Corporations Act 2001* and *Corporations Regulation 10.5.01* gave interim legal endorsement from 1 July 2004 to the majority of Auditing Standards made by the former Auditing & Assurance Standards Board of the Australian Accounting Research Foundation. The AUASB has reviewed the Auditing Standards and has proceeded to make them as legally enforceable Auditing Standards under the *Corporations Act 2001*.

The Auditing Standards have been made also in accordance with the Financial Reporting Council's Strategic Direction to the AUASB dated 6 April 2005, pursuant to section 225 of the *ASIC Act*.

The Strategic Direction, *inter alia*, provides that the AUASB develops Auditing Standards that:

- have a clear public interest focus and are of the highest quality;

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- use the International Standards on Auditing (ISAs) of the International Auditing and Assurance Standards Board (IAASB) as a base;
- conform with the Australian regulatory environment; and
- are capable of enforcement.

In implementing the Strategic Direction, the AUASB has undertaken a process of thorough review and revision that has:

- addressed the enforceability of mandatory requirements;
- clarified auditors' obligations under the Auditing Standards;
- provided for sector neutrality in the Auditing Standards; and
- included other amendments as necessary.

Purpose of Auditing Standard ASA 550 *Related Parties*

The purpose of Auditing Standard ASA 550 is to establish mandatory requirements and to provide explanatory guidance on the auditor's responsibilities and audit procedures regarding related parties and transactions with such parties when:

- (a) Australian Accounting Standard AASB 124 *Related Party Disclosures*, or similar requirement, is part of the applicable financial reporting framework; or
- (b) in other circumstances, the auditor considers it appropriate to identify related parties and related party transactions.

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Auditing Standard ASA 550 is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

Operative Date

This Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.

Main changes from Auditing Standard AUS 518 (July 2002) *Related Parties*

The main differences between ASA 550 and AUS 518 are that in ASA 550:

1. The word 'shall', in the **bold-type** paragraphs, is the terminology used to describe an auditor's mandatory requirements, whereas an auditor's degree of responsibility is described in AUS 518 by the word 'should'.
2. The explanatory paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas in AUS 518 some obligations are implied within certain explanatory paragraphs. Accordingly, such paragraphs have been redrafted to clarify that the matter forms part of the explanatory guidance.
3. The following implied obligations in AUS 518, have been elevated and re-stated as specific mandatory requirements:
 - (a) based on the auditor's understanding of the entity and its environment including its internal control, the auditor shall make an assessment of the risk of material misstatement as it relates to the identification of related parties and the authorisation and recording of related party transactions (paragraph 13);

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- (b) the auditor shall review information provided by those charged with governance and management identifying the names of all known related parties and shall perform the following audit procedures to reduce the risk of related parties remaining undetected to an acceptably low level:
 - (i) review prior year working papers for names of known related parties;
 - (ii) review the entity's procedures for identification of related parties;
 - (iii) enquire as to the affiliation of those charged with governance and officers with other entities;
 - (iv) review shareholder records to determine the names of principal shareholders or, if appropriate, obtain a listing of principal shareholders from the share register;
 - (v) review minutes of the meetings of shareholders and those charged with governance and other relevant statutory records such as the register of directors' interests;
 - (vi) enquire of other auditors currently involved in the audit, or predecessor auditors, as to their knowledge of additional related parties; and
 - (vii) review the entity's income tax returns and other information supplied to regulatory agencies.

If, in the auditor's judgement, there is a lower risk of significant related parties remaining undetected, these

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- procedures may be modified as appropriate (paragraph 18);
- (c) the auditor shall endeavour to obtain a written representation from management concerning:
 - (i) the completeness of information provided regarding the identification of related parties; and
 - (ii) the adequacy of related party disclosures in the financial report (paragraph 33);
4. The following specific mandatory requirements, not in AUS 518, have been included:
- (a) where there is any indication that there are limitations that may affect the persuasiveness of audit evidence, the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement at the assertion level (paragraph 7);
 - (b) where the applicable financial reporting framework requires disclosure of related party relationships, the auditor shall be satisfied that the disclosure is in accordance with that framework (paragraph 23); and
 - (c) the auditor shall discuss with those charged with governance the nature, extent and business rationale of significant related party relationships and transactions, including those involving actual conflicts of interest (paragraph 31).
5. Additional explanatory guidance paragraphs have been included on:
- (a) the application of this Auditing Standard to public sector entities (paragraph 4);

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- (b) communication with those charged with governance (paragraph 32); and
 - (c) circumstances when management is unable to or refuses to provide the auditor a written representation (paragraph 34).
6. The following mandatory requirement in paragraph .13 of AUS 518 and associated explanatory guidance at paragraphs .14 to .16 have been replaced with explanatory guidance at paragraph 17:
- (a) the auditor should consider the assessed levels of inherent and control risks in determining the nature, timing and extent of substantive audit procedures.

Consultation prior to issuing this Auditing Standard

The AUASB has consulted publicly as part of its due process in developing this Auditing Standard. Exposure Draft ED 26/05 *Proposed Auditing Standard: Related Parties (Re-issuance of AUS 518)* was issued on 16 November 2005 with a 45 day comment period. Submissions were received by the AUASB and it has considered these submissions as part of the development and finalisation of this Auditing Standard.