ADVANCED AUDIT AND ASSURANCE

CORPORATE LEVEL

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RELATED PARTIES - (S.L.Au.S - 550)

INITIAL AUDIT ENGAGEMENTS OPENING BALANCES – (S.L.Au.S 510)

COMPARATIVE INFORMATION – CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS – (S.L.Au.S 710)

by

Jeewantha Perera

(FCA, ACCA, MBA, B.Sc Accountancy (sp)

RELATED PARTIES - (S.L.Au.S - 550)

Introduction

The Importance of Related Parties due to following reasons.

A) Transactions between the two or more parties are not 'at arm's length'.

B) Knowledge of the relationship between parties to a transaction may affect the way in which the transaction is viewed by the users of financial statements, even if it is conducted on normal commercial terms.

Therefore, due to the above reasons, it is important for the auditors to identify any related party relationships and scrutinise transactions between the entity and those related parties.

Many related party transactions are in the normal course of business. In such circumstances, they may not carry a higher risk of material misstatements. However, the nature of the related party relationships and transactions may in some circumstances give rise to higher risk of material misstatements of the financial statements than transactions with unrelated parties.

Eg: Related Party Transactions may not be concluded under the normal market conditions and terms

Who Are Related Parties?

Persons & Entities

- ✓ That controls, influences or joint controls a Reporting Entity
- ✓ That is controlled, influenced or joint controlled by a Reporting Entity

Entities connected with persons

"A related party is a person or entity that is related to a Reporting Entity"

Reporting Entity is an entity that prepares Financial Statements

A person or a close family member of that person's family is related to a reporting entity, if that person

a) Has Control or Jointly Control over the reporting entity
b) Has Significant Influence over the reporting entity or
c) Is a member of Key Management Personnel (KMP's) of the reporting entity or a Parent of the Reporting Entity

Management Responsibility for Related Parties

Management is responsible for the identification of related party transactions. Such transactions should be properly approved as they are frequently not at arm's length. Management is also responsible for the disclosure of related party transactions.

Responsibility of the Auditor for Related Parties

An audit cannot be expected to detect all material related party transactions. The risk that undisclosed related party transactions will not be detected by the auditors is especially high when:

- Related party transactions have taken place without charge.
- Related party transactions are not self-evident to the auditors.
- Transactions are with a party that the auditors could not reasonably be expected to know is a related party.
- Active steps have been taken by management to conceal either the full terms of a transaction, or that a transaction is, in substance, with a related party.
- The corporate structure is complex.

1) To obtain ***an understanding of related party relationships and transactions and assessment and identification of Risks associated with related parties sufficient to be able:***

- To recognise fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud

- To 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.

As part of the risk assessment procedures required by S.L.Au.S 315, the auditor must carry out the following procedures to obtain information relevant to identifying risks associated with related parties.

Following procedures will be performed by the Auditor

1) Enquire of management and the Directors
   - The identity of related parties including changes from prior period
   - The nature of the relationships between the entity and its related parties
   - Whether any transactions occurred between the parties, and if so, what
   - What controls the entity has to identify, account for and disclose related party relationships and transactions
   - What controls the entity has to authorise and approve significant transactions and arrangements with related parties
   - What controls the entity has to authorise and approve significant transactions and arrangements outside the normal course of business (The auditor may have to perform risk assessment procedures, in addition, in respect of the latter three points.)

2) Review prior year working papers for names of known related parties

3) Review minutes of meetings of shareholders and directors and other relevant statutory records such as the register of directors' interests

4) Review accounting records for large or unusual transactions or balances, in particular transactions recognised at, or near, the end of the financial period

5) Review confirmations of loans receivable and payable and confirmations from banks. Such a review may indicate the relationship, if any, of guarantors to the entity

6) Review investment transactions, for example purchase or sale of an interest in a joint venture or other entity

7) Enquire of other auditors currently involved in the audit, or predecessor auditors, as to their knowledge of additional related parties

2) Response to 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

Situation	Action by the Auditor
Management has asserted in the financial statements that related party transactions were carried out at Arm's |Length Basis	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
Auditor identifies related parties and transactions are not disclosed by management	Request the management to identify all transactions with the related parties
	Make inquires as to why Company failed to identify related parties
	If the non-disclosure is intentional and therefore indicating a Fraud, evaluate the impact to the Audit
Auditor Identifies related party transactions are outside normal cause of business	Make inquiries from Management to identify the rational
	Whether the transaction have been accounted property and disclosed in the financial statements

3) Written Representation

Where the applicable financial reporting framework establishes related party requirements, the auditor shall ***obtain written representations from management***, and where relevant, those charged with governance, that 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 they have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.

4) ***Audit conclusions and reporting***

If the auditor is unable to obtain sufficient appropriate audit evidence concerning related parties and transactions with such parties or concludes that their disclosure in the financial statements is not adequate, the auditor should modify the auditor's opinion appropriately.

The auditor must communicate all significant matters arising during the audit in connection with the entity's related parties (unless all those charged with governance are involved in managing the entity).

Additional Notes

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INITIAL AUDIT ENGAGEMENTS – OPENING BALANCES – (S.L.Au.S 510)

Introduction

Opening balances are those account balances that exist at the beginning of the period. They are based on the closing balances of the prior period and reflect the effects of transactions of prior periods and accounting policies applied in the prior period. They also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

An initial audit engagement is one in which either:

(a) the financial statements for the prior period were not audited; or

(b) the financial statements for the prior period were audited by a predecessor auditor.

S.L.Au.S 510 Initial audit engagements - opening balances provides guidance to auditors on the audit of opening balances when conducting an initial audit engagement.

The S.L.Au.S states that, for initial audit engagements, the **auditor's objective** is to obtain sufficient appropriate audit evidence whether:

- ***Opening balances*** contain misstatements that materially affect the current period's financial statements.
- ***Appropriate accounting policies are consistently applied,*** or changes have been properly accounted for and adequately presented and disclosed.

Audit Procedures to perform for Opening Balances

The auditor ***shall read the most recent financial statements and the predecessor auditor's report for information relevant to opening balances.***

Auditor shall obtain ***sufficient appropriate audit evidence about whether opening balances*** contain misstatements that materially affect the current period's financial statements by;

- Determining whether the prior period's closing balances have been correctly brought forward or restated
- Determining whether the opening balances reflect the application of appropriate accounting policies

Audit Procedures to be performed

- Where the prior period's financial statements were audited, reviewing the predecessor auditor's working papers
- Evaluating whether audit procedures performed in the current period provide evidence relevant to opening balances
- Performing specific audit procedures to obtain evidence regarding opening balances

Audit Conclusions and Reporting

A) If the auditor cannot obtain sufficient appropriate audit evidence for opening balances, the auditor shall express a ***qualified opinion or a disclaimer of opinion.***

B) If the opening balances contain misstatements that materially affect the current year's financial statements, the auditor shall express a ***qualified opinion or an adverse opinion***.

C) If the auditor concludes that the current period's accounting policies are not consistently applied in relation to opening balances, or changes have not been properly accounted for and adequately presented and disclosed, the auditor shall express a ***qualified opinion or an adverse opinion.***

D) If a prior-period modification remains relevant and material to the current period's financial statements, the auditor ***shall modify the auditor's opinion on the current period's financial statements accordingly.***

Additional Notes.

Comparative Information – Corresponding Figures and Comparative Financial Statements – (S.L.Au.S 710)

Introduction

Comparative information is amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

This comparative information may be presented in one of two ways:

A) Corresponding figures
Where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements and are intended to be read only in relation to the amounts and other disclosures relating to the current period. The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.

B) Comparative financial statements
Where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion.

S.L.Au.S 710 Comparative information - corresponding figures and comparative financial statements provides guidance to auditors on comparatives, both corresponding figures and comparative financial statements. Whether corresponding figures or comparative financial statements are required is usually dictated by law or regulation, but may also be specified in the terms of engagement.

In terms of audit reporting, for corresponding figures, the auditor's opinion refers to the current period only. For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

Auditor's Responsibilities for Comparative Information

The SLAuS states that the auditor must determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether it is appropriately classified.

This includes an evaluation of whether;

- ***The accounting policies used*** for corresponding figures or comparative financial statements are consistent with the current period.

- The corresponding figures or comparative financial statements ***agree with the amounts and other disclosures presented in the prior period.***

If the auditor becomes aware of a possible material misstatement regarding the comparative information, the auditor must perform additional audit procedures to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists.

Corresponding figures reporting

In terms of reporting, the audit report does not specifically refer to the corresponding figures because the opinion is on the current period's financial statements as a whole, and this includes the corresponding figures.

Comparative financial statements reporting

Comparative financial statements are not required in Sri Lanka. The only requirement is to include corresponding figures.