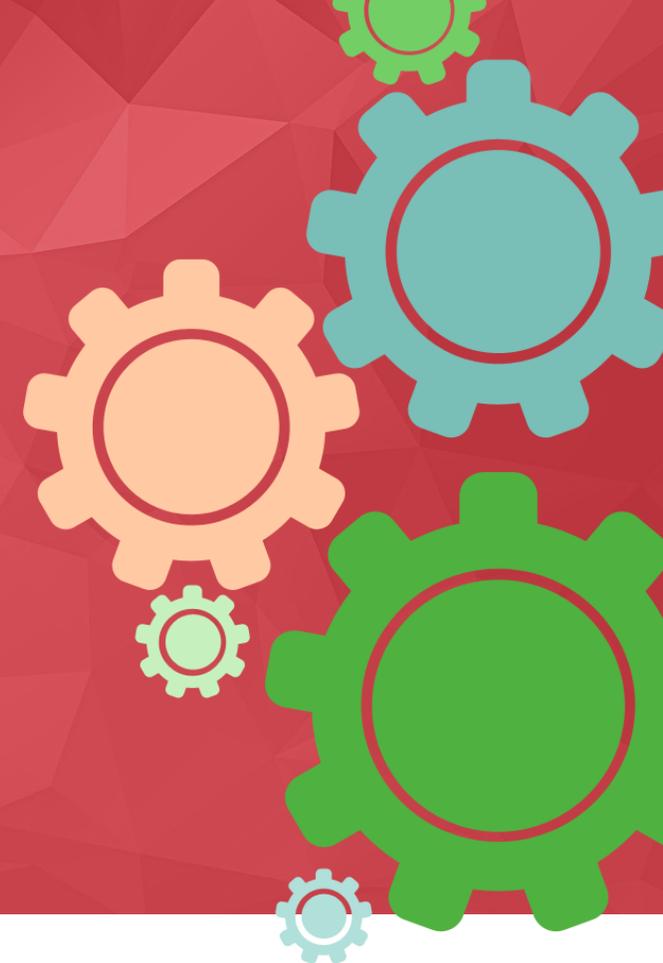


Session F4-C: Related Parties

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Audit Training of Trainers



Road to Europe: Program of Accounting Reform and Institutional Strengthening



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Summary objective of ISA 550:

The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions or balances in accordance with the requirements of the reporting framework.



Session outline

Accounting requirements

Auditing requirements



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Brief overview of IAS 24 Related Parties

Objectives and purpose of related party disclosures

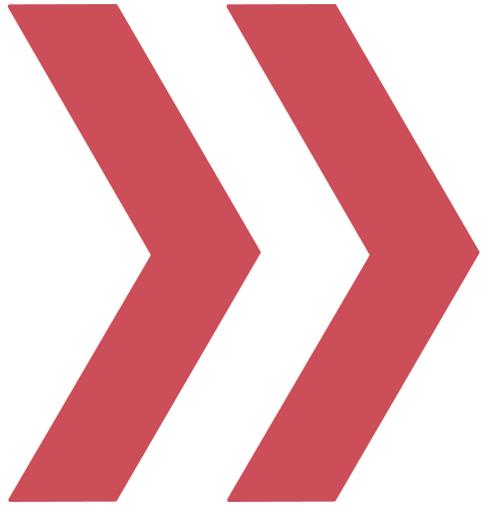
- » **Objective:** Financial statement contain **disclosures** necessary to draw attention to the possibility that its financial position and profit or loss may have been **affected** by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties.
- » **Example of reasons that could impact financial statements**
 - Transactions between related parties may not be made at the same amounts as between unrelated parties e.g with no exchange of consideration
 - Related parties may enter into transactions that unrelated parties would not
 - The mere existence of the relationship may be sufficient to affect the transactions of the entity with other entities that are not related.



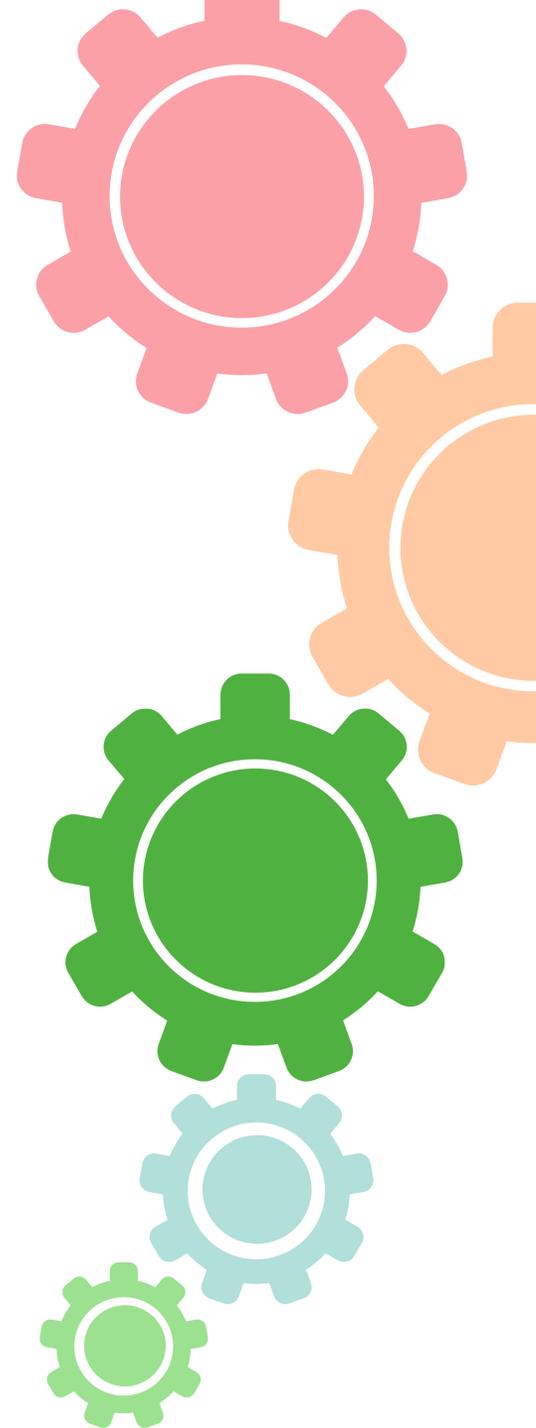
Scope of IAS 24 – requirements related to disclosure

1. Identifying related party relationships and transactions;
2. Identifying outstanding balances, including commitments, between an entity and its related parties;
3. Identifying the circumstances in which disclosure of the items in (1) and (2) is required; and
4. Determining the disclosures to be made about those items.





What is a related party?



Who is a related party? (1 of 2)

A related party is a **person** or **entity** that is related to the entity that is preparing its financial statements.

- a) A **person** or a **close member of that person's family** is related to a reporting entity if that person:
- i. has control or joint control over the reporting entity;
 - ii. has significant influence over the reporting entity; or
 - iii. is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.



Who is a related party? (2 of 2)

- b. An **entity** is related to a reporting entity if any of the following conditions applies:
- i. The entity and the reporting entity are members of the same group
 - ii. One entity is an associate or joint venture of the other entity
 - iii. Both entities are joint ventures of the same third party.
 - iv. One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - v. The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity.
 - vi. The entity is controlled or jointly controlled by a person identified in (a).
 - vii. A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).



Key principles in identifying a related party

» **Control** is the **power to govern** the financial and operating policies of an entity so as to obtain benefits from its activities.

- *Legal form*: it is considered that the parent company has control of the Company if it directly or indirectly through subsidiaries own more that 50% of the voting power in the company.
- *The essence of the relationship*: The parent company that owns 50% or less of the voting power in the Company (subsidiary) has control of the company
 - Based on the agreement, the parent company has the power to control the voting rights of other shareholders of the Company.
 - Contract or Articles of Association specifies that the parent company has the power to govern the financial and operating policies of the company
 - The parent company has the right to appoint or remove the majority of the members of the Management Board or the Company's ability to manage their votes.



Key principles in identifying a related party

» **Significant influence:** the **power to participate** in the financial and operating policy decisions of an entity, but is not control over those policies.

- *Legal form:* it is considered that the investor has significant influence over the entity if it directly or indirectly through subsidiaries has 20-50% of the voting power in that legal entity.
- *The essence of relationship:*
 - Representation on the Management Board of the Company
 - Participation in the process of making strategic financial and operating decisions of the company
 - Materially significant intercompany transactions between the investor and the Company
 - Significant reliance and dependence of the Company on the provision of technical information by investors.



Key principles in identifying a related party

- » **Joint control:** is the contractually agreed sharing of control over an economic activity. Exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).
- » **Close members** of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:
 - a) that person's children and spouse or domestic partner;
 - b) children of that person's spouse or domestic partner; and
 - c) dependants of that person or that person's spouse or domestic partner.

Specific examples

Related parties examples

Control: power to govern

Significant influence: power to participate

Scenario 1

Parent Company

Control
> 50% shares

Significant influence
(20% -50% of shares)

Subsidiary A

Associate X

Parents and subsidiary are Related Parties

Parents and Associates are Related Parties

Subsidiaries and Associate are Related parties

Scenario 2

Parent Company

Subsidiary A

Subsidiary B

Scenario 3

Parent Company

Sub A

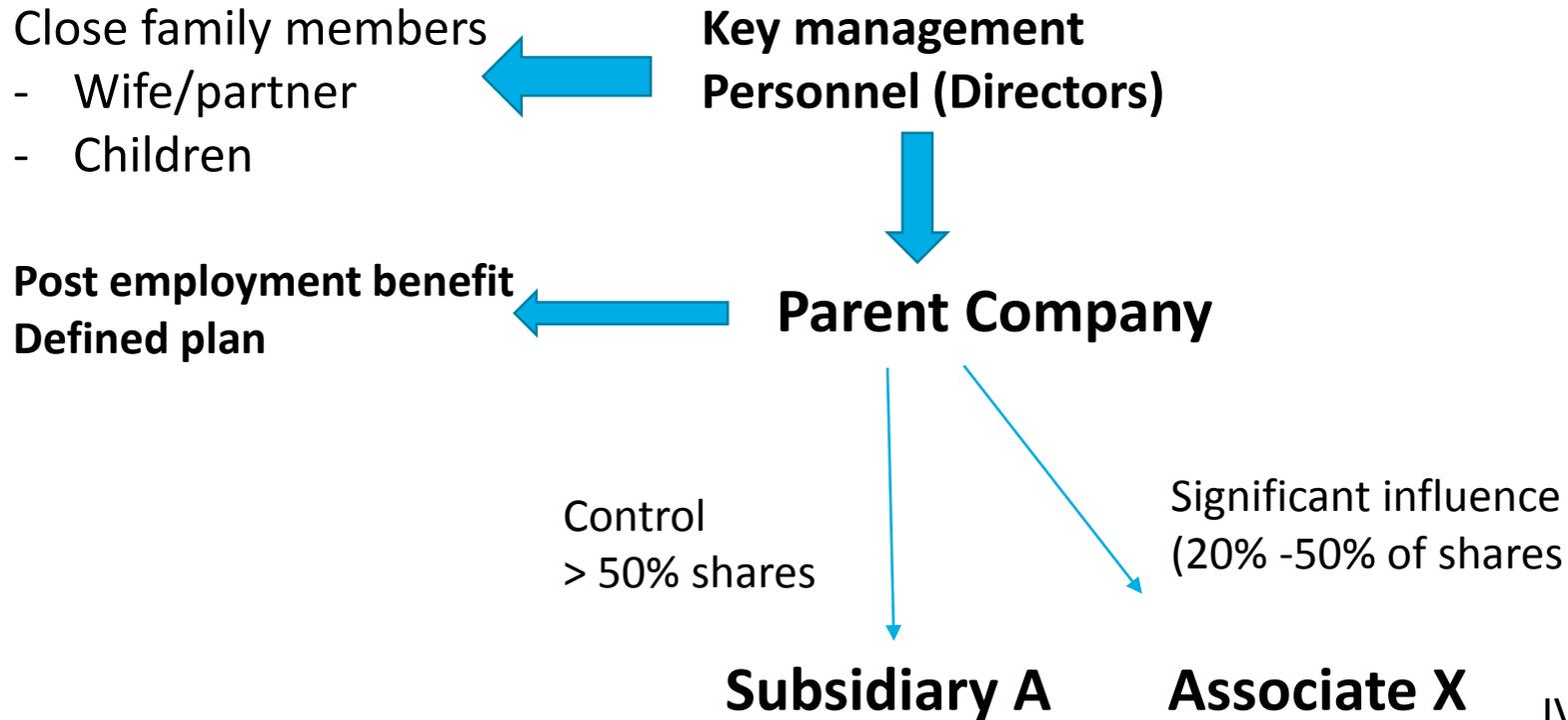
Sub B

Parent Co, Sub A and Sub B RP



Related parties examples

Scenario 5

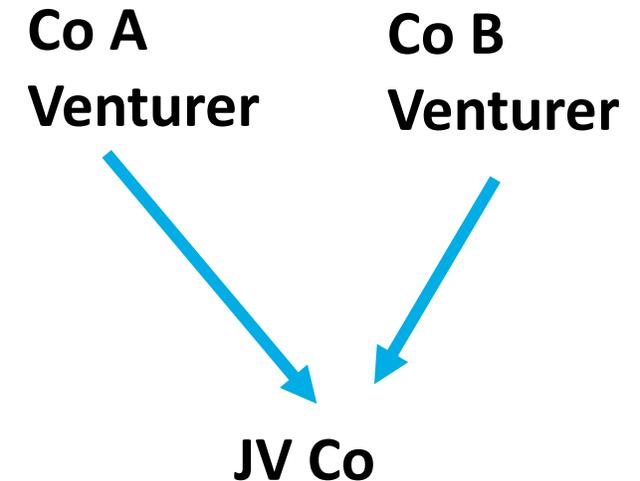


Parents and subsidiary are Related Parties

Parents and Associates are Related Parties

Subsidiaries and Associate are Related parties

Scenario 6



JV and Co A are Related Parties

JV and Co B are Related Parties

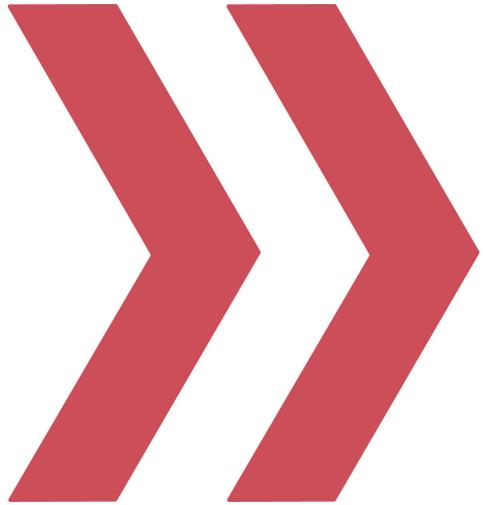
Co A and Co B are not Related parties



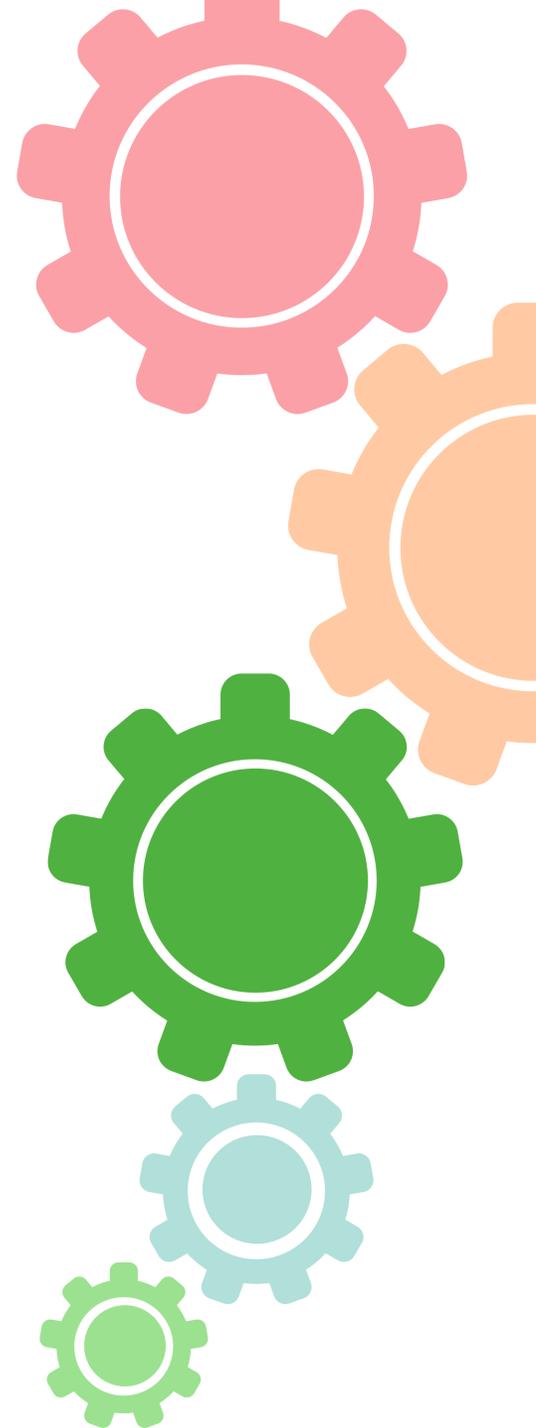
Related parties examples (continued)

- » Suppliers
- » Customers
- » Bank
- » Government
- » Trade Union

Not related parties



What are the disclosure requirements?



Disclosure requirements (1 of 3)

- 1. Relationships between a parent and its subsidiaries (nature of relationship) shall be disclosed irrespective of whether there have been transactions between them.**
 - An entity shall disclose the name of its parent and, if different, the ultimate controlling party.
 - If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.

Disclosure requirements (2 of 3)

2. An entity shall disclose key management personnel compensation in total and for each of the following categories:

- short-term employee benefits;
- post-employment benefits;
- other long-term benefits;
- termination benefits; and
- share-based payment.

Disclosure requirements (3 of 3)

3. If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose:

- » the nature of the related party relationship
- » Information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. At a minimum, disclosures shall include:
 - the amount of the transactions;
 - the amount of outstanding balances, including commitments, terms and conditions and details of any guarantees received.
 - Provision for doubtful debt on outstanding about.
 - Expenses for the period relating to bad debts

Disclosure – types of transactions

The following are examples of transactions that are disclosed if they are with a related party:

- » purchases or sales of goods (finished or unfinished);
- » purchases or sales of property and other assets;
- » rendering or receiving of services;
- » leases;
- » transfers of research and development;
- » transfers under finance arrangements (including loans and equity contributions in cash or in kind);
- » provision of guarantees or collateral;
- » settlement of liabilities on behalf of the entity or by the entity on behalf of that related party.



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Auditing requirements ISA 550

Auditors objectives

- » To obtain sufficient appropriate **audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for and disclosed in financial statements** in accordance with reporting framework
- » To obtain an understanding of related party relationships and transactions sufficient to be able to:
 - Recognize **fraud risk factors**, if any, arising from related party relationships and transactions
 - **Conclude**, based on the audit evidence obtained, whether financial statements , insofar as they are affected by those relationships and transactions achieve fair presentation or are not misleading.

Audit procedures

1. Risk assessment procedures and related activities (ISA 315 and ISA 240)
 - » understanding the entity's related party relationships and transactions
 - » maintain alertness of related party information during the audit reviews
 - » Share related party information with the engagement team
2. Identification and assessment of the risks of material misstatements associated with related party relationships and transactions

Audit procedures

3. Responses to the risks of material misstatements associated with related party relationships and transactions (ISA 330)
 - » Identification of previously unidentified or undisclosed related parties or significant related party transactions
 - » identified significant related party transactions outside the entity's normal course of business
 - » Assertions that related party transactions were conducted on terms equivalent to those prevailing in an arm's length transaction.

Audit procedures

4. Evaluation of the accounting for and disclosure of identified related party relationships and transactions
5. **Written representations** – obtained from management
6. **Communication with those charged with Governance** – significant matters on related parties
7. **Audit documentation:** names of related parties, nature

Thank you

Questions
Comments



