



Audit Conference 2019

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Friday 4 October
Chartered Accountants' Hall, Moorgate, London

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A Practical Guide to Auditing Related Party Transactions

4 September 2019

PRESENTED BY PETER HERBERT

Today's presenters

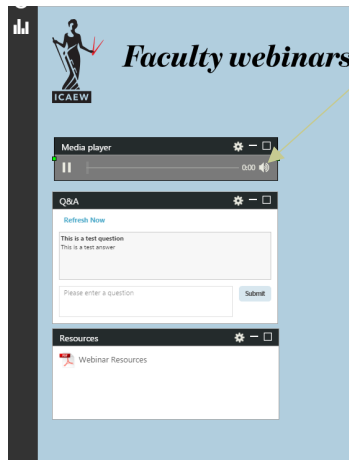


Peter Herbert
Insight Training



Alex Russell
ICAEW

Introduction



Audio problems?

- ensure your volume is turned on
- if you experience poor sound quality you may benefit from refreshing your page

Programme

Overview of key requirements

Key planning considerations

Fieldwork essentials

Where documentation goes wrong

Getting the accounting right

Important charity specifics

Q & A session

Overview

Key considerations

Unidentified/undisclosed transactions

Related party transactions outside the course of business

Related internal controls

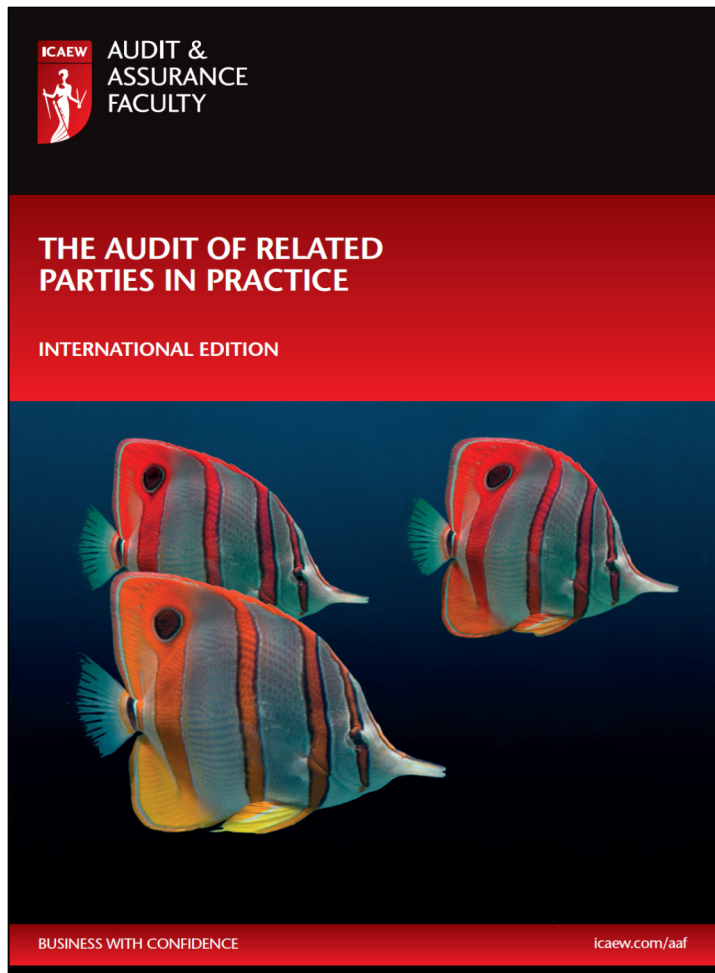
SME challenges

Related party transactions hard to spot

Lack of management awareness

Lack of internal controls

AAF guide



1. Plan work on RP relationships and transactions thoroughly

2. Focus work on risk of material misstatement that might arise from RP transactions

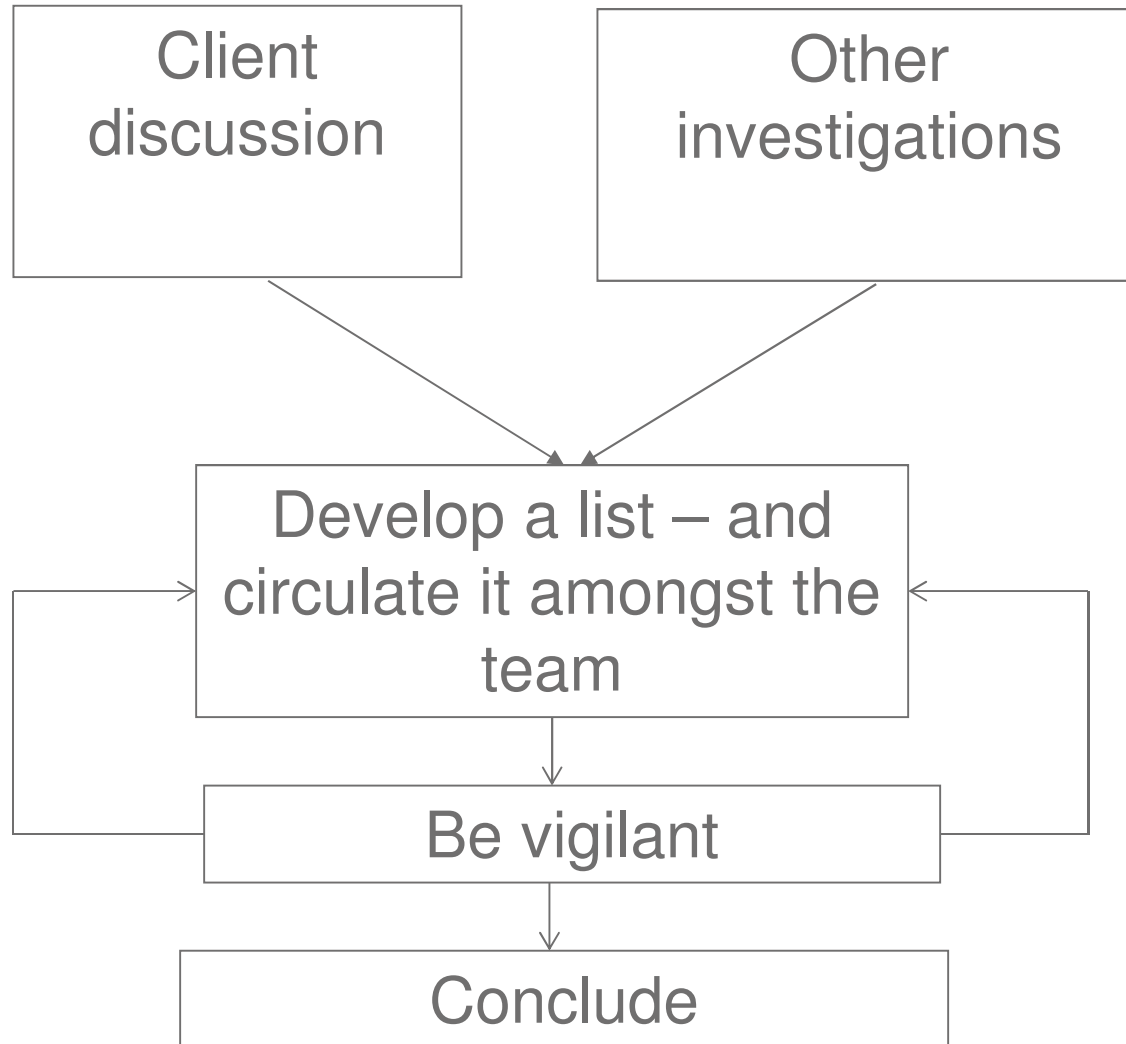
3. Understand controls to identify RPs and record RPTs

4. Design procedures to respond to risks identified

5. Perform completion procedures

The ISA 550 mindset ...

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Step 1 – plan work

Plan
thoroughly

- Brief client
- Discuss changes with the client
- Update existing information
- Assess risk
- Brief team

Common questions



What's the point? Clients don't know what related parties are!



Do we really have to start from scratch every year?



If we know there will be no disclosable transactions can we ignore it?



Since charities are governed better, do we have to dig as deeply?

Step 2 – assess risk

Focus on
risks of
material
misstatement

- Error and/or fraud
- Ownership/governance structures
- Input from others
- Consider potential risk factors
- Remain alert
- Implications where undisclosed transactions come to light

Problem areas in owner managed businesses

Feature	Problem
Involvement of family members	<ul style="list-style-type: none">• Change of name means identification difficulty in 3rd/4th generation
Owners with other business interests	<ul style="list-style-type: none">• Sensitivity to disclosure of the identity of other businesses that are trading with the entity
Owner has overall control despite existence of finance function	<ul style="list-style-type: none">• Transactions with no ascertainable market value• Non market rate business property trading• Loans at non market rate of interest; provision of unsecured loans or preferential security

Fraud risk examples



During your audit of a client's P&L expenses you notice that the client's gardener's hours do not reflect the amount of grass at the factory.



Your audit work has unearthed transactions with a market intelligence company controlled by the MD's ex-brother in law

Materiality

‘Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements’

Paragraph 2 – ISA 320 (Materiality)

Step 3 - understand controls

Policies or procedures for the disclosure of interests in transactions

Assessment of the capability of IT system for capturing RPTs

Assignment of responsibilities for identifying and recording RPTs

Discussions between management and those charged with governance about RPTs outside the normal course of business

Existence of guidelines for the approval of RPTs involving actual or perceived conflicts of interest



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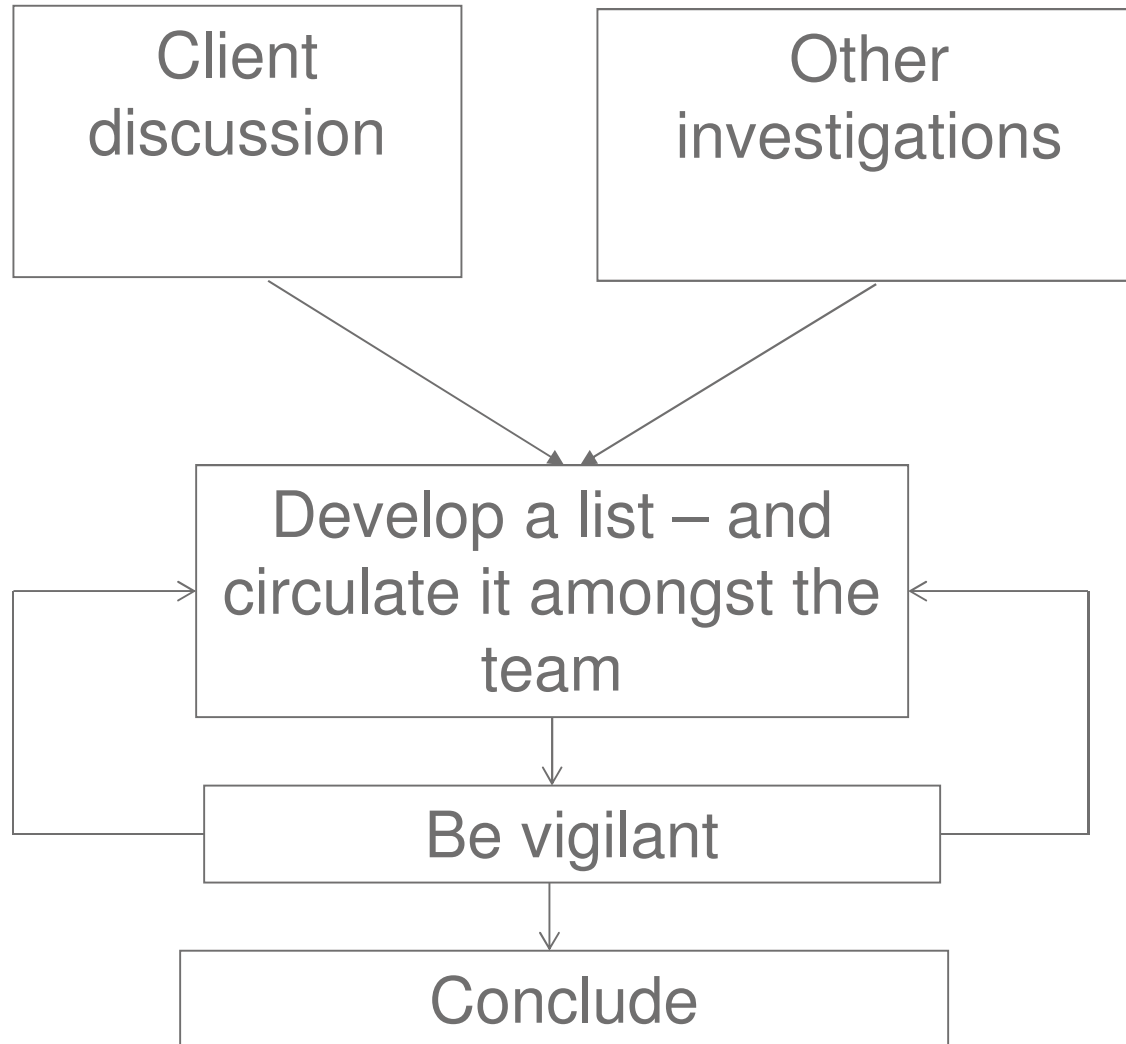
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The ISA 550 mindset ...

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Step 4 - fieldwork procedures

General requirements

Remain alert

Respond to identified risks

Review bank and legal confirmations

Review shareholder/board meeting minutes

RPTs outside normal course of business

Inspect contracts + assess rationale etc

Obtain evidence of approval & authorisation

Previously unidentified/undisclosed RPTs

Communicate with audit team

Identify all relevant transactions

Understand reasons for non-disclosure and reassess risk

Care re 'arms length assertions'

What a work programme might look like

Objective

D1

To ensure the complete and accurate recording of all related party transactions.

Method

The following procedures will be undertaken:

1. During the client planning meeting, we will provide management with our related parties checklist and ask them to update us on any new related parties this year.
2. Companies House searches will be carried out on all directors to evidence additional related companies of which we were not previously aware.
3. We will discuss related parties and related risks at the audit team meeting. Team members will be reminded to be vigilant for additional related parties when carrying out audit work.
4. Debtors and creditors ledgers will be scanned for potential related parties when we select sample for our debtors and creditors circularisations.
5. We will be vigilant for related party transactions when carrying out our cash book, after date invoice reviews and sales and purchases transaction testing
6. Relevant board and shareholder meeting minutes and bank/legal confirmations will be reviewed for evidence of any relevant transactions that require disclosure.
7. We will review documentation and understand and document the rationale for any related party transactions outside the normal course of business.
8. We will check the disclosures of related party and directors' transactions in the notes to the statutory accounts ensuring that any relevant transactions not concluded under normal market conditions are adequately disclosed.

Step 5 – completion requirements

Written representation

Communication with those charged with governance

Completeness and accuracy of disclosure notes

Implication of non-disclosure for audit report

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Common file review findings

No evidence of discussion in planning meeting

No list of related parties

Work programme deemed 'not applicable'

Little thought to completion of proprietary audit programme

Inadequate work on recoverability of related party debtors

Lack of challenge on holding company letters of support

Errors in statutory accounts

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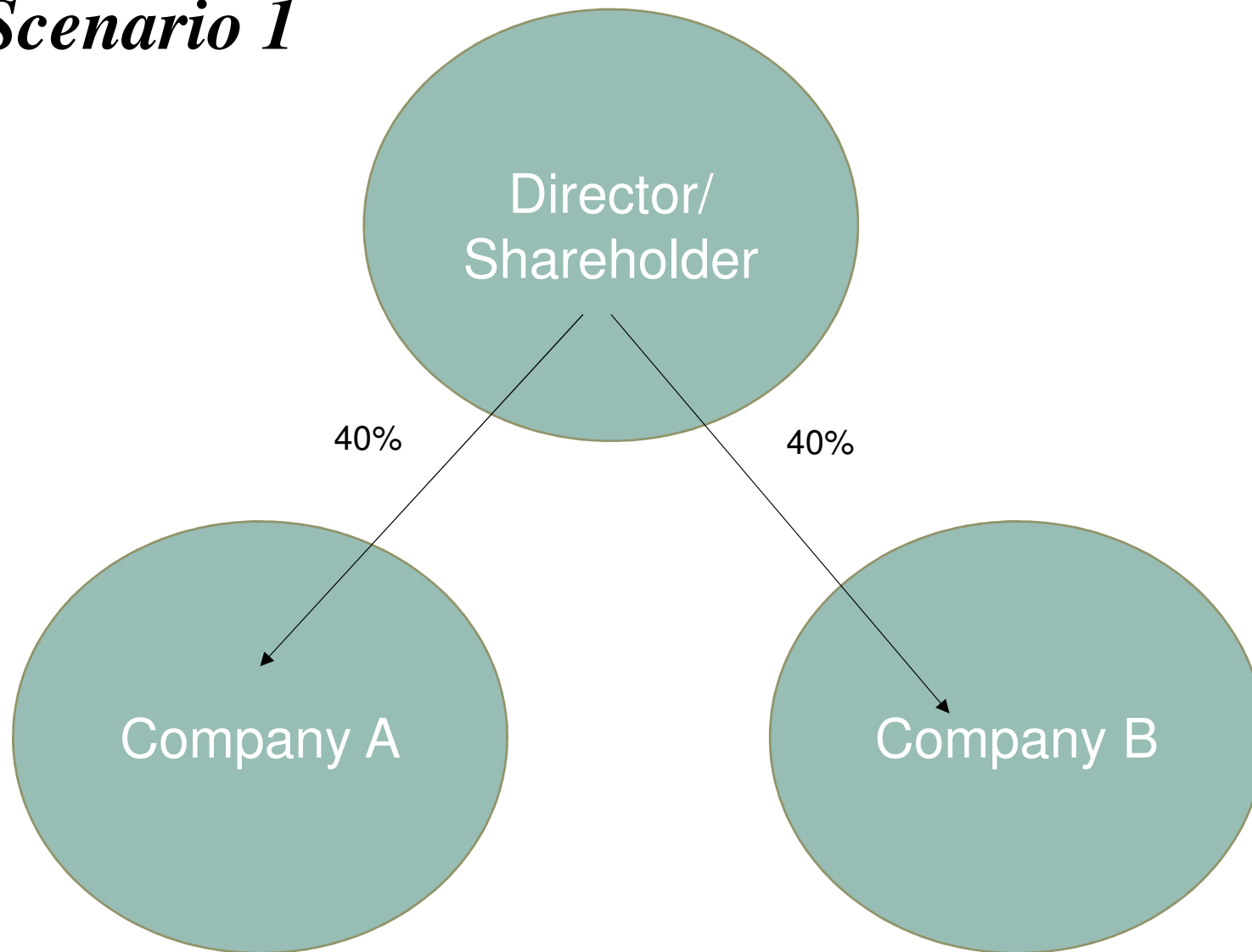
Three key questions

Is the party
related?
(FRS 102
para 33.2)

Is the
transaction
material?

Is the
transaction
exempt from
disclosure?

Scenario 1



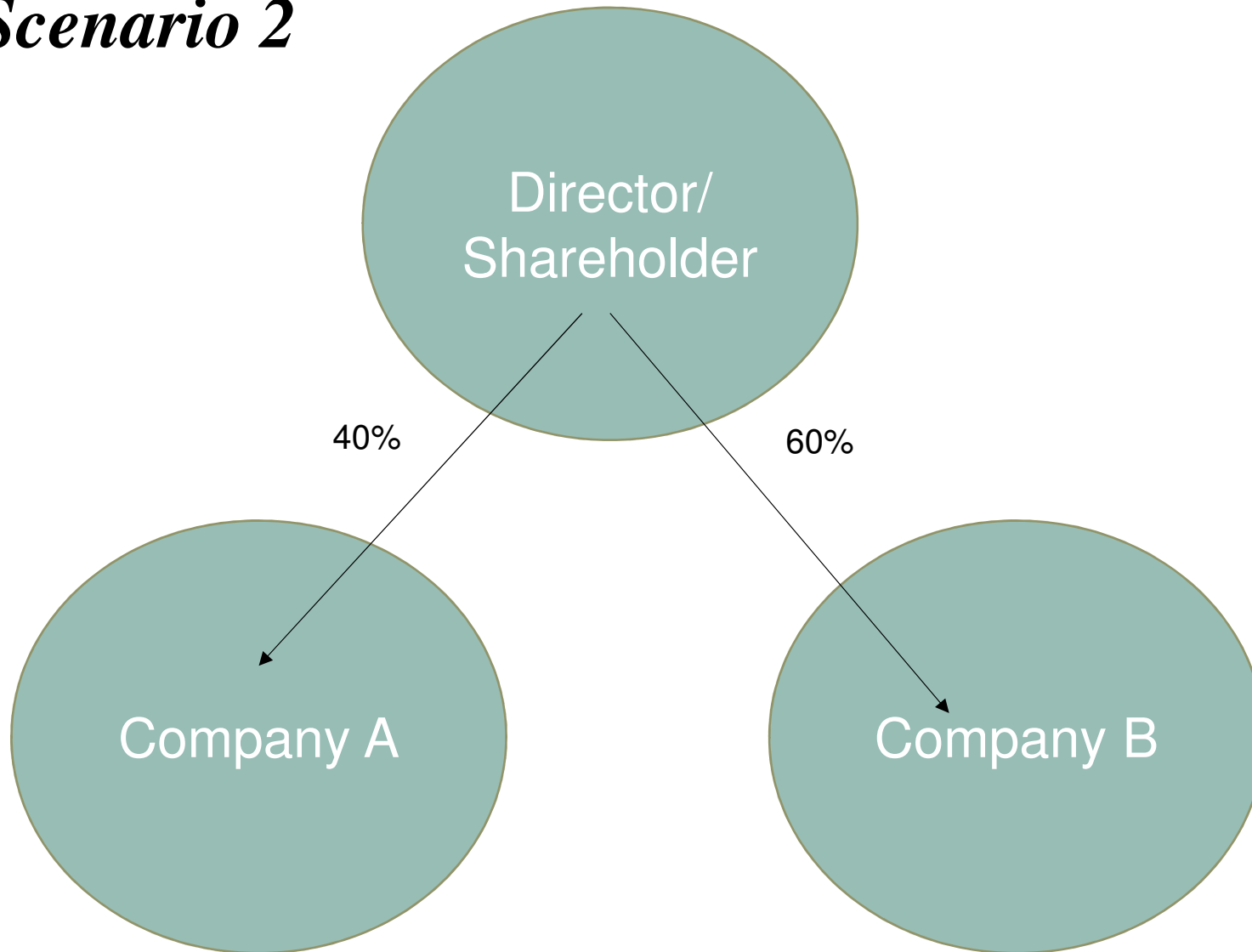
FRS 102 para 33.2

(a) A person or close member of that person's family is related to a reporting entity if that person (i) has control ... over the reporting entity (or) (ii) has significant influence over the reporting entity

(b) (vi) An entity is related to a reporting entity if the entity is controlled or jointly controlled by a person identified in (a)

(b) (vii) An entity is related to a reporting entity if a person identified in (a) (i) has significant influence over the entity or is a member of the key management personnel ...

Scenario 2



Common issues

Use not made of tabular presentation

Naming names!

Disclosure of key management personnel compensation

Controlling party disclosure

Inappropriate use made of old UK GAAP disclosure exemptions

Incorrect use made of intra-group exemptions (including FRS 102 RDF)

FRS 102 Section 1A

Related party transactions

..not under normal market conditions

- a. >20% owners
- b. >20% investments
- c. directors

Advances, credits and guarantees (s413)

- a. its amount
- b. an indication of the interest rate
- c. its main conditions
- d. any amounts repaid
- e. any amounts written off
- f. any amounts waived

Section 1A scenario

Would an interest free loan from a director typically be disclosed as a related party transaction?

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Charity SORP - related party transactions

Related party disclosures must include names

A transaction involving a trustee or other related party must always be regarded as material

Where there are no related party transactions, this fact must be disclosed

Charity scenario

The spouse of one of the 'key management personnel' works for the charity and is paid a modest salary. Does this require disclosure?

Academy audits

ISA 550 approach
the same

Better controls
more likely?

Additional work
(‘regularity’ – at
cost etc)

Disclosure based
on Charity SORP

Different disclosure
requirements
(Accounts
Direction)

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Any questions?

Future events

For details, please visit [icaew.com/aafevents](https://www.icaew.com/aafevents)



Webinars

24 October - Changes in audit regulation

20 November - Demystifying assurance



Audit Conference

04 October 2019

Thank you for attending

Please take the time to fill out our short survey.

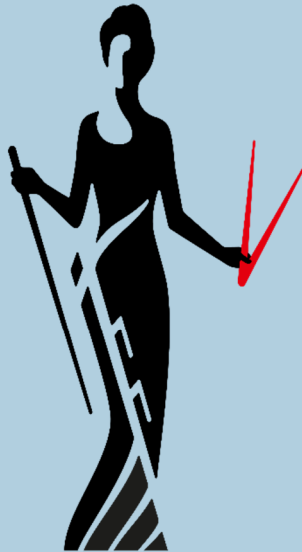
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